

SUPPORTING STATEMENT
Rule 2a-7

A. JUSTIFICATION

1. Necessity for the Collection Information

Money market funds are open-end management investment companies that differ from other open-end management investment companies in that they seek to maintain a stable price per share, usually \$1.00. Rule 2a-7 (17 CFR 270.2a-7) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the “Act”) exempts money market funds from the valuation requirements of the Act, and, subject to certain risk-limiting conditions, permits money market funds to use the “amortized cost method” of asset valuation or the “penny-rounding method” of share pricing. It also imposes certain recordkeeping and reporting obligations on money market funds.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) was enacted on July 21, 2010.¹ Section 939A of the Dodd-Frank Act requires the Securities and Exchange Commission to review its regulations for any references to or requirements regarding credit ratings that require the use of an assessment of the credit-worthiness of a security or money market instrument, remove these references or requirements and substitute in those regulations other standards of credit-worthiness in place of the credit ratings that we determine to be appropriate.²

On March 2, 2011, to implement section 939A of the Dodd-Frank Act, the Commission issued a release proposing amendments to rule 2a-7 that would remove references to credit ratings. The proposed amendments would affect five elements of the rule: determination of whether a security is an eligible security; determination of whether a security is a first tier

¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

² Section 939A(a)-(b) of the Dodd-Frank Act.

security; credit quality standards for securities with a conditional demand feature; requirements for monitoring securities for ratings downgrades and other credit events; and stress testing.³ The proposed amendments are designed to offer protections comparable to those provided by the NRSRO ratings.

Eligible Securities and First Tier Securities. Rule 2a-7 currently limits a money market fund's portfolio investments to securities that the fund's board of directors has determined present minimal credit risk and at the time of acquisition are "eligible securities".⁴ Eligible securities are defined as securities that have received credit ratings from certain NRSROs in one of the two highest short-term rating categories or comparable unrated securities. Rule 2a-7 further limits money market fund investments in second tier securities (those eligible securities that are not rated in the highest short-term category, i.e., first tier securities) to no more than three percent of the portfolio. The proposal would eliminate the requirement that an eligible security be rated by an NRSRO or be of comparable quality. Under the proposal, a security would be an eligible security only if the board of directors (or its delegate) determines that it presents minimal credit risks, which determination must be based on factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations.⁵ The proposal would define first tier security as a security whose issuer (or, in the case of a security subject to a guarantee, the guarantor), the fund's board (or its delegate) determines has the "highest capacity to meet its short-term financial obligations."⁶

³ See [cite proposing release]. The proposed amendments also would make conforming changes to rule 2a-7's recordkeeping and reporting requirements. Proposed rule 2a-7(c)(11). These proposed conforming changes would not result in changes in the estimated hourly burden associated with the recordkeeping and reporting requirements under rule 2a-7.

⁴ Rule 2a-7(c)(3).

⁵ Proposed rule 2a-7(a)(11).

⁶ Proposed rule 2a-7(a)(13). A second tier security would continue to be defined as an eligible security that is not a first tier security.

Securities Subject to Conditional Demand Features.⁷ Under current rule 2a-7, a security subject to a conditional demand feature may be determined to be an eligible security or a first tier security if, among other conditions, (i) the conditional demand feature is an eligible security or a first tier security, and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating, as the case may be, within the highest two categories from certain NRSROs or is a comparable unrated security.⁸ Instead of requiring the underlying security (or its guarantee) to have received a rating, the proposal would require that an underlying security (or its guarantee) subject to a conditional demand feature must itself be of high quality and subject to very low credit risk as determined by the fund's board (or a delegate).⁹

Monitoring Minimal Credit Risk. Rule 2a-7 currently requires a money market fund board (or its delegate) to promptly reassess whether a portfolio security that has been downgraded by an NRSRO continues to present minimal credit risks, and take such action as the board (or its delegate) determines is in the best interests of the fund and its shareholders.¹⁰ The proposal would eliminate the reference to credit ratings in the rule's downgrade and default provisions and instead require that in the event the money market fund's investment adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that suggests that the security is no longer a first tier security or a

⁷ "Demand feature" is defined in rule 2a-7(a)(9); "conditional demand feature" is defined in rule 2a-7(a)(6).

⁸ Rule 2a-7(c)(3)(iv)(C).

⁹ Proposed rule 2a-7(c)(3)(iv)(C).

¹⁰ Rule 2a-7(c)(7)(i)(A).

second tier security, as the case may be, the money market fund’s board of directors would have to reassess promptly whether the portfolio security continues to present minimal credit risks.¹¹

Stress Testing. Rule 2a-7 currently requires money market funds to stress test the fund’s ability to maintain a stable net asset value per share based on certain hypothetical events, including a downgrade of portfolio securities.¹² The proposal would eliminate the reference to a downgrade and instead require the stress testing procedures to include as a hypothetical event, “an adverse change in the ability of the issuer of a portfolio security to meet its short term financial obligations.”¹³

The proposed amendments would affect collection of information requirements relating to written policies and procedures under rule 2a-7. The affected collections of information are mandatory for funds that hold themselves out as money market funds.

2. Purpose of the Information Collection

The requirement to have written policies and procedures and the recordkeeping requirements in rule 2a-7 are designed to enable Commission staff in its examinations of money market funds to determine compliance with the rule, as well as to ensure that money market funds have established procedures for collecting the information necessary to make adequate credit reviews of securities in their portfolios, to monitor credit events, to conduct stress testing and for boards to exercise appropriate oversight over delegated tasks. The reporting requirements of rule 2a-7 are intended to assist Commission staff in overseeing money market funds.

3. Role of Improved Information Technology

¹¹ Proposed rule 2a-7(c)(7)(i)(A).

¹² Rule 2a-7(c)(10)(v)(A).

¹³ Proposed rule 2a-7(c)(10)(v)(A).

Rule 2a-7, as it is proposed to be amended, would continue to require money market funds to maintain written policies and procedures. The Electronic Signatures in Global and National Commerce Act (P.L. 106-229, 114 Stat. 464 (June 30, 2000)) and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

4. Efforts to Identify Duplication

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or form, or a change in either. Although the requirement in rule 2a-7 for policies and procedures is encompassed by the more general requirement for compliance policies and procedures contained in rule 38a-1 under the Investment Company Act (17 CFR 270.38a-1), the requirement in rule 2a-7 is intended to ensure that money market funds have established procedures for collecting the information necessary to make adequate credit reviews of securities in their portfolios, to monitor credit events, to conduct stress testing and for boards to exercise appropriate oversight over delegated tasks.

5. Effect on Small Entities

The Commission does not believe that the proposed amendments to rule 2a-7 will have a significant effect on small entities. In the proposing release, the Commission certifies that the proposed amendments to rule 2a-7 would not, if adopted, have a significant economic impact on a substantial number of small entities. Based on information in filings submitted to the Commission, the Commission believes that there are no money market funds that are small entities.¹⁴

¹⁴ See Proposing Release, supra note 3. An investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. See 17 CFR 270.10(a).

As under the current rule, the reporting and recordkeeping requirements under the proposed amendments would be the same for all money market funds, including those that are small entities. As noted in item 12 below, we do not anticipate that the proposed amendments would significantly change collection of information requirements under the rule because we believe that funds would likely rely on their current policies and procedures to comply with the proposed amendments.

6. Consequences of Less Frequent Collection

As described above, rule 2a-7 requires the fund's board to adopt written policies and procedures with respect to credit quality determinations, monitoring credit events, stress testing and board oversight over delegated tasks. None of these is a recurring obligation. They are, however, essential to the Commission's ability to determine compliance with the rule.

The rule also requires money market funds to perform periodic analyses of portfolio securities and reviews of the credit risks associated with those securities as the need arises. These reviews are necessary to ensure that securities that remain in a fund's portfolio continue to present minimal credit risks.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Rule 2a-7 requires money market funds to retain certain written records for more than three years. The proposed amendments would require money market funds to retain records of procedures for monitoring credit events, stress testing, board oversight of delegated tasks and records of the board's considerations and actions taken in connection with the discharge of its responsibilities for at least six years (the first two in an easily accessible place). The long-term retention of these records is necessary for the Commission's inspections program to determine compliance with rule 2a-7.

8. Consultation Outside the Agency

In its release proposing amendments to rule 2a-7, the Commission requests public comment on the effect on information collections under these amendments. The Commission will consider all comments received on the proposal. In addition, the Commission and the staff of the Division of Investment Management participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Estimates of Hour Burden

The approved collection of information burden for rule 2a-7 is 395,779 hours. We do not anticipate that the proposed amendments to rule 2a-7 would significantly change collection of information requirements under the rule because we believe funds would likely rely on their current policies and procedures to comply with the proposed amendments. Under current rule 2a-7, money market fund boards, or their delegates, are required to perform a minimal credit risk evaluation with respect to each of the fund's portfolio securities. Funds also must adopt policies and procedures regarding those determinations and for monitoring credit events and stress testing.¹⁵ Eligible securities and first tier securities currently are defined with reference to credit

¹⁵ See rules 2a-7(c)(3); 2a-7(c)(10)(v); 2a-7(e); 38a-1.

ratings, and rated securities subject to a conditional demand feature must meet a minimum credit rating threshold. With respect to monitoring for downgrades and defaults, Commission staff understands that money market funds generally monitor for information regarding credit events that may affect the portfolio in addition to those specified in the rule. In addition, a fund could treat a downgrade as a credit event that might adversely affect a portfolio security. Finally, staff also understands that money market funds stress test for credit events other than downgrades that might affect the fund's portfolio.

With respect to each of the proposed amendments, money market funds could continue to use evaluations of outside sources, including credit ratings, in making credit quality determinations, monitoring credit events and stress testing. We expect that funds would likely continue to rely on their current policies and procedures with respect to credit quality determinations, monitoring for credit events and stress testing because that is likely to be less costly than revising policies. Accordingly, as we noted above, we do not expect the proposed amendments would significantly change current collection of information burden estimates for rule 2a-7. Nevertheless, money market funds may make technical changes to their policies and procedures in response to the proposed amendments, if adopted.

Commission staff estimates that it will take on average 1.5 hours of a senior business analyst's time for an individual money market fund to make these technical changes, for an estimated one time burden of 978 hours for all money market funds at a total cost of \$226,896.¹⁶

¹⁶ This estimate is based on the following calculation: (652 money market funds x 1.5 hours = 978 hours); (978 hours x \$232 per hour = \$226,896). As of December 31, 2010, Commission staff estimates that there are 652 money market funds, all of which are subject to rule 2a-7. This estimate is based on the Investment Company Institute, Trends in Mutual Fund Investing (December 2010), Jan. 27, 2011. available at http://www.ici.org/research/stats/trends/trends_12_10. The staff estimates that the internal cost for time spent by a senior business analyst is \$232 per hour. This estimate is derived from SIFMA's Management and Professional Earnings in the Securities Industry 2010, modified by Commission staff to account for an 1800-hour work week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

Amortized over three years, we estimate that the total annual burden would be 326 hours at a cost of \$75,632. Accordingly, we estimate that the new total annual burden under rule 2a-7 would be 396,105 hours if the proposed amendments were adopted.

These estimates are made solely for the purposes of the PRA and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules.

13. Estimate of Total Annual Cost Burden

Commission staff estimates that the proposed amendments to rule 2a-7 would not result in any costs other than those described in section 12 for the estimated burden hours associated with the proposed amendments. Thus, the estimates of costs other than those discussed in section 12 remain the same.

14. Estimate of Cost to the Federal Government

Rule 2a-7 does not impose any costs on the federal government.

15. Explanation of Changes in Burden

The estimated total annual burden is being increased from 395,779 hours to 396,105 hours. This increase is primarily attributable to the burden of making any technical changes to written policies and procedures described above. The proposed amendments would not affect the staff's total annual cost estimate.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to not Display Expiration Date

Not applicable.

18. Exceptions to Certification Statement

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.