amendments also will modernize existing provisions that will apply to all Commission registrants.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, and 274

[Release Nos. 33–9193; IC–29592; File No. S7–07–11]

RIN 3235–AL02

References to Credit Ratings in Certain Investment Company Act Rules and Forms

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: This is one of several releases that the Securities and Exchange Commission ("Commission") will be considering relating to the use of credit ratings in our rules and forms. In this release, we are proposing a new rule as well as rule and form amendments under the Securities Act of 1933 and the Investment Company Act of 1940 to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Commission is proposing amendments to two rules and four forms under the Investment Company Act and the Securities Act that contain references to credit ratings. The proposed amendments would give effect to provisions of the Dodd-Frank Act that call for the amendment of Commission regulations that contain credit rating references. In addition, the Commission is proposing a new rule under the Investment Company Act to establish a standard of credit-worthiness in place of a statutory reference to credit ratings in that Act that the Dodd-Frank Act removes.

DATES: Comments should be received on or before April 25, 2011.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7–07–11 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–07–11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: With respect to the proposed rule, rule amendments or Form N–MFP, Anu Dubey, Attorney, or Penelope Saltzman, Assistant Director (202) 551–6792, Office of Regulatory Policy, or with respect to Forms N–1A, N–2 and N–3, Jane H. Kim, Attorney, or Mark T. Uyeda, Assistant Director, (202) 551–6784, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing for public comment amendments to rules 2a–7 [17 CFR 270.2a–7] and 5b–3 [17 CFR 270.5b–3] and new rule 6a–5 [17 CFR 270.6a–5] under the Investment Company Act of 1940 ("Investment Company Act").[1] The Commission is also proposing for comment amendments to Forms N–1A [17 CFR 239.15A and 17 CFR 274.11A], N–2 [17 CFR 239.14 and 17 CFR 274.11a–1] and N–3 [17 CFR 239.17a and 17 CFR 274.11b] under the Investment Company Act and the Securities Act of 1933 ("Securities Act")[2] and Form N–MFP [17 CFR 274.201] under the Investment Company Act.

[1] 15 U.S.C. 80a–1. Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act are to Title 17, Part 270 of the Code of Federal Regulations [17 CFR 270].

[2] 15 U.S.C. 77a.

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I. Background

The Dodd-Frank Act was enacted on July 21, 2010.[3] Section 939A of the Act requires the 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.[4] Section 939 of the Dodd-Frank Act removes a reference to credit ratings from section 6(a)(5) of the Investment Company Act and replaces it with a reference to "such standards of credit-worthiness as the Commission shall adopt."[5]

In 2008, we undertook a review similar to that required under section 939A for references to credit ratings in our rules. As a result of that review, we proposed to eliminate references to ratings issued by nationally recognized statistical rating organizations ("NRSROs") in four rules under the Investment Company Act.[6] Specifically,

[3] Public Law 111–203, 124 Stat. 1376 (2010).

[4] Section 939A(a)–(b) of the Dodd-Frank Act.

[5] Section 939(c) of the Dodd-Frank Act (amending section 6(a)(5)(A)(iv)(I) of the Investment Company Act). The Dodd-Frank Act also requires the Commission to adopt a number of rules concerning the integrity and transparency of the credit rating process and the accountability of credit rating agencies. *See* sections 931 to 939H of the Dodd-Frank Act.

[6] *See* References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008) [73 FR 40124 (July 11, 2008)] ("2008 Ratings Removal Proposing Release"). The Commission also proposed to eliminate references to credit ratings in rules under the Securities Act and the Securities Exchange Act of 1934 (15 U.S.C. 78a) ("Exchange Act"). *See* Security Ratings, Securities Act Release No. 8940 (July 1, 2008) [73

we proposed to remove references to credit ratings in rules 2a–7, 3a–7, 5b–3 and 10f–3 under the Investment Company Act. In 2009, we adopted certain of the proposed amendments to rules 5b–3 and 10f–3 and reopened the comment period for the other proposed amendments to rules 3a–7 and 5b–3.[7] In 2010, when we adopted amendments to rule 2a–7 (which governs the operation of money market funds), we retained the use of credit ratings in rule 2a–7 as an initial threshold requirement for whether a money market fund may invest in the security, but eliminated a requirement that all asset-backed securities in which a money market fund invests have received a rating.[8]

As directed by section 939A of the Dodd-Frank Act, we have reviewed our regulations for any references to or requirements regarding credit ratings in regulations that require the use of an assessment of the credit-worthiness of a security or money market instrument. In light of our review, and as further directed by the Dodd-Frank Act, we are proposing in this release to amend two rules and four forms under the Investment Company Act and the Securities Act.[9] In addition, in order to implement section 939(c) of the Dodd-Frank Act, we are proposing a new rule to establish a standard of credit-worthiness for purposes of section 6(a)(5) of the Investment Company Act.

II. Discussion

Three rules—rules 2a–7, 3a–7 and 5b–3 and four forms—Forms N–1A, N–2, N–3 and N–MFP under the Investment Company Act currently contain references to credit ratings issued by NRSROs.[10] We propose to remove the references to credit ratings in rules 2a–7 and 5b–3 and replace them with alternative standards of credit-worthiness that are designed to appropriately achieve the same purposes as the ratings requirements. In addition to the amendments to rules 2a–7 and 5b–3, we are proposing a new rule—rule 6a–5 under the Investment Company Act—to establish a credit-worthiness standard to replace the credit rating reference in section 6(a)(5) of that Act that the Dodd-Frank Act eliminates.[11] Finally, we propose to eliminate required disclosures of credit ratings in Form N–MFP and remove from Forms N–1A, N–2 and N–3 the requirement that NRSRO credit ratings be used when portraying credit quality in shareholder reports. We discuss our proposed amendments and new rule in greater detail below.

A. Rule 2a–7

Rule 2a–7 under the Investment Company Act governs the operation of money market funds. Unlike other investment companies ("funds"), money market funds seek to maintain a stable share price, typically at $1.00 per share. To do so, most money market funds use the amortized cost method of valuation ("amortized cost method") and the penny-rounding method of pricing ("penny-rounding method") permitted by rule 2a–7.[12] The Investment Company Act and applicable rules generally require funds to calculate current net asset value per share by valuing their portfolio instruments at market value or, if market quotations are not readily available, at fair value as determined in good faith by the board of directors.[13] These valuation requirements are designed to prevent unfair share pricing from diluting or otherwise adversely affecting the interests of investors.[14]

Rule 2a–7 exempts money market funds from these provisions but contains conditions designed to minimize the amount of risk a money market fund may assume and thus reduce the deviation between a money market fund's stabilized share price and the market value of its portfolio.[15] Among these conditions, rule 2a–7 limits a money market fund's portfolio investments to securities that have received credit ratings from the "requisite NRSROs" in one of the two highest short-term rating categories or comparable unrated securities (*i.e.,* "eligible securities").[16] A requisite NRSRO must be one of the NRSROs that a money market fund's board of directors has designated ("designated NRSRO") for use, and determines at least annually issues credit ratings that

FR 40106 (July 11, 2008)]; References to Ratings of Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 58070 (July 1, 2008) [73 FR 40088 (July 11, 2008)]. Prior to this initiative, in 2003, the Commission published a concept release in which we sought comment on the use of NRSRO ratings in our rules. *See* Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws, Investment Company Act Release No. 26066 (June 4, 2003) [68 FR 35258 (June 12, 2003)].

[7] *See* References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28939 (Oct. 5, 2009) [74 FR 52358 (Oct. 9, 2009)] ("2009 Ratings Removal Adopting Release") (adopting amendments to rule 5b–3, with respect to the treatment of refunded securities, and rule 10f–3); References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28940 (Oct. 5, 2009) [74 FR 52374 (Oct. 9, 2009)] at Section IV (reopening the comment period for the proposed amendments to rules 3a–7 and 5b–3, with respect only to repurchase agreements). We also sought comment on removing references to credit ratings in rule 2a–7 in our 2009 proposal for certain reforms for money market funds. *See* Money Market Fund Reform Proposing Release, *infra* note 8. We received over 70 comments in response to the 2008 proposed amendments. Most commenters opposed the proposals. These comment letters are available on the Commission's Internet Web site (*http://www.sec.gov/comments/s7-19-08/s71908.shtml; http://www.sec.gov/comments/s7-17-08/s71708.shtml*). In light of today's proposal to amend rule 5b–3, we are withdrawing the 2008 proposed amendments to rule 5b–3 from further consideration.

[8] *See* Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060 (Mar. 4, 2010)] ("Money Market Fund Reform Adopting Release"). *See also* Money Market Fund Reform, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("Money Market Fund Reform Proposing Release"). Most commenters that responded to our request for additional comment on the 2008 proposed amendments to rule 2a–7 in the Money Market Fund Reform Proposing Release opposed that approach.

[9] We have already proposed to remove references to credit ratings in certain rules and forms under the Securities Act and the Exchange Act. *See* Security Ratings, Securities Act Release No. 9186 (Feb. 9, 2011) [76 FR 8946 (Feb. 16, 2011)].

[10] Rule 2a–7 defines the term NRSRO to have the same meaning as in section 3(a)(62) of the Exchange Act [15 U.S.C. 78c(a)(62)]. Rule 5b–3 defines NRSRO with reference to Exchange Act rule 15c3–1(c)(2)(vi)(E), (F), and (H) [17 CFR 240.15c3–1(c)(2)(vi)(E), (F), (H)].

[11] We intend to propose amendments to rule 3a–7 in a separate release.

[12] Under the amortized cost method, portfolio instruments are valued by reference to their acquisition cost as adjusted for amortization of premium or accretion of discount. *See* rule 2a–7(a)(2). Share price is determined under the penny-rounding method by valuing securities at market value, fair value or amortized cost and rounding the per share net asset value to the nearest cent on a share value of a dollar, as opposed to the nearest one tenth of one cent as otherwise would be required. *See* Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380 (July 11, 1983) [48 FR 32555 (July 18, 1983)] ("1983 Money Market Fund Adopting Release") at n.6 ("Release 9786 sets the amount of less than 1/10 of one cent on a share value of one dollar as the benchmark for materiality."); Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)] at text accompanying n.11; rule 2a–7(a)(20) (defining penny-rounding method).

[13] *See* section 2(a)(41) of the Investment Company Act (defining value) and rules 2a–4 (defining current net asset value) and 22c–1 (generally requiring open-end funds to sell and redeem their shares at a price based on the funds' current net asset value as next computed after receipt of a redemption, purchase or sale order).

[14] If shares are sold or redeemed based on a net asset value that turns out to have been either understated or overstated compared to the amount at which portfolio instruments could have been sold, then the interests of either existing shareholders or new investors will have been diluted. *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Currency,* 76th Cong., 3d Sess. 136–138, 288–289 (1940).

[15] Rule 2a–7 contains conditions that apply to each investment a money market fund proposes to make, as well as conditions that apply to a money market fund's entire portfolio.

[16] The term "eligible security" is currently defined in rule 2a–7(a)(12).

are sufficiently reliable for the fund to use, in determining the eligibility of portfolio securities.[17] Rule 2a–7 further restricts money market funds to securities that the fund's board of directors (or its delegate[18]) determines present minimal credit risks, and specifically requires that determination "be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO."[19]

We are proposing to remove references to credit ratings in rule 2a–7, which 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 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.[20] The proposed amendments to rule 2a–7, which are similar to those we proposed in 2008, are designed to offer protections comparable to those provided by the NRSRO ratings.[21]

1. Eligible Securities

Under the proposed amendments, a money market fund would continue to be limited to investing in securities that money market fund boards of directors (or their delegates) determine present minimal credit risks,[22] and each of which is either a "first tier security" or a "second tier security" under the rule.[23] Fund boards of directors (which typically rely on the fund's adviser) would still be able to consider quality determinations prepared by outside sources, including NRSRO ratings, that fund advisers conclude are credible and reliable, in making credit risk determinations. We would expect the fund advisers to understand the method for determining the rating and make an independent judgment of credit risks, and to consider an outside source's record with respect to evaluating the types of securities in which the fund invests.

We propose to eliminate the requirement that an eligible security be rated by an NRSRO or be of comparable quality while maintaining the two-step analysis currently required by rule 2a–7. Under the proposed amendments, a security would be a first tier security (regardless of the ratings it has received from any credit rating agency) if the fund's board (or its delegate) determines that the issuer (or in the case of a security subject to a guarantee, the guarantor) [24] has the "highest capacity to meet its short-term financial obligations." [25] A security would be a second tier security if it is an eligible security but is not a first tier security.[26] In addition, 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.[27]

We have designed these amendments to retain a degree of risk limitation on money market funds similar to the current rule. The proposed amendments would continue to require that funds invest at least 97 percent of their total assets in the highest quality short-term debt securities.[28] Money market fund holdings of these first tier securities would have to satisfy a standard similar to the credit quality standards that have been articulated by the credit ratings agencies.[29] An issuer of a first tier

[17] *See* rule 2a–7(a)(11) (defining "designated NRSRO"); 2a–7(a)(23) (defining "requisite NRSRO").

[18] *See* rule 2a–7(e).

[19] Rule 2a–7(c)(3)(i). Thus, under the current rule, where the security is rated, having the requisite NRSRO rating is a necessary but not sufficient condition for investing in the security and cannot be the sole factor considered in determining whether a security presents minimal credit risks. *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)] ("1991 Money Market Fund Adopting Release") at text preceding n.18.

[20] The proposed rule also would make conforming amendments to rule 2a–7's recordkeeping and reporting requirements. *See* proposed rule 2a–7(c)(11)(iii).

[21] We previously adopted certain of the amendments that we proposed in 2008 as part of the 2010 money market fund reforms. *See* Money Market Fund Reform Adopting Release, *supra* note 8, at Sections II.C.2, II.G.2. Specifically, we expressly limited money market funds' investments in illiquid securities. *See* rule 2a–7(c)(5)(i). We also required money market funds to notify the Commission promptly when an affiliate has purchased certain securities, including a security that is no longer an eligible security, from the fund in reliance on rule 17a–9, which permits certain affiliated persons to purchase certain portfolio securities from a money market fund under certain conditions. *See* rule 2a–7(c)(7)(iii)(B). *See also* 2008 Ratings Removal Proposing Release, *supra* note 6, at Sections III.A.2, III.A.4.

[22] *See* proposed rule 2a–7(a)(11).

[23] The proposal would not change current rule 2a–7 limitations on money market fund investments in second tier securities, under which a money market fund cannot acquire second tier securities with remaining maturities greater than 45 days, generally must limit its investments in second tier securities to no more than three percent of fund assets, and limit investments in the second tier securities of any one issuer to one half of one percent of fund assets. Rule 2a–7(c)(3)(ii); 2a–7(c)(4)(i)(C).

[24] *See* rule 2a–7(c)(3)(iii) (allowing the credit quality of a guarantee to substitute for the credit quality of the security subject to the guarantee); 2a–7(a)(17) (defining "guarantee" to mean "an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an unconditional demand feature, an obligation that entitles the holder to receive upon exercise the approximate amortized cost of the underlying security or securities, plus accrued interest, if any.").

[25] Proposed rule 2a–7(a)(13). As under the current rule, government securities and securities issued by a money market fund also would be first tier securities. Proposed rule 2a–7(a)(13); see rule 2a–7(a)(14).

Our proposed amendments would eliminate the defined terms "designated NRSRO," "rated security," "requisite NRSRO," and "unrated security" from the rule. As a result, under the proposal, fund boards would no longer be required to designate NRSROs and funds would not have to disclose designated NRSROs in their statements of additional information ("SAI"). *See* rule 2a–7(a)(11) (defining "designated NRSRO" as one of at least four NRSROs that, among other things, the fund's board has designated as an NRSRO whose credit ratings will be used by the fund to determine the eligibility of portfolio securities, the board determines at least annually issues credit ratings sufficiently reliable for such use, and the fund discloses in its SAI is a designated NRSRO, including any limitations on the fund's use of the designation). We note that after enactment of the Dodd-Frank Act, money market funds received Commission staff assurances that the staff would not recommend enforcement action if a money market fund board did not designate NRSROs and did not make related disclosures in its SAI before the Commission had completed its review of rule 2a–7 required by the Dodd-Frank Act and made any modifications to the rule. *See* Investment Company Institute, SEC No-Action Letter (Aug. 19, 2010).

[26] *See* proposed rule 2a–7(a)(21). The specific language of this provision would not change (*compare* current rule 2a–7(a)(24)), but the definitions of "eligible security" and "first tier security" would change under the proposal.

[27] Proposed rule 2a–7(a)(11). Currently, the requirement that the fund board (or its delegate) determine that a security presents minimal credit risks is contained in paragraph (c)(3)(i) of the rule. In connection with the amendments discussed above, we propose to restructure the rule to incorporate the minimal credit risk determination into the definition of "eligible security," currently in paragraph (a)(12) of the rule, but which would be renumbered as paragraph (a)(11).

[28] *See* proposed rule 2a–7(a)(13) (defining first tier security); rule 2a–7(c)(3)(ii) (prohibiting money market funds from acquiring second tier securities if, as a result of the acquisition, second tier securities would comprise more than three percent of the fund's total assets).

[29] *See, e.g.,* Standard & Poor's Ratings Definitions, Short-Term Issue Credit Ratings, *http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245219848760* ("S&P Ratings Definitions") (a short-term obligation rated "A–1" is rated in the highest category, and the obligor's capacity to meet its financial commitment on the obligation is strong; obligations within the category designated with a plus sign (+) indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong); Moody's Investors Service Rating Symbols and Definitions, *http://v3.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004* ("Moody's Ratings Definitions") at 5–6 (issuers rated Prime-1 "have a superior ability to repay short-term debt obligations."); FitchRatings, International Issuer and Credit Rating Scales, *http://www.fitchratings.com/creditdesk/public/ratings_definitions/index.cfm?rd_file=ltr* ("Fitch Ratings Definitions") (stating that a rating of F1 is the highest short-term rating, indicating the "strongest intrinsic capacity for

security that would satisfy our proposed standard should have an exceptionally strong ability to repay its short-term debt obligations and the lowest expectation of default.[30] The credit risk associated with a second tier security, which would continue to be limited to three percent of total fund assets,[31] would differ from that associated with first tier securities only to a small degree. Thus, the issuer of a second tier security that would satisfy our proposed standard should have a very strong ability to repay its short-term debt obligations, and a very low vulnerability to default.[32] Finally, we propose to eliminate the requirement that guarantors or guarantees of securities held by a money market fund be rated by an NRSRO.[33]

Our proposal would eliminate the objective standard provided by credit ratings in the definitions of eligible security and first tier security and instead require a subjective determination of both eligible securities and first tier securities. We request comment on this proposed approach.

- Would our proposed approach achieve the goal of retaining a degree of risk limitation on money market funds similar to the current rule?
- Are there alternatives to our proposed approach that would provide a more robust or objective evaluation of credit quality?
- Is there a better way to describe the characteristics of a first tier security?
- Should we instead simply limit money market funds to investing in securities solely based on a minimal credit risk determination, *i.e.,* establish a single test for determining whether a fund could invest in a security?
- Would such an approach allow money market funds to invest a large portion of their portfolios in what are currently second tier securities?

2. Securities With a Conditional Demand Feature

Under rule 2a–7, a security subject to a conditional demand feature[34] 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 the requisite NRSROs or is a comparable unrated security.[35] We propose to remove the credit rating requirement from this provision of the rule and amend the provision to require that the fund's board (or its delegate) determine that the underlying security be of high quality and subject to very low credit risk.[36] The proposed standard is designed to retain a similar degree of risk limitation to that in the current rule. An issuer that is determined to have a very strong capacity to meet its financial commitments, a very low risk of default, and a capacity for payment of its financial commitments that is not significantly vulnerable to reasonably foreseeable events would satisfy the proposed definition.[37] In making the credit quality determinations required under the proposed amendment, a fund board (or its delegate) would continue to be able to consider analyses provided by third parties, including ratings provided by ratings agencies, that it concludes are credible and reliable for such purposes.[38]

We request comment on the proposed credit quality standard for securities with a conditional demand feature.

- Does our proposed standard retain the same or similar degree of risk limitation as that under the current rule?
- Are there alternative standards that would provide a more robust or objective evaluation of credit quality?

3. Monitoring Minimal Credit Risks

Rule 2a–7 currently requires a money market fund board (or its delegate) promptly to reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks, and take such action as it

timely payment of financial commitments; may have an added '+' to denote any exceptionally strong credit feature.").

[30] We note that all money market fund portfolio securities also must be eligible securities (i.e., present minimal credit risks under the proposed amendments). *See* proposed rule 2a–7(a)(13). Thus, even if the issuer had the highest capacity to meet its short-term financial obligations, a security, such as a subordinated short-term security secured by assets that are not of high credit quality, likely would not present minimal credit risks to a money market fund's portfolio and therefore likely would not be an eligible security.

[31] Rule 2a–7(c)(3)(ii).

[32] Nothing in the proposed rule would prohibit a money market fund from relying on policies and procedures it has adopted to comply with the current rule as long as the board (or its delegate) concluded that the ratings specified in the policies and procedures establish similar standards to those proposed, and are credible and reliable for that use. A fund also would be able to revise its policies and procedures to change or eliminate the use of specific NRSRO ratings or to incorporate other third party evaluations of credit quality.

[33] *See* rule 2a–7(a)(12)(iii)(A). We also propose to move the provision that conditions the eligibility of a demand feature or guarantee of the issuer, or another institution, on an undertaking promptly to notify the fund in the event of a substitution of a demand feature or guarantee, which is currently in paragraph (a)(12)(iii)(B), to paragraphs (c)(3)(iii) (permitting money market funds to substitute the credit quality of a guarantee for the credit quality of the security subject to the guarantee in determining whether a security is an eligible or first tier security) and (c)(3)(iv)(D) (conditions under which a security subject to a conditional demand feature may be determined to be an eligible security or first tier security).

[34] A conditional demand feature is a demand feature that a fund may be precluded from exercising because of the occurrence of a condition. *See* rule 2a–7(a)(6) (defining "conditional demand feature" as a demand feature that is not an unconditional demand feature); 2a–7(a)(28) (defining "unconditional demand feature" as a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security). For purposes of rule 2a–7, a demand feature allows the security holder to receive, upon exercise, the approximate amortized cost of the security, plus accrued interest, if any. In addition, a demand feature must be exercisable either: (i) At any time on no more than 30 calendar days' notice; or (ii) at specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice. Rule 2a–7(a)(9)(i). If an asset-backed security is subject to a demand feature, the feature must permit the security holder unconditionally to receive principal and interest within 397 calendar days of making demand. Rule 2a–7(a)(9)(ii).

[35] Rule 2a–7(c)(3)(iv).

[36] Proposed rule 2a–7(c)(3)(iv)(C). The rule references both short-term and long-term ratings because most money market fund portfolio securities with demand features are long-term securities (that would not meet the portfolio maturity requirements of rule 2a–7 without the demand feature). Under current rule 2a–7, a money market fund must limit its investments in securities subject to a demand feature or guarantee of the same issuer that are second tier securities to 2.5% of the fund's total assets. Rule 2a–7(c)(4)(iii). If, as a result of a downgrade, a fund exceeds this limitation on such securities, the fund must reduce its investment in the securities to no more than 2.5% of total assets by exercising the demand feature at the next succeeding exercise date(s). Rule 2a–7(c)(7)(i)(C). In a conforming change, we propose to amend this provision to require the fund to reduce its investment in securities subject to a demand feature or guarantee of a single issuer that are second tier securities, if, as a result of a portfolio security that ceases to be a first tier security, the fund exceeds the 2.5% investment limit on such securities. Proposed rule 2a–7(c)(7)(i)(B).

[37] These credit quality characteristics are similar to credit quality standards that have been articulated by credit rating agencies. *See, e.g.,* S&P Ratings Definitions, *supra* note 29 (describing the capacity of an issuer of long-term obligations rated "AA" as "very strong"); Moody's Ratings Definitions, *supra* note 29 (describing Aa-rated long-term obligations as "judged to be of high quality and are subject to very low credit risk."); Fitch Ratings Definitions, *supra* note 29 (describing AA-rated long-term obligations as denoting expectations of very low default risk and indicating that the issuer's capacity for payment of financial commitments is very strong and "not significantly vulnerable to foreseeable events").

[38] The proposed amendment would not prohibit a money market fund from relying on policies and procedures it has adopted to comply with the current rule regarding the credit quality of securities with conditional demand features as long as the board (or its delegate) concluded that the ratings specified in the policies and procedures establish similar standards to those proposed, and that the agencies providing ratings used in the policies and procedures are credible and reliable for that use. A fund also could revise its policies and procedures to change or eliminate the consideration of specific NRSRO ratings or to incorporate other third party evaluations of credit quality.

determines is in the best interests of the fund and its shareholders.[39] We propose to amend the rule to require that, in the event the money market fund's adviser (or any person to whom the board 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 second tier security, as the case may be, the board or its delegate would have to reassess promptly whether the portfolio security continues to present minimal credit risks.[40] To satisfy the proposed standard, an investment adviser would be required to exercise reasonable diligence in keeping abreast of new information about a portfolio security that the adviser believes to be credible. We understand that most money market fund advisers currently exercise a similar degree of diligence in monitoring their portfolios in order to meet the rule 2a–7 requirement that portfolio investments be limited to securities that the board determines present minimal credit risks.

We request comment on the proposed amendments for monitoring minimal credit risks.

• Would our proposed approach to describing when reassessment of whether a portfolio security presents minimal credit risks is required achieve the objective of retaining a degree of risk limitation on money market funds similar to the current rule?

• Is there an alternative or more objective standard for determining when the board must reassess the credit risk of a security that would provide adequate investor protections?

• Are we correct in our understanding of current monitoring practices?

4. Stress Testing

Rule 2a–7 currently requires money market funds to adopt written procedures for stress testing their portfolios. Specifically they must 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.[41] We propose to replace this reference to ratings downgrades with a hypothetical event that is designed to have a similar impact on a money market fund's portfolio. Our proposal would require that money market funds stress test for an adverse change in the ability of a portfolio security issuer to meet its short-term financial obligations.[42] Under the proposed rule, funds could continue to test their portfolios by treating a downgrade as a credit event that might adversely affect the value or liquidity of the portfolio security (and affect the fund's ability to maintain a stable net asset value per share).

We request comment on our proposed amendment to the stress testing requirements.

• Does the standard we propose adequately address the same concerns that arise when a security is downgraded?

• Is the proposed standard too broad?

• Would the proposed standard provide adequate guidance to funds?

• Is there a narrower standard that we should specify?

B. Form N–MFP

As part of the money market fund reforms we adopted in 2010, money market funds must provide to the Commission a monthly electronic filing of portfolio holdings information on Form N–MFP.[43] The information money market funds must disclose with respect to each portfolio security (and any guarantee, demand feature or other enhancement associated with the portfolio security) includes the name of each designated NRSRO for the portfolio security and the rating assigned to the security.[44] We propose to eliminate the items requiring disclosure of ratings information from the form. We also propose to amend Item 33 of Form N–MFP to remove the reference to a rating in this item so that funds would only disclose whether a portfolio security is first or second tier or no longer an eligible security.[45]

We request comment on the proposed form amendments.

C. Rule 5b–3

Rule 5b–3 under the Investment Company Act permits a fund, subject to certain conditions, to treat a repurchase agreement as an acquisition of the securities collateralizing the repurchase agreement in determining whether the fund is in compliance with two provisions of the Investment Company Act that may affect a fund's ability to invest in repurchase agreements. In a typical investment company repurchase agreement, a fund enters into a contract with a broker, dealer or bank (the "counterparty" to the transaction) for the purchase of securities. The counterparty agrees to repurchase the securities at a specified future date, or on demand, for a price that is sufficient to return to the fund its original purchase price, plus an additional amount representing the return on the fund's investment.[46]

Section 12(d)(3) of the Investment Company Act generally prohibits a fund from acquiring an interest in a broker, dealer, or underwriter. Because a repurchase agreement may be considered to be the acquisition of an

[39] Rule 2a–7(c)(7)(i)(A). This current reassessment is not required, however, if the downgraded security is disposed of or matures within five business days of the specified event and in the case of events specified in rule 2a–7(c)(7)(i)(A)(2), the board is subsequently notified of the adviser's actions. Rule 2a–7(c)(7)(i)(B).

[40] Proposed rule 2a–7(c)(7)(i)(A). As under the current rule, the proposal would not require reassessment in certain circumstances. *See supra* note 39. Our proposed standard differs slightly from our proposal in 2008, which would have required the board's reassessment if the money market fund's investment adviser became aware of any information about a portfolio security or an issuer of a portfolio security that suggested that the security might not have continued to present minimal credit risks. *See* 2008 Ratings Removal Proposing Release, *supra* note 6, at Section III.A.3. We believe that requiring the relevant information to relate to whether the portfolio security may no longer be first or second tier (as compared with the standard proposed in 2008) is more similar to the current standard. In addition, as noted by several commenters on the standard proposed in 2008, without limiting the information to be monitored in any way, the standard could be interpreted to require monitoring of all information regarding portfolio securities, including unreliable sources or unsubstantiated market rumors. *See, e.g.,* Comment Letter of CFA Institute Centre for Financial Market Integrity (Mar. 26, 2009); Comment Letter of Charles Schwab & Co., Inc. (Sept. 5, 2008); Comment Letter of Federated Investors, Inc. (Sept. 5, 2008).

[41] Rule 2a–7(c)(10)(v)(A).

[42] Proposed rule 2a–7(c)(10)(v)(A).

[43] *See* rule 30b1–7. *See also* Money Market Fund Reform Adopting Release, *supra* note 8, at n.301 and accompanying and preceding text.

[44] *See* Items 34 (requiring disclosure of each designated NRSRO for a portfolio security and the credit rating given by the designated NRSRO for each portfolio security); 37b–c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security demand feature); 38b–c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security guarantee); 39c–d (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security enhancement) of Form N–MFP.

[45] *See* Item 33 of Form N–MFP (requiring money market funds to disclose whether a security is a "rated" first or second tier security, an unrated security, or no longer an eligible security).

[46] Repurchase agreements provide funds with a convenient means to invest excess cash on a secured basis, generally for short periods of time. Economically, a repurchase agreement functions as a loan from the fund to the counterparty, in which the securities purchased by the fund serve as collateral for the loan and are placed in the possession or under the control of the fund's custodian during the term of the agreement. *See* Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, Investment Company Act Release No. 25058 (July 5, 2001) [66 FR 36156 (July 11, 2001)] ("Rule 5b–3 Adopting Release"). Various issues arose during the market events of 2007 to 2009 that affected the market for repurchase agreements. In response, a task force of participants in the market for tri-party repurchase agreements was formed and issued a report setting forth its findings and recommendations for improvements. *See* Report of Task Force on Tri-Party Repo Infrastructure, (May 17, 2010) at *http://www.ny.frb.org/prc/report_100517.pdf.*

interest in the counterparty, section 12(d)(3) may limit a fund's ability to enter into repurchase agreements with many of the firms that act as repurchase agreement counterparties. Section 5(b)(1) of the Investment Company Act limits the amount that a fund that holds itself out as being a diversified investment company may invest in the securities of any one issuer (other than the U.S. Government). This provision may limit the number and principal amounts of repurchase agreements a diversified fund may enter into with any one counterparty.

Rule 5b–3 allows funds to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of sections 5(b)(1) and 12(d)(3) of the Investment Company Act if the obligation of the seller to repurchase the securities from the fund is "collateralized fully." [47] A repurchase agreement is collateralized fully if, among other things, the collateral for the repurchase agreement consists entirely of (i) cash items, (ii) government securities, (iii) securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the "requisite NRSROs" [48] or (iv) unrated securities that are of a comparable quality to securities that are rated in the highest rating category by the requisite NRSROs, as determined by the fund's board of directors or its delegate.[49] In proposing rule 5b–3, the Commission explained that the highest rating category requirement in the definition of collateralized fully was designed to help ensure that the market value of the collateral would remain stable and that the fund could more readily liquidate the collateral quickly in the event of a default.[50]

We propose to eliminate the requirement that collateral other than cash or government securities be rated in the highest category by the requisite NRSROs or be of comparable quality. In place of this requirement, we propose to require that collateral other than cash or government securities consist of securities that the fund's board of directors (or its delegate) determines at the time the repurchase agreement is entered into are: (i) Issued by an issuer that has the highest capacity to meet its financial obligations; and (ii) sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven calendar days.[51] For purposes of rule 5b–3, an issuer would be defined to include an issuer of an unconditional guarantee of the security.[52] Thus, a collateral security with an unconditional guarantee, the issuer of which meets the proposed credit quality test, would satisfy that element of the proposed standard.

We have designed the proposed amendments to retain a degree of credit quality similar to that under the current rule. An issuer of collateral securities that the board (or its delegate) determined has an exceptionally strong capacity to repay its short or long-term debt obligations, as appropriate, the lowest expectation of default, and a capacity for repayment of its financial commitments that is the least susceptible to adverse effects of changes in circumstances would satisfy the proposed standard.[53]

Our proposal also would require that at the time the repurchase agreement is entered into, collateral could be sold at approximately its carrying value in the ordinary course of business within seven calendar days.[54] We expect that securities that trade in a secondary market at the time of the acquisition of the repurchase agreement would satisfy this liquidity standard. We also understand that most securities that are currently used to collateralize repurchase agreements [55] generally trade in a secondary market.

We have designed the proposed amendments to be clear enough to permit a fund board or fund investment adviser to make a determination regarding credit quality and liquidity that would achieve the same objectives that the credit rating requirement was designed to achieve, i.e., to limit collateral securities to those that are likely to retain a fairly stable market value and that, under ordinary circumstances, the fund would be able to liquidate quickly in the event of a counterparty default.[56] We believe that fund advisers have experience with or knowledge of the evaluation of securities and would be qualified to make the credit and liquidity

[47] Rule 5b–3(a). The term "collateralized fully" is defined in rule 5b–3(c)(1). In general, a fund investing in a repurchase agreement looks to the value and liquidity of the securities collateralizing the repurchase agreement rather than the credit quality of the counterparty for satisfaction of the repurchase agreement. *See* Rule 5b–3 Adopting Release, *supra* note 46, at Section II.A.3. *But see* rule 2a–7(c)(4)(ii)(A) (requiring money market funds to evaluate the counterparty's credit-worthiness).

[48] The term "requisite NRSROs" means any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer or, if only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the investment company acquires the security, that NRSRO. Rule 5b–3(c)(6).

[49] Rule 5b–3(c)(1)(iv). The term "unrated securities" means securities that have not received a rating from the requisite NRSROs. Rule 5b–3(c)(8). We note, however, that as a result of our recent money market fund reforms, money market funds seeking similar treatment with respect to the diversification requirements under rule 2a–7 are subject to stricter limitations. In order to qualify for such special treatment, a repurchase agreement is collateralized fully only if the collateral for the repurchase agreement consists entirely of cash or government securities. Rule 2a–7(a)(5). *See* Money Market Fund Reform Adopting Release, *supra* note 8, at Section II.D.

[50] *See* Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, Investment Company Act Release No. 24050 (Sept. 23, 1999) [64 FR 52476 (Sept. 29, 1999)] ("Rule 5b–3 Proposing Release") at n.43 and accompanying text (noting that the high quality requirement is designed to limit a fund's exposure to the ability of the counterparty to maintain sufficient collateral, and that securities of lower quality may be subject to greater price fluctuation).

[51] Proposed rule 5b–3(c)(1)(iv)(C). Under the proposal, the board would make credit quality determinations for all collateral securities that are not government securities, rather than just unrated securities. As in the current rule, the proposed rule would permit the board to delegate the credit quality and liquidity determination. The proposed amendment to rule 5b–3 would not affect a money market fund that seeks special treatment under the diversification provisions of rule 2a–7 because in order to obtain such treatment, a money market fund is limited to investing in repurchase agreements collateralized by cash items or government securities. *See supra* note 49. We are proposing to amend rule 2a–7(a)(5), which defines "collateralized fully," to conform the references in that provision to the proposed amendments to rule 5b–3.

The first element of this proposed standard reflects the same standard as that proposed for the definition of first tier security under rule 2a–7. *See* proposed rule 2a–7(a)(13).

[52] Proposed rule 5b–3(c)(4) (defining "issuer" to mean "the issuer of a collateral security or the issuer of an unconditional obligation of a person other than the issuer of the collateral security to undertake to pay, upon presentment by the holder of the obligation (if required), the principal amount of the underlying collateral security plus accrued interest when due or upon default.").

[53] *See supra* text accompanying note 30.

[54] The proposed liquidity standard is the same as that we use for rule 2a–7. *See, e.g.,* rule 2a–7(a)(19) (defining illiquid security to mean a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund).

[55] *See* Tri-Party Repo Infrastructure, Reform Task Force, Tri-Party Repo Margin Data, Summary Statistics for the U.S. Tri-Party Repo Market (as of Jan. 11, 2011), *http://www.newyorkfed.org/tripartyrepo/margin_data.html* (describing 98.7% of tri-party repurchase agreement collateral as composed of asset-backed securities, agency collateralized mortgage backed obligations ("CMOs"), agency debentures and strips, agency mortgage-backed securities, private label CMOs, corporate debt, equity securities, money market instruments and U.S. Treasury securities).

[56] *See supra* note 50. A fund that acquires repurchase agreements would, under rule 38a–1, have to adopt and implement a written policy reasonably designed to comply with the conditions of rule 5b–3, including any credit quality and liquidity requirements we might adopt under the rule. *See* rule 38a–1(a) (requiring registered funds to adopt and implement written policies and procedures reasonably designed to prevent the fund's violation of Federal securities laws).

determinations proposed under the rule.[57]

Under the proposal, the board could delegate day-to-day determinations regarding the quality and liquidity of collateral if it chooses, provided that the board retained sufficient oversight. In addition, although the rule would no longer require the collateral to be rated by an NRSRO, fund boards (or their delegates) would still be able to consider analysis provided by outside sources, including credit agency ratings, that they conclude are credible and reliable, for purposes of making these credit quality evaluations.[58]

We request comment on our proposed amendment to rule 5b–3.

- Would the proposed determinations sufficiently address our concerns that collateral securities be of high quality in order to limit a fund's exposure to counterparties' credit risks? If not, are there additional or alternative standards that do not use credit ratings that would better address our concerns?
- Should a fund board (or its delegate) be permitted to consider assessments issued by third parties, as we anticipate? What, if any, criteria or standards should be imposed on the use of such assessments? Would the use of third party assessments help fund boards (or their delegates) arrive at consistent determinations regarding the credit quality of collateral under the rule?
- We propose to allow the credit quality of an issuer of an unconditional guarantee to substitute for the credit quality of the issuer of a collateral security subject to the guarantee.[59] This is designed to preserve a fund's ability to use the same types of collateral securities as it currently uses to satisfy the conditions of rule 5b–3. Should we instead limit collateral to securities that alone satisfy the proposed credit quality standard regardless of whether the security is subject to an unconditional guarantee?
- Would the proposed standard adequately address our concern that a fund be able to readily liquidate collateral securities in the event of a counterparty default?
- As noted above, we expect that, in general, securities that trade in secondary markets and most securities that are used as collateral for repurchase agreements would meet the proposed liquidity requirement. Are there securities typically used for collateral that would not meet the proposed liquidity standard?
- We have noted before that high quality securities generally are more liquid than lower quality securities.[60] Would the proposed credit quality requirement alone be sufficient to address concerns regarding liquidity of the collateral?
- We acknowledge that securities that may be liquid at the time of acquisition of the repurchase agreement may be less liquid when the counterparty defaults.[61] Would a different standard of liquidity provide any greater protection? For example, if we required that collateral could be sold at carrying value almost immediately, would it be more likely to remain liquid if many holders of the security are trying to sell at the same time? Would such a standard limit collateral securities to U.S. Treasury securities as a practical matter?
- In light of the potential for decreased liquidity of collateral securities at the time of a counterparty default, should we limit the exemption to repurchase agreements that are collateralized only by cash or government securities?
- Would we better achieve the goals of rule 5b–3 if the rule provided that a fund could no longer rely on rule 5b–3 if, at any point after the time a fund enters into a repurchase agreement, the collateral no longer met the proposed liquidity standard?

D. Proposed Rule 6a–5

Business and industrial development companies ("BIDCOs") are companies that operate under state statute that provide direct investment and loan financing, as well as managerial assistance, to state and local enterprises.[62] Because they invest in securities, BIDCOs frequently meet the definition of "investment company" under the Investment Company Act.[63] In 1996, the Investment Company Act was amended to add section 6(a)(5) to exempt these companies from most provisions of the Act subject to certain conditions.[64] The statutory exemption was premised on states having a strong interest in overseeing the structure and operations of these companies, thus rendering regulation under the Investment Company Act largely duplicative and unnecessary.[65]

BIDCOs that seek to rely on the exemption in section 6(a)(5) are limited with respect to the types of securities issued by investment companies and companies exempt from the definition of investment company under section 3(c)(1) or 3(c)(7) of the Act ("private funds") that they may purchase. Specifically, section 6(a)(5)(A)(iv) limits these BIDCOs from purchasing securities issued by investment companies and private funds other than debt securities that are rated investment grade by at least one NRSRO and securities issued by registered open-end investment companies that invest at

[57] We note that under the current rule, if collateral securities are unrated, fund boards of directors (or their delegates) must determine that the securities are of comparable quality to securities rated in the highest category by an NRSRO. Rule 5b–3(c)(iv)(D).

[58] We understand that credit quality standards for securities collateralizing repurchase agreements are typically contained in the agreements between funds and counterparties. We expect that those standards include a rating (for rated collateral securities) and any additional criteria a fund manager considers necessary to ensure that the credit quality of collateral securities meets the fund's requirements, or for unrated securities, a comparable credit quality standard. The proposed amendment would not prohibit fund boards (or their delegates) from relying on the credit quality standards in current repurchase agreements and policies and procedures adopted to comply with the current rule regarding the credit quality of collateral securities as long as they conclude that the ratings specified in the repurchase agreements and policies and procedures establish similar standards to those proposed, and that the agencies providing the ratings used in the policies and procedures are credible and reliable for that use. A fund could also revise its repurchase agreements and policies and procedures to change or eliminate the consideration of specific NRSRO ratings or to incorporate other third party evaluations of credit quality.

[59] *See* proposed rule 5b–3(c)(1)(iv)(C)(4).

[60] *See* Rule 5b–3 Proposing Release, *supra* note 50, at n.43.

[61] We have noted before the difficulties of liquidating collateral in the case of a default by a large counterparty when many investors in repurchase agreements seek to liquidate similar collateral at the same time. *See* Money Market Fund Reform Proposing Release, *supra* note 8, at n.229 and accompanying and preceding text.

[62] *See* S. Rep. No. 103–166, at 11 (1993) ("1993 Senate Report").

[63] For purposes of the Investment Company Act, an "investment company" means any issuer that (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of government securities and cash items) on an unconsolidated basis. 15 U.S.C. 80a–3(a)(1).

[64] 15 U.S.C. 80a–6(a)(5); Pub. L. 104–290 § 501, 110 Stat. 3416, 3444 (1996). Section 6(a)(5)(B) provides that section 9 and, to the extent necessary to enforce section 9, sections 38 through 51, apply to a BIDCO as though the company were a registered investment company. Among other conditions to reliance on the exemption in section 6(a)(5), a BIDCO may not issue redeemable securities.

[65] *See* 1993 Senate Report, *supra* note 62, at 19 (further stating that states are well positioned to monitor these companies and address the needs of resident investors). Prior to the addition of section 6(a)(5), the Commission had granted orders to exempt BIDCOs from regulation under the Act. *See, e.g.,* The Idaho Company, Investment Company Release Nos. 18926 (Sept. 3, 1992) (notice) and 18985 (Sept. 30, 1992) (order).

least 65 percent of their assets in investment grade securities or securities that the fund determines are comparable in quality.[66] This provision was intended to provide limited flexibility to invest capital not immediately needed for the company's long-term commitments.[67] Although the legislative history of the provision does not specifically explain why Congress restricted BIDCOs to acquiring "investment grade" debt of investment companies and private funds, it may have been designed to limit BIDCOs to investing in debt securities of sufficiently high credit quality that they are likely to maintain a fairly stable market value and that could be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities.

As described above, section 939(c) of the Dodd-Frank Act eliminates the credit rating reference in section 6(a)(5)(A)(iv) of the Investment Company Act. Instead of limiting BIDCOs to purchasing debt securities issued by investment companies and private funds that are rated "investment grade," the amendment requires such debt securities to meet "such standards of credit-worthiness as the Commission shall adopt."

We are proposing new rule 6a–5 to establish this standard of credit-worthiness. Proposed rule 6a–5 would deem a BIDCO to have met the requirements for credit-worthiness of certain debt securities under section 6(a)(5)(A)(iv)(I) if the board of directors or members of the company (or its delegate) determines that the debt security is (i) subject to no greater than moderate credit risk and (ii) sufficiently liquid that the security can be sold at or near its carrying value within a reasonably short period of time.[68] The proposed standard is designed to limit BIDCOs to purchasing debt securities issued by investment companies or private funds of sufficiently high credit quality that they are likely to maintain a fairly stable market value and may be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities. The board of directors or members of a BIDCO (or its delegate) would have to make the determination at the time of acquisition.[69] As a result of the proposed rule, section 6(a)(5) of the Act would also limit a BIDCO's investments in registered open-end funds to those funds that invest at least 65 percent of their assets in debt securities that meet our proposed standard.[70]

Moderate credit risk would denote current low expectations of default risk, with an adequate capacity for payment of principal and interest.[71] Debt securities (or their issuers) subject to a moderate level of credit risk would demonstrate at least average credit-worthiness relative to other similar debt issues (or issuers of similar debt).[72] In making these determinations, a BIDCO's board of directors, members or managers would be able to consider credit quality reports prepared by outside sources, including NRSRO ratings, that they conclude are credible and reliable for this purpose.

We request comment on proposed rule 6a–5.

- Does the standard we have proposed provide BIDCOs with flexibility to invest in certain debt securities that are likely to retain their value and that a BIDCO could sell quickly if necessary to support its investment and financing activities? If not, are there additional or alternative standards that do not use credit ratings that would be more appropriate to the statutory intent of section 6(a)(5)?
- Is our understanding that BIDCOs are organized as corporations with a board of directors or limited liability companies with members or managers correct? Are there BIDCOs that are formed as partnerships or other structures?
- Do BIDCO directors or members have sufficient experience with or knowledge of evaluating securities to allow them to make the determinations called for by proposed rule 6a–5 or to oversee decisions made by a delegate?

E. Forms N–1A, N–2 and N–3

We are proposing to amend Forms N–1A, N–2 and N–3 to remove the required use of credit ratings assigned by an NRSRO. Forms N–1A, N–2 and N–3, among other things, contain the requirements for shareholder reports of mutual funds, closed-end funds, and certain insurance company separate accounts that offer variable annuities.[73]

Currently, Forms N–1A, N–2 and N–3 each require shareholder reports to include a table, chart, or graph depicting portfolio holdings by reasonably identifiable categories (*e.g.,* type of security, industry sector, geographic region, credit quality or maturity).[74] The forms require the categories to be selected in a manner reasonably designed to depict clearly the types of investments made by the fund, given its investment objectives. If credit quality is

[66] 15 U.S.C. 80a–6(a)(5)(A), as in effect prior to July 21, 2012 (exempting any company that is not engaged in the business of issuing redeemable securities, the operations of which are subject to regulation by the State in which the company is organized under a statute governing entities that provide financial or managerial assistance to enterprises doing business, or proposing to do business in that state if, among other things, the company does not purchase any security issued by an investment company or by any company that would be an investment company except for the exclusions from the definition of the term "investment company" under sections 3(c)(1) or 3(c)(7), other than (I) any debt security that is rated investment grade by not less than 1 nationally recognized statistical rating organization; or (II) any security issued by a registered open-end fund that is required by its investment policies to invest not less than 65% of its total assets in securities described in subclause (I) or securities that are determined by such registered open-end fund to be comparable in quality to securities described in subclause (I)).

[67] *See* 1993 Senate Report, *supra* note 62, at 20.

[68] Proposed rule 6a–5. The standard for credit-worthiness that we are proposing in rule 6a–5 is similar to the standard that we adopted in rule 10f–3 under the Investment Company Act. *See* 2009 Ratings Removal Adopting Release, *supra* note 7, at Section II.B.2; rule 10f–3(a)(3). This credit quality standard differs from those we propose for rules 2a–7 and 5b–3 because it reflects the different standard of credit quality associated with the ratings referenced in rule 10f–3 and section 6(a)(5)(A)(iv)(I) of the Act before the amendment of each provision. *Compare supra* notes 16, 48, and accompanying text *with supra* note 66 and accompanying text and rule 10f–3(a)(3), as in effect before November 12, 2009 (conditioning an exemption to permit an investment company that is affiliated with members of an underwriting syndicate to purchase securities from the syndicate if certain conditions are met, including if the securities are municipal securities, that have received an investment grade rating, or if the securities are less seasoned, one of the three highest ratings, from an NRSRO).

[69] Proposed rule 6a–5. From our review of the state statutes under which BIDCOs are formed and operate, we understand that BIDCOs must be organized as corporations with boards of directors or limited liability companies that are managed by members or managers. *See, e.g.,* Mich. comp. Laws § 301 (2010) (stating that a company other than a Michigan corporation or a limited liability company cannot apply for a license to be a BIDCO); Mont. Code Ann. § 102 (2010) (defining a BIDCO as a corporation that is licensed under the act to provide financial and management assistance to businesses); Alaska Stat. § 20 (2010) (stating that a license to operate a BIDCO will be issued to a corporation if certain conditions are met); Tenn. Code Ann. § 208 (2010) (stating that a person other than a Tennessee corporation cannot apply for a license to be a BIDCO).

[70] Section 6(a)(5)(A)(iv)(II) (permitting a BIDCO to purchase any security issued by a registered open-end fund that is required by its investment policies to invest not less than 65% of its total assets in securities described in subclause (I) (*i.e.,* securities that meet the standards of credit-worthiness that the Commission adopts) or securities that are determined by such registered open-end fund to be comparable in quality to securities described in subclause (I)).

[71] *See* 2009 Ratings Removal Adopting Release, *supra* note 7, at n.86.

[72] *Id.*

[73] Form N–1A is used by open-end management investment companies, commonly known as mutual funds. Form N–2 is used by closed-end management investment companies. Form N–3 is used by separate accounts, organized as management investment companies, that offer variable annuity contracts.

[74] Item 27(d)(2) of Form N–1A; Instruction 6(a) to Item 24 of Form N–2; Instruction 6(i) to Item 28(a) of Form N–3.

used to present portfolio holdings, the forms require that credit quality be depicted using the credit ratings assigned by a single NRSRO.

We are proposing to amend Forms N–1A, N–2 and N–3 to eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in the required table, chart or graph of portfolio holdings. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposal, like the current forms, generally would require the fund to use the credit ratings of a single NRSRO. This requirement is intended to eliminate the possibility that a fund could choose to use NRSRO credit ratings and then select the most favorable ratings among credit ratings assigned by multiple NRSROs. The proposal would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.[75] Funds typically provide this discussion in their shareholder reports today.[76]

We request comment on the proposal to eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in shareholder reports.

- Are there better methods than the proposal by which funds could portray credit quality for purposes of the required table, chart or graph that presents portfolio holdings?
- Does the proposal adequately address situations where a fund would choose to portray credit quality using NRSRO ratings and there is no single NRSRO that has rated all of the fund's portfolio holdings?

III. Request for Comment

We request comment on the rule and form amendments and new rule proposed in this release. We also request suggestions for additional changes to existing rules, and comments on other matters that might have an effect on the proposals contained in this release. Commenters are requested to provide empirical data to support their views.

IV. Paperwork Reduction Act

Certain provisions of our proposal contain "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[77] The titles for the existing collections of information are: (1) "Rule 2a–7 under the Investment Company Act of 1940, Money market funds"; (2) "Rule 30e–1 under the Investment Company Act of 1940, Reports to Stockholders of Management Companies";[78] (3) "Rule 38a–1 under the Investment Company Act of 1940, Compliance procedures and practices of registered investment companies"; and (4) "Form N–MFP under the Investment Company Act of 1940, Portfolio Holdings of Money Market Funds." We adopted the rules and form pursuant to the Investment Company Act. The Commission is submitting these collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

There is currently no approved collection of information for rule 5b–3 and the proposed amendments would not create any new collections under that rule. The proposed amendments to rule 5b–3 would, however, affect the collection of information burden for rule 38a–1. Proposed rule 6a–5 also would not create any new collections of information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The approved collection of information associated with rule 2a–7 displays control number 3235–0268. The approved collection of information associated with rule 30e–1 displays control number 3235–0025. The approved collection of information associated with rule 38a–1, which would be revised by the proposed amendments to rule 5b–3, displays control number 3235–0586. The approved collection of information associated with Form N–MFP displays control number 3235–0657.

A. Money Market Funds

1. Rule 2a–7

As discussed above, we are proposing to remove references to credit ratings in rule 2a–7, which would affect five elements of the rule. First, we propose to eliminate the requirement that an eligible security be rated by an NRSRO or be of comparable quality, while maintaining the two-step analysis currently required by rule 2a–7. 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.[79] Second, we propose to define first tier security as a security whose issuer the fund's board (or its delegate) determines has the "highest capacity to meet its short-term financial obligations."[80] Third, we propose to require that with respect to a security (or its guarantee) subject to a conditional demand feature, in addition to other conditions, the underlying security (or its guarantee) must itself be of high quality and subject to very low credit risk as determined by the fund's board (or its delegate).[81] Fourth, we propose to eliminate the use of credit ratings in the rule's downgrade and default provisions. The proposed amendment would 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 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.[82] Finally, we propose to eliminate the reference to portfolio securities' downgrades in the stress testing provisions. Under the proposal, a money market fund's stress testing procedures would be required to include as a hypothetical event, "an adverse change in the ability of the issuer of a portfolio security to meet its

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[75] Proposed Item 27(d)(2) of Form N–1A; proposed Instruction 6(a) to Item 24 of Form N–2; proposed Instruction 6(i) to Item 28(a) of Form N–3. In these items, we are also proposing to define NRSRO by reference to the Exchange Act definition, rather than by reference to Exchange Act rule 15c3–1 as is currently the case, and to replace the use of the term "rating" with "credit rating" as defined under the Exchange Act. See sections 3(a)(60) [15 U.S.C. 78c(a)(60)] and 3(a)(62) [15 U.S.C. 78c(a)(62)] of the Exchange Act, which define "credit rating" and "nationally recognized statistical rating organization," respectively.

[76] This statement is based on a staff review of a sample of fund shareholder reports filed with the Commission.

[77] 44 U.S.C. 3501–3520.

[78] The proposed amendments to Forms N–1A, N–2 and N–3 relate solely to the contents of fund shareholder reports. The PRA burden associated with fund shareholder reports is included in the burden associated with the collection of information for rule 30e–1 under the Investment Company Act rather than Forms N–1A, N–2 and N–3.

[79] Proposed rule 2a–7(a)(11). *See supra* Section II.A.1.

[80] Proposed rule 2a–7(a)(13). *See supra* Section II.A.1.

[81] Proposed rule 2a–7(c)(3)(iv)(C). *See supra* Section II.A.2.

[82] Proposed rule 2a–7(c)(7)(i)(A). *See supra* Section II.A.3.

short-term financial obligations."[83] The respondents to these collections of information are money market funds. A fund must comply with the requirements of rule 2a–7, including the collections of information, in order to obtain the exemptive relief provided under the rule and to operate as a money market fund.

We do not anticipate that the proposed amendments would significantly change collection of information requirements under rule 2a–7 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.[84] Eligible securities and first tier securities currently are defined with reference to credit ratings, and securities subject to a conditional demand feature must meet a minimum credit rating threshold or if unrated, be of comparable quality. 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. As we have noted above, with respect to each of the amendments we propose today, money market funds could continue to consider evaluations of outside sources, including credit ratings, in making credit quality determinations, monitoring and stress testing. Moreover, we anticipate 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, we do not expect the proposed amendments would significantly change current collection of information burden estimates for rule 2a–7.[85] Nevertheless, money market funds may make technical changes to their policies and procedures in response to the proposed amendments, if adopted. Staff estimates that it would take, on average, 1.5 hours of a senior business analyst's time to make any technical changes for an individual money market fund, for an estimated one-time burden of 978 hours for all money market funds at a total cost of $226,896.[86] Amortized over three years, we estimate that the total annual burden would be 326 hours at a cost of $75,632.

- We request comment on these assumptions. If commenters believe these assumptions are not accurate, we request they provide specific data that would allow us to make more accurate estimates.

2. Form N–MFP

Rule 30b1–7 requires money market funds to file electronically a monthly report on Form N–MFP within five business days after the end of each month. The information required by the form must be data-tagged in XML format and filed through EDGAR. Preparing Form N–MFP is a collection of information under the PRA.[87] The respondents to the requirement to prepare Form N–MFP are investment companies that are regulated as money market funds under rule 2a–7. Compliance with the requirement to prepare Form N–MFP is mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a–7. Responses to the disclosure requirement of Form N–MFP are not kept confidential.

As discussed previously, the proposed amendments would eliminate the items requiring disclosure for each portfolio security (and any guarantee, demand feature or enhancement associated with the portfolio security) of the designated NRSROs for the security and the rating assigned to the security in Items 34, 37, 38 and 39 of the Form. The proposed amendments would also eliminate the requirement in Item 33 that a money market fund disclose whether a security is a rated security or an unrated security.

The staff estimates that, as of December 31, 2010, there are approximately 652 money market funds that are required to file Form N–MFP.[88] The staff estimates that our proposed amendments would reduce the time it takes money market funds to complete Form N–MFP by 0.5 hours. Because Form N–MFP is completed 12 times a year, the staff estimates that each respondent would save approximately 6 hours annually (at an internal cost of $301 per hour).[89] The staff therefore estimates that our proposed amendments to Form N–MFP would result in total incremental time savings of approximately 3912 hours (and $1,177,512) annually.[90]

- We request comment on these estimates. If commenters believe these estimates are not accurate, we request they provide specific data that would allow us to make more accurate estimates.

B. Rule 5b–3

Rule 5b–3 under the Investment Company Act allows funds to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of sections 5(b)(1) and

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[83] Proposed rule 2a–7(c)(10)(v)(A). *See supra* Section II.A.4. As a result of eliminating the term "designated NRSRO," the proposal would eliminate the requirement that boards of directors designate NRSROs and disclose such designated NRSROs in their SAIs. *See supra* note 25. We believe that the deletion of the disclosure requirement would not affect the collection of information requirements in the SAI, however, and therefore would not change current paperwork burden estimates. When we adopted the requirement to disclose designated NRSROs in the SAI, we stated that we anticipated that making this disclosure would not result in additional hourly burdens or printing costs beyond those currently approved in the existing collection of information for Form N–1A. *See* Money Market Fund Reform Adopting Release, *supra* note 8, at 106. The proposed amendments also would make conforming amendments to rule 2a–7's recordkeeping and reporting requirements. *See* proposed rule 2a–7(c)(11)(iii). These conforming changes would not result in changes in the estimated hourly burden associated with the recordkeeping and reporting requirements.

[84] *See* rules 2a–7(c)(3); 2a–7(c)(11)(ii); 2a–7(e); 38a–1.

[85] The current approved annual burden for rule 2a–7 under the PRA is 395,779 hours. The estimated number of respondents is 652 money market funds as of December 31, 2010. The estimated number of money market funds is based on the Investment Company Institute, Trends in Mutual Fund Investing, December 2010 (Jan. 27, 2011), *http://www.ici.org/research/stats/trends/trends_12_10*.

[86] These estimates are based on the following calculation: (652 money market funds × 1.5 hours = 978 hours); (978 hours × $232 per hour = $226,896). The staff estimates that the internal cost of a senior business analyst is $232 per hour. This estimate, as well as other internal time cost estimates made in this analysis, 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.

[87] For purposes of the PRA analysis, the current burden associated with the requirements of rule 30b1–7 is included in the collection of information requirements of Form N–MFP. The current approved annual burden for Form N–MFP under the PRA is 94,189 hours.

[88] *See supra* note 85.

[89] The staff estimates that the internal cost of a senior database administrator is $301 per hour.

[90] These estimates are based on the following calculation: (652 × 6 hours = 3912 hours); (3912 hours × $301 per hour = $1,177,512). We understand that some money market funds may outsource all or a portion of their responsibilities regarding Form N–MFP to a filing agent, software consultant, or other third-party service provider. We believe that a fund would engage third-party service providers at an external cost similar to or less than the estimated internal costs so the amount of the savings would be comparable.

12(d)(3) of the Act under certain conditions. We propose to amend rule 5b–3 to require that the securities collateralizing a repurchase agreement consist of securities that the fund's board of directors, or its delegate, determines are issued (or have unconditional guarantees that are issued) by an issuer that has the highest capacity to meet its financial obligations and are highly liquid.[91] To that end, the fund's board of directors, pursuant to rule 38a–1 under the Act, would have to develop procedures to ensure that at the time the repurchase agreement is entered into, the securities meet the requirements for collateral outlined in the proposed amendments to the rule.[92] As discussed above, these procedures are designed to limit collateral securities to those that are likely to retain a stable market value and that, in ordinary circumstances, the fund would be able to liquidate quickly in the event of a default. This collection of information would be mandatory for funds that rely on rule 5b–3. Records of information made in connection with this requirement would be required to be maintained for inspection by Commission staff, but the collection would not otherwise be submitted to the Commission. The information, when provided to the Commission in connection with staff examinations or investigations, would be kept confidential to the extent permitted by law.

We do not anticipate that the proposed amendments would significantly change collection of information burdens under rule 38a–1 because we believe funds would likely rely on their current policies and procedures to determine the credit quality of collateral securities to comply with rule 5b–3, as we propose to amend it. We understand that credit quality standards for securities collateralizing repurchase agreements are contained in the repurchase agreements between funds and counterparties. We expect that those standards currently include a rating and any additional criteria a fund manager considers necessary to ensure that the credit quality of the collateral securities meets the fund's requirements, or, for unrated securities, a comparable credit quality standard. Counterparties provide collateral securities to conform to these standards and funds confirm that the securities are conforming. As we have noted above, funds could continue to consider evaluations of outside sources, including credit ratings, that the board determines are credible and reliable in making their credit quality determinations under the proposed rule. We expect that funds would likely continue to rely on their current policies and procedures (*i.e.,* using credit quality standards that include ratings currently set forth in their repurchase agreements with counterparties). Thus, we do not expect that the proposed amendments would significantly change the current collection of information burden estimates for rule 38a–1.[93] Nevertheless, funds may review their repurchase agreements and policies and procedures that address rule 5b-3 compliance and make technical changes to those documents in response to the proposed amendments, if adopted. Staff estimates that it will take, on average, 1.5 hours of a senior business analyst's time to perform this review and make any technical changes for an individual fund portfolio, for an estimated burden of 12,690 hours for all fund portfolios (other than money market fund portfolios)[94] at a total cost of $2,944,080.[95] Amortized over three years, we estimate that the total burden would be 4230 hours at a cost of $981,360. We anticipate that the fund's board would review the fund manager's recommendation, but that the cost of this review would be incorporated in the fund's overall annual board costs and would not result in any particular additional cost.

- We request comment on these estimates. If commenters believe these estimates are not accurate, we request they provide specific data that would allow us to make more accurate estimates.
- Is our expectation that funds would continue to consider ratings in their credit quality standards to evaluate rated collateral securities for repurchase agreements correct? If funds choose not to continue this consideration of ratings, we request comment on how long it would take a fund to confirm that collateral securities satisfy the credit quality standards in a repurchase agreement under our proposed standard.

C. Rule 30e–1

The proposed amendments to Forms N–1A, N–2 and N–3 eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposed amendments, like the current forms, generally would require the fund to use the credit ratings of a single NRSRO. The proposed amendments would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.

The Commission believes that the proposed amendments to Forms N–1A, N–2 and N–3 would not affect the current PRA burden under rule 30e–1, because funds would remain obligated to provide a table, chart, or graph of portfolio holdings by reasonably identifiable categories. The proposed amendments only eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations. The Commission further believes that the proposed clarification for cases when credit ratings of the NRSRO selected by a fund are not available for certain holdings would not impose any additional PRA burden because funds typically provide this disclosure in their shareholder reports today.[96]

- We request comment on this analysis. If commenters believe this analysis is not accurate, we request that they provide specific data that would allow us to make a more accurate analysis.

D. Request for Comments

We request comment on whether the estimates provided in this PRA analysis are accurate. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper

[91] Proposed rule 5b–3(c)(1)(iv)(C). *See supra* Section II.C.

[92] Under rule 38a–1, funds must have written policies and procedures reasonably designed to prevent violation of the Federal securities laws. Rule 38a–1(a)(1). Funds thus would have policies and procedures for complying with rule 5b–3, which would include policies and procedures relating to credit quality determinations of unrated collateral securities, if appropriate.

[93] The current approved annual burden for rule 38a–1 under the PRA is 254,703 hours.

[94] For purposes of this PRA analysis, we assume that all funds enter into repurchase agreements and rely on rule 5b–3. We have not included money market funds in our estimates, however, because they are subject to different requirements under rule 2a–7, as noted above. *See supra* note 49. The staff's estimate of the number of fund portfolios is based on staff examination of industry data as of December 31, 2010.

[95] These estimates are based on the following calculation: (8,460 fund portfolios × 1.5 hours = 12,690 hours); (12,690 hours $232 per hour = $2,944,080). The staff estimates that the internal cost for time spent by a senior business analyst is $232 per hour.

[96] This assessment is based on a staff review of a sample of fund shareholder reports filed with the Commission.

performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. S7–7–11. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–7–11, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE., Washington, DC 20549–0213.

V. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. We have identified certain costs and benefits of the proposed rule and form amendments and proposed rule, and we request comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in each section of this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular funds, including funds that are small entities, as well as any other costs or benefits that may result from the adoption of the proposed rule and rule and form amendments. Where possible, we request commenters provide empirical data to support any positions advanced.

As discussed above, to implement provisions of the Dodd-Frank Act, we propose to (i) remove the references to credit ratings in rules 2a–7 and 5b–3 and replace them with alternative standards of credit-worthiness that are designed to appropriately achieve the same purposes as the ratings, (ii) eliminate references to credit ratings in Form N–MFP, and (iii) remove from Forms N–1A, N–2 and N–3 the requirement that NRSRO credit ratings be used when portraying credit quality in shareholder reports. We are also proposing rule 6a–5 to replace a statutory reference to credit ratings that the Dodd-Frank Act removes from the Investment Company Act and for which the Dodd-Frank Act anticipates the Commission will adopt a replacement standard. Thus, the benefits and costs associated with the replacement of credit rating references with alternative standards of credit-worthiness are attributable to the Dodd-Frank Act. The Commission has discretion, however, in adopting the alternative standards of credit-worthiness, and we undertake below to discuss the costs and benefits of the rule and form amendments and new rule that we are proposing.

A. Money Market Funds

1. Rule 2a–7

As discussed above, we are proposing to remove references to credit ratings in rule 2a–7, which would affect five elements of the rule. First, we propose to eliminate the requirement that an eligible security be rated by an NRSRO or be of comparable quality, while maintaining the two-step analysis currently required by rule 2a–7. 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.[97] Second, we propose to define first tier security as a security whose issuer the fund's board (or its delegate) determines has the "highest capacity to meet its short-term financial obligations."[98] Third, we propose to require that with respect to a security (or its guarantee) subject to a conditional demand feature, in addition to other conditions, the underlying security (or its guarantee) must itself be of high quality and subject to very low credit risk as determined by the fund's board (or its delegate).[99] Fourth, we propose to remove the reference to credit ratings in the rule's downgrade and default provisions. The proposed amendment would 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 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.[100] Finally, we propose to eliminate the reference to portfolio securities' downgrades in the stress testing provisions. Under the proposal, a money market fund's stress testing procedures would be required 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."[101]

a. Benefits

We believe that the proposed amendments to rule 2a–7 may provide certain benefits to money market funds. As discussed above, in connection with the PRA analysis, money market funds have adopted policies and procedures that with respect to portfolio securities (including securities subject to a conditional demand feature) address credit quality, minimal credit risk determinations, monitoring for downgrades and defaults and stress testing. Under the proposed rules, money market funds could revise their policies and procedures with respect to each of these requirements to change or eliminate the consideration of credit ratings or consider other sources of credit quality evaluations as funds determine would be appropriate. Nevertheless, because the proposed amendments are designed to retain the same degree of credit risk limitation and similar standards for monitoring credit

[97] Proposed rule 2a–7(a)(11). *See supra* Section II.A.1.

[98] Proposed rule 2a–7(a)(13). *See supra* Section II.A.1.

[99] Proposed rule 2a–7(c)(3)(iv)(C). *See supra* Section II.A.2.

[100] Proposed rule 2a–7(c)(7)(i)(A). *See supra* Section II.A.3.

[101] Proposed rule 2a–7(c)(10)(v)(A). *See supra* Section II.A.4. As noted above, *see supra* note 20, the proposed amendments would make conforming changes to rule 2a–7's recordkeeping and reporting requirements. We do not believe that these amendments would affect costs.

events and stress testing as under current rule 2a–7, the proposed amendments would not prohibit a money market fund from using its current policies and procedures to comply with the proposed amendments. In particular, as discussed above, fund boards (or their delegates) could still consider credit quality evaluations prepared by outside sources, including NRSRO ratings, that they conclude are credible and reliable for purposes of making credit quality determinations with respect to portfolio securities (including securities subject to a conditional demand feature), monitoring minimal credit risks of the portfolio and stress testing. We expect that each money market fund would undertake its own analysis of the costs or benefits of revising policies and procedures and would only change them to the extent the fund believed the benefits justified the costs of doing so.

Although some money market funds may eliminate the specific use of ratings in their credit risk determinations, we anticipate that many of those funds are likely to consider some outside analyses in evaluating the credit quality of, and minimal credit risks presented by, portfolio securities (including securities subject to a conditional demand feature). Fund boards' (or their delegates') consideration of external analyses by third party sources determined to be credible and reliable to the extent the fund board (or its delegate) considers appropriate may contribute to the accuracy of funds' determinations and thus help money market funds arrive at consistent credit risk determinations.

b. Costs

We recognize that there may be minor costs associated with the proposed amendments to rule 2a–7. Money market funds may incur some costs internally or to consult outside legal counsel to evaluate any need to change their policies and procedures relating to determinations of credit quality, monitoring for credit events and stress testing if the proposed amendments were adopted. We do not believe, however, that these costs are attributable to the proposed rule and form amendments because the requirement in the Dodd-Frank Act that we replace the use of credit ratings in rules with alternative standards of credit-worthiness would result in similar costs of evaluating compliance with a new credit quality standard.

As discussed above, because the proposed amendments are designed to retain the same degree of credit risk limitation and similar standards for monitoring credit events and stress testing as under current rule 2a–7, a money market fund also could use its current policies and procedures to comply with the proposed amendments. In particular, as discussed above, a fund could still incorporate credit quality evaluations prepared by outside sources, including NRSRO ratings, that the fund's board or adviser concludes are credible and reliable for purposes of making credit quality determinations with respect to portfolio securities (including securities subject to a conditional demand feature), monitoring minimal credit risks of the portfolio, and stress testing. We expect that each money market fund would undertake its own analysis of the costs or benefits of revising policies and procedures and would only change its policies to the extent the fund believed the benefits justified the costs of doing so. Nevertheless, money market funds may make technical changes to their policies and procedures in response to the proposed amendments, if adopted. We estimate that money market funds would incur a one-time aggregate cost of $226,896 to make any technical changes.[102]

In addition to the costs that funds may incur, the removal of credit ratings pursuant to the Dodd-Frank Act may result in increased risks to money market funds and their shareholders. As discussed above, rule 2a–7 limits money market funds to investing in securities that, among other things, have received a rating in one of the highest two short-term rating categories from the requisite NRSROs or are unrated securities of comparable quality.[103] The rule further limits money market funds' investments in second tier securities to no more than three percent of the fund's portfolio.[104] The minimum credit rating requirement in the current rule provides the Commission with an objective standard to use in examining and enforcing money market fund compliance with rule 2a–7's credit quality conditions, including the limitation on investments in second tier securities. As discussed above, the proposed rule would eliminate the requirement that eligible securities meet minimum rating requirements, while maintaining the two-step analysis provided in the current rule and the limitation on investments in second tier securities.[105] Although we anticipate that funds would continue to manage risk in the same manner as under the current rule, under the proposed subjective standard, a money market fund board (or its delegate) could disregard a second tier rating in order to invest a larger portion of the fund's portfolio in lower quality securities that it classifies as first tier securities. In addition, it could be difficult for the Commission to challenge the determination of a money market fund board (or its delegate) in those circumstances.[106]

2. Form N–MFP

We propose to amend Form N–MFP to eliminate the items requiring disclosure for each portfolio security (and any guarantee, demand feature or enhancement associated with the portfolio security) of the designated NRSROs for the security and the rating assigned to the security. We also propose to eliminate the requirement that a money market fund disclose whether a security is a rated security or an unrated security.

a. Benefits

The proposed amendments to Form N–MFP would conform the disclosure in Form N–MFP to the proposed amendments to rule 2a–7. The proposed amendments to Form N–MFP should reduce costs for money market funds by eliminating from the form certain disclosure items relating to designated NRSROs and ratings, which would no longer be elements of rule 2a–7. For purposes of the PRA analysis, we estimate that money market funds would realize, in the aggregate, a cost savings of $1,177,512 in completing Form N–MFP as a result of the proposed amendments.[107]

b. Costs

We do not believe there would be any costs associated with the proposed amendments to Form N–MFP.

B. Rule 5b–3

We propose to amend rule 5b–3 to allow a fund to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of sections 5(b)(1) and 12(d)(3) of the Investment Company Act if the

[102] *See supra* note 86 and accompanying text.

[103] *See* rule 2a–7(a)(12)(i)–(ii); *supra* notes 15–17 and accompanying text.

[104] Rule 2a–7(c)(3)(ii).

[105] *See supra* note 23, notes 24–25 and accompanying and preceding text.

[106] The increased risks to money market funds associated with investments in short-term securities rated second tier are discussed in detail in the Money Market Fund Reform Adopting Release, *supra* note 8, at Section II.A.1. and Money Market Fund Reform Proposing Release, *supra* note 8, at Section II.A.1.

[107] *See supra* note 90 and accompanying text. As noted above, however, money market funds have not had to make these disclosures so actual savings may be less.

collateral other than cash or government securities consists of securities that the fund's board of directors, or its delegate, determines at the time the repurchase agreement is entered into are: (i) Issued by an issuer that has the highest capacity to meet its financial obligations; and (ii) sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven days.

1. Benefits

We believe that the proposed amendments to rule 5b–3 may yield certain benefits. First, our proposed standard is designed to achieve the same purpose as the credit rating reference in the existing rule. *i.e.,* limit collateral securities to those that are likely to retain a stable market value and that, under ordinary circumstances, the fund would be able to liquidate quickly in the event of a counterparty default. Second, we believe that the proposed standards would not result in significant changes in fund evaluations of the quality of collateral securities. A fund's board of directors or its delegate is already required under the rule to assess the credit quality of unrated securities.[108] As noted above, funds typically establish standards for the credit quality of collateral securities (that include credit ratings and additional credit quality criteria required by the fund) in repurchase agreements with counterparties.[109] In addition, although the rule would no longer require the collateral to be rated by an NRSRO, the evaluation of credit risk could incorporate ratings, reports, analyses and other assessments issued by third parties, including NRSRO ratings, that the board concludes are credible and reliable for purposes of making the evaluation. We expect that the ability to consider outside assessments would help minimize any burdens on the fund's board or its delegate under the proposed amendments. In addition, the use of external analyses by third party sources that fund boards (or their delegates) believe are credible and reliable to the extent the fund board (or its delegate) considers appropriate may contribute to the accuracy of funds' determinations and thus help funds arrive at consistent minimal credit risk determinations.

2. Costs

The proposed credit quality standard for rule 5b–3 may impose costs on funds that rely on the rule. A fund's board of directors, or its delegate, pursuant to rule 38a–1 of the Act, would be required to develop written policies or procedures to ensure that at the time the repurchase agreement is entered into, the collateral meets the requirements outlined in the proposed amendments.[110] Consistent with the requirements of rule 38a–1 under the Act, we expect that boards of funds relying on rule 5b–3 have established procedures regarding compliance with the rule. We recognize that these funds may incur minor costs associated with the proposed amendments to rule 5b–3 including some internal costs or costs of consulting outside legal counsel to determine whether they must change their policies and procedures for evaluating collateral securities if the proposed amendments are adopted. We do not believe, however, that those costs are attributable to the proposed amendments because the requirement in the Dodd-Frank Act that we replace the use of credit ratings in rules with alternative standards of credit-worthiness would result in similar costs of evaluating compliance with a new standard of credit quality.

As noted above, funds typically set forth credit quality standards for securities collateralizing a repurchase agreement in the agreement with the counterparty. We expect that those standards include a rating and any additional criteria a fund manager considers necessary to ensure that the credit quality of the collateral meets the fund's requirements. As we have noted above, fund boards (or their delegates) could continue to consider evaluations of outside sources, including credit rating agencies, in making their credit quality determinations under rule 5b–3, as we propose to amend it. We anticipate that funds would likely continue to rely on the credit quality standards in their current repurchase agreements and their existing policies and procedures that address compliance with rule 5b–3 if the proposed amendments were adopted. We expect that each fund would undertake its own analysis of the costs or benefits of revising repurchase agreements and policies and procedures that address compliance with rule 5b–3 and would only change these documents to the extent the fund believed the benefits justified the costs of doing so. Nevertheless, funds may consider whether to amend their repurchase agreements and policies and procedures that address compliance with rule 5b–3, including making technical changes to these documents in response to the proposed amendments, if adopted. As noted above, we estimate that funds would incur a one-time aggregate cost of $2,944,080 to make any of these changes.[111]

- We request comment on these cost estimates. Do commenters foresee additional or alternative costs if the proposed amendments to rule 5b–3 are adopted? Have we accurately estimated costs of amending repurchase agreements and policies and procedures for the evaluation of the credit quality and liquidity of collateral securities?

C. Proposed Rule 6a–5

We are proposing new rule 6a–5, which would establish a credit-worthiness standard under section 6(a)(5)(A)(iv)(I) of the Investment Company Act. BIDCOs that seek to rely on the exemption in section 6(a)(5) of the Act would be limited to investing in debt securities issued by investment companies and private funds if, at the time of purchase, the board of directors or members of the BIDCO (or their delegate) determines that the debt security is (i) subject to no greater than moderate credit risk and (ii) sufficiently liquid that the security can be sold at or near its carrying value within a reasonably short period of time.

1. Benefits

We anticipate that proposed rule 6a–5 would result in certain benefits. Our proposed standard is intended to achieve the same purpose as the credit rating it would replace. In particular, the proposed standard is designed to limit BIDCOs to purchasing debt securities issued by investment companies or private funds of sufficiently high credit quality that they are likely to maintain a fairly stable market value and may be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities.

Furthermore, to comply with the proposed standard, we do not believe that BIDCOs would be required to change any policies and procedures they may have with respect to the evaluation of these debt securities. As noted above, under proposed rule 6a–5, in evaluating whether debt securities issued by investment companies and private funds present moderate credit risk, boards of directors and members of BIDCOs (or their delegates) would be able to consider credit quality determinations prepared by outside sources, including NRSRO ratings, that they conclude are credible and reliable for purposes of making these determinations. We expect that the

[108] Rule 5b–3(c)(1)(iv)(D).

[109] *See supra* text preceding note 93.

[110] Rule 38a–1(a).

[111] *See supra* note 95 and accompanying text.

ability to consider outside assessments in making these determinations would help minimize the burden on BIDCOs and contribute to a BIDCO's ability to make consistent credit quality determinations.

2. Costs

We recognize that BIDCOs may incur some costs if we adopted proposed rule 6a–5. These may be internal costs or costs to consult outside legal counsel to evaluate whether changes to any policies and procedures the BIDCOs may have currently for acquiring debt securities issued by investment companies or private funds may be appropriate in light of the proposed rule. We do not believe, however, that these costs are attributable to the proposed rule because the Dodd-Frank Act's replacement of the credit rating standard in the Investment Company Act with a standard to be adopted by the Commission would result in similar costs of evaluating compliance with a new credit quality standard.

We expect that, although not required by the Investment Company Act, as a matter of good business practice, directors or members of most BIDCOs that do not currently have them may prepare policies and procedures to make the credit quality and liquidity determinations required by the proposed rule. Commission staff estimates that the costs of preparing the procedures for making determinations of credit quality and liquidity under the rule would be borne upfront. Once generated, reviewed and implemented by directors or members of BIDCOs (or their delegates), directors and members (or their delegates) would be able to follow them for purposes of making future determinations under the rule. Our staff has estimated that each BIDCO would incur, on average, an initial one-time cost of $928 to prepare policies and procedures and an average of $928 in annual costs for making credit determinations with respect to the acquisition of debt securities.[112]

We anticipate that many BIDCOs that invest cash in these types of debt securities would continue to consider credit quality determinations prepared by outside sources, including NRSRO ratings, that they conclude are credible and reliable for purposes of making these determinations. Nevertheless, we recognize that some BIDCO boards or members may choose to hire consultants to assist in developing procedures and to make or oversee the proposed determinations.[113] Staff estimates that the cost to hire such consultants would be, on average, $8,000 for each BIDCO.[114]

- We request comment on these cost estimates. Are the costs estimates accurate regarding the proposed procedures for making credit quality determinations? Do commenters foresee additional or alternative costs if proposed rule 6a–5 were adopted?

D. Forms N–1A, N–2 and N–3

The proposed amendments to Forms N–1A, N–2 and N–3 would eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposed amendments, like the current forms, generally would require the fund to use the credit ratings of a single NRSRO. The proposed amendments would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.

1. Benefits

Under the proposed amendments, funds will have greater flexibility to depict credit quality in the most meaningful manner, which may lead to better information for investors. This largely results from the congressionally mandated removal of the required use of credit ratings under section 939A of the Dodd-Frank Act.

2. Costs

The Commission believes that because the proposed amendments only eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations, any cost imposed on funds would not be material. Funds might incur costs to the extent that they choose to develop new methodologies for depicting credit quality. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposed amendments would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings. The Commission believes that the proposed clarification would not impose any additional cost because funds typically provide this disclosure in their shareholder reports today.[115]

E. Request for Comment

The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this Release, as well as any other costs or benefits that may result from the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[116] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

VI. Consideration of Promotion of Efficiency, Competition and Capital Formation

Section 2(c) of the Investment Company Act and section 2(b) of the Securities Act each requires the Commission, when engaging in rulemaking under the respective Act that requires it to consider or determine whether an action is consistent with or necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the

[112] We estimate that each BIDCO would incur on average a one-time burden of 4 hours for a senior business analyst (under board or member delegation) to develop policies and procedures for evaluating credit and liquidity risk (4 hours × $232 per hour = $928). Commission staff believes that additional costs incurred by boards or members for review of procedures would be incorporated into BIDCOs' overall board or member costs and would not add any particular costs. In addition, Commission staff estimates that a BIDCO board or member is likely to delegate the credit risk determinations, and that such determinations would take on average 1 hour of a senior business analyst's time (at $232 per hour) to evaluate the credit quality for each of an average of 4 investment company or private fund debt securities that a BIDCO would purchase each year (4 hours × $232 per hour) for a total cost of $928 per year.

[113] We do not expect that money market funds would incur similar development assistance costs with respect to the proposed amendments to rule 2a–7 because rule 2a–7 currently requires these funds to perform credit quality determinations with respect to portfolio securities. Similarly, we expect that funds that rely on rule 5b–3 currently incorporate credit quality standards for collateral securities in addition to ratings in their repurchase agreements.

[114] Staff estimates that a BIDCO would need up to 16 hours of consulting advice to assist in developing procedures and to make or oversee the proposed determinations. Staff estimates that this advice would cost a BIDCO $500 per hour based on an understanding of the rates typically charged by outside consulting firms.

[115] This assessment is based on a staff review of a sample of fund shareholder reports filed with the Commission.

[116] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

action will promote efficiency, competition, and capital formation.[117]

Our proposed amendments to rules 2a–7 and 5b–3 and Forms N–MFP, N–1A, N–2 and N–3 implement provisions of the Dodd-Frank Act that call for the Commission to remove credit rating references in its regulations and to substitute other appropriate standards of credit-worthiness in place of the credit ratings. Thus, effects on efficiency, competition, and capital formation that arise from the removal of credit ratings are attributable to the congressionally mandated removal of the required use of credit ratings under section 939A of the Dodd-Frank Act. The Commission has discretion, however, to adopt rule and rule amendments that set forth the alternative standards of credit-worthiness, and we undertake below to discuss the effects on efficiency, competition and capital formation of the specific standards that we are proposing.

We do not believe that the proposed amendments to rules 2a–7 and 5b–3 and Forms N–MFP, N–1A, N–2 and N–3 would significantly affect competition or have an adverse effect on efficiency or capital formation.

Rule 2a–7. With respect to rule 2a–7, as we have discussed above, money market funds have procedures for making credit quality and credit risk determinations under current rule 2a–7. In addition, we have designed the proposed standard to retain a degree of risk limitation similar to that reflected by the credit ratings in the current rule. Because we do not anticipate that the proposed amendments are likely to change the types of investments that are made by money market funds, we do not believe that the proposed amendments would have a significant effect on competition or capital formation. As we have noted above, we believe that money market funds could change their policies and procedures to reflect changes in the proposed amendments or continue to rely on their current policies and procedures to comply with the proposed amendments. We expect that money market funds are likely to make changes only if the benefits of such changes would justify the costs, which would not be likely to have an adverse effect on efficiency.

Form N–MFP. The proposed amendments would conform the disclosures in Form N–MFP to the proposed amendments to rule 2a–7. We do not believe that our proposal to remove certain disclosures from the form would change the types of securities money market funds invest in and, therefore, would have no effect on competition or capital formation. To the extent that the proposed amendments reduce the time funds spend making the disclosures required in Form N–MFP, the proposed amendments may slightly increase efficiency.

Rule 5b–3. The proposed standard for determining the credit quality of collateral securities in rule 5b–3 is designed to achieve the same purpose as the credit rating reference in the existing rule, *i.e.,* to limit collateral securities to those that are likely to retain a stable market value and that, under ordinary circumstances, the fund could liquidate quickly in the event of a counterparty default. Because we do not anticipate that the proposed amendments would change the types of collateral securities that funds relying on 5b–3 would use, we do not believe that the proposed amendments would have a significant effect on competition or capital formation. Furthermore, funds typically establish credit quality standards for collateral securities that include credit ratings in repurchase agreements they enter into with counterparties. Funds could change their policies and procedures to reflect changes in the proposed amendments, but the rule would not prohibit funds from relying on the standards in current repurchase agreements and policies and procedures that address compliance with rule 5b–3. We anticipate that the consideration of outside sources in making credit quality determinations with respect to collateral securities may help funds arrive at consistent credit quality determinations. For these reasons, we do not believe that the proposed amendments to rule 5b–3 would have a significant effect on efficiency.

Forms N–1A, N–2 and N–3. The proposed amendments to Forms N–1A, N–2 and N–3 would eliminate the required use of NRSRO ratings by funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposed amendments would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings, including, if applicable, the use of credit ratings assigned by another NRSRO. We do not believe that the proposed clarification would affect efficiency, competition or capital formation because funds typically provide this disclosure in their shareholder reports today.[118] The effect, if any, on efficiency, competition and capital formation that would arise from the proposed amendments to Forms N–1A, N–2 and N–3 results from the congressionally mandated removal of the required use of credit ratings under section 939A of the Dodd-Frank Act.

Request for comment. We request comment whether the proposed rule and rule and form amendments would, if adopted, promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data to support their views.

VII. Regulatory Flexibility Act Certification

Pursuant to section 5(b) of the Regulatory Flexibility Act,[119] the Commission hereby certifies that the proposed amendments to rule 2a–7 and Form N–MFP under the Investment Company Act would not, if adopted, have a significant economic impact on a substantial number of small entities. For purposes of the RFA, 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.[120] Based on information in filings submitted to the Commission, we believe that there are no money market funds that are small entities. For this reason, the Commission believes that the amendments to rule 2a–7 and Form N–MFP under the Investment Company Act would not, if adopted, have a significant economic impact on a substantial number of small entities.

The Commission requests written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small businesses and provide empirical data to support the extent of the impact.

VIII. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") in accordance with section 3(a) of the Regulatory Flexibility Act.[121] It relates to the Commission's proposed amendments to rule 5b–3 under the Investment Company Act and Forms N–1A, N–2 and N–3 under the Investment Company Act and Securities

[117] 15 U.S.C. 80a–2(c); 15 U.S.C. 77b(b).

[118] This assessment is based on a staff review of fund shareholder reports filed with the Commission.

[119] 5 U.S.C. 605(b).

[120] 17 CFR 270.0–10(a).

[121] 5 U.S.C. 603(a).

Act and proposed rule 6a–5 under the Investment Company Act.

A. Objectives and Legal Basis

As described more fully in Sections I and II of this Release, to implement section 939A of the Dodd-Frank Act, the Commission is proposing to amend (i) rule 5b–3 to eliminate references to the credit rating and replace it with an alternative standard of credit-worthiness that is designed to appropriately achieve the same purpose as the use of the credit rating and (ii) Forms N–1A, N–2 and N–3 to eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings in their shareholder reports. The Commission is also proposing new rule 6a–5 to set forth a standard of credit-worthiness for purposes of section 6(a)(5)(A)(iv) of the Act, as anticipated by the Dodd Frank Act, which eliminates the investment grade standard from section 6(a)(5) of the Investment Company Act.

The Commission is proposing amendments to rule 5b–3 pursuant to our authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–37(a)] and section 939A of the Dodd-Frank Act. The Commission is proposing rule 6a–5 pursuant to our authority set forth in section 38(a) of the Investment Company Act [15 U.S.C. 80a–37(a)] and section 939 of the Dodd-Frank Act, codified at section 6(a)(5)(A)(iv)(I) of the Investment Company Act [15 U.S.C. 80a–6(a)(5)(A)(iv)(I)]. The Commission is proposing amendments to Forms N–1A, N–2 and N–3 pursuant to the authority set forth in sections 5, 6, 7, 10 and 19(a) of the Securities Act and sections 8, 24(a), 30 and 38 of the Investment Company Act.

B. Small Entities Subject to the Rule

The proposed amendments to rule 5b–3 and proposed rule 6a–5 under the Investment Company Act would affect funds and BIDCOs, respectively, including entities that are considered to be a small business or small organization (collectively, "small entity") for purposes of the Regulatory Flexibility Act.

Investment Companies. For purposes of the Regulatory Flexibility Act, 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.[122] Based on a review of filings submitted to the Commission, we estimate that 181 investment companies may be considered small entities and that all of these investment companies may potentially rely on rule 5b–3.[123] We estimate that approximately 150 investment companies that meet the definition of small entity would be subject to the proposed amendments to Forms N–1A, N–2 and N–3.

BIDCOs. Under the standards adopted by the Small Business Administration, small entities in the financial investment industry include entities with $7 million or less in annual receipts.[124] We do not have any data and are not aware of any databases that compile information regarding how many BIDCOs would be small entities under this definition. We request comment on how many BIDCOs are small entities under this definition.

C. Reporting, Recordkeeping, and Other Compliance Requirements

Rule 5b–3. We propose to amend rule 5b–3 to allow a fund to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of sections 5(b)(1) and 12(d)(3) of the Act if the collateral other than cash or government securities consists of securities that the fund's board of directors (or its delegate) determines at the time the repurchase agreement is entered into are: (i) Issued by an issuer that has the highest capacity to meet its financial obligations; and (ii) sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven days. A fund that acquires repurchase agreements and intends the acquisition to be treated as an acquisition of the collateral securities must adopt and implement written policies and procedures reasonably designed to comply with the conditions of rule 5b–3, including any credit quality or liquidity requirements that we adopt.[125]

We have estimated the costs of these amendments previously in the cost-benefit analysis in Section V above.[126]

Proposed rule 6a–5. Proposed rule 6a–5 would impose no reporting, recordkeeping or other compliance requirements.

Forms N–1A, N–2 and N–3. The proposed amendments to Forms N–1A, N–2 and N–3 would apply to open-end management investment companies, closed-end management investment companies and separate accounts organized as management investment companies that offer variable annuity contracts, including those that are small entities. We are proposing to amend the forms to eliminate the required use of NRSRO credit ratings by funds that choose to use credit quality categorizations in the required table, chart, or graph of portfolio holdings in their shareholder reports. If a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, the proposed amendments, like the current forms, generally would require the fund to use the credit ratings of a single NRSRO. The proposed amendments would clarify that, if credit ratings of the NRSRO selected by a fund are not available for certain holdings, the fund must briefly discuss the methodology for determining credit quality for those holdings, including, if applicable, the use of credit ratings assigned by another NRSRO. For purposes of the cost-benefit analysis, we have estimated that any cost imposed on funds would not be material.

D. Duplicating, Overlapping, or Conflicting Federal Rules

Rule 31a–1 under the Act requires the retention of ledger accounts for each portfolio security and each person through which a portfolio transaction is effected, including certain records of collateral for monies borrowed and loaned.[127] Although some of the procedures under the proposed amendments to rule 5b–3 may overlap with information in the ledgers, we believe any overlap would be minimal and the rule 5b–3 procedures would contain additional information specifically related to the concerns underlying these rules. The Commission believes that there are no other rules that duplicate, overlap, or conflict with the proposed amendments to Forms N–1A, N–2 and N–3 and proposed new rule 6a–5.

E. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small issuers. In connection with the proposed rule and rule and form amendments, the Commission considered the following alternatives: (i)

[122] 17 CFR 270.0–10(a).

[123] The 181 investment companies that meet the definition of small entity include business development companies, which are subject to sections 5 and 12 of the Investment Company Act. 15 U.S.C. 80a–58; 15 U.S.C. 80a–59.

[124] 13 CFR 121.201.

[125] 17 CFR 270.38a–1(a).

[126] *See supra* Section V.B.2.

[127] *See* rule 31a–1(b)(2)(i)(d).

Establishing different compliance standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance and reporting requirements under the rule for small entities; (iii) use of performance rather than design standards; and (iv) exempting small entities from all or part of the requirements.

The Commission believes that, at the present time, special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The proposed rule and amendments to rules and forms are intended to implement sections 939 and 939A of the Dodd-Frank Act. We believe that, with respect to rule 5b–3, different credit quality standards, special compliance requirements or timetables for small entities, or an exemption from coverage for small entities, may create a risk that those entities could acquire repurchase agreements with collateral that is less likely to retain its market value or liquidity in the event of a counterparty default. Similarly, with respect to proposed rule 6a–5, we believe that special compliance requirements or timetables for small entities, or an exemption from coverage for small entities, may create a risk that those BIDCOs could acquire debt securities that are not of sufficiently high credit quality that they would be likely to maintain a fairly stable market value or be liquidated easily, as we believe may have been intended for the BIDCO to support its long-term commitments. Further consolidation or simplification of the proposals for funds that are small entities would be inconsistent with the Commission's goals of fostering investor protection.

The proposed form amendments, if adopted, would apply to all investment companies that use Forms N–1A, N–2 and N–3 to register under the Investment Company Act and to offer their securities under the Securities Act. If the Commission excluded small entities from the proposed form amendments, small entities would be required to use NRSRO credit ratings if they choose to depict credit quality, while other entities would not be subject to that requirement. We believe this outcome is inconsistent with section 939A of the Dodd-Frank Act. We believe that special compliance or reporting requirements, or an exemption, for small entities would not be appropriate because the proposed requirement—that if a fund chooses to use NRSRO credit ratings to depict credit quality of portfolio holdings, generally it must use the ratings of a single NRSRO—is intended to eliminate the possibility that a fund of any size could choose to use NRSRO credit ratings and then select the most favorable ratings among credit ratings assigned by multiple NRSROs.

We have endeavored through the proposed form amendments to minimize regulatory burden on investment companies, including small entities, while meeting our regulatory objectives. We have endeavored to clarify, consolidate, and simplify the requirements applicable to investment companies, including those that are small entities. Finally, the proposal would use performance rather than design standards for determining the credit quality of specific securities.

For these reasons, we have not proposed alternatives to the proposed rule and rule and form amendments.

F. Request for Comments

We encourage the submission of comments with respect to any aspect of the IRFA. In particular, the Commission seeks comment on the number of small entities that would be subject to the proposed rule and rule and form amendments and whether the effect of the proposed rule on small entities subject to it would be economically significant. Commenters are asked to describe the nature of any impact and provide empirical data supporting its extent. These comments will be considered in connection with any adoption of the proposed rule and rule and form amendments, and reflected in a Final Regulatory Flexibility Analysis.

Comments should be submitted in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090. Comments may also be submitted electronically to the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–7–11, and this file number should be included on the subject line if e-mail is used.[128] Comment letters will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549–1520, on official business days between the hours of 10 a.m. and 3 p.m. Electronically submitted comment letters also will be posted on the Commission's Internet Web site (*http://www.sec.gov*).

[128] Comments on the IRFA will be placed in the same public file that contains comments on the proposed rule and rule and form amendments.

Statutory Authority

The Commission is proposing amendments to rules 2a–7 and 5b–3 under the authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–37(a)] and section 939A of the Dodd-Frank Act. The Commission is proposing new rule 6a–5 under the authority set forth in section 38(a) of the Investment Company Act [15 U.S.C. 80a–37(a)] and section 939 of the Dodd-Frank Act, to be codified at section 6(a)(5)(A)(iv)(I) of the Investment Company Act [15 U.S.C. 80a–6(a)(5)(A)(iv)(I)]. The Commission is proposing amendments to Form N–1A, Form N–2 and Form N–3 under the authority set forth in sections 5, 6, 7, 10 and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)] and sections 8, 24(a), 30 and 38 of the Investment Company Act [15 U.S.C. 80a–8, 80a–24(a), 80a–29 and 80a–37]. The Commission is proposing amendments to Form N–MFP under the authority set forth in sections 8(b), 30(b), 31(a) and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–29(b), 80a–30(a) and 80a–37(a)] and section 939A of the Dodd-Frank Act.

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule and Form Amendments

For reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

1. The authority citation for Part 239 continues to read in part as follow:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78*l,* 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll,* 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

2. The authority citation for part 270 is revised to read in part as follows:

Authority: 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

* * * * *

Section 270.6a–5 is also issued under 15 U.S.C. 80a–6(a)(5)(A)(iv)(I).

* * * * *

3. Section 270.2a–7 is amended by:

a. In paragraph (a)(5), removing the words "and (D)";

b. Removing paragraph (a)(11);

c. Redesignating paragraphs (a)(12) through (a)(20) as (a)(11) through (a)(19);

d. Revising newly designated paragraph (a)(11);

e. Revising newly designated paragraph (a)(13);

f. Removing paragraph (a)(21);

g. Redesignating paragraph (a)(22) as paragraph (a)(20);

h. Removing paragraph (a)(23);

i. Redesignating paragraphs (a)(24) through (a)(29) as paragraphs (a)(21) through (a)(26);

j. Removing paragraph (a)(30);

k. Redesignating paragraphs (a)(31) and (a)(32) as paragraphs (a)(27) and (a)(28);

l. Revising paragraphs (c)(3)(i), (c)(3)(iii), and (c)(3)(iv)(C);

m. Adding paragraph (c)(3)(iv)(D);

n. In paragraph (c)(7):

i. Revising the paragraph heading;

ii. Revising paragraph (c)(7)(i);

iii. In the introductory text of paragraph (c)(7)(ii), removing the phrase "paragraphs (c)(7)(ii)(A) through (D)" and adding in its place "paragraphs (c)(7)(ii)(A) through (C)";

iv. Adding "or" at the end of paragraph (c)(7)(ii)(B);

v. Removing paragraph (c)(7)(ii)(C) and redesignating paragraph (c)(7)(ii)(D) as paragraph (c)(7)(ii)(C);

o. Revising paragraph (c)(10)(v)(A);

p. Revising paragraph (c)(11)(iii);

q. In paragraph (e):

i. Removing the words "(a)(11)(i) (designation of NRSROs);" from the introductory text of paragraph (e); and

ii. Revising paragraph (e)(1).

These additions and revisions read as follows:

§ 270.2a–7 Money market funds.

(a) * * *

(11) *Eligible Security* means a security with a remaining maturity of 397 calendar days or less that the fund's board of directors determines 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).

* * * * *

(13) *First Tier Security* means any Eligible Security:

(i) The issuer of which the fund's board of directors has determined has the highest capacity to meet its short-term financial obligations;

(ii) That is a security issued by a registered investment company that is a money market fund; or

(iii) That is a Government Security.

* * * * *

(c) * * *

(3) * * *

(i) *General.* The money market fund shall limit its portfolio investments to those United States Dollar-Denominated securities that are at the time of Acquisition Eligible Securities.

* * * * *

(iii) *Securities Subject to Guarantees.* A security that is subject to a Guarantee may be determined to be an Eligible Security or a First Tier Security based solely on whether the Guarantee is an Eligible Security or First Tier Security, as the case may be, provided however, that the issuer of the Guarantee, or another institution, has undertaken to promptly notify the holder of the security in the event the Guarantee is substituted with another Guarantee (if such substitution is permissible under the terms of the Guarantee).

(iv) * * *

(C) The fund's board of directors determines that the Underlying Security or any Guarantee of such security is of high quality and subject to very low credit risk; and

(D) The issuer of the Conditional Demand Feature, or another institution, has undertaken to promptly notify the holder of the security in the event the Conditional Demand Feature is substituted with another Conditional Demand Feature (if such substitution is permissible under the terms of the Conditional Demand Feature).

* * * * *

(7) *Monitoring, Defaults and Other Events.*

(i)(A) *Monitoring.* 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 may suggest that the security is no longer a First Tier Security or a Second Tier Security, as the case may be, the board of directors shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders. This reassessment shall not be required if the fund disposes of the security (or it matures) within five Business Days after the date the money market fund's adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware of the relevant information, and the board is subsequently notified of the adviser's actions.

(B) *Special Rule for Certain Securities Subject to Demand Features.* If, as a result of a portfolio security that ceases to be a First Tier Security, more than 2.5 percent of the fund's Total Assets are invested in securities issued by or subject to Demand Features from a single institution that are Second Tier Securities, the fund shall reduce its investment in securities issued by or subject to Demand Features from that institution to no more than 2.5 percent of its Total Assets by exercising the Demand Features at the next succeeding exercise date(s), absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund.

* * * * *

(10) * * *

(v) * * *

(A) The periodic testing, at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions, of the money market fund's ability to maintain a stable net asset value per share based upon specified hypothetical events that include, but are not limited to, a change in short-term interest rates, an increase in shareholder redemptions, an adverse change in the ability of the issuer of a portfolio security to meet its short-term financial obligations or a default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund.

* * * * *

(11) * * *

(iii) *Credit Risk Analysis.* For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record of the determination that a portfolio security presents minimal credit risks used to determine the status of the security as an Eligible Security shall be maintained and preserved in an easily accessible place.

* * * * *

(e) * * *

(1) *Written Guidelines.* The Board shall establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraph (c)(3) of this section (by

reference to paragraph (a)(11)) and procedures under which the delegate makes such determinations.

* * * * *

4. Section 270.5b–3 is amended by:

a. Adding "or" at the end of paragraph (c)(1)(iv)(B);

b. Revising paragraph (c)(1)(iv)(C);

c. Removing paragraph (c)(1)(iv)(D);

d. Removing paragraphs (c)(5), (c)(6), and (c)(8);

e. Redesignating paragraph (c)(4) as (c)(5);

f. Adding new paragraph (c)(4); and

g. Redesignating paragraph (c)(7) as paragraph (c)(6).

The revisions read as follows:

§ 270.5b–3 Acquisition of repurchase agreement or refunded security treated as acquisition of underlying securities.

* * * * *

(c) * * *

(1) * * *

(iv) * * *

(C) Securities that the investment company's board of directors, or its delegate, determines at the time the repurchase agreement is entered into:

(*1*) Each issuer of which has the highest capacity to meet its financial obligations; and

(*2*) Are sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven calendar days; and

* * * * *

(4) *Issuer,* as used in paragraph (c)(1)(iv)(C) of this section, means the issuer of a collateral security or the issuer of an unconditional obligation of a person other than the issuer of the collateral security to undertake to pay, upon presentment by the holder of the obligation (if required), the principal amount of the underlying collateral security plus accrued interest when due or upon default.

* * * * *

5. Section 270.6a–5 is added to read as follows:

§ 270.6a–5 Purchase of certain debt securities by companies relying on section 6(a)(5) of the Act.

For purposes of reliance on the exemption for certain companies under section 6(a)(5)(A) of the Act (15 U.S.C. 80a–6(a)(5)(A)), a company shall be deemed to have met the requirement for credit-worthiness of certain debt securities under section 6(a)(5)(A)(iv)(I) of the Investment Company Act (15 U.S.C. 80a–6(a)(5)(A)(iv)(I)) if, at the time of purchase, the board of directors (or its delegate) determines or members of the company (or their delegate) determine that the debt security is:

(a) Subject to no greater than moderate credit risk; and

(b) Sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

6. The authority citation for part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

* * * * *

7. Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by revising Item 27(d)(2) to read as follows:

Note: The text of Form N–1A does not, and these amendments will not, appear in the Code of Federal Regulations.

Form N–1A

* * * * *

Item 27. Financial Statements

* * * * *

(d) *Annual and Semi-Annual Reports.* * * *

(2) *Graphical Representation of Holdings.* One or more tables, charts, or graphs depicting the portfolio holdings of the Fund by reasonably identifiable categories (*e.g.,* type of security, industry sector, geographic region, credit quality, or maturity) showing the percentage of net asset value or total investments attributable to each. The categories and the basis of presentation (*e.g.,* net asset value or total investments) should be selected, and the presentation should be formatted, in a manner reasonably designed to depict clearly the types of investments made by the Fund, given its investment objectives. If the Fund uses the credit ratings, as defined in section 3(a)(60) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(60)], assigned by a nationally recognized statistical rating organization ("NRSRO"), as defined in section 3(a)(62) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(62)], to categorize the credit quality of portfolio holdings, it should use the credit ratings of only one NRSRO except in the case of portfolio holdings that are not rated by that NRSRO. If credit ratings of that NRSRO are not available for certain holdings, the Fund must briefly discuss the methodology for determining credit quality for such holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.

* * * * *

8. Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by revising Instruction 6(a) to Item 24 to read as follows:

Note: The text of Form N–2 does not, and these amendments will not, appear in the Code of Federal Regulations.

Form N–2

* * * * *

Item 24. Financial Statements

* * * * *

Instructions:

* * * * *

6. * * *

a. One or more tables, charts, or graphs depicting the portfolio holdings of the Registrant by reasonably identifiable categories (*e.g.,* type of security, industry sector, geographic region, credit quality, or maturity) showing the percentage of net asset value or total investments attributable to each. The categories and the basis of presentation (*e.g.,* net asset value or total investments) should be selected, and the presentation should be formatted, in a manner reasonably designed to depict clearly the types of investments made by the Registrant, given its investment objectives. If the Registrant uses the credit ratings, as defined in Section 3(a)(60) of the Exchange Act [15 U.S.C. 78(c)(a)(60)], assigned by a nationally recognized statistical rating organization ("NRSRO"), as defined in Section 3(a)(62) of the Exchange Act [15 U.S.C. 78(c)(a)(62)], to categorize the credit quality of portfolio holdings, it should use the credit ratings of only one NRSRO except in the case of portfolio holdings that are not rated by that NRSRO. If credit ratings of that NRSRO are not available for certain holdings, the Registrant must briefly discuss the methodology for determining credit quality for such holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.

* * * * *

9. Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by revising Instruction 6(i) to Item 28(a) to read as follows:

Note: The text of Form N–3 does not, and these amendments will not, appear in the Code of Federal Regulations.

Form N–3

* * * * *

Item 28. Financial Statements

(a) * * *

Instructions:

* * * * *

6. * * *

(i) One or more tables, charts, or graphs depicting the portfolio holdings of the Registrant by reasonably identifiable categories (*e.g.,* type of security, industry sector, geographic region, credit quality, or maturity) showing the percentage of net asset value or total investments attributable to each. If the Registrant has sub-accounts, provide the information separately for each sub-account. The categories and the basis of presentation (*e.g.,* net asset value or total investments) should be selected, and the presentation should be formatted, in a manner reasonably designed to depict clearly the types of investments made by the Registrant, given its investment objectives. If the Registrant uses the credit ratings, as defined in Section 3(a)(60) [15 U.S.C. 78c(a)(60)] of the Exchange Act, assigned by a nationally recognized statistical rating organization ("NRSRO"), as defined in Section 3(a)(62) of the Exchange Act [15 U.S.C. 78c(a)(62)], to categorize the credit quality of portfolio holdings, it should use the credit ratings of only one NRSRO except in the case of portfolio holdings that are not rated by that NRSRO. If credit ratings of that NRSRO are not available for certain holdings, the Registrant must briefly discuss the methodology for determining credit quality for such holdings, including, if applicable, the use of credit ratings assigned by another NRSRO.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

10. Form N–MFP (referenced in § 274.201) is amended by:

a. Revising Item 33;

b. Removing Item 34;

c. Revising Item 37.b;

d. Removing Item 37.c;

e. Removing Items 38.b and 38.c;

f. Removing Items 39.c and 39.d;

g. Redesignating Items 35 through 46 as Items 34 through 45; and

h. In redesignated Item 38, replacing "Items 37 and 38" with "Items 36 and 37".

The revisions read as follows:

Note: The text of Form N–MFP does not, and this amendment will not, appear in the Code of Federal Regulations.

Form N–MFP

* * * * *

Item 33

Indicate whether the security is a First Tier Security, a Second Tier Security or no longer an Eligible Security.

* * * * *

Item 37

* * * * *

b. The period remaining until the principal amount of the security may be recovered through the Demand Feature.

Dated: March 3, 2011.

By the Commission.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2011–5184 Filed 3–8–11; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 310

[Docket No. FDA–1981–N–0012] (Formerly Docket No. 1981N–0022)

RIN 0910–AF45

Benzocaine; Weight Control Drug Products for Over-the-Counter Human Use

AGENCY: Food and Drug Administration, HHS.

ACTION: Proposed rule.

SUMMARY: The Food and Drug Administration (FDA) is issuing a proposed rule to reclassify benzocaine from its previously proposed monograph status (category I) for over-the-counter (OTC) weight control use to nonmonograph status. Although, in the **Federal Register** of February 26, 1982, an advanced notice of proposed rulemaking (ANPR) included the recommendation of an Advisory Panel, consisting of health care providers from outside FDA, recommended that benzocaine should be generally recognized as safe and effective (GRASE) for weight control, this document includes our first evaluation of benzocaine for this use. Based on our evaluation of the available data and information, we have tentatively concluded that the data are not sufficient to support the safety and effectiveness of benzocaine for this use. This proposed rule, if finalized, would require an approved new drug application (NDA) or abbreviated new drug application (ANDA) for the marketing of OTC weight control products containing benzocaine.

DATES: Submit written or electronic comments on the proposed rule by June 7, 2011. See section IX of this document for information on the proposed effective date of this proposed rule.

ADDRESSES: You may submit comments, identified by Docket No. FDA–1981–N–0012 (formerly Docket No. 1981N–0022 and RIN No. 0910–AF45 by any of the following methods:

Electronic Submissions

Submit electronic comments in the following way:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Written Submissions

Submit written submissions in the following ways:

- *FAX:* 301–827–6870.
- *Mail/Hand delivery/Courier (for paper, disk, or CD–ROM submissions):* Division of Dockets Management (HFA–305), Food and Drug Administration, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852.

Instructions: All submissions received must include the Agency name and Docket No. FDA–1981–N–0012 (formerly Docket No. 1981N–0022) and RIN No. 0910–AF45 for this rulemaking. All comments received may be posted without change to *http://www.regulations.gov,* including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to *http://www.regulations.gov* and insert the docket number, found in brackets in the heading of this document, into the "Search" box and follow the prompts and/or go to the Division of Dockets Management, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852.

FOR FURTHER INFORMATION CONTACT: Michelle M. Jackson, Center for Drug Evaluation and Research (HFD–560), Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 22, MS 5411, Silver Spring, MD 20993–0002, 301–796–2090.

SUPPLEMENTARY INFORMATION:

I. Purpose of This Document

In the **Federal Register** of February 26, 1982, we (FDA) published an ANPR to establish a monograph for OTC weight control drug products. The ANPR included the recommendations of an Advisory Review Panel on the OTC Miscellaneous Internal Drug Products (the Panel) that evaluated all OTC weight control drug products on the market at the time the OTC drug review began in 1972. The Panel consisted of