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August 29, 2008

Via Electronic Mail

Ms. Florence E. Harmon, Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Amendments to References to Ratings of Nationally Recognized Statistical Rating Organizations (Release Nos. IC-28327; IA-2751)
File No. S7-19-08

Dear Ms. Harmon:

Fidelity Management & Research Company ("Fidelity") strongly opposes the Securities and Exchange Commission's proposal to eliminate references to ratings by credit rating agencies in Rule 2a-7 under the Investment Company Act of 1940.[1] Fidelity believes the proposed changes would weaken the standards in Rule 2a-7, result in lesser protections for investors and potentially disrupt the money market industry.[2]

Rule 2a-7 has worked remarkably well since its adoption in 1983. Investors have entrusted over $3.5 trillion to money market mutual funds.[3] Clearly, the fund model of seeking to maintain a $1.00 NAV has proven successful with investors, without government insurance or other financial backing from state or federal governments. A large part of investor confidence in money market mutual funds stems from the Rule 2a-7 requirements with regard to credit quality, maturity and diversification. For the reasons set forth below, Fidelity urges the Commission to keep this effective regulation in place in its current form.

[1] References to Ratings of Nationally Recognized Statistical Rating Organizations, 73 Fed. Reg. 40124 (proposed July 1, 2008).
[2] Fidelity, investment advisor to the Fidelity funds, manages approximately $485 billion in money market mutual funds through its Fixed Income Division, and, therefore, our comments relate primarily to the proposed changes to Rule 2a-7.
[3] Investment Company Institute, *Money Market Mutual Fund Assets*, http://www.ici.org/stats/mf/mm_08_28_08.html#TopOfPage (August 28, 2008).

1. Current Rule 2a-7 Effectively Prevents Undue Reliance on Ratings by Money Market Funds.

In its proposing release, the Commission stated that its goal was to "reduce undue reliance on credit ratings and result in improvements in the analysis that underlies investment decisions."[4] Similarly, at the Commission's June 11, 2008 Open Meeting on Rules for Credit Rating Agencies, Chairman Cox said:

> [S]everal observers . . . have made the observation that the official recognition of credit ratings for a variety of securities regulatory purposes may have played a role in encouraging investors' over-reliance on ratings. To the extent that the SEC's references to credit ratings in our rules are viewed by the marketplace as giving credit ratings an implied official seal of approval, they have argued, our own rules may be contributing to an uncritical reliance on credit ratings as a substitute for independent evaluation.[5]

Fidelity agrees that investment advisers to money market funds should not place undue reliance on credit ratings--but Rule 2a-7 in its current form already prohibits such conduct. Under Rule 2a-7, money market funds must limit purchases to securities that have eligible ratings (or are of comparable quality) from the Requisite NRSROs (as defined in Rule 2a-7) and are determined by the fund's board, or its delegate, to represent minimal credit risk.[6]

Both the plain text of Rule 2a-7 and Commission guidance make clear that money market funds cannot rely solely on credit rating agencies. Section 3(i) of Rule 2a-7 specifies that an independent minimal credit risk determination "must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO."[7] In 1991, when adding this language to Rule 2a-7, the Commission explained why a rating from a credit rating agency was not sufficient to make a security eligible for investment under Rule 2a-7:

> Possession of a certain rating by a NRSRO is not a "safe harbor." 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 has minimal credit risks. To underscore this point, a parenthetical has been added to the rule stating that the determination of whether an instrument presents minimal credit risks "must be based on factors pertaining to credit quality in addition to the rating assigned * * * by a NRSRO."[8]

The Commission staff reaffirmed the impermissibility of undue reliance on NRSRO ratings in a 1994 No-Action Letter:

> We emphasize that a report by a credit information service is not a substitute for the minimal credit risk analysis by the fund's investment adviser. During an inspection of

[4] 73 Fed. Reg. 40124 (2008).
[5] Chairman Christopher Cox, U.S. Securities and Exchange Commission, *Speech by SEC Chairman: Statement at Open Meeting on Rules for Credit Rating Agencies*, http://www.sec.gov/news/speech/2008/spch061108cc.htm (June 11, 2008).
[6] 17 C.F.R. §270.2a-7(3)(i) (emphasis added).
[7] 17 C.F.R. §270.2a-7(3)(i) (emphasis added).
[8] Revisions to Rules Regulating Money Market Funds, 56 Fed. Reg. 8113 (1991) (internal citations omitted).

> a money market fund, the Commission staff will not accept a fund's possession of a report on a security (or its issuer) from a credit information service as demonstrating that the fund's adviser has performed a minimal credit risk analysis with respect to the security. The fund should present documentation to substantiate that it has performed a minimal credit risk analysis and reached its own conclusion about whether the security presents such risks.[9]

We continue to believe that the Commission has properly gauged the benefits of requiring a third-party benchmark of credit quality (embodied in the NRSRO rating process) and a separate, independent minimum credit determination made by the money market fund's investment adviser. Any money market fund that fails to make the necessary independent minimal credit risk decision or that relies solely on the rating of a credit rating agency to purchase a portfolio security would already violate Rule 2a-7 as it exists today.

2. The Proposed Changes Will Decrease Protection for Investors.

Fidelity is concerned that the proposed changes to Rule 2a-7 will decrease protection for investors. As noted above, currently, Rule 2a-7 limits the credit quality of portfolio securities to those that (1) are Eligible Securities[10] and (2) present minimal credit risk.[11] Both requirements must be met. The former is an objective, third-party standard. The latter is a subjective standard. The Commission's proposal, if adopted, would eliminate the objective standard and rely solely on the subjective standard to ensure the credit quality of securities purchased by money market funds. Fidelity is concerned that the removal of the objective standard introduces risk to investors that some money market funds, in an effort to deliver higher yields, will take advantage of the potentially looser subjective standard to add more credit risk.

This proposed shift to a subjective standard represents a significant reversal of long-standing Commission policy. When Rule 2a-7 was adopted in 1983, the Commission rightly concluded that investors would have greater protection from the combination of a subjective standard with an objective standard:

> The requirement that a security have a high quality rating provides protection by ensuring input into the quality determination by an outside source. However, the mere fact that an instrument has or would receive a high quality rating may not be sufficient to ensure stability. The Commission believes that the instrument must be evaluated for the credit risk that it presents to the particular fund at that time in light of the risks attendant to the use of amortized cost valuation or penny-rounding. Moreover, the board may look at some aspects when evaluating the risk of an investment that would not be considered by the rating services.[12]

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[9] Red Flag Research Inc., SEC No-Action Letter, 1994 SEC No-Act. LEXIS 515 (May 10, 1994).

[10] Generally, Rule 2a-7 defines "Eligible Security" as security with a remaining maturity of 397 days or less that (1) has received a rating from the Requisite NRSROs (as defined in the rule) in one of the two highest short-term categories or (2) an unrated security that is of comparable quality to a security in (1).

[11] 17 C.F.R. 270. 2a-7(3)(i).

[12] Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), 48 Fed. Reg. 32555 (1983).

Fidelity believes that Rule 2a-7 is an effective regulation. Weakening the current test for portfolio quality will not, in our view, promote the Commission's goal of protecting investors. If anything, the proposed changes may result in harm to investors and potentially the entire money market fund industry.

Not only will a weakened eligibility test for securities increase the likelihood that an aggressive money market fund may "break the buck," but a reduction in public confidence in money market funds could lead to systemic liquidity concerns. Money market mutual funds provide key daily liquidity to the global capital markets by purchasing short-term instruments issued by large financial institutions and by entering into overnight repurchase agreements with banks and broker-dealers. If money market funds were to suffer significant outflows due to lack of investor confidence, this important source of daily liquidity could decrease drastically. The resulting consequences for large financial institutions, banks and broker-dealers are uncertain, but likely negative. Fidelity believes that money market fund investors, and the broader capital markets, will benefit from retaining the protections afforded by the combination of subjective and objective tests that limit the securities that are eligible for purchase under Rule 2a-7.

3. Liquidity and Notice Changes to Rule 2a-7 are not Necessary.

In addition to the proposed changes to the determination of and monitoring for changes to minimal credit risk, the Commission seeks comment on changes to two other provisions of Rule 2a-7 in the proposing release. The first would codify existing Commission guidance on liquidity of portfolio securities, and the second would require notice to the Commission when an affiliated person purchases a security out of a money market fund. Fidelity believes that these changes are unnecessary.

With respect to liquidity, as the Commission notes in its proposing release, these changes would merely codify the standard that governs money market funds today.[13] Fidelity believes that money market fund advisers understand the current standards, and therefore rulemaking in this area is not needed. With regard to providing notice to the Commission, Fidelity suggests that the Commission consider amending Rule 17a-9 if it identifies a need to revise reporting requirements surrounding purchases of a security out of a fund by an affiliate. Any regulatory changes carry a risk of creating uncertainty in the marketplace, and therefore we believe that the wiser course is to leave the existing standards in place and not make any changes to Rule 2a-7.

4. The Proposed Changes do not Further the Purpose of the Credit Rating Agency Reform Act of 2006 ("CRA").

In 2007, as required by the CRA,[14] the Commission reviewed its rules and reported that no changes were needed.[15] Now, in light of admittedly difficult and, in many cases, unexpected market developments, the Commission has proposed a broad range of potential rule changes in a very short period of time. The first two initiatives, proposed at the Commission's open meeting on June 16, 2008, would impose requirements on NRSROs designed to enhance the credit rating processes, transparency, and investor comprehension of ratings symbology.[16] In the proposing release for the

[13] 73 Fed. Reg. 40124 (2008).
[14] 15 U.S.C. § 78o-7(n)(2).
[15] 72 Fed. Reg. 33564, at 33565 (2007).
[16] 73 Fed. Reg. 36212 (2008).

amendments to Rule 2a-7, the Commission described all three rulemaking initiatives as "in furtherance of the Credit Rating Agency Reform Act of 2006."[17]

Congress provided that the purpose of the CRA is "[t]o improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[18] Fidelity agrees that the first two rulemaking initiatives further the purpose of the CRA. However, we respectfully suggest that removal of NRSRO ratings requirements from Rule 2a-7 does not similarly further the CRA's purpose. Instead, we believe that reinforcing the Commission's long-standing position that money market funds should use credit ratings in the manner set forth in Rule 2a-7 is more likely to foster accountability, transparency and competition in the credit rating agency industry.[19]

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Fidelity appreciates the opportunity to comment on the proposed rules. If you or your staff have any comments, questions or would like additional information, please feel free to contact me at (617) 563-0371.

Very truly yours,

Scott C. Goebel

cc: Honorable Christopher Cox, Chairman
Honorable Kathleen L. Casey, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner

Andrew J. Donohue, Director, Division of Investment Management
Robert E. Plaze, Associate Director, Division of Investment Management
Erik R. Sirri, Director, Division of Market Regulation

[17] 73 Fed. Reg. 40124 (2008).
[18] Credit Rating Agency Reform Act of 2006, 109 P.L. 291, 120 Stat. 1327 (2006) (codified at 15 U.S.C. § 78o-7).
[19] Similarly, Fidelity does not believe that the purposes of the CRA are advanced by the proposals to remove references to NRSROs in Rule 3a-7, Rule 5b-3, Rule 10f-3 or Rule 206(3)-3T.