

MEMO# 22851

September 5, 2008

ICI Comment Letter on SEC Proposal to Remove NRSRO Ratings from Rule 2a-7

[22851]

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 40-08
FIXED-INCOME ADVISORY COMMITTEE No. 24-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 19-08
INVESTMENT COMPANY DIRECTORS No. 14-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 22-08
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 33-08
SEC RULES MEMBERS No. 84-08 RE: ICI COMMENT LETTER ON SEC PROPOSAL TO
REMOVE NRSRO RATINGS FROM RULE 2a-7

As we previously informed you, the Securities and Exchange Commission has proposed to remove references to credit ratings of nationally recognized statistical rating organizations (“NRSROs”) from several rules under the Investment Company Act of 1940 – most significantly, from Rule 2a-7, the rule governing money market mutual funds. [\[1\]](#) The proposed amendments comprise the third of three rulemaking initiatives relating to credit ratings and NRSROs that the Commission is proposing. [\[2\]](#) The Institute has filed a comment letter, which is limited to a discussion concerning the proposed changes to Rule 2a-7. The letter is attached and briefly summarized below.

The Institute’s letter supports the Commission’s decision to institute a review of its rules in response to concerns about the appropriateness of using references to NRSRO ratings in rules, and about whether such references have, in effect, placed an “official seal of approval” on such ratings. The letter also expresses an understanding regarding the Commission’s desire to ensure that the use of NRSRO ratings in its rules does not cause market participants to place “undue reliance” on NRSRO ratings or make them “vulnerable to failures in the ratings process.”

Nonetheless, the letter strongly opposes the Commission's proposal to remove references to credit ratings of NRSROs from Rule 2a-7. The letter notes that for more than two decades, credit ratings, together with other requirements of the rule, have formed the basis for the tremendous success of money market funds.

The letter states that the proposal to remove references to NRSRO ratings from Rule 2a-7 is unnecessary to address the Commission's stated policy concerns, and it could have serious unintended consequences. It would weaken the investor protections embedded in Rule 2a-7, and it may create the potential to harm investor and market confidence in the entire money market fund industry, which has operated effectively under the safeguards provided by Rule 2a-7 for 25 years.

The letter also includes a thorough history of Rule 2a-7 that clearly demonstrates that it has never been appropriate for money market funds to rely solely on a security's NRSRO rating without also separately considering whether that security presents minimal credit risks. The letter explains that the rating requirement in Rule 2a-7 provides an important "floor," below which investments may not be made, that serves to provide an additional and important layer of protection for investors.

Finally, the letter recommends that if the Commission determines to remove references to NRSRO ratings from Rule 2a-7 and/or the other Investment Company Act rules, the Commission should clarify and, to the extent feasible, harmonize the intended scope of the credit standards that would replace such references. It also recommends that the Commission provide specific examples of how funds might satisfy these standards. The letter states that without such guidance, it would prove difficult for fund advisers to craft – and fund boards to approve – policies and procedures that are reasonably designed to ensure compliance with the new standards.

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Associate Counsel Rachel H. Graham
Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) See References to Ratings of Nationally Recognized Statistical Rating Organizations, SEC Release No. IC-28327 (July 1, 2008), 73 FR 40124 (July 11, 2008). See also companion releases, References to Ratings of Nationally Recognized Statistical Rating Organizations, SEC Release No. 34-58070 (July 1, 2008), 73 FR 40087 (July 11, 2008) and Security Ratings,

[\[2\]](#) The first two initiatives address concerns relating to the integrity of the NRSRO's credit rating procedures and the differentiation between ratings for structured products. See Proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC Release No. 34-57967 (June 17, 2008), 73 FR 36211 (June 25, 2008). For a discussion concerning the Institute's position on the first two initiatives, see Memorandum to Equity Markets Advisory Committee No. 34-08, Municipal Securities Advisory Committee No. 29-08, Money Market Funds Advisory Committee No. 20-08, Inst. Money Market Funds Advisory Committee No. 15-08, Fixed-Income Advisory Committee No. 21-08, and SEC Rules Members No. 69-08 [22740], dated July 28, 2008.

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