

MEMO# 22821

August 27, 2008

Draft ICI Comment Letter on SEC's Proposal to remove NRSRO ratings from Rule 2a-7

[22821]

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 38-08
FIXED-INCOME ADVISORY COMMITTEE No. 23-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 21-08
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 32-08
SEC RULES COMMITTEE No. 63-08 RE: DRAFT ICI COMMENT LETTER ON SEC'S 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 amendments comprise the third of three rulemaking initiatives relating to credit ratings by an NRSRO that the Commission is proposing. [\[2\]](#) The Institute's draft letter, which is limited to a discussion concerning the proposed changes to Rule 2a-7, is attached and summarized below.

In light of recent events in the credit markets, the draft letter expresses strong support for the Commission's efforts to address concerns regarding the rating system through its earlier proposed reforms to the oversight and operation of credit rating agencies. The letter further expresses support for 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 its rules. The letter notes, however, that the resulting proposal that the Commission has put forth appears to be an overreaction that fails to consider carefully the precise role that credit ratings play under each rule. In particular, the letter states that

removing references to NRSRO ratings from Rule 2a-7 is unnecessary to address the Commission's concerns, and it could have serious unintended consequences. The letter explains that the proposal 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, one that has operated effectively under the safeguards provided by Rule 2a-7 for 25 years.

The draft 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 draft 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 both clarify the intended scope of the credit standards that would replace the ratings references and provide specific examples of how funds might satisfy these standards. 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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[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, SEC Release No. 33-8940 (July 1, 2008), 73 FR 40106 (July 11, 2008).

[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). 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, dated July 28, 2008 [22740].