

**MEMO# 6403**

November 22, 1994

## **DRAFT INSTITUTE COMMENT LETTER TO SEC CONCERNING RATINGS AND RATING AGENCIES**

November 22, 1994 TO: CLOSED-END FUND COMMITTEE No. 28-94 SEC RULES COMMITTEE No. 123-94 SUBCOMMITTEE ON ADVERTISING No. 19-94 UNIT INVESTMENT TRUST COMMITTEE No. 76-94 RISK MEASUREMENT TASK FORCE RE: DRAFT INSTITUTE COMMENT LETTER TO SEC CONCERNING RATINGS AND RATING AGENCIES

The Securities and Exchange Commission recently issued a concept release soliciting comment on the appropriate role of ratings and nationally recognized statistical rating organizations ("NRSROs"). Of particular interest to investment companies is the Commission's solicitation of comment on prospectus use of mutual fund risk ratings and the adequacy of current disclosure concerning rated portfolio securities. The Commission also proposed rule amendments to require mandatory disclosure of certain ratings. The Commission requested comment on whether the mandatory disclosure requirement should apply to closed-end funds and other investment companies. Comments on the releases are due by December 6, 1994. The Institute has drafted the attached comment letter on the releases. While our draft is preliminary and may be subject to some revision, we would appreciate your input as soon as possible. Please provide your comments on the Institute's draft letter no later than Thursday, December 1st. You may submit your comments to the undersigned at 202/326-5819. The Institute's letter states that the ratings by NRSROs of the credit quality of debt securities and preferred stock serve an important function in the marketplace, and that it is proper for the Commission to rely upon NRSRO credit ratings in certain circumstances. On the other hand, the Commission should not transform the limited function of NRSROs into a more substantive regulatory role, nor should the Commission rely on other types of ratings, such as ratings of mutual fund shares, for which the NRSROs' expertise is questionable. In particular, the Institute's letter states that we continue to believe that Rule 3a-7 under the Investment Company Act of 1940 represents an improper delegation to the ratings industry of the Commission's authority to exempt persons from the Act, and we would strongly oppose relaxing liability standards under the Securities Act of 1933 for mutual fund ratings, particularly "volatility ratings." The Institute's letter also states that we would oppose application of the Commission's proposed mandatory disclosure requirement to closed-end funds and other investment companies. Finally, the letter states that the Institute believes that current disclosure requirements with respect to rated portfolio securities are sufficient to warn investors of the limitations and scope of credit ratings. Thomas M. Selman Associate Counsel Attachment

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