

MEMO# 2993

August 7, 1991

SEC STAFF ISSUES INTERPRETIVE LETTER REGARDING HOW THE DESIGNATION OF THOMPSON BANKWATCH AS AN NRSRO AFFECTS MONEY MARKET FUNDS

August 7, 1991 TO: SEC RULES MEMBERS NO. 42-91 MONEY MARKET MEMBERS - ONE PER
COMPLEX NO. 22-91 RE: SEC STAFF ISSUES INTERPRETIVE LETTER REGARDING HOW THE
DESIGNATION OF THOMPSON BANKWATCH AS AN NRSRO AFFECTS MONEY MARKET FUNDS

The SEC's Division of Market Regulation issued a letter yesterday recognizing Thompson Bankwatch ("Bankwatch") as a "nationally recognized statistical rating organization" ("NRSRO") for purposes of Rule 15c3-1 under the Securities Exchange Act. (A copy of the letter is attached as Appendix A.2.) In response, the Division of Investment Management issued a letter to the Institute regarding how this designation affects money market funds under Rule 2a-7 of the Investment Company Act. (The staff's letter is attached as Appendix A.1.) Under Rule 2a-7, a fund can only buy securities that are "Eligible Securities", which are defined as securities that, among other things, have received one of the two highest ratings assigned by the "Requisite NRSROs" or, if unrated, are of comparable quality to securities having received such ratings. "Requisite NRSROs" is defined under the Rule as (i) any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer or (ii) if only NRSRO has issued a rating with respect to a security or issuer at the time the fund purchases or "rolls over" the security, that NRSRO. In its letter, the SEC staff states that, "Since Bankwatch could not have been a Requisite NRSRO for the existing securities of any issuer, the designation of Bankwatch as an NRSRO will not affect the status of a security that is currently held by a fund as an Eligible Security, even if Bankwatch assigns the security a rating that is below its second highest rating category for short-term debt." The staff notes, however, that the Bankwatch rating must be taken into consideration if a fund makes an additional investment in that security or "rolls over" the security. With respect to downgradings, the staff advises funds that if Bankwatch assigns a rating below its top two categories (TBW-1 or TBW-2) to a second tier or comparable unrated security held by a fund, the fund's board must, as required under Rule 2a-7, promptly reassess whether the security presents minimal credit risks, unless the security is sold or matures within five business days. In addition, a security that was rated first tier at the time a fund acquired will not be deemed to be a second tier security for purposes of the quality and diversification requirements under Rule 2a-7 if Bankwatch assigns it a second tier rating.

However, the Bankwatch rating would have to be taken into account when the fund "rolls over" the security. On a related matter, the SEC staff, responding to a request by the Institute, issued an interpretive letter clarifying that investment companies that hold themselves out as "money market" funds in accordance with paragraph (b) of Rule 2a-7 are excluded from the requirement to provide a portfolio turnover rate in response to Item 3 of Form N-1A and Item 71 of Form N-SAR. In addition, the staff responded favorably to our request that the definition of the term "money market fund" in Instruction G of Form N-SAR be interpreted to refer to an investment company that holds itself out as a "money market fund" in accordance with Rule 2a-7(b). There was some concern that these items may have caused confusion since they were not amended to conform to the recent changes to Rule 2a-7. (A copy of the staff's letter is attached as Appendix B.) Amy B.R. Lancellotta Assistant General Counsel Attachments

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