

MEMO# 6448

December 9, 1994

INSTITUTE COMMENT LETTER TO SEC CONCERNING RATINGS AND RATING AGENCIES

1 See Memorandum 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, dated November 22, 1994. December 9, 1994 TO: CLOSED-END FUND COMMITTEE No. 33-94 SEC RULES COMMITTEE No. 130-94 SUBCOMMITTEE ON ADVERTISING No. 22-94 UNIT INVESTMENT TRUST COMMITTEE No. 81-94 RISK MEASUREMENT TASK FORCE RE: INSTITUTE COMMENT LETTER TO SEC CONCERNING RATINGS AND RATING AGENCIES

As we previously informed you, 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") and proposed rule amendments to require mandatory disclosure of certain ratings.¹ Attached is a copy of the Institute's comment letter on the releases. 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 quality ratings in certain circumstances. On the other hand, the Commission should not rely on NRSROs to conduct regulatory oversight on matters such as potential self-dealing and overreaching by insiders. Thus, 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 regulatory responsibilities. In addition, the Commission should recognize the important distinctions between credit ratings of debt securities and preferred stock and other types of ratings, such as ratings of mutual fund shares, as to which the NRSROs' expertise is questionable. The letter thus strongly opposes relaxing liability standards under the Securities Act of 1933 for mutual fund ratings, including "volatility ratings." In response to a specific request for comment, the Institute's letter also opposes application of the Commission's proposed mandatory disclosure requirement to closed-end funds and other investment companies. Finally, in response to a specific request for comment, the Institute's letter states 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

should not be considered a substitute for, legal advice.