

## COMMENT LETTER

April 25, 2011

# ICI Comment Letter on SEC's Proposal to Remove NRSRO References from Rules 2a-7 and 5b-3 (pdf)

April 25, 2011 Ms. Elizabeth M. Murphy Secretary Securities and Exchange Commission 100 F Street, NE Washington, DC 20549-1090 Re: References to Credit Ratings in Certain Investment Company Act Rules and Forms (File No. S7-07-11) Dear Ms. Murphy: The Investment Company Institute<sup>1</sup> appreciates the opportunity to offer its views on the Securities and Exchange Commission's proposal to remove references to credit ratings of nationally recognized statistical rating organizations (NRSROs) from certain rules and forms under the Investment Company Act of 1940.<sup>2</sup> The proposed amendments give effect to provisions of the Dodd- Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that call for the amendment of SEC regulations that contain any references to or requirements regarding credit ratings that require the use of an assessment of the credit-worthiness of a security or money market instrument. Although the Release states that the amendments "are designed to offer protections comparable to those provided by the NRSRO ratings,"<sup>3</sup> ICI is concerned that the proposed alternative standards of credit-worthiness in Investment Company Act Rules 2a-7 and 5b-3 may have the unintended consequence of raising some credit standards and lowering others. While the elimination of standards based on credit ratings must necessarily alter these regulations to some degree, we suggest below some different approaches that would keep these regulations more in line with their current standards.<sup>4</sup> We

<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.0 trillion and serve over 90 million shareholders.

<sup>2</sup> See SEC Release No. IA-29592 (March 3, 2011) (Release), available on the SEC's website at <http://sec.gov/rules/proposed/2011/33-9193.pdf>.

<sup>3</sup> Release at 8.

<sup>4</sup> Although we acknowledge that Section 939A of the Dodd-Frank Act would seem to require the SEC to remove from Rules 2a-7 and 5b-3 references to credit ratings that require the use of a credit-worthiness assessment, we previously have commented that such measures are unnecessary to address concerns about ratings and fail adequately to consider the role Ms. Elizabeth M. Murphy April 25, 2011 Page 2 also offer a recommendation that would permit funds to use NRSRO ratings to disclose credit quality information in shareholder reports in a manner that is consistent with their investment policies. In summary, our recommendations are as follows: Rule 2a-7 • We recommend that Rule 2a-7 define an eligible security as "a security with a remaining maturity of 397 days or less that the fund's board of directors

determines presents minimal credit risks and the issuer of which the fund's board of directors determines has a strong capacity to meet its short-term obligations." The proposed standard would eliminate the "first tier" and "second tier" categories from the rule and effectively limit money market fund purchases to those securities that meet one uniform, but very high, standard (e.g., securities generally comparable to securities rated in the highest short-term rating category, which would be first tier securities under the current rule).

- For a security subject to a conditional demand feature, we recommend that if the demand feature provides for its termination upon a downgrade of the underlying security by a credit rating agency, the rule prohibit a money market fund from acquiring the security unless the security (or its issuer or guarantor, as the case may be) has received ratings from such rating agency at least two full ratings categories higher (without regard to gradations or subcategories) than the highest rating that would terminate the demand feature. We do not believe that Section 939A of the Dodd-Frank Act should preclude the SEC from recognizing in its regulations that demand features may terminate as a result of ratings changes and the risk associated with such terminations.
- We recommend that the requirement to reassess minimal credit risk under paragraph (c)(7)(i) be eliminated and that paragraph (c)(10)(i) be redrafted to include a general, ongoing obligation to monitor the credit risks of portfolio securities. An express requirement for funds to review their credit assessments under Rule 2a-7 on an ongoing basis would obviate the need for a separate requirement to identify specific triggers for reassessment.
- We do not believe that Section 939A of the Dodd-Frank Act precludes the SEC from promulgating regulations that simply refer to existing credit ratings without requiring an assessment of a security's credit-worthiness, such as in the stress testing paragraph of Rule 2a-7. Accordingly, we recommend that the SEC retain the stress testing provision in its current form.

that NRSRO ratings play under these rules. See, e.g., Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated September 8, 2009 (ICI letter on proposed amendments to Rule 2a-7) and December 8, 2009 (ICI letter on proposed amendments to Rule 5b-3). Ms. Elizabeth M. Murphy April 25, 2011 Page 3 Rule 5b-3

- We recommend that at the time a fund enters into a repurchase agreement, the fund's board (or delegate) be required to determine that the issuer of any underlying non- government securities have an "exceptionally strong capacity" to repay financial obligations, which would be consistent with the definitions used by many rating agencies to define their highest long-term rating category. We would not object to the additional proposed requirement that the underlying securities qualify as liquid securities.

Form N-MFP

- Although the references to credit ratings in Form N-MFP are to existing credit ratings and are merely a collection of data points so regulators and investors will better understand funds' portfolios, we would not object to the removal of this information from Form N-MFP, provided that it is clear that funds may choose to include ratings from one or more NRSROs in the monthly website portfolio disclosure required by Rule 2a-7.

Shareholder Reports

- We support the SEC's proposal that would permit funds to present the credit quality of their portfolio holdings by disclosing NRSRO and/or internal credit ratings in shareholder reports. Given the range of ways that funds can and do portray credit risk associated with certain bonds, however, we recommend that the SEC permit funds to choose which NRSRO rating to use in shareholder reports, provided that the choice is made consistently pursuant to a disclosed policy.

Use of Credit Ratings by Directors and in Procedures

- We recommend that the SEC include a statement in the adopting release acknowledging that funds may continue to refer to credit ratings in their policies and procedures, investment strategies, reports to their directors and shareholders, and marketing literature.

I. Rule 2a-7

Rule 2a-7 under the Investment Company Act governs the operation of money market funds. Unlike other mutual funds, money market funds use amortized cost accounting to seek to maintain a stable share price, typically at \$1.00 per

share. Rule 2a-7 contains numerous risk-limiting conditions intended to help a fund achieve the objective of maintaining a stable net asset value. Among these conditions, Rule 2a-7 restricts money market funds to securities that the fund's board (or its delegate) determines present minimal credit risks. Rule 2a-7 further limits a money market fund's portfolio investments to securities that have received credit ratings from the "requisite NRSROs" in one of the two highest short-term rating categories or comparable unrated securities (i.e., "eligible securities"). Ms. Elizabeth M. Murphy April 25, 2011 Page 4 Rule 2a-7 also divides eligible securities into first tier and second tier securities, and imposes more stringent portfolio and diversification limits on second tier securities. The SEC is proposing to remove references to credit ratings from Rule 2a-7, which would affect various elements of the rule, including: determination of whether a security is an eligible security; determination of whether a security is a first tier or second tier security; credit quality standards for securities with a conditional demand feature; requirements for monitoring securities for ratings downgrades and other credit events; and stress testing. ICI's comments and recommendations on each of these topics are set forth below.

**A. Eligible Securities** The SEC's proposal would eliminate the objective requirement that an eligible security be rated by an NRSRO or be of comparable quality while maintaining the distinction between first tier and second tier securities. First, the proposed revisions would combine the eligible security and minimal credit risk determinations, so that any security determined by the fund's board (or its delegate) to present minimal credit risk, which determination must be based on factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations, would be an eligible security. Second, a security would be a "first tier security" (regardless of the ratings it has received from any credit rating agency) if the fund's board (or its delegate) determines that the issuer has the "highest capacity to meet its short-term financial obligations." As in the current rule, a money market fund would be required to invest at least 97 percent of its total assets in first tier securities. Although a "second tier security" has the same definition under both the current rule and the proposal—an "eligible security that is not a first tier security"—the criteria for determining that a security is eligible but not first tier would change under the proposal. Under the current rule, a second tier security is an eligible security (i.e., a security that has ratings in one of the highest two short-term rating categories or is an unrated security of comparable quality) that is not rated in the top tier (or an unrated security of comparable quality). Under the proposal, a second tier security is a security that is determined to present minimal credit risk but does not satisfy the new subjective definition of "first tier security." We are concerned that the SEC's proposed approach could be interpreted to raise the credit standards for first tier securities and lower them for second tier securities. Rule 2a-7 currently defines a rating category without regard to sub-categories or gradations. For instance, a security is a first tier security if it receives an A-1+ or A-1 rating from Standard & Poor's in its highest short-term rating category. Thus, the current definition clearly refers to securities whose issuers and guarantors fall within a range of capacities to repay their short-term obligations. Under the proposal, however, a determination that an issuer has the highest capacity to meet its short-term financial obligations, if taken literally, does not seem to contemplate any variation in credit-worthiness among issuers of first tier securities. Ms. Elizabeth M. Murphy April 25, 2011 Page 5

On the other hand, the proposed standard for second tier securities may weaken the rule's credit standards by permitting a fund to invest in a security that would not have qualified under the rule's current standards, thereby increasing the potential for harm to shareholders. Indeed, the SEC acknowledges this possibility in the cost-benefit analysis of the proposal. The Release states that among the costs associated with the removal of credit ratings from Rule 2a-7 is in "increased risks to money market funds and their shareholders."<sup>5</sup> The Release also notes that because the proposal would eliminate the

requirement that eligible securities meet minimum rating requirements “it could be difficult for the SEC to challenge the determination of a money market fund board (or its delegate)” with respect to credit quality decisions.<sup>6</sup> Our members view giving money market funds the ability to take these increased risks as potentially detrimental to the market’s perception of money market funds as a whole, and strongly oppose a rule change that could expand the universe of eligible securities. Ratings keep all funds operating at or above the same level and restrain any particular money market fund from taking greater risks than other competing funds to increase yield (thus gaining competitive advantage in a yield- sensitive market). Under Rule 2a-7, ratings provide a clear reference point for money market funds, both large and small, by which to measure compliance with the rule’s requirements. Indeed, it is difficult to contemplate eliminating this external, objective evaluation and replacing it with an internal, subjective standard. At the same time, we understand that the proposed amendments are designed to give effect to provisions of the Dodd-Frank Act that would seem to require the SEC to create an appropriate substitute for the credit rating references in Rule 2a-7. To this end, we recommend defining an eligible security to mean “a security with a remaining maturity of 397 days or less that the fund’s board of directors determines presents minimal credit risks and the issuer of which the fund’s board of directors determines has a strong capacity to meet its short-term obligations.” Given that both Standard & Poor’s and Fitch use variants of the word “strong” to define their highest short-term rating category, this should convey the appropriate standard. Although Moody’s uses “strong” to define its second highest category, the adopting release could explain that the use of “strong” in the definition of an eligible security was intended to convey a higher credit standard. Our proposed standard would eliminate the first tier and second tier categories and effectively limit money market fund purchases to those securities that meet one uniform, but very high, standard (e.g., securities generally comparable to securities rated in the highest short-term rating category, which would be first tier securities under the current rule). Without an objective, external ratings floor, we are concerned that it would be difficult, if not impossible, to retain the current distinctions between first and second tier securities without exceeding the risk parameters currently dictated by the rule’s rating requirements. Although the Dodd-Frank Act does not leave any means of explicitly limiting 5 Release at 45. 6 Id. at 46. Ms. Elizabeth M. Murphy April 25, 2011 Page 6 acquisitions of securities rated below the highest category, this would at least require money market funds to determine that such securities do not diminish the overall credit quality of their portfolios. Under both the proposal and the existing provisions of Rule 2a-7, a fund would be required to dispose of a security that ceases to be an eligible security unless the fund’s board finds that such disposal would not be in the best interests of the fund.<sup>7</sup> By eliminating a specific second tier category (as our proposal would), money market funds may avoid purchasing securities that are perceived as potentially “lower quality” eligible securities because a subsequent minor decrease in the issuer’s capacity to meet its short-term obligations may result in the fund owning an ineligible security and thus trigger the board requirement. To avoid this unintended result (and the possible chilling effect it could have on these issuers), we suggest that the fund be allowed to continue to hold such a security provided the security continues to present minimal credit risks. In other words, the SEC should retain the current requirement that a fund must dispose of securities determined to present more than minimal credit risk, but remove the required disposition of securities that no longer qualify as eligible securities (i.e., an issuer that no longer has a “strong capacity” to meet its short-term obligations).

B. Securities with a Conditional Demand Feature Currently, a security subject to a conditional demand feature may be determined to be an eligible security or a first tier security if, among other things, (1) the conditional demand feature is an eligible security or a first tier security, and (2) the underlying security (or its guarantee) has received either a short-term rating or a long-term

rating, as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security. Under the proposal, the SEC would remove the credit rating requirement and amend the provision to require that the fund's board (or its delegate) determine that the underlying security or any guarantee of such a security be of high quality and subject to very low credit risk. ICI is concerned that this change may lead to greater risks than the SEC is anticipating. Most conditional demand features include a provision terminating the demand feature whenever a specified rating agency downgrades the underlying security below investment grade. As conditional demand features are used most frequently to reduce the maturity of long-term securities to 397 days or less, so that they will be eligible investments for money market funds, the termination is based on the security's long-term credit rating. In other words, a conditional demand feature for a security rated by Standard & Poor's or Fitch often may terminate if the underlying security is downgraded below BBB-; the demand feature often may terminate upon a downgrade below Baa3 if Moody's rates the security. Under the current rule, securities with such conditional demand features cannot be eligible securities unless the underlying securities are rated in one of the two highest long-term rating categories—at least AA- by Standard & Poor's or Fitch or Aa3 by Moody's. This means that a downgrade of the underlying security will not terminate the demand feature until it reduces the long- 7 Rule 2a-7(c)(7)(ii). Ms. Elizabeth M. Murphy April 25, 2011 Page 7 term rating by more than two full rating categories (without regard to gradations or subcategories). This large buffer between the underlying security's current rating and the rating that would terminate the demand feature greatly limits the risk of termination.<sup>8</sup> Removing references to ratings from the requirements for conditional demand features could substantially reduce this buffer and thereby increase the risk that money market funds would not be able to exercise these demand features following a downgrade. Under the proposal, nothing would prevent a fund from determining that an underlying security rated A is of high quality and subject to very low credit risk, even if the security's demand feature would terminate if the security was downgraded below investment grade. ICI does not believe Section 939A of the Dodd-Frank Act mandates this result. The SEC should be able to recognize in its regulations that demand features may terminate as a result of ratings changes and the risk associated with such terminations. In this circumstance, the provider of the demand feature has already chosen to rely on the credit assessment of a rating agency to determine when the demand feature terminates. Any references to such conditions in Rule 2a-7 would be a consequence of preexisting market conditions, rather than a requirement that anyone rely on the rating agency's credit assessment. We therefore recommend, in addition to the proposed credit determination requirement, that if a demand feature provides for its termination upon a downgrade of the underlying security by a credit rating agency, a money market fund cannot acquire the security unless the security (or its issuer or guarantor, as the case may be) has received ratings from such rating agency at least two full ratings categories higher (without regard to gradations or subcategories) than the lowest rating at which the demand feature would remain exercisable.

C. Monitoring Minimal Credit Risks The proposal also would establish a more burdensome standard for reassessing minimal credit risk that would require the fund's board or its delegate to reassess if it "becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that may suggest that the security is no longer a First Tier Security or a Second Tier Security, as the case may be." Currently, paragraph (c)(7)(i) of Rule 2a-7 requires a money market fund board (or its delegate) to reassess promptly whether a security continues to present minimal credit risks if either (i) the security ceases to be a first tier security or (ii) the money market fund's investment adviser becomes aware that any unrated security or second tier security held by the money market fund has, since the security was acquired by the fund, been given a rating by any NRSRO below the NRSRO's second highest short- 8 When a short-term

underlying security has a conditional demand feature, the termination event may be based on a downgrade of the underlying security's short-term credit rating below investment grade (e.g., below A-3 for Standard & Poor's, MIG-3 for Moody's, or F-3 for Fitch). In this circumstance, we recommend that the underlying security be required to have a rating in the highest short-term rating category (e.g., A1 for Standard & Poor's, MIG-1 for Moody's and F-1 for Fitch). This is a higher standard than currently required by Rule 2a-7 (which permits underlying securities in the two highest short or long-term rating categories), but applies a more consistently high credit standard to both long and short-term underlying securities. Ms. Elizabeth M. Murphy April 25, 2011 Page 8 term rating category. This provision was added to the rule in 1991 "to assure that a money market fund will remain sensitive to, and take appropriate action in response to, perceived changes in the credit quality of Second Tier and Unrated Securities after they have been acquired by the fund."<sup>9</sup> It provides a clear trigger for a reassessment of a security's minimum credit risks and assures that actions by an NRSRO receive appropriate attention. By removing this objective trigger and setting the standard for reassessment of a security's eligibility under the rule to the mere suggestion of an adverse credit development, the proposal would potentially complicate investment advisers' responsibility to monitor and maintain records of negative credit information about a portfolio security or an issuer. "Suggestions" could be of limited validity, and considerable time could be expended tracking and, for compliance or other purposes, perhaps documenting these assessments. Further, funds would have to bear the costs and risks of being second-guessed for failing to respond to information that later proves to have been "credible" and had significant credit implications. Without an objective trigger, the proposed reassessment requirement is simply too vague and impossible to administer from a compliance perspective. We recommend instead that paragraph (c)(7)(i) be eliminated and paragraph (c)(10)(i) be redrafted to include a general, ongoing obligation to monitor the credit risks of portfolio securities. An express requirement for funds to review their credit assessments under Rule 2a-7 on an ongoing basis would obviate the need for a separate requirement to identify specific triggers for reassessment. Thus, we recommend the following changes to paragraph (c)(10)(i).

10) Specific Procedures: Amortized Cost and Penny-Rounding Methods. Included within the procedures adopted by the board of directors for money market funds using either the Amortized Cost or Penny-Rounding Methods shall be the following: (i) Continued Minimal Credit Risk of Portfolio Investments. Written procedures shall require ongoing monitoring of the continued minimal credit risks of each portfolio investment and of the determination of whether the issuer of the portfolio investment or of a Guarantee of the portfolio investment, or the provider of a Demand Feature for the portfolio instrument, has a strong capacity to repay its short-term financial obligations, and that monitoring must be based on, among other things and if relevant to the determination of minimal credit risk, currently available financial data for the issuer of the portfolio investment or of a Guarantee of the portfolio investment, and for the issuer of any Demand Feature to which the portfolio instrument is subject, and, in the case of a security subject to a Conditional Demand Feature, 9 See Revisions to Rules Regulating Money Market Funds, SEC Release No. IC-18005 (February 20, 1991) at text immediately following note 72. The provision codified guidance that the SEC had provided to fund boards concerning the actions that should be taken if securities ceased to be "high quality." See Revisions to Rules Regulating Money Market Funds, SEC Release No. IC-17589 (July 17, 1990) at note 54 and accompanying text. Ms. Elizabeth M. Murphy April 25, 2011 Page 9 the issuer of the security or Guarantee whose financial condition must be monitored under paragraph (c)(3)(iv) of this section, whether such data is publicly available or provided under the terms of the security's governing documentation. D. Stress Testing Rule 2a-7 currently requires a money market fund to stress test for, among other things, ratings downgrades of portfolio securities. The SEC's proposal would replace this reference to

ratings downgrades and require a money market fund to stress test for an adverse change in the ability of a portfolio security issuer to meet its short-term financial obligations. The Release notes that under the proposal, funds could continue to test their portfolios by treating a downgrade as a credit event that might adversely affect the value or liquidity of the portfolio security (and affect the fund's ability to maintain a stable net asset value per share). Unlike other provisions of Rule 2a-7 that reference credit ratings, the reference to ratings downgrades in the stress testing paragraph does not require an assessment of a security's credit-worthiness. Rather, this paragraph of the rule simply refers to whether a downgrade of a portfolio security by an NRSRO would impact a fund. As previously noted, we do not believe that Section 939A of the Dodd-Frank Act precludes the SEC from promulgating regulations that simply refer to existing credit ratings. Accordingly, we recommend that the SEC retain the stress testing provision in its current form.

II. Rule 5b-3 Rule 5b-3 under the Investment Company Act allows a fund, for purposes of meeting the diversification requirements in Section 5(b)(1) and the limitation on investments in broker-dealers in Section 12(d)(3) of the Act, to treat the acquisition of a repurchase agreement as an acquisition of the securities collateralizing that agreement if the obligation of the seller to repurchase the securities is "collateralized fully." For funds other than money market funds, "collateralized fully" means that the collateral must consist entirely of cash items, government securities, securities that are rated in the highest rating category by the requisite NRSROs, or unrated securities of a comparable quality as determined by the fund's board of directors or its delegate. The SEC is proposing to replace the reference to NRSRO ratings with a requirement that non-government collateral consist of securities that the fund's board (or its delegate) determines at the time the fund enters into the repurchase agreement are both issued by an issuer that has the highest capacity to meet its financial obligations and sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven calendar days. The provision in Rule 5b-3 relating to credit ratings was designed to "ensure that the market value of the collateral will remain fairly stable and that the fund will be able to liquidate the collateral Ms. Elizabeth M. Murphy April 25, 2011 Page 10 quickly in the event of a default."<sup>10</sup> This objective is consistent with the purpose of the rule—to permit funds to "look through" certain repurchase agreements to the underlying collateral for purposes of the Investment Company Act's diversification provisions and limitations on investments in broker-dealers. Although we have no objection to the addition of a liquidity requirement, the proposed credit standard raises the same concerns as the proposed definition of "first tier securities." As noted above, a determination that an issuer has the highest capacity to meet its financial obligations may not necessarily be viewed as consistent with the current standards for receiving a rating in the highest rating category because the standard does not seem to contemplate any variation in credit-worthiness among such issuers. We would recommend using an "exceptionally strong capacity" to repay financial obligations as the standard, which would be consistent with the definitions used by many rating agencies to define their highest long-term rating category.

III. Form N-MFP Currently, money market funds must provide to the SEC a monthly filing of portfolio holding information on Form N-MFP through EDGAR in an XML tagged and standardized data format. The proposal would eliminate items in the form that require disclosure of the ratings of the securities in the portfolio. Similar to the stress testing requirement discussed above, the references to credit ratings in Form N-MFP concern existing credit ratings and are merely a collection of data points so regulators and investors will better understand funds' portfolios. Nevertheless, we would not object to the removal of this information from Form N-MFP (which could be quite voluminous and not standardized if no longer limited to designated NRSROs), provided it is clear that funds may choose to include ratings from one or more NRSROs in the monthly website portfolio disclosure required by Rule 2a-7.

IV. Shareholder Reports Mutual funds

and closed-end funds currently are required to provide one or more tables, charts, or graphs depicting portfolio holdings by reasonably identifiable categories in shareholder reports (e.g., credit quality). If a fund chooses to use credit quality to present portfolio holdings, it must be depicted using the credit ratings assigned by a single NRSRO.<sup>11</sup> Under the proposal, funds would be permitted, but not required, to use NRSRO credit ratings to depict credit quality. The SEC's proposal would permit funds to present the credit quality of their portfolio holdings by disclosing NRSRO and/or internal credit ratings in shareholder reports, recognizing that fund advisers have experience with, and knowledge of, the evaluation of securities and are qualified to make credit determinations.<sup>12</sup> We support this approach. Fund shareholders stand to benefit from 10 Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, SEC Release No. IC-25058 (July 5, 2001). 11 See Item 27(d)(2) of Form N-1A and Instruction 6(a) to Item 24 of Form N-2. 12 See Release at 21. Ms. Elizabeth M. Murphy April 25, 2011 Page 11 information about the credit quality of the bonds held in the fund's portfolio, whether determined by an NRSRO or the fund's adviser. Under the proposal, a fund that chooses to use credit ratings assigned by an NRSRO to categorize the credit quality of the portfolio holdings would be required to use the credit ratings of a single NRSRO except in the case of portfolio holdings that are not rated by that NRSRO. If credit ratings of that NRSRO are not available for certain holdings, the fund would be required to briefly discuss the methodology for determining credit quality for such holdings, including, if applicable, the use of credit ratings assigned by another NRSRO. Funds typically subscribe to the rating services of more than one NRSRO and, therefore, may have available multiple NRSRO ratings for a single bond. There is a range of possible approaches as to how to portray the credit risk of "split-rated" bonds. The Financial Industry Regulatory Authority (FINRA) permits funds to choose which NRSRO rating to use in marketing materials, provided that the choice is made consistently pursuant to a disclosed policy. This approach provides useful flexibility. For purposes of compiling data for the publication of its fixed-income style boxes, Morningstar prefers that bonds be classified according to the Barclays Capital Family of Indices ratings rules (i.e., use the middle rating of Moody's, S&P, and Fitch after dropping the highest and lowest available ratings; if only two rating agencies rate a security then the lowest rating should be used; and if only one agency rates a security then that rating should be used).<sup>13</sup> Some funds follow Morningstar's preferred approach. Other funds use the SEC's proposed approach. Given the range of ways that funds can and do portray credit risk associated with split-rated bonds, we recommend that the SEC permit funds to choose which NRSRO rating to use in shareholder reports, provided that the choice is made consistently pursuant to a disclosed policy. Doing so would be consistent with FINRA's approach, and, thus, would permit funds to portray credit risk in the same manner in shareholder reports and marketing materials. Funds receive credit rating information through data feeds, and it would be more cost efficient to be able to rely on a single data feed to comply with one consistent SEC/FINRA requirement. Disclosure of the policy would allow shareholders and others to sufficiently evaluate this information in the context of other information in the shareholder report, which provides information about the fund's investment policies. Under our recommended approach, funds would be able to disclose credit quality information in shareholder reports in a manner that is consistent with their investment policies. For example, a fund's investment policies might dictate that a specified percentage of bonds must be rated investment grade or higher and that for purposes of determining the rating of split-rated bonds, the fund would choose the most favorable rating. Under the SEC's approach, such a fund could not necessarily depict its portfolio holdings in its shareholder reports in a manner consistent with its investment policies (i.e., 13 See Fixed Income Survey Guidelines, Morningstar, Inc. (August 31, 2010). Ms. Elizabeth M. Murphy April 25, 2011 Page 12 if the single NRSRO chosen did not provide

the most favorable rating for particular split-rated bonds), which may prove confusing to investors. This is a curious, and perhaps unintended, consequence. Therefore, we urge the SEC to reconsider the proposed approach and instead permit funds to choose which NRSRO rating to use in shareholder reports, provided that the choice is made consistently pursuant to a disclosed policy. V. Use of Credit Ratings by Directors and in Procedures We appreciate the repeated statements in the Release to the effect that the proposals will not require funds to remove references to credit ratings from their existing policies and procedures. Directors of money market funds in particular find credit ratings useful in establishing guidelines for determining minimal credit risk and in monitoring those determinations. Chief Compliance Officers also may find credit ratings useful in developing risk-based compliance tests. ICI agrees that nothing in Section 939A of the Dodd-Frank Act should be construed to limit the voluntary use of credit ratings, even in procedures for compliance with Federal regulations. This point is sufficiently important that we would recommend that the SEC include a statement to this effect in the adopting release. We would further recommend that the statement be made as broadly as possible, so that there is no doubt that funds may continue to refer to credit ratings not only in their policies and procedures, but also in their investment strategies, reports to their directors and shareholders, and in their marketing literature. \* \* \* \* Ms. Elizabeth M. Murphy April 25, 2011 Page 13 We look forward to working with the SEC as it continues to examine these critical issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 326-5815 or Jane Heinrichs, Senior Associate Counsel, at (202) 371-5410 (on issues relating to Rules 2a-7 or 5b-3 and Form N-MFP) or Dorothy Donohue, Senior Associate Counsel, at (202) 218-3563 (on issues relating to shareholder reports). Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The Honorable Mary L. Schapiro The Honorable Kathleen L. Casey The Honorable Elisse B. Walter The Honorable Luis A. Aguilar The Honorable Troy A. Paredes Eileen Rominger, Director Robert E. Plaze, Associate Director Division of Investment Management