IDC
INDEPENDENT DIRECTORS COUNCIL

1401 H Street, NW, Suite 1200
Washington, DC 20005-2148
Phone 202/326-8300
Fax 202/326-5828
www.idc1.org

April 25, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: References to Credit Ratings in Certain Investment Company Act Rules and Forms; File No. S7-07-11

Dear Ms. Murphy:

The Independent Directors Council[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to eliminate references to credit ratings of nationally recognized statistical rating organizations ("NRSROs") from the money market fund rule.[2] The Commission's proposal is in response to a directive in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that the Commission, to the extent applicable, review any regulation that requires an assessment of credit-worthiness, modify any such regulations identified by the review to remove references to or requirements for reliance on ratings, and substitute a standard of creditworthiness as the Commission determines to be appropriate.[3]

[1] IDC serves the fund independent director community by advancing the education, interaction, communication, and policy positions of fund independent directors. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of $13 trillion and serve over 90 million shareholders, and there are over 2,000 independent directors of ICI member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] References to Credit Ratings in Certain Investment Company Act Rules and Forms, SEC Release No. IC-29592 (March 3, 2011) ("Release").

[3] Section 939A of the Dodd-Frank Act.

IDC has previously noted the benefits of retaining the references to credit ratings in the rule.[4] IDC urges the Commission, in adopting any substitute for the credit rating requirements, to not weaken the investor protections provided under the current rule and to provide a standard that is workable for money market funds, their boards, and their advisers.

Eligible Securities

The Commission states that its proposal to remove references to credit ratings would affect five elements of the money market fund rule, including the determinations of whether a security is an eligible security and whether it is a first tier security. Under the proposed amendments, a money market fund would continue to be limited to investing in securities that the board (or its delegate) determines present minimal credit risks, which determination must be made based on factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations. A security would be "first tier" if the fund's board (or its delegate) determines that the issuer (or in the case of a security subject to a guarantee, the guarantor) has the "highest capacity to meet its short-term financial obligations."

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 does not have ratings in the top tier or is 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."

IDC supports the Commission's goal of maintaining the investor protections offered under the current requirements, as reflected in its statement that the proposed amendments "are designed to offer protections comparable to those provided by the NRSRO ratings" and to "retain a degree of risk limitation on money market funds similar to the current rule."[5] IDC also appreciates the

---

[4] *See* Letter from Michael S. Scofield, Chair, IDC Governing Council, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, regarding Money Market Fund Reform; File No. S7-11-09 (September 8, 2009); Letter from Amy B.R. Lancellotta, Managing Director, Independent Directors Council, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, regarding Roundtable on Credit Rating Agencies; File No. 4-579 (May 6, 2009); Letter from Robert W. Uek, Chair, IDC Governing Council, to Florence E. Harmon, Acting Secretary, U.S. Securities and Exchange Commission, regarding References to Nationally Recognized Statistical Rating Organizations; File No. S7-19-08 (August 29, 2008).

[5] Release, *supra* n. 2, at 8, 10.

Commission's acknowledgement that a fund board (which typically relies on the fund's adviser) would still be able to consider quality determinations prepared by outside sources, including NRSRO ratings, that the fund adviser concludes are credible and reliable, in making credit risk determinations.[6] Indeed, the point that funds can continue to incorporate credit ratings in their policies and procedures is an important one, and IDC recommends that the Commission's adopting release include statements to this effect. We note that, although the Commission is proposing to eliminate references to NRSROs in its rules, pursuant to the Dodd-Frank Act, it is also providing more focused oversight over the NRSROs.[7]

As the Commission acknowledges, the proposal would replace the objective standard provided by credit ratings with subjective determinations of both eligible securities and first tier securities.[8] The shift to subjective standards raises a number of concerns, including that funds may apply the standards differently, with some deeming certain securities as eligible that others do not consider to be of sufficient quality to be eligible securities. It is, therefore, critical that the Commission get it right: the subjective standard must be clear and workable so as to avoid the potential for gamesmanship by funds, enable appropriate examination and oversight by the SEC, and facilitate oversight by fund boards, which will approve policies and procedures based on the new standards.

IDC is concerned that the Commission's proposed new 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, to the potential detriment of fund shareholders. The Commission acknowledges this possibility when it states that "increased risks to money market funds and their shareholders" are among the costs associated with the removal of credit ratings from the rule.[9] The Commission also notes that because the proposed rule would eliminate the requirement that eligible securities meet minimum rating requirements, it could be difficult for the Commission to

---

[6] Id. at 9; see also id. at n. 32 ("Nothing in the proposed rule would prohibit a money market fund from relying on policies or procedures it has adopted to comply with the current rule as long as the board (or its delegate) concluded that the ratings specified in the policies and procedures establish similar standards to those proposed, and are credible and reliable for that use. A fund also would be able to revise its policies and procedures to change or eliminate the use of specific NRSRO ratings or to incorporate other third party evaluations of credit quality.").

[7] See Title XI, Subtitle C, of the Dodd-Frank Act.

[8] Release, *supra* n. 2, at 12.

[9] Id. at 45.

challenge the determination of a money market fund board (or its delegate) with respect to credit quality decisions.[10]

Conversely, the proposed new standard for first tier securities raises the concern that it could inadvertently decrease the number of securities eligible for this category. Under the proposal, a determination that an issuer has the *highest* capacity to meet its short-term financial obligations, if taken literally, does not seem to contemplate the range of ratings (*i.e.*, a top category or tier) that qualifies a security as first tier under the current definition.

The Investment Company Institute, in its comment letter, offers alternative definitions that would provide a more workable standard for funds and their boards and advisers.[11] ICI suggests, among other things, eliminating the first and second tier categories and effectively limiting 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). IDC urges the Commission to adopt ICI's suggested changes.

Monitoring Minimal Credit Risks

Another concern with the proposal relates to the proposed standard for reassessing minimal credit risk. Currently, the rule requires a 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 adviser becomes aware that any unrated security or second tier security held by the fund has, since the security was acquired by the fund, been given a rating by any NRSRO below its second highest short-term rating category. The proposed standard would require the board (or its delegate) to reassess if the adviser "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."[12]

The proposed change would replace an objective trigger with a vague standard that would be more burdensome to administer. By requiring a reassessment of a security's eligibility at the mere *suggestion* of an adverse credit development, the proposal would potentially complicate the adviser's responsibility to monitor and maintain records of negative credit information about a portfolio security

---

[10] Id. at 46.

[11] See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, Securities and Exchange Commission, regarding References to Credit Ratings in Certain Investment Company Act Rules and Forms; File No. S7-07-11 (April 25, 2011).

[12] Proposed Rule 2a-7(c)(7)(i)(A) (emphasis supplied).

or an issuer. The proposal also raises the risk for boards and their delegates of being second-guessed for failing to respond to information that later proves to have been "credible" and had significant credit implications, which can lead to increased costs to the funds.

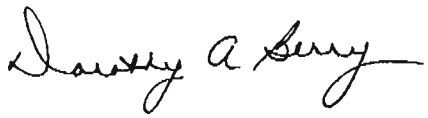
ICI recommends in its letter that the rule be redrafted to include a general ongoing obligation to monitor the credit risks of portfolio securities and not impose a separate requirement to identify specific triggers for reassessment. IDC supports this suggested modification. By acknowledging that funds must review their credit assessments under the rule on an ongoing basis, there does not appear to be a need for the separate requirement, and this approach would address the concerns with the ambiguous proposed standard.

* * *

In conclusion, we recognize the challenges in developing subjective standards that are comparable to the objective standards under the current rule. We support the Commission's goal of maintaining the investor protections of the current rule and believe that the alternative language suggested by ICI is consistent with that goal and provides more workable standards. Accordingly, we urge the Commission to incorporate ICI's recommended language in adopting any replacement to the credit ratings.

If you have any questions about our comments, please contact Amy B.R. Lancellotta, Managing Director, at (202) 326-5824.

Sincerely,



Dorothy A. Berry
Chair, IDC Governing Council

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