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August 1, 2008

Filed Electronically

Ms. Florence E. Harmon, Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Proposed rules regarding references to ratings of Nationally Recognized Statistical Ratings Organizations, Investment Company Act Release No. 28327, File No. S7-19-08

Dear Ms. Harmon:

The Vanguard Group, Inc. ("Vanguard")[1] strongly opposes the Commission's proposal to eliminate references to credit ratings in Rule 2a-7[2] – a rule that has provided a strong regulatory framework for money market funds since its adoption 25 years ago. As a leading provider[3] of money market funds dedicated to the best interests of shareholders, it is our view that the proposed elimination of NRSRO ratings would remove an important investor protection from Rule 2a-7, weaken investment standards, and, potentially, pose a risk to the long history of stability of the $3.5 trillion money market fund industry.[4]

NRSRO ratings provide an independently established baseline for money market fund investments and are a valuable assurance to investors that money market fund investments are not subject to unnecessary risks. Vanguard understands the urgency of the Commission's concern over the integrity of NRSRO ratings and the role that misplaced reliance on potentially flawed ratings may have played in recent credit market problems. And, we are very supportive of the Commission's efforts to address the root problems of flawed ratings and undue reliance on them in certain sectors of the financial markets. The

[1] Vanguard, headquartered in Valley Forge, Pennsylvania, is one of the world's largest mutual fund complexes, offering more than 150 funds with assets in excess of $1.2 trillion.

[2] In *References to Ratings of Nationally Recognized Statistical Rating Organizations,* SEC Release No. IC-28237 (July 1, 2008) ("NRSRO Release No. 2"), the Commission proposed to amend four rules under the Investment Company Act of 1940 – Rules 2a-7, 3a-7, 5b-3, and 10f-3 – and one rule under the Investment Advisers Act of 1940 – Rule 206(3)-3T – by removing references to credit ratings issued by nationally recognized statistical ratings organizations ("NRSROs"). Although Vanguard believes that the elimination of references to credit ratings in all of these rules is problematic, we are most concerned with their removal from Rule 2a-7 (the "Proposed Rule"), for the reasons set forth in this comment letter.

[3] Investors have entrusted close to $190 billion to Vanguard's ten money market mutual funds.

[4] *See* Investment Company Institute, *Money Market Mutual Fund Assets* (July 10, 2008), *available at* http://www.ici.org/stats/latest/mm_07_31_08.html.

Commission's recent proposals to improve ratings quality by fostering accountability, transparency, and competition in the credit rating industry are a good start towards reducing the risk of flawed ratings.[5]

We are concerned, however, that the Proposed Rule misses the mark with respect to money market funds. In fact, for money market fund investors, *greater* regulatory emphasis on Rule 2a-7's existing requirement of independent minimal credit risk analysis and a comprehensive examination program are better solutions to any concerns about undue reliance on credit ratings. Ratings – even if occasionally imperfect – protect investors by establishing a uniform, minimum credit quality for all money market funds. Removing that investor protection is akin to outlawing seat belts with the hope that drivers will be less likely to be injured if a defective belt fails in a crash.

NRSRO Ratings Should Be Improved, But Retained

In the proposing release, the Commission articulated its concern that some funds may have placed "undue reliance" on ratings and, as a result, "may be vulnerable to failures in the ratings process."[6] If that is the case, we believe those funds failed to meet their obligations to their investors. The appropriate remedy for any "undue reliance" is to demand that all fund managers and Boards of Directors adhere to the long-established and successful "minimal credit risk" standard that exists in Rule 2a-7, *not* to *lower* the minimum threshold for eligible instruments. Good credit analysis can catch the "failures in the ratings process," and the Commission's efforts to enhance the transparency of the ratings process will make it easier for a fund to catch those flaws when they occur. The Proposed Rule, on the other hand, would not improve funds' evaluation of money market instruments but instead would enable funds to select investments that may not have met the independent NRSRO's standards.

It appears as though the Commission's concern over funds' potential vulnerability to poor ratings reflects its reservations about the ratings process itself. But the fact that *deficient* ratings pose a danger to money market funds does not mean that *all* ratings are dangerous; indeed, the history of the Commission's adoption of Rule 2a-7, discussed below, demonstrates the Commission's belief that ratings – properly generated and adequately understood – are valuable safeguards against the temptation for a fund to invest in higher yielding, but riskier, instruments. If the Commission is concerned about the dangers of *deficient* ratings, the answer is not to throw out *all* ratings; the answer is to address the reliability of the ratings and transparency of the process. The Commission already has begun to do this by virtue of its proposals in NRSRO Release No. 1. Such enhancements to the ratings process will be a better means of addressing the Commission's concerns and would bolster investor protections without the uncertainty and potential instability that would accompany the wholesale elimination of NRSRO ratings from Rule 2a-7.

The Proposed Rule Ignores The Value Of The "Ratings Floor" That Rule 2a-7 Provides

Vanguard believes that the Commission's original view that NRSRO ratings play an integral role in Rule 2a-7 by establishing an independent floor for money market investments is still valid today. By demanding that money market fund directors make a minimal credit risk determination with respect to every instrument the fund proposes to hold, the Commission set the credit quality bar very high. The ratings requirement ensures that potential investments meet a standard, industry-wide minimum threshold in order to even reach the directors' consideration. Independent third-party credit ratings protect investors

[5] *See Proposed Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-57967 (June 16, 2008) ("NRSRO Release No. 1").
[6] NRSRO Release No. 2 at 6.

by limiting the fund's ability to chase higher yields through riskier securities, based on their own subjective assessment. NRSRO ratings serve as an objective and *necessary, but not sufficient,* qualification for buying a security. If ratings are eliminated from Rule 2a-7, a common standard for investment quality upon which money market fund investors can rely will be eliminated, to the detriment of those investors.

Any perceived problems with over-reliance on flawed ratings do not shake our belief that sound, reasonably transparent NRSRO ratings create an indispensible "lower bound" for money market investments. Although it is now questioning their utility, up to this point the Commission has always recognized the value of NRSRO ratings as an independent benchmark for money market fund investments. In the adopting release for Rule 2a-7, the Commission noted that a "high quality rating provides protection by ensuring input into the quality determination by an outside source."[7] In fact, the Commission specifically included ratings as a baseline to fund directors' credit risk analysis, precluding a money market fund that is relying on Rule 2a-7 from investing in a security that does not have a "high quality" rating, *even if the board of directors believes that the rating service incorrectly rated the instrument too low*.[8]

Eliminating Ratings Opens The Door To Greater Risk Taking

Although credit analysts and portfolio managers will continue to evaluate money market securities, and may continue, as permitted by the Proposed Rule, to utilize credit ratings as a factor in their eligibility determinations, all funds may not choose to do so to the same extent. Without the NRSRO baseline, the door is open for funds to do exactly what the Commission wanted to preclude by including the NRSRO ratings in the Rule 2a-7 requirements in the first place. Money market fund credit analysts will be free to "disagree" with the judgment of independent rating agencies and approve the use of instruments that do not meet the NRSROs' standards of credit quality and liquidity. The Commission did not believe this was wise when it adopted Rule 2a-7 in the first place, or when it reconsidered Rule 2a-7 on several additional occasions.[9] Recent events do not suggest that the need for these safeguards has diminished; if anything, they suggest that an even more restricted universe for eligible money market fund securities is entirely appropriate in the best interests of investors. As a result, the Commission must continue to support a regulatory framework for money market funds that will protect investors from the loosening of credit standards. This effort is best accomplished through enhancing the transparency of the ratings process and appropriate compliance examinations and sanctions against those who fail to meet Rule 2a-7's requirements for performing the required minimal credit risk analysis.

[7] *See Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds)*, SEC Release No. IC-13380 (July 11, 1983).
[8] *Id.*
[9] *See, e.g., Revisions to Rules Regulating Money Market Funds,* SEC Release Nos. IC-18005 (Feb. 20, 1991), IC-19959 (Dec. 17, 1993), and IC-21837 (Mar. 21, 1996).

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We commend the Commission for addressing the need for enhanced clarity regarding the role of NRSRO ratings in the Commission's rules and forms and we appreciate the opportunity to comment on the proposal. If you have any questions about Vanguard's comments or would like any additional information, please contact me or Ari Gabinet at 610-503-5663.

Sincerely,

/s/ John J. Brennan

John J. Brennan
Chairman and Chief Executive Officer
The Vanguard Group, Inc.

cc: Honorable Christopher Cox, Chairman
Honorable Kathleen L. Casey, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
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Andrew J. Donohue, Director, Division of Investment Management
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