



## Asset Management USA

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September 4, 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: References to Ratings of Nationally Recognized Statistical Rating Organizations, Release No. IC-28327, File No. S7-19-08 (the "Release")

Dear Ms. Harmon:

TDAM USA Inc.<sup>1</sup> appreciates the invitation to comment on the Release issued by the Securities and Exchange Commission (the "Commission") regarding proposed amendments to certain rules under the Investment Company Act of 1940 that reference ratings issued by nationally recognized statistical rating organizations ("NRSROs").<sup>2</sup> While we have concerns about each of the proposals, we take this opportunity to comment specifically on the proposal regarding Rule 2a-7 (the "Rule"), which we believe will have a tremendous impact on money market funds and investors.

We recognize that recent events have undermined the integrity of NRSRO ratings, and fully support the Commission's goal of improving the analysis that underlies investment decisions. We believe, however, that certain provisions of the proposed amendments will actually diminish, rather than enhance, the quality of credit analysis, and thereby reduce the safety of principal that has generally been afforded to investors in money market funds.

### **Minimum Credit Risk Determination**

The Commission proposes to amend certain definitions within Rule 2a-7 by eliminating references to NRSRO ratings and substituting alternative provisions that are designed to achieve the same purpose. Specifically, under the proposed amendments a

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<sup>1</sup> TDAM USA Inc. is the investment adviser to money market funds that comprise the TD Asset Management USA family of funds, managing more than \$26 billion in money market fund assets. TDAM USA Inc. changed its name from TD Asset Management USA Inc. in July 2008.

<sup>2</sup> The Release proposes amendments to Rules 2a-7, 3a-7, 5b-3, and 10f-3 under the Investment Company Act and Rule 206(3)-3T under the Investment Advisers Act of 1940.

security would be an Eligible Security if the board of directors of the money market fund determines, based upon factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations, that the security presents minimal credit risk. Similarly, a security would be a First Tier Security if the board of directors of the money market fund determines the issuer has the *highest capacity* to meet its short-term financial obligations. Under the proposed amendments, a board of directors may choose to continue to use NRSRO ratings in making credit quality determinations, but would not be obligated to do so. The Commission believes that removing the references to NRSRO ratings from the current definitions will reduce "undue reliance" on credit ratings and improve the quality of credit analysis.

As an initial matter, we note that under Rule 2a-7 fund managers are required to assess an instrument's credit quality independent from NRSRO ratings. Rule 2a-7 establishes a framework in which credit quality determinations for each portfolio investment must be based on: (i) factors pertaining to credit quality, and (ii) any rating assigned to such investment by an NRSRO. In this regard, ratings serve as a baseline against which independent credit analysis is performed and facilitate a fund manager's ability to determine that a security presents minimum credit risk. We believe that reinforcement of the Rule is a better approach to address concerns about "undue reliance" on ratings.<sup>3</sup>

Ratings serve an important role in credit analysis, as they are objective benchmarks which promote consistency in credit quality determinations across issuers throughout the industry. The Commission has acknowledged the benefits of such objectivity numerous times, by noting "[t]he requirement that a security have a high quality rating provides protection by ensuring input into the quality determination by an outside source."<sup>4</sup> The elimination of NRSRO ratings from the Rule will result in a subjective, and thus more ambiguous, standard as to what constitutes a permissible investment.

The proposal to remove ratings is particularly troublesome with respect to classifying First Tier Securities, as defined in the Release, since money market funds' boards of directors will certainly have divergent views on what it means for an issuer to

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<sup>3</sup> Significantly, the Commission chose to retain this two-part test for credit quality determinations when it revised the Rule in 1991, concluding that "having the requisite NRSRO rating is a necessary but not sufficient condition for investing in the security and cannot be the sole factor considered in determining whether a security has minimal credit risk." See *Revisions to Rules Regulating Money Market Funds*, Investment Company Act Release No. 18005 (February 20, 1991). We believe the Commission's position articulated in 1991 remains valid today.

<sup>4</sup> See *Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds)*, Investment Company Act Release No. 13380 (July 11, 1983); and *Revisions to Rules Relating to Money Market Funds*, Investment Company Act Release Nos. 19959 (December 17, 1993), and 21837 (March 21, 1996).

have the *highest capacity* to meet short-term obligations.<sup>5</sup> The proposal is likely to result in credit quality determinations that vary substantially from fund complex to fund complex, which will make it more difficult for investors to compare credit risk and research methodologies among funds. We do not believe this was the Commission's intended result, and urge the Commission to leave the current definitions intact.

Because the proposed amendments would allow money market funds to overlook ratings in determining credit risk, the disparity in resources available to fund managers may place certain funds at a competitive disadvantage. Small funds lacking research staff may adopt an aggressive approach to credit analysis by pursuing high yields rather than low risk. Larger complexes with sufficient staff and resources may be more likely to continue to conduct a thorough due diligence on each instrument's risk profile, and may end up with lower money market fund yields relative to those of less research based fund groups. This divergence in quality of research and ability to focus primarily on yield could increase the possibility that a fund will 'break the dollar', which could in turn lead to a loss of confidence in the entire money market fund industry. Ratings act as constraints upon aggressive risk analysis as they establish minimum boundaries of permissible risk, and in this manner they serve as an important protection for investors.

### **Portfolio Liquidity**

We generally agree with the Commission's proposal to expressly limit a money market fund's investment in illiquid securities to not more than 10 percent of its total assets, as this has been industry standard for quite some time.

### **Monitoring Minimum Credit Risks**

Consistent with the objective of reducing "undue reliance" on NRSRO ratings, the Commission proposes to modify the downgrade and default provisions of the Rule by requiring the board of directors of money market funds to promptly reassess minimum credit risk in the event the fund's investment adviser becomes aware of *any information* about a portfolio security or an issuer that *may suggest* that the security does not continue to present minimal credit risk.

We believe the vagueness of this proposed amendment will generate doubt and a lack of certainty about quality standards within the money market fund industry. Although the Commission states that it does not expect fund managers to subscribe to every rating service publication in order to comply with this proposal, fund managers will be unsure as to what measures they should take in order to ensure they are receiving sufficient information. Information is publically disseminated through various channels,

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<sup>5</sup> We do not address the burden the proposed amendments would place on fund boards – a quality determination that is far beyond their normal duty of oversight.

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and while we are optimistic that reports of financial significance are widely circulated, we would be reluctant to impose upon fund managers or boards of directors a regulatory requirement that assumes receipt of all such information. The Rule's current downgrade provision makes it exceedingly clear when a security must be reassessed, and we urge the Commission to leave this provision intact.

We also expect the proposed amendments will significantly increase the amount of compliance reporting and recordkeeping required of advisory personnel. Fund managers will need to educate the board of directors about new research methodologies and standards, and compliance departments may need to document on a daily basis that there has been no new information suggesting a security needs to be reassessed. Compliance testing will necessarily become more complex, as tests previously performed against objective ratings will be performed against a new set of subjective and imprecise criteria.

Recent events involving NRSRO ratings in the structured finance market have indeed demonstrated the need for reform. The concerns articulated in the Release do not appear to stem from the utility of NRSRO ratings, but rather the lack of integrity within the ratings process. We believe the better approach to resolve this issue is embodied in a separate rulemaking initiative, which proposes to control more effectively conflicts of interest and enhance disclosure by NRSROs.<sup>6</sup> The Commission's examination staff is also available to inspect and identify money market funds that are not performing the comprehensive, minimum credit risk analysis that is currently required. In its present form, Rule 2a-7 requires fund managers and boards of directors to conduct an extensive credit risk analysis comprised of both ratings and independent research. We urge the Commission to reinforce the Rule, and not to discard an important protection for investors.

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We appreciate the opportunity to submit our comments on the Release. If you have any questions or if you need additional information, please feel free to contact either Michele Teichner at 212-827-7061 or Maya Gittens at 212-827-7024.

Very truly yours,



Maya Gittens

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<sup>6</sup> See *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-57967 (June 16, 2008).

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cc: Honorable Christopher Cox, Chairman  
Honorable Kathleen L. Casey, Commissioner  
Honorable Elisse B. Walter, Commissioner  
Honorable Luis A. Aguilar, Commissioner  
Honorable Troy A. Paredes, Commissioner

Andrew J. Donohue, Director  
Robert E. Plaze, Associate Director  
Division of Investment Management