IMMFA
Institutional Money Market Funds Association

5 September 2008

By email to: rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Sirs

RE: References to ratings of nationally recognised statistical rating organisations

The Institutional Money Market Funds Association (IMMFA) is grateful for the opportunity to comment on the proposals relating to the ratings of nationally recognised statistical rating organisations (NRSROs).

IMMFA is the trade association representing the promoters of triple-A rated money market funds and covers nearly all of the major promoters of this type of fund outside the US. Total assets in IMMFA members' funds as at August 2008 were in excess of $650 billion. You may obtain more information from our website, www.immfa.org.

Our member's funds are essentially the European equivalent of the US money market funds operating in accordance with SEC rule 2a-7. Within Europe, there is no legislation relating specifically to money market funds, but our members' funds are all authorised under the UCITS directive 85/611/EEC, have been awarded a triple-A rating, and must comply with the IMMFA Code of Practice. This Code establishes common standards of best practice. In some respects, the IMMFA Code of Practice is more restrictive than rule 2a-7; for example, the IMMFA Code requires a maximum weighted average maturity of 60 days, whereas the 2a-7 equivalent is 90 days.

We are responding to this consultation as, although our members' funds are domiciled in Europe, we consider that the proposals from the SEC could have a detrimental impact on European domiciled funds, and therefore, it is essential that we too comment. Whilst we are supportive of attempts within the US and in other jurisdictions to reduce the reliance which is placed on credit ratings, we do not believe that sufficient consideration has been given to all the implications of the proposals within the consultation paper.

We are strongly opposed to the proposal to remove reference to the ratings of NRSROs from rule 2a-7. We do not consider that this removal is either necessary or welcome. Instead, we believe that the removal would likely result in an ultimate relaxation of standards due to the absence of a minimum standard. This relaxation could cause the subsequent demise of money markets funds which would reverberate around the globe due to the globalisation of financial services.

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Money market fund success

Money market funds are a success story. Within the US, total funds under management now exceed $3.5 trillion. In Europe, where the market for 2a-7 equivalent funds is less mature, IMMFA funds under management are now in excess of $650 billion. Both markets have seen significant growth in recent years, with the US market growing by 26% within the last 12 months, and the European market growing by over 27% in the last 12 months[1].

This growth in the US is in no small part due to the regulation in force, which has provided a robust set of requirements to which money market funds must adhere. Since the inception of rule 2a-7, only one money market fund has ever 'broken the buck' – and this was an unrated fund. Whilst a number of parents or sponsors have taken action to mitigate the impact of assets held within money market funds over the course of the last 12 months, this has been at a time of unparalleled illiquidity. The core framework established by rule 2a-7 has proved over a lengthy period to be sufficient to protect the interests of investors.

The consultation paper rightly notes that within rule 2a-7 the presence of a credit rating is not of itself sufficient to permit investment in a security, and that the credit rating cannot be the sole factor considered in determining whether a security presents minimal credit risk.

However, the presence of a credit rating – and at a level which is one of the two highest short-term rating categories (or comparable unrated securities) – is the means through which a minimum standard is established amongst money market fund providers. This minimum standard provides a level of protection to investors by essentially determining the maximum level of credit risk which is permissible within a money market fund.

Using this as a minimum standard, money market funds are then able to determine the level of risk they are willing to take, and which is consistent with the objectives of the fund and its manager. The assessment by the fund's directors of what is minimal credit risk will never be permitted to exceed a specified level.

To remove the reference in rule 2a-7 to the ratings of the NRSROs will not in effect change the obligations which are placed on money market funds in terms of the requirements which must be considered before investing in a security – i.e. the board of directors of the money market fund will, as now, need to be ultimately satisfied that the security represents minimal credit risk.

If reliance is placed purely on the fund's board of directors (or their delegates) to determine that which presents minimal credit risk, there is a significant risk that the lessons learnt over recent months will be short lived. As markets stabilise, investors will again seek yield, resulting in increasing amounts of risk being taken by money market fund managers. The interpretation then of what constitutes minimal credit risk will become more relaxed, and in the absence of any minimum standard, would be open to abuse. It would not then be beyond the realms of possibility that a money market fund 'breaks the buck' due to the fact that standards have lowered to accommodate the wishes of investors without due regard to the potential implications.

[1] US data from the Investment Company Institute; European data from iMoneyNet.

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To retain the need for money market funds to only invest in those securities which have received a credit rating in one of the two highest short-term categories (or an equivalent unrated security) will ensure that a floor is maintained. Such a floor does not permit credit risk within a money market fund to reach an unacceptable level, and is integral to rule 2a-7's robustness and prudence.

European impact

Financial services are increasingly global. The subprime crisis which originated in parts of the US quickly spread to financial centres in other continents, resulting in an almost global disruption. These impacts are an indication of the inter-linkages of the financial services industry, where an event in one market can now result in more significant consequences for other markets. For this reason, it is likely that amendments to rule 2a-7 will have a significant impact on other money market fund industries. The likelihood of this is increased further when consideration is given to the relative maturities of the two major markets, with the US being more established and accepted as a benchmark.

The European equivalent of US money market funds would be adversely impacted should there be a situation in which a US money market fund 'broke the buck'. If this situation were to arise, we anticipate that there would be considerable investor nervousness and uncertainty, which could result in a significant outflow of investment. The growth in funds under management has been based upon the solid foundations which have been established over a number of years. The stigmatism associated with a 'break the buck' situation – irrespective of its geographical location given the globalisation of financial services – could irreversibly damage the reputation of all money market funds to such an extent that funds redeemed may never again be received. It is unacceptable to consider that this would be the result of a removal of a regulatory minimum standard.

The financial crisis which commenced last summer highlighted the need for financial regulation to address the issues of liquidity and credit assessment. These problems should not be addressed through removing minimum standards, but through ensuring that the systems and controls operated by financial institutions are sufficiently robust, and overseen by the highest levels of management. This would place emphasis and responsibility where it is most needed, increasing the accountability of individuals whilst focusing attention on the importance of governance and controls. Minimum standards always assist through the provision of a fallback position in the event of a failure of an internal control.

It should be remembered that the credit crunch has largely been a liquidity event, as evidenced by the actions of a variety of central banks to inject liquidity into the financial system. A credit rating is an indication of the propensity of an obligor to default on its obligations, and is not therefore an opinion or indication of the liquidity of an entity. It is therefore inappropriate to apportion blame for the events within financial markets to the NRSROs.

We accept that improvements could and should be made in a number of operational areas of the NRSROs, and that work has been undertaken at international levels (for example, by the International Organisation of Securities Commissions) and by the NRSROs themselves to address their shortcomings.

Greater attention should also be paid to the fact that investors did not in all cases perform the necessary due diligence which should have been conducted before an investment was made. The solution to this problem is not to remove the reliance upon credit ratings, but to increase the onus on investors to undertake appropriate assessments before making investments. This should operate in conjunction with the minimum standard which is established through the requirement for a high quality rating to have been awarded.

We do not therefore accept that reference to the NRSROs should be removed from rule 2a-7. The NRSROs are able to offer an independent opinion on the creditworthiness of an obligor and should be considered as part of an *overall* assessment of credit risk.

Other proposals

Whilst we have concentrated our comments on the proposed removal of references to the ratings of the NRSROs within rule 2a-7, we note the almost complete removal of all other such references in other rules.

Within European legislation and within the revised international capital framework (Basel II), there are a significant number of references to credit ratings. For example, the Basel II framework establishes minimum capital requirements for banks; the standardised approach to credit risk within this framework is totally reliant upon the ratings assigned by an external credit assessment institution (ECAI).

If the SEC is to pursue their proposed approach to reduce the reliance upon rating agencies through the almost complete removal of all references to such, there is a significant risk of adverse consequences for wider usage of such ratings, especially those with an international context. It cannot be the intention of the SEC to question the validity of the recently agreed capital framework, but their public rejection of the rating agencies could instigate such a review before there has been sufficient time to embed and evaluate the framework.

We therefore request that the SEC review the proposals, and give sufficient consideration to the international implications which the current draft would have. Furthermore, we are strongly opposed to the proposal relating to rule 2a-7, and advocate that no change should be made to this rule in the context of the current consultation.

If you require any further information, please do not hesitate to contact me.

Yours faithfully

Nathan Douglas.

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