



August 14, 2008

U. S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Attention: Secretary

File No.: S7-19-08

Re: Realpoint LLC (“Realpoint”) Comments to Release No. IC-28327 References to Ratings of Nationally Recognized Statistical Rating Organizations (“NRSROs”)

Summary:

The Commission may accomplish its stated goals¹ without also eliminating the benefits that independent NRSRO credit ratings may provide to investors in: (a) money market funds, (b) funds² that enter into repurchase agreements,³ (c) funds that purchase eligible municipal securities,⁴ or (d) funds that purchase underwritten, non-convertible investment grade securities.⁵

Instead of eliminating these benefits to investors, the Commission’s reaction to the “recent credit market turmoil”⁶ should be to require boards and investment advisers to: (i) separately consider independent credit rating(s) of Requisite NRSROs⁷ (ii) document any determination of credit risk that is not supported by a similar determination by Requisite NRSROs (including the reasons for such determination), and (iii) publish any such determination. This requirement would not conflict with the Commission’s goal of requiring boards and investment advisers to make independent determinations of credit risks. Boards and investment advisers would not be permitted to either place undue reliance on, or choose to ignore, NRSRO credit ratings.

Additionally, the Commission should amend its definition of “Requisite NRSROs” to include at least one unsolicited NRSRO credit rating.⁸ This recommendation is consistent with the Commission’s

¹ The Commission “believes that [its] proposals could reduce undue reliance on credit ratings and result in improvements in the analysis that underlies investment decisions,” Release Page 5, and increase the level of independent analysis performed by fund boards and their investment advisers in making credit risk determinations. See. e.g., Release Pages 8, 13 and 19.

² Investment companies are defined as funds in the Release. Release Page 10.

³ See Release Page 18 n.48 (“In a typical . . . repurchase agreement, [the] fund enters into a contract with a broker, dealer, or bank[,] . . . which agrees to repurchase the securities at a specified future date, or on demand, for a price that is sufficient to return to the fund its original purchase price, plus an additional amount representing the return on the fund’s investment.”)

⁴ Existing Rule 10f-3 “defines municipal securities that may be purchased during an underwriting in reliance on the rule (‘eligible municipal securities’) to include securities that have an investment grade rating from at least one NRSRO or, if the issuer or the entity supplying the revenues or other payments from which the issue is to be paid has been in continuous operation for less than three years (*i.e.*, a less seasoned security), one of the three highest ratings from an NRSRO. Release Page 23.

⁵ Except for “a non-convertible debt security that, at the time of sale, is rated in one of the four highest rating categories of at least two” NRSROs.” 17 CFR § 275.206(3)-3T(c), “[n]either the investment adviser nor any person controlling, controlled by, or under common control with the investment adviser is the issuer of, or, at the time of the sale, an underwriter . . . of[] the security. 17 CFR § 275.206(3)-3T(a)(2).

⁶ Proposed Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-57967 73 FR 36212 (June 25, 2008) [hereinafter, “Proposed Rules for NRSROs”], various pages.

⁷ See Note 11, *infra*.

⁸ See Note 12, *infra*.

goals of strengthening (i) credit rating processes by NRSROs⁹ and (ii) diligence by board members and investment advisers. See Release Page 13.

Given the inherent and potential conflicts of interest of a fund's board and its investment advisers, when they are simultaneously considering and evaluating yields and credit risk, the Commission should not reduce its regulatory requirements for funds or, as a possible unintended consequence, reduce investor confidence in funds.

Responses to Specific Questions:

Release Section III.A.1 Rule 2a-7; Minimal Credit Risk Determination

Q. On Release Page 9, the first through fourth questions posed are as follows: "What are the advantages and disadvantages of eliminating the requirement to use NRSRO ratings from [R]ule 2a-7?" "Would eliminating the rating requirements from [R]ule 2a-7 affect the amount or nature of risks money market funds would be willing or able to take?" "What are the advantages and disadvantages of relying on minimum credit risk determinations?" "What are the advantages and disadvantages of having fund directors and investment advisers exclusively make credit quality determinations?"

A. There are no advantages to relying solely on money market fund boards of directors to make minimum credit risk determinations. Existing Rule 2a-7 requires¹⁰ a money market fund's board of directors to determine whether an investment presents minimal credit risks. Existing Rule 2a-7 was never intended to permit NRSRO credit ratings to supersede or obviate board obligations.

Instead of eliminating, from Rule 2a-7, the requirement to refer to NRSRO ratings, the Commission should consider revising Rule 2a-7 to require the board to separately consider credit rating(s) of Requisite NRSROs and document or publish when the board's determinations deviate therefrom. Such a requirement would support the Commissions stated goals without authorizing a complete disregard for readily-available NRSRO credit ratings.

One consequence, and thus disadvantage, of the revised rule as proposed by the Commission may be that a money market fund's board of directors and investment advisers may not determine credit risk independent of yields. A money market fund's board of directors and investment advisers have a conflict of interest when simultaneously considering and evaluating yields and credit risk. Credit ratings are "are, at their most basic level, an opinion regarding the likelihood the issuer will repay its financial obligation" in accordance with its terms. U.S. Securities and Exchange Commission Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets (Jan. 24, 2003), at page 25. "An outlook is an opinion on the future direction of the rating." *Id.*, at page 27. Credit rating agencies determine credit risk independent of yields. Credit rating agencies do not opine on pricing.

The Commission's proposed Rule 2a-7 thus runs counter to the Commission's goals of reducing conflicts of interests in the rating of securities, promoting unsolicited credit ratings and increasing the

⁹ See Note 14, *infra*.

¹⁰ Under existing Rule 2a-7, one requirement, for a money market fund to hold an investment, is "that the fund's board of directors determines [that the investment] present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO)." 17 CFR § 270.2a-7(c)(3); Release Pages 7 and 8. In contrast, under proposed Rule 2a-7, the Commission wishes to solely "rely on money market fund boards of directors to determine that each portfolio instrument presents minimal credit risks." "[M]oney market fund boards of directors would still be able to use quality determinations prepared by outside sources, including NRSRO ratings that the conclude are credible, in making credit determinations," but there is no express requirement to do so. Release Page 8.

transparency of credit ratings and the processes by which they are developed. See Proposed Rules for NRSROs. Proposed Rule 2a-7 may inadvertently spur a loss of confidence in, and flight from, money market funds.

The Commission should also consider amending the definition of “Requisite NRSROs”¹¹ to include therein at least one unsolicited NRSRO credit rating¹² (when such a rating is available). When independent credit ratings and credit risk information are available from unsolicited NRSROs, the Requisite NRSROs need not be, and should not be, the same NRSROs solicited by and compensated by the issuer, due to the conflicts of interest inherent in the arranger-pay business model for rating agencies.¹³ By requiring independent credit ratings and credit risk information from unsolicited NRSROs, the Commission fosters its goals, of strengthening rating processes and eliminating conflicts of interest inherent in the arranger-pay business model for credit ratings.¹⁴

This recommendation is also consistent with the Commission’s proposed standard of care, for board members and investment advisers, which is to “exercise reasonable diligence in keeping abreast of new information about a portfolio security.” Release Page 13. Board members and investment advisers will want to subscribe to credit ratings of unsolicited NRSROs in part because unsolicited NRSRO credit ratings are generally subscriber-paid ratings that are reviewed on a regular and frequent basis by the NRSRO for updates (including not only downgrades/upgrades but also “watch list” items and reports).

Q. On Release Page 10, the first question posed is: “What other alternatives could we adopt to encourage more independent credit risk analysis and meet the regulatory objectives of [R]ule 2a-7’s requirement of NRSRO ratings?”

A. The Commission may wish to amend the record keeping and reporting requirements under existing Rule 2a-7(c)(10) to require a money market fund to certify “that the fund’s board of directors determine[d] [that the investments] present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO).” 17 CFR § 270.2a-7(c)(3), (c)(10).

The Commission may also wish to require that the fund’s board of directors document any determination that a security presents minimal credit risks when such determination is not supported by a similar determination by Requisite NRSROs. The reasons for such determination should also be documented. The fund should then be required to publish any such determination.

¹¹ Under existing Rule 2a-7, “Requisite NRSROs” means: (i) [a]ny two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) [i]f only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that NRSRO. 17 CFR § 270.2a-7(a)(21). This response includes a recommendation that the Commission amend its definition of “Requisite NRSROs” to include at least one unsolicited NRSRO credit rating.

¹² “[A]n “unsolicited rating” is one that is determined without the consent and/or payment of the obligor being rated or issuer, underwriter, or [other] arranger of the securities being rated.” Proposed Rules for NRSROs, Page 30, n.65. “Arrangers earn fees from originating, structuring, and underwriting.” *Id.* at Page 19.

¹³ See Note 14, *infra*.

¹⁴ The Commission’s goals, regarding NRSROs, include “further enhancing the utility of NRSRO disclosure to investors, strengthening the integrity of the ratings process, and more effectively addressing the potential for conflicts of interest inherent in the ratings process for structured finance products,” Proposed Rules for NRSROs, Page 27, “arranger-pay business model.” *Id.* at Page 52.

Q. On Release Page 10, the second and third questions posed are as follows: “Are the distinctions our proposed amendments would draw between First Tier and Second Tier Securities workable?” “Is there a better way to describe the characteristics of a First Tier Security without reference to ratings?”

A. No / Yes. The Commission proposes to define “First Tier Security”¹⁵ as “a security the issuer of which the fund’s board of directors has determined has the highest capacity to meet its short-term financial obligations.” See Release Pages 9 and 62. The Commission’s approach would allow each money market fund’s board of directors, investment advisers and other persons with conflicts of interest to make wholly subjective determinations as to an issuer’s creditworthiness and to define, for their funds, what is meant by an AAA or AA equivalent rating, based on relative, rather than absolute, financial strength.

As with the Commission’s above-noted approach to minimum credit risk determinations, the Commission’s approach to defining a First Tier Security runs counter to the Commission’s goals of reducing conflicts of interests in, and promoting increased transparency of, credit ratings and the processes by which they are developed, which may inadvertently spur a loss of confidence in the credit risk decisions of money market fund boards of directors and their advisers. In part because of the number of money market funds¹⁶ (compared to the number of NRSROs) the Commission’s approach may open a Pandora’s Box of variations, among money market funds, regarding their respective interpretations of applicable standards for, and resulting determinations of, an issuer’s creditworthiness. Two suggestions follow.

First, the Commission should give consideration to adopting definitions similar to those set forth in the respective Form NRSRO of various NRSROs. In general, most rating agencies define an AAA rating to mean that the issuer has an extremely strong ability to repay its financial obligations in accordance with its terms and practically no risk of default. A rating of AA, although also an investment-grade rating, would mean that the issuer is very strong but presents a slightly higher risk of default.

Second, the Commission should require that the board document when it makes a determination that a security is a First Tier Security and such determination is not supported by a similar determination by the Requisite NRSROs and the reasons for such a determination. The fund should also be required to publish any such determination not supported by a similar determination by the Requisite NRSROs.

Release Section III.A.3 Rule 2a-7; Monitoring Credit Risks

Q. On Release Page 13, the first question posed is: “Would the requirement that the board of directors reassess the credit risk of a security when investment advisers become aware of information that may suggest the security no longer presents minimal credit risks provide adequate investor protections?”

¹⁵ A “First Tier Security” under existing Rule 2a-7(12)) is any Eligible Security that: “(i) Is a Rated Security that has received a short-term rating from the Requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing); or (ii) Is an Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(12)(i) of this section, as determined by the fund's board of directors; or (iii) Is a security issued by a registered investment company that is a money market fund; or (iv) Is a Government Security.” 17 CFR § 270.2a-7(a)(12).

¹⁶ Commission staff estimates that there are 808 money market funds, all of whom are subject to [R]ule 2a-7. Release Page 30. These include registered money market funds and series of registered money market funds. *Id.* n.85.

A. No. The Commission proposes to eliminate the requirement¹⁷ that, in the event of a downgrade by an NRSRO “with respect to a portfolio security, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks.” 17 CFR § 270.2a-7(c)(6)(A)(i). Investors would benefit by the retention of this requirement. Investors would not benefit from the Commission’s proposal. The elimination of this requirement is an unnecessary and imprudent reduction in the obligations of a money market fund’s board of directors.

Instead, the Commission need only reinforce the board’s existing obligations. Regardless of whether a downgrade by an NRSRO occurred, existing Rule 2a-7 requires that a “money market fund shall limit its portfolio investments to those . . . that the fund’s board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO).” 17 CFR § 270.2a-7(c)(3).

Q. On Release Page 13, the second question posed is: “Would investment advisers be able to stay abreast of new information about their portfolio securities?”

A. No. Directors and advisers will voice concern regarding the extent of the data, information and opinions regarding financial markets and individual securities of which they will be expected to have knowledge.¹⁸ The lack of independent credit ratings and credit risk information, in some case, and, in other cases, the potential volume of data and information, and the possibility for biased opinions or conflicting information, “in the national financial press or in publications to which the investment adviser subscribes,” will create uncertainty among directors and advisers as to whether, in some circumstances, action on their part is required “to reassess promptly whether the portfolio security continues to present minimal credit risks.” Release Page 12 or 64.

The Commission’s reliance on the national financial press or other publications to timely report independent credit ratings and credit risk information is misplaced. These sources do not have access to and do not systematically report credit ratings and credit risk information for every investment in which a fund’s board, investment advisers and investors have a direct or indirect interest. Board members and investment advisers who only subscribe to such resources may fall short of the standards required for them to properly and fully discharge their existing legal duties on an informed basis and may not meet the Commission’s new proposed standard of care, which is to “exercise reasonable diligence in keeping abreast of new information about a portfolio security.” Release Page 13. Thus, the above recommendation to revise the definition of Requisite NRSROs to include independent credit ratings and

¹⁷ Under existing Rule 2a-7, “[u]pon the occurrence of either of the events specified in paragraphs . . . (1) and (2) of this section with respect to a portfolio security, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders: (1) A portfolio security of a money market fund ceases to be a First Tier Security (either because it no longer has the highest rating from the Requisite NRSROs or, in the case of an Unrated Security, the board of directors of the money market fund determines that it is no longer of comparable quality to a First Tier Security); and (2) The money market fund’s investment adviser (or any person to whom the fund’s board of directors has delegated portfolio management responsibilities) 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-term rating category. *Id.*

¹⁸ “Although the Commission “do[es] not believe that the proposed amendments would require investment advisers to subscribe to every rating service publication . . . , the Commission expect[s] an investment adviser to exercise reasonable diligence in keeping abreast of new information about a portfolio security that is reported in the national financial press or in publications to which the investment adviser subscribes.” Release Page 13.

credit risk information of at least one unsolicited NRSRO will not result in an undue additional burden on board members and investment advisers because they have a legal duty to seek such information.

In addition to a fund's own subjective risk management and decision-making processes, the Commission can maintain objective criteria for when reassessment of credit risk is required by the retention of the requirement of a reaction to a downgrade by Requisite NRSROs. As noted above, the board would remain required to act independently of a downgrade by any NRSROs. Boards and investment advisers would not be permitted to either place undue reliance on, or choose to ignore, NRSRO credit ratings.

Release Section III.C Rule 5b-3 (Repurchase Agreements)

Q. On Release Page 21, the second and third questions posed are as follows: "Would the proposed board determinations sufficiently address our concerns that collateral securities be of high quality in order to limit a fund's exposure to counterparties' credit risks? If not, are there additional or alternative standards that would better address our concerns?"

A. No. The Commission's approach, in its proposal to redefine when a repurchase agreement collateralized by non-government securities may be treated as an acquisition of the underlying securities,¹⁹ is similar²⁰ to its approach in its proposal to redefine "First Tier Security" for money market funds. In each case, the Commission is proposing to allow each fund's board of directors, investment advisers and other persons with conflicts of interest to make subjective determinations of an issuer's creditworthiness without reference to whether Requisite NRSROs have similarly opined on such issuer's creditworthiness.

If the Commission's goal is to emphasize the responsibility of the board for determining that a repurchase agreement is "collateralized fully," Release Page 18, the Commission should also consider a requirement (similar to that suggested above in connection with the determination of credit risk by a money market fund's board of directors) that a fund's board, when determining whether a repurchase agreement is collateralized fully, separately consider independent credit rating(s) of Requisite NRSROs and document or publish when the board's determinations deviate therefrom.

The Commission should also retain the requirement that non-governmental securities collateralizing a repurchase agreement be rated by Requisite NRSROs as part of the requirements to treat the repurchase agreement as an acquisition of the underlying securities.²¹

¹⁹ The Commission's proposal is to permit a repurchase agreement collateralized by non-government securities to be treated as an acquisition of the underlying securities when the non-government securities "consist of securities that the fund's board of directors (or its delegate) determines at the time the repurchase agreement is entered into (i) are sufficiently liquid that they can be sold at or near their carrying value within a reasonably short period of time, (ii) are subject to no greater than minimal credit risk, and (iii) are issued by a person that has the highest capacity to meet its financial obligations." Release Page 19 or 68.

²⁰ Unlike the definition of "First Tier Security" for money market funds, for which the issuer must have "the highest capacity to meet its short-term financial obligations," Release Pages 9 and 62 (emphasis added), with respect to repurchase agreements, the issuer need only have "the highest capacity to meet its financial obligations." Release Pages 19 and 68.

²¹ "[T]he acquisition of a repurchase agreement may be deemed to be an acquisition of the underlying securities" if, among other requirements, "the securities collateralizing the repurchase agreement" are "[s]ecurities that at the time the repurchase agreement is entered into are rated in the highest rating category by" either "(i) [a]ny two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) [i]f only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the investment company acquires the security, that NRSRO." 17 CFR § 270.5b-3(a), (c)(1)(iv)(C).

Release Section III.D Rule 10f-3 (Eligible Municipal Securities)

Q. **On Release Page 24, the questions posed are as follows:** “What would be the effect of eliminating the rating requirement in the definition of “eligible municipal securities”? Is the proposed standard that municipal securities purchased in reliance on rule 10f-3 present no more than moderate credit risks and are highly liquid sufficient to limit the possibility underwriters may sell unmarketable securities to the fund? Is there an alternative that would better address our regulatory concerns?”

A. The Commission notes the inherent and potential conflicts of interest addressed by Rule 10f-3²² but fails to adequately address them in its proposal to eliminate the rating requirement from the definition of “eligible municipal securities.”

Consistent with the recommendations made above, in the definition of “eligible municipal securities,” the Commission should also consider a requirement that a fund’s board, when determining whether securities are eligible municipal securities, separately consider independent credit rating(s) of Requisite NRSROs and document or publish when the board’s determinations deviate therefrom.

The Commission should also retain the requirement that non-governmental securities collateralizing a repurchase agreement be rated by Requisite NRSROs as part of the requirements to treat the repurchase agreement as an acquisition of the underlying securities.

**Release Section III.E Rule 206(3)-3T (Principal Trade Rule
Revised Definition of Investment Grade Debt)**

Q. **On Release Page 27, the questions posed are as follows:** “Is it appropriate for us to allow advisers seeking to rely upon the rule to determine whether a security is investment grade based on the criteria in the rule? Is there another definition of “investment grade” elsewhere in the federal securities laws that we should incorporate by reference into the rule? Are there alternative methods to ensure that advisers seeking to rely on the exception to the underwriting exclusion do so only with respect to investment grade debt? Are there alternative or additional factors we should require an adviser to consider in making its determination? In addition, we expect that advisers, in order to establish their eligibility to rely on the rule, would document their determination that a security is investment grade quality, as well as the process for making such a determination. Are we correct? Should we make such documentation an explicit requirement of the rule, or amend rule 204-2 under the Advisers Act80 (the books and records rule) to require such documentation?”

A. The below comments to these questions are consistent with and substantially the same as the comments to the preceding section regarding the definition of eligible municipal securities.

With respect to underwritten, non-convertible investment grade securities, the Commission notes the inherent and potential conflicts of interest addressed by Rule 206(3)-3T²³ but fails to adequately

²² “The prohibition was intended to address Congress’s concern that underwriters were ‘dumping’ otherwise unmarketable securities on affiliated funds, either by forcing the fund to purchase unmarketable securities from the underwriting affiliate itself, or by forcing or encouraging the fund to purchase the securities from another member of the syndicate. Congress also expressed concern regarding the amount of underwriting fees earned by the sponsors and affiliated persons who placed the securities with the fund.” Release Page 22. “[T]he rule would no longer require municipal securities to be rated by an NRSRO.” Release Page 24.

²³ “Rule 206(3)-3T contains several conditions that are designed to prevent overreaching by advisers by requiring an adviser to disclose to its client the conflicts of interest involved in principal transactions, inform the client of the circumstances in which the adviser may effect a trade on a principal basis, and provide the client with meaningful opportunities to refuse to consent to a particular transaction or revoke the prospective general consent to these transactions..” Release Page 25.

U. S. Securities and Exchange Commission
Attention: Secretary
August 14, 2008
Page 8 of 8

address them in its proposal to eliminate an adviser's ability to rely exclusively on NRSRO ratings to determine whether a security is investment grade for purposes of the rule." See Release Page 26.

Consistent with the recommendations made above, advisers should be separately required to consider independent credit rating(s) of Requisite NRSROs and document or publish when their determinations deviate therefrom.

The Commission should also retain the requirement that non-governmental securities collateralizing a repurchase agreement be rated by Requisite NRSROs as part of the requirements to treat the repurchase agreement as an acquisition of the underlying securities.

Thank you for the opportunity to comment on the Proposed Amendment. Please do not hesitate to contact us if you have any questions.

Very truly yours,



Robert Dobilas
CEO and President
Realpoint LLC