Fund Democracy
Consumer Federation of America

September 5, 2008

BY EMAIL

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

Dear Ms. Harmon,

We are writing on behalf of Fund Democracy and the Consumer Federation of America in response to the Commission's request for comments on its recent proposal regarding the role of Nationally Recognized Statistical Ratings Organizations ("NRSROs") in the regulation of money market funds.[1] Although we applaud the Commission's desire to address concerns raised by NRSROs and the recent crisis in the credit markets, we believe strongly that eliminating the requirement to use NRSRO ratings pursuant to rule 2a-7 would weaken investor protection and further undermine the stability of fixed income markets.

We generally agree with the points raised by Vanguard, Fidelity, the Independent Directors Council and others in comment letters questioning the Commission's proposal and encourage the Commission to withdraw the proposal. If the proposal is not withdrawn, we urge the Commission at a minimum to address the concerns raised by commentators before taking final action. In this letter, we wish to direct the Commission's attention to certain respects in which we believe that the Commission's proposal is logically flawed.

The Commission appears to believe that the NRSRO rating requirement encourages lax oversight by fund directors. What is illogical about the Commission's position is that at the same time it argues that fund directors may be so derelict in their duties so as to allow a satisfactory NRSRO rating to dilute or supplant their oversight role as to credit risk, it proposes to solve this problem by shifting *more* responsibility to *the same directors* as provided by new paragraph (a)(10) of the rule. If directors are so lax, then one could argue persuasively that the NRSRO rating requirement is needed now more than ever because an unsatisfactory rating protects against the overly lax board by preventing the investment from being made.

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[1] *See* References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008) ("NRSRO Proposal").

Another logical difficulty with the proposal is that it would require a body that is designed to act in an oversight capacity to participate in overly technical evaluations of the credit risk of portfolio securities. The Commission proposes to require directors to "determine" that each portfolio security "presents minimal credit risk (which determination must be based on factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations)."[2] This requirement would not strengthen fund oversight, but rather require directors to participate in technical evaluations that are inconsistent with the board's function. We agree with the IDC that the proposal "falls back on the tendency to adopt rules that place specific, management-level responsibilities on fund boards to address perceived regulatory issues."[3] We recognize that there is substantial room for improvement as to board oversight of money market funds, as attested to by the many bailouts of funds in the last year. However, the Commission's proposal would not be an effective way to achieve this goal.

In addition, we are skeptical that the NRSRO rating requirement itself encourages lax board oversight. Fund directors already are legally obligated to take reasonable steps to protect funds against credit risk. The Commission states that "[u]nder the proposed amendments, we would rely on money market fund boards of directors to determine that each portfolio instrument presents minimal credit risks,"[4] but rule 2a-7 already places primary oversight responsibility on fund directors as to the creditworthiness of a money market fund's portfolio securities.[5] Even if the NRSRO rating requirement were eliminated, money market securities would continue to be rated and the boards that the Commission is concerned are too lax will undoubtedly continue to use them as part of their credit risk oversight. **If the Commission believes that some directors find a satisfactory NRSRO rating to be sufficient, then it should consider amending rule 2a-7 to state expressly that the ratings are not sufficient and that the board must ensure that additional methods are used to evaluate credit risk, with appropriate recordkeeping provisions to facilitate compliance inspections.**[6]

Finally, we are concerned that the Commission's proposal reflects a flawed strategy in dealing with the current crisis in the fixed income markets. The issues raised in the Commission's proposal are highly susceptible to empirical analysis, yet no such analysis

[2] Proposed rule 2a-7(a)(10).

[3] Letter from Robert Uek, Chair, Governing Council, Independent Directors Council to Florence Harmon, Secretary, U.S. Securities and Exchange Commission at 5 (Aug. 29, 2008). We believe that paragraph (e)'s delegation provision is not adequate to counter the wording of paragraph (10).

[4] NRSRO Proposal at n.21.

[5] The Commission seems to agree, stating that the requirement would impose no additional costs "because the proposed rules would codify the determinations regarding credit risk and liquidity that we believe boards (or their delegates) make under the current rule." NRSRO Proposal at 41. If this is the case, it is not clear how the proposal could be viewed as filling the gap left by the elimination of the NRSRO rating requirements.

[6] *See* proposed rule 2a-7(c)(11)(iii).

is presented in support of the Commission's proposal. For example, there is no evidence in the proposing release that the Commission has determined the extent to which the securities that have caused problems for money market funds actually received incorrect satisfactory NRSRO ratings, much less whether alternative credit evaluation techniques would have identified the credit problems that the NRSROs overlooked. Nor is there any evidence regarding the kind of credit analysis that directors of funds that had portfolio problems actually conducted, much less any indication that they were over-reliant on NRSRO ratings.

There are empirical answers to the question of what has caused many money market funds to find themselves in a bailout scenario, just as there are empirical answers to the question of how many short-term bond funds experienced a substantial loss of principal, the latter issue being one that also should be of significant concern to the Commission. We strongly encourage the Commission to determine what has actually caused the problems that fixed income funds have experienced and to continue to develop proposals to improve the regulation of fixed income mutual funds and promote efficient fixed income markets based on its findings.

Sincerely,

Mercer Bullard
Founder and President
Fund Democracy

Barbara Roper
Director of Investor Protection
Consumer Federation of America

cc by U.S. Mail:

Honorable Christopher Cox, Chairman
Honorable Kathleen Casey, Commissioner
Honorable Elisse Walter, Commissioner
Honorable Luis Aguilar, Commissioner
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Andrew Donohue, Director, Division of Investment Management
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