ICI VIEWPOINTS

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ICI Will Scrutinize Proposal Removing Ratings Requirement from Money Market Fund Rules

By Jane Heinrichs and Heather Traeger

On Wednesday, the Securities and Exchange Commission voted unanimously in favor of a proposal that would eliminate credit ratings as a required element in determining which securities are permissible investments for money market funds. The proposal stems from the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires federal agencies to review regulations and replace credit ratings as an assessment of creditworthiness.

Under current law, money market funds conduct their own thorough credit risk analysis for investments through a two-part test. First, a money market fund can only invest in securities that are "first-tier" or "second-tier" securities, based on a rating agency granting those securities the highest or second-highest short-term credit rating.

The second test is more subjective: a money market fund's board of directors (or its delegate) must determine that a security presents minimal credit risks, based on factors relating to credit quality.

Credit ratings, of course, are not perfect. Indeed, the financial crisis of 2008–2009 made clear the serious flaws in the ratings process. For its part, ICI has long advocated for better regulation and measures to improve the quality, accuracy, and integrity of credit ratings and the rating process.

The SEC's proposal would change the two-part test to two subjective analyses. The proposal removes all references to credit ratings from Rule 2a-7, which governs money market funds. Under the new proposed analysis, money market funds would still have to assess the credit quality of a security and determine that each portfolio security presents minimal credit risk.

However, the determination of whether the portfolio security is a first- or second-tier security would be different. Specifically, under the proposal, a security would be first tier if the fund's board (or its delegate) determines that the issuer has the "highest capacity to meet its short-term financial obligations." A security would be second-tier if the board determines that it presents minimal credit risks but does not meet the criteria for a first-tier security. Like the current rule, a money market fund would be required to invest at least 97 percent of its assets in first-tier securities.

ICI will comment on the SEC's proposal when we've had a chance to analyze the full details. But our core position remains the same. Money market funds seek to meet investors' need for a stable $1.00 net asset value by investing in high-quality, liquid, short-term securities. With our members, we'll examine the SEC's proposal closely to ensure that it helps funds meet that objective.

- Read the SEC's press release.
- Read SEC Chairman Schapiro's opening statement at the Open Meeting on March 2
- Visit ICI's money market funds resource center.
- Visit ICI's resource center on financial services regulatory reform.

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