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SEC Approves Stripping Credit Rating References from MMF Rule.

WASHINGTON – The Securities and Exchange Commission adopted amendments to its money market fund rule that would remove credit ratings references funds use to comply with the rule — an action many market participants applauded but others said could pose risks.

The approved late Wednesday of changes to Rule 2a-7 and Form N-MFP, which MMFs use to provide updates to the SEC, follow a Dodd-Frank Act mandate for federal agencies to review their policies and remove "any reference to, or requirement of, reliance on credit ratings" and substitute the requirements with a "standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations."

The amendments will become effective 30 days after they are published in the Federal Register but funds won't need to comply with them until as Oct. 14, 2016. MMFs previously could only invest in securities that were in one of the two highest short-term credit ratings, or, if they were not rated, in securities that were of comparable quality. Of the total number of securities in the fund, 97% had to be rated in the highest short-term category.

The amendments change the requirements to allow funds to invest in securities that present "minimal credit risks." The SEC said a fund's board should consider the following factors when determining if a security has minimal credit risks: financial condition; sources of liquidity; ability to react to future market-wide and issuer or guarantor-specific events, including ability to repay debt in a highly adverse situation; the strength of the issuer or guarantor's industry within the economy and relative to economic trends; and issuer or guarantor's competitive position within its industry.

The SEC removed credit rating references from several of its rules in 2011 to comply with the mandate, but decided to re-propose the more controversial MMF amendments in 2014 to solicit more comments. While the majority of the comments were supportive of the commission's proposed change, there were some concerns that Dodd-Frank was forcing the SEC to trade objective portions of the rule for more subjective ones.

Jane Heinrichs, Investment Company Institute associate general counsel, said ICI is still reviewing the changes but that the revised rule "retains a similar degree of high credit quality standards."

An industry source familiar with the SEC's work on the amendments said the changes will have little effect because asset managers will not alter the way they manage the funds despite the removal of reliance on credit ratings.

Asset managers "are going to manage [an MMF] today the same way they managed it a year ago, and two years ago," said the source, who did not want to be named. "The truth is that asset managers have their own systems of reviewing credit analysis and the way in which they manage these funds."

Stephen Austin, a spokesperson for Fidelity Investments, said the company welcomes the final rules and echoed the industry source in saying the company's MMFs already do not rely on credit rating agencies to make risk determinations but instead depend on "an experienced research team to analyze the credit-worthiness of each issuer or security purchased by the funds" the company manages.

But Robert Plaze, a partner at Stroock & Stroock & Lavan, said the rule change gives managers an option that they did not have before. He said maintenance of the status quo "may very well happen," but noted, "There may be some funds out there who decide to attempt to reach for yield by investing a greater percentage of their assets in second-tier securities, which had heretofore been prohibited."

He also said the SEC staff may find it harder to enforce the rules now that they are more subjective.

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