

MULTIPLE-MARKETS



Jill M. Peterson
Assistant Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, DC

Comments on: Proposed Rules for Nationally Recognized Statistical Rating Organizations

[RELEASE NO. 34-57967; File No. S7-13-08]

Dear Ms. Peterson:

We welcome the opportunity to comment on the Proposed Rules for Nationally Recognized Statistical Rating Organizations (NRSROs).

The work of our firm is the development of tools and systems for the visualization of credit risk and return for retail investors, registered representatives and financial advisors. These tools and systems transform the complex and varied data of the fixed income markets into simple charts and graphs.

We commend the Commission for their work on the issue of enhancing competition and transparency for NRSROs. Investors will participate in transparent and open markets. The results of this round of rulemaking will add significantly to market confidence in the accuracy and integrity of credit ratings.

The goal of 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 is worthy.

Because our work is centered on retail investors we have no comments on issues related to the issuance of credit ratings for structured finance or ABS products.

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- - - Amend Rule 17g-5(c) to add a new paragraph (5) that would prohibit an NRSRO from issuing a credit rating with respect to an obligor or security where the NRSRO or a person associated with the NRSRO, as defined in Section 3(a)(63) of the Exchange Act, made recommendations to the obligor or the issuer, underwriter, or sponsor of the security (that is, the parties responsible for structuring the security) about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. - - -

Underwriters and arrangers have exerted disproportionate influence on the selection of NRSROs in the securities issuance process.

Previously, the opportunity for significant influence on the credit rating analyst by the underwriters or arrangers agent was not balanced by other safeguards.

The Commission has reported in its recent examination of the current dominant NRSROs evidence of the need for this conflict to be mediated.

The following from page 32 of The Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies:

~~~~ "... Second, there is a high concentration in the firms conducting the underwriting function. Based on data provided by the three rating agencies examined, the Staff reviewed a sample of 642 deals. While 22 different arrangers underwrote subprime RMBS deals, 12 arrangers accounted for 80% of the deals, in both number and dollar volume.

Similarly, for 368 CDOs of RMBS deals, although 26 different arrangers underwrote the CDOs, 11 arrangers accounted for 92% of the deals and 80% of the dollar volume.

In addition, 12 of the largest 13 RMBS underwriters were also the 12 largest CDO underwriters, further concentrating the underwriting function, as well as the sources of the rating agencies' revenue stream.

Achieving accuracy in ratings in a fast-changing market for a relatively new security may require frequent updating of the models used to produce the ratings, leading to quickly-changing ratings processes. The combination of the arrangers' influence in determining the choice of rating agencies and the high concentration of arrangers with this influence appear to have heightened the inherent conflicts of interest that exist in the "issuer pays" compensation model.

One area where arrangers could have benefited in this context is in the ratings process itself. In discussions with OEA Staff, the ratings agencies indicated that arrangers preferred that the ratings process be fast and predictable. For instance, arrangers and their employees are generally compensated, at least in part, by the volume of deals completed and the total dollar volume of those deals. The Staff understands that at least one rating agency allowed deals that were already in the ratings process to continue to use older criteria, even when new criteria had been introduced.

Pressure from arrangers could also come in the form of requiring more favorable ratings or reduced credit enhancement levels. Such outcomes would reduce the cost of the debt for a given level of cash inflows from the asset pool. This benefit is particularly valuable to an arranger when it also serves as the sponsor of the RMBS or CDO trust. Such pressure could influence the rating agencies' decisions on whether to update a model when such an update would lead to a less favorable outcome.

High profit margins from rating RMBS and CDOs may have provided an incentive for a rating agency to encourage the arrangers to route future business its way. Unsolicited ratings were not available to provide an independent check on the rating agencies' ratings, and the structures of these securities were complex, and information regarding the composition of the portfolio of assets, especially prior to issuance, was difficult to obtain for parties unrelated to the transaction...." ~ ~ ~ ~

We fully endorse the adoption of this amendment which bars a credit analyst from making recommendations about the corporate or legal structure, assets, liabilities or activities of the obligor or issuer of the security.

In sum it bars the "*transition from an objective credit analyst to subjective consultant.*"

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- - - Amend Rule 17g-5 by adding a new paragraph (c)(6) of Rule 17g-5 to address the conflict of interest that arises when a fee paid for a rating is discussed or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings (including analysts and rating committee members) or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models. - - -

We support, to the extent practicable, the severing of analytical and commercial responsibilities in NRSROs.

Free functioning markets rely on unconflicted credit analysis.

Large credit rating firms have the resources to separate these responsibilities and should do so.

For small NRSROs, (less than 20 associated persons) who are compensated by issuers or arrangers, a prudent course would be for the rater to establish a price list for their services and expose that to those seeking their services.

For any fee arrangement that deviated substantively from the pre-established price list enhanced documentation standards for the fee determination process should be imposed. The managing director or other upper management should attest to the proper management of conflicts attendant in the deviation from established pricing.

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- - - Amend Rule 17g-5 by adding a new paragraph (c)(7) that would prohibit an NRSRO from having a conflict of interest relating to the issuance or maintenance of a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating, received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than \$25. - - -

This prohibition is appropriate in the context of the credit analysis process given that often subjective factors are taken into account within certain rating methodologies and processes.

Further, if credit analysts regularly received gifts from those whose securities they review, they might be inclined to skew a methodology to favor the arranger or underwriter.

The adoption of this rule banning gifts with a value greater than \$25 would relieve analysts, issuers and their representatives from the need to monitor this conflict and allow them to focus on more substantive matters within the credit ratings process.

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*- - - Amend Exchange Act Rule 17g-2 to add a new paragraph (8) to Rule 17g-2 that would require a registered NRSRO to make and retain a record showing all rating actions (initial rating, upgrades, downgrades, and placements on watch for upgrade or downgrade) and the date of such actions identified by the name of the security or obligor and, if applicable, the CUSIP for the rated security or the Central Index Key (CIK) number for the rated obligor.*

*Furthermore, the Commission is proposing to amend Rule 17g-2(d) to require that this record be made publicly available on the NRSRO's corporate Internet Web site in an interactive data file that uses a machine-readable computer code that presents information in eXtensible Business Reporting Language ("XBRL") in electronic format ("XBRL Interactive Data File").*

*The purpose of this disclosure is to provide users of credit ratings, investors, and other market participants and observers the raw data with which to compare how the NRSROs initially rated an obligor or security and, subsequently, adjusted those ratings, including the timing of the adjustments. In order to expedite the establishment of a pool of data sufficient to provide a useful basis of comparison, this requirement would apply to all currently rated securities or obligors as well as to all future credit ratings.*

*The goal of this proposal is to foster greater accountability of the NRSROs with respect to their credit ratings as well as competition among the NRSROs by making it easier for persons to analyze the actual performance of the credit ratings the NRSROs issue in terms of accuracy in assessing creditworthiness. The disclosure of this information on the history of each credit rating would create the opportunity for the marketplace to use the information to develop performance measurement statistics that would supplement those required to be published by the NRSROs themselves in Exhibit 1 to Form NRSRO. - - - (page 36228)*

There is general agreement in the financial markets that the widespread misrating of structured finance products was one of the central causes of the Credit Crisis of '07-08. The misrating of these products was not the only cause of the crisis but it clearly obscured the risk embedded in an entire class of securities. This led to the significant mispricing of these assets.

Significant concentrations of credit and liquidity risk were created by the assignment of ratings from a small number of NRSROs who appear to have had conflicts of interests in the ratings process.

A lack of transparency in the public reporting of off-balance sheet obligations (ABCP conduits, SIVs, etc) of financial entities, in addition to the misrating and mispricing of securities, imperiled the stability of the global financial system.

Given the enormous market value of the global pool of fixed income securities we surely will look back and wonder why so little information on these assets was available. We wonder if market concentration and opacity exists in other financial markets now to the extent documented in the structured finance area.

It is understandable why the SEC and other global regulators are seeking exceptional new levels of transparency for the credit markets.

Global market stability requires new approaches to information disclosure and analysis.

Within this context we commend the Commission for the proposed measures to expose the credit rating actions of the NRSROs to public scrutiny in a readily accessible form (XBRL).

Public confidence in our financial institutions and markets demands this level of transparency.

When the Financial Times questioned the application of ratings methodologies to constant proportion debt obligations (CPDO) on May 20<sup>th</sup>, 2008 the media, academia, international regulators, oversight boards and market participants were generally not able to assess the validity of the Financial Times claims.

This proposal, for NRSROs to expose their rating actions, will create a method for all these parties to have easy access to the credit ratings of NRSROs, gather this data and perform various types of analysis.

This increased disclosure and transparency will create confidence in the credit ratings process and more generally enhance the stability of the financial system.

- Is the six-month delay before publicly disclosing a rating action sufficiently long to address the business concerns of the subscriber-based NRSROs and the issuer-paid NRSROs? Should the delay be for a longer period such as one or two years or even longer? Alternatively, is six months too long and should it be a shorter period of time such as three months or even shorter?

We recommend the Commission consider the application of this rule in a manner that varies according to the business model of the NRSRO.

If the NRSRO utilizes a "subscriber pay" model we recommend that the placement of rating actions on the NRSRO's website include a 12 month delay. This will serve to protect the intellectual property and labor embodied in the creation of the analysis.

If the NRSRO utilizes an "issuer pay" model we recommend that the placement of rating actions on the NRSRO's website occur with no delay or alternatively a very short (less than one week) delay.

We make these recommendations bearing in mind the substantial conflicts that are embedded in the "issuer pay" models.

Because the Commission choose not to require issuer "equivalent disclosure" for all classes of ratings (amendment of Rule 17g-5 new (a)(3) for structured finance products) the likelihood is high that "ratings shopping" will persist for "issuer pay" credit ratings of the other four classes of NRSRO ratings.

It does not appear that any of the proposed new rules will directly restrict the other classes of issuers from "ratings shopping." Or mandate broad disclosure of the material non-public information of the issuer to all NRSROs.

We assume this decision is premised on the Commission's belief that enhanced disclosure of rating actions and performance measurements will leverage market transparency forces to cure information asymmetry.

The proposed approach to rating action disclosure will increase market participants and academics ability to assess the accuracy of an NRSRO using comparative and historical analysis.

It is not clear that these forces will be sufficient to address base level asymmetries between compensated and non-compensated NRSROs and issuers.

It will be a relatively simple matter for these issuers to continue to rate shop even with the enhanced disclosure of rating actions.

The issuer need only pre-query the various NRSROs about the credit rating they would assign a security. The issuer would then choose to compensate the NRSROs with the highest ratings.

Although corporate securities, as a class, currently appear to have minimal conflicts embedded in the ratings process it is really not so long ago that significant issues arose when a dominant underwriter, Drexel Burnham Lambert, controlled the high yield market.

One need only look back to the 70's and 80's to see highly concentrated activity in that market. We are aware of no regulatory restraints that would limit the emergence of another underwriting entity with such dominance.

We recommend the immediate publication of "issuer pay" ratings on an NRSRO's website due to the following:

- a) The assurance of global financial stability when issues arise related to the rating of entire classes of securities or an exceptionally large issuer
- b) The potential for increased concentration of underwriting
- c) The need to counterbalance "rating shopping" in the other four classes of securities

- Should the rule require that a notice be published along with the XBRL Interactive Data File warning that because of the permitted delay in updating the record some of the credit ratings in the record may no longer reflect the NRSRO's current assessment of the creditworthiness of the obligor or debt security?

We believe that a general disclaimer, prominently displayed on the NRSROs website, would serve as appropriate notice concerning whether the credit ratings made available in XBRL were "current assessments" or their publication was delayed for a specific period of time.

- Are there ways in which the NRSROs should be required to sort the credit ratings contained on the record such as by asset class or type of ratings?

It would be useful for the purposes of analysis by market participants and academics if the class of rating was identified in the published XBRL record of a rating. This would allow users to sort the data in any manner that was useful for their analysis.

- What mechanisms are appropriate for identifying rated securities? Are there other identifiers in addition, or as an alternative, to CUSIP or CIK number that could be used in the rule?

Generally the use of the CIK and CUSIP are excellent. We encourage the Commission to consider the use of TRACE symbols for corporate securities which are reported to FINRA's TRACE system.

- Should the Commission allow the ratings action data to be provided in a format other than XBRL, such as pipe delimited text data ("PDTD") or eXtensible Markup Language ("XML")? Is there another format that is more widely used or would be more appropriate than XBRL for NRSRO data? What are the advantages/disadvantages of requiring the XBRL format?

No, NRSRO should be required to provide ratings action data in XBRL.

Because the Commission is in the process of mandating the use of XBRL for public reporting company financials and mutual fund summaries the use of XBRL for NRSRO performance statistics will be particularly useful.

Further we anticipate that European securities regulators will embrace a similar framework for the oversight of credit rating agencies.

XBRL has been enjoying global adoption. We encourage the Commission to envision a future with vast quantities of readily parsable data available to market participants and regulators in XBRL. The addition of NRSRO performance data available in an XBRL format will greatly enrich the global dataset.

- Should the Commission take the lead in creating the new tags that are needed for the XBRL format or should it allow the tags to be created by another group and then review the tags? How long would it take to create new tags?

Yes. The Commission should determine a minimum set of tags and mandate the use of those tags by the NRSROs. This should be done within 30 days.

Concurrently, the Commission should engage XBRL US to create a comment process and craft an additional body of tags for voluntary use by NRSROs and market participants for NRSRO data.

This voluntary set of tags would build on the basic set of tags and allow the extension and customization of the reporting of performance statistics. The development and ongoing maintenance of this voluntary set of tags should be done by XBRL US in coordination with their international counterparts.

- The Commission anticipates that the data provided by NRSROs would be simple and repetitive (*i.e.*, the data would be name, CUSIP, date, rating, date, rating, etc.). Is there a need for more detailed categories of data?

It would be useful if the minimum tag set listed above included a tag for the “class” of rating. This would allow users to parse out data for different classes of securities and provide more detailed performance statistics.

Additional tags should be voluntary.

- What would be the costs to an NRSRO to provide data in the XBRL format? Would there be a cost burden on smaller NRSROs? Is there another format that would cost less but still allow investors and analysts to easily download and analyze the data?

Smaller NRSROs would likely provide the minimum set of tags for the universe of ratings which they produce. It should not be prohibitive for smaller firms to either develop or contract the development of a lightweight database and file serving system to meet this Commission requirement. Additionally significant development resources are available via [XBRL.us](http://XBRL.us) and various XBRL vendors.

In the extreme, the Commission could allow a small NRSRO to petition for exemption from this requirement. This would not likely happen though as the market will come to expect a higher level of transparency related to performance statistics reporting.

- Should the Commission institute a test phase for providing this information in an XBRL format (such as a voluntary pilot program, similar to what it is currently doing for EDGAR filings)? How long should this test phase last?

We believe that a test phase should be relatively short in keeping with the simplicity of the requirements of this mandate. We suggest 90 days for a test pilot and an additional 45 days for users to provide comments to the Commission.

- Where is the best place to store the data provided by NRSROs? Currently, information that needs to be made publicly available is stored on each NRSRO’s website. Should the Commission create a central database to store

the information? If so, should it use the EDGAR database or should it create a new database?

We have commented previously that we believe a central repository for performance statistics (NRSRO Exhibit 1) utilizing the Edgar system would be useful to investors. This would be in addition to the placement of Exhibit 1 on a NRSRO's site.

For the dissemination of individual rating actions we believe that the NRSRO's own site is a more effective location (in XBRL format). We believe that it is not necessary and would be challenging administratively to require the timely aggregation of this data within Edgar.

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- - - Amend *paragraph (a)(2) of Rule 17g-2 to add an additional record that would be required to be made for each current credit rating, namely, if a quantitative model is a substantial component in the process of determining the credit rating, a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued.*

- Would this proposal have the impermissible effect of regulating the substance of credit ratings in any way?

No. We do not believe that this requirement for a disclaimer record would constitute regulating the substance of ratings. This requirement would support enhanced transparency for the ratings process and investor protection.

- Should the Commission define in the rule when the use of a model would be a "substantial component" in the process of determining a credit rating? Commenters endorsing the adoption of such a definition should provide specific proposals.

No.

- Are there certain types of rated products (e.g., corporate debt, municipal bonds) which generally employ a quantitative model as a substantial component of the ratings process? Commenters should identify the types of bonds and a general description of the models used to rate them.

The Credit Rating Agency Reform Act allows qualitative and quantitative methodologies for the analysis of rated debt. The current NRSROs have stated that they generally use a combination of quantitative and qualitative methodologies. It is very difficult to predict what new methodologies and systems will evolve.

- Should the Commission define in the rule when the divergence from a model would be "material"? Commenters endorsing the adoption of such a definition should provide specific proposals.

Defining materiality in this context would be difficult given the large number of data sources, models and rated products. We recommend allowing the NRSROs to determine "material." It would be useful for the NRSROs to disclose their guidelines for this determination.















The result of this effort should be an important new framework for a central part of our global financial markets.

We appreciate being part of this work.

Very kind regards,

Cate Long

Rhinebeck, New York

July 25, 2008