RapidRatings

July 25, 2008

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

Re: File Number S7-13-08

Dear Ms. Harmon,

On behalf of Rapid Ratings International Inc. ("Rapid Ratings") we are pleased to submit these comments to the U.S. Securities and Exchange Commission (the "Commission") in response to Release No 34-57967, Proposed Rules for Nationally Recognized Statistical Rating Organizations ("NRSROs").

Rapid Ratings is a subscriber-paid credit rating firm that employs proprietary quantitative models to produce Financial Health Ratings (FHRs™) on listed and unlisted companies in the US and abroad using only historical corporate financial information.

We have had an excellent track record for the last 10 years in anticipating the deterioration, distress, default and turnaround of securities issuers months and years prior to issuer-paid rating agencies, CDS spreads, share prices and models which employ market signals.

Our niche in the market is to provide early warning signals about the creditworthiness and underlying financial health of issuers, a service of increasing importance since the collapse of Enron, WorldCom, Global Crossing and others. Rapid Ratings does not rate asset-backed securities.

We recognize that in the three related recommendations announced in June 2008 the Commission has completed an extensive review of the actions, and consequences of actions, of the NRSROs and other players involved in the recent structured products/sub-prime crisis. We believe that the largest of the NRSROs, and other market participants, clearly had a material role in the circumstances that led to the current credit volatility and general financial market dislocation.

The stated intent of the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Act") was to "improve ratings quality for the protection of investors and in the public interest by fostering

accountability, transparency and competition in the credit rating industry."[1] We agree that these are worthy and necessary goals. Although these goals were not wholly achieved by the Rating Agency Act, we commend the Commission's efforts to bring transparency to aspects of the structured products ratings business now. The disclosure of ratings criteria and due diligence measures and the public availability of data on collateral underlying structured products are positive steps for providing insight and accountability into this industry.

However, we believe some aspects of the current proposed rules, specifically those addressing conflicts of interest, do not push far enough, and do not truly address the core issues of conflict at hand. We expand on this point further below.

More troubling is that it seems there has been an unintended consequence of the proposed rules amendments. Elements of the proposed rules run counter to the Commission's stated objective to foster competition in the ratings business and do not assist in creating a "level playing field" for issuer-paid NRSROs and subscriber-paid NRSROs. In its efforts to increase transparency with the Proposed Rules, the Commission is erecting a significant new barrier to competition and fostering de facto support of the issuer-paid firms. As an inadvertent result of the Commission's new proposals, subscriber-paid NRSROs would be materially disadvantaged.

The Commission estimates that approximately 30 rating agencies will register as NRSROs, a 200% increase from present numbers. We caution the Commission that, if all the proposed rules are passed following this comment period, this number is an unlikely, optimistic projection.

In the recent credit market turmoil one or more NRSROs withheld information from the market about certain risk factors affecting the likelihood of default and loss given default for certain structured products. This behavior is being addressed, among other things, by the requirement for all NRSROs to make all of their ratings and their rating actions available to the public. On the surface, this will mean that external, objective observers can assist the market to learn which rating agencies offer the most accurate and timely services. However, there is a major level playing field consequence that apparently was either overlooked or dismissed. If this proposal is enacted, and all NRSROs are required to present their ratings and ratings histories free of charge on their websites, it will severely undermine the business model of subscriber-paid NRSROs, regardless of the time lag (e.g. 6mo, 1yr, 2yr) embedded into the rule. This is a major new barrier to entry and creates a significant disincentive to apply for the NRSRO designation.

Our ratings are the foundations for our products, and not being compensated by issuers presents a key foundation for our unconflicted, independent voice. We must remember that a key economic motivation of the issuers in paying for ratings is to get their bonds sold. Thus, the issuers primarily pay for the "marketing" service the issuer-paid NRSROs provide (the "toll" to

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[1] Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006)

access the capital markets), not for the information provided in the ratings. This of course is why the issuer-paid NRSROs are less affected by a requirement to provide free ratings; they've already been paid irrespective of whether the ultimate consumers (investors) of the ratings actually use, or even ask for, the ratings. Our business, in contrast, is built solely upon subscribers' requesting and paying for our ratings. We expand on this point further below.

The focus in the proposals mainly deals with the failings of the issuer-paid ratings model. This is appropriate given that, either by commission or omission, they were the source of some of the problems in the sub-prime crisis. Unfortunately, the discussion of solutions remains centered on fixing the issuer-paid model, where some of the problems are irremediable, and ignores the value of the solutions that can be brought to bear by creating a level playing field for subscriber-paid ratings firms.

Greater objectivity, independence and accountability from the dominant NRSROs are expected to flow from a reduction of the potential for conflicts of interest which arose, in part, from dominant NRSRO participation in the design of structured products such as residential mortgage-backed securities. But left unaddressed is the more compelling fact that the business model of the dominant NRSROs naturally invites conflict of interest because the rating agencies are paid directly by the issuers of securities. As long as regulations directly or indirectly favor issuer-pay NRSROs over subscriber-paid rating agencies, the potential to raise the ethical standards of the incumbent NRSROs will be undermined. Ironically before the 1970s, the subscriber-paid model, which has the best potential for protecting the interests of investors, was the dominant rating agency business model.

In the following pages we provide answers to many of the specific questions asked in the Proposed Rules as well as comments to some of the critical topics.

II. PROPOSED AMENDMENTS

A. Amendments to Rule 17g-5

1. Addressing the Particular Conflict Arising from Rating Structured Finance Products by Enhancing the Disclosure of Information Used in the Rating Process

a. The Proposed Amendment

from page 39: **Unsolicited Ratings**
Q: Would the information proposed to be required to be disclosed sufficient to permit the determination of an unsolicited credit rating? Conversely, would the proposed amendment require the disclosure of more information than would be necessary to permit the determination of an unsolicited credit rating? Commenters believing more information should be disclosed should specifically describe the additional information and the practicality of requiring its disclosure, while commenters believing that less information should be disclosed should specifically describe what information would be unnecessary and explain why it would be unnecessary to disclose.

A: This is not directly applicable to Rapid Ratings as we rate corporate entities from their publicly disclosed financials and private companies from financials provided to us from various customers. As such, we cannot comment sufficiently on the completeness of this disclosure for the purposes of conducting structured asset class ratings.

We note for the Commission that the very term "Unsolicited Ratings" has its origins in the issuer-paid paradigm and its continued use carries an issuer-paid bias and indeed a negative bias when unsolicited ratings were thought to be a coercive technique by a particular NRSRO to force unrated 144A issuers into paying for their ratings services. As stated on Page 30 "As used herein, an "unsolicited rating" is one that is determined without the consent and/or payment of the obligor being rated or issuer, underwriter, or arranger of the securities being rated."

In Rapid Ratings' estimation, our ratings are "solicited" because we are paid by our customers who want to have ratings on companies, and we provide those ratings from publicly available information without regard to a company's desire to be rated (or not). We have no contact whatsoever with the companies we rate and have no insight into their views on our ratings. In fact, we rate companies based on financial statements' being available and some are not even issuers of debt securities. Are our ratings solicited? They are not solicited by issuers but they are solicited by subscribers to our products.

Disclosure Requirements vs, Safe Harbor

Q: The proposed amendment would require the disclosure of information provided to an NRSRO by the "issuer, underwriter, sponsor, depositor, or trustee" based on the Commission's preliminary belief that these would be the parties relevant to an NRSRO's performance of the ratings process, i.e., that taken together, these are the parties that would provide all relevant information to the NRSRO. Are there other entities that should be included in this category?

And

Q: Should the Commission provide a "safe harbor" so that an NRSRO that obtained a representation from one or more parties to a transaction to disclose the required information would not be held in violation of the rule if the party did not fulfill its disclosure obligations under the representation?

A: No other entities should be included. Ultimately the responsibility should lie with the NRSRO to disclose or verify that all information to which they have been privy is disclosed, regardless of the discloser unless the disclosure breaches property rights or promotes breach of contract. If the NRSRO is not the elected party performing the disclosure, it should not be exempt from this responsibility. If, for instance, the arranger/investment bank assumed the responsibility for the disclosure and de facto indemnified the NRSRO from this responsibility that could be construed as, or be manipulated into, a "gift." The arranger prepared to assume this responsibility/liability could become a favored counterparty for the NRSRO. This type of

potential behavior could become a competitive tool for the arranger and curry favor from the NRSRO. Essentially, assumption of liability is a valuable currency.

From page 40 **Asset Disclosure**
Q: Should the Commission also require the disclosure of information about the steps, if any, that were taken by the NRSRO, issuer, underwriter, sponsor, depositor, or trustee to verify information about the assets underlying or referenced by the security or money market instrument, or, if no such steps were taken, a disclosure of that fact?

A: Yes. The current NRSROs have not comported themselves in a way that fosters benefit of doubt in their due diligence or inclination towards forthcoming disclosure. Requiring their participation in full asset disclosure is seemingly necessary.

Competition Implications of Disclosure Timing Issues
Q: Would the disclosure of the initial information on the pricing date provide enough time for other NRSROs to determine unsolicited ratings before the securities were sold to investors? If not, would it be appropriate to require that this information be disclosed prior to the pricing date? Alternatively, would it be more appropriate to require NRSROs hired by the arranger to wait a period of calendar or business days (e.g. 2, 4, 10 days) after the asset pool is settled upon by the arranger before issuing the initial credit rating in order to provide other NRSROs with sufficient time to determine an unsolicited rating?

A: Rapid Ratings does not have an opinion on the time necessary required to rate structured products from first receipt of data. However, if the Commission is attempting to promote greater due diligence by the investment community buying these products, it is incumbent upon the Commission to enable multiple sources of information to be digested by market participants. If not, the Commission is inadvertently promoting the buyers' reliance on the handful of NRSRO's ratings (with which they are most familiar) alone in the shortest time frame to act in order to accept pricing. This is counterproductive to the stated goal of promoting greater investor research and due diligence. Allowing for a lead period is essential to have any other ratings system digest and provide an opinion (fundamental or quantitative) on the data underlying the structured product.

We note that most investors cannot perform thorough due diligence on many complex structured products from a prospectus alone. Given the nature of the underlying data to which the issuer-paid NRSROs have been privy in the ratings process that is not included in the prospectus, investors have necessarily deepened their reliance on these agencies. Full disclosure of information is the only way to provide alternate analytical opinions/ratings and to promote satisfactory due diligence by securities' buyers.

Disclosure of Verification Steps
Q: Should the Commission also require the disclosure of the results of any steps taken by the NRSRO, issuer, underwriter, sponsor, depositor, or trustee to verify information about the assets underlying or referenced by a structured finance product? Alternatively, should the

Commission require a general disclosure of whether any steps were taken to verify the information and, if so, a description of those steps?

A: Yes. Please see both answers immediately above.

Unsolicited Ratings and Related Disclosure Issues
Q: Do NRSROs obtain information about the underlying assets of structured products – particularly in the surveillance process – from third-parties such as vendors rather than from issuers, underwriters, sponsors, or trustees? If so, would it be necessary to require the disclosure of this information as proposed or can the goals of the proposed amendments in promoting unsolicited ratings be achieved under current practices insomuch as the information necessary for surveillance can be obtained from third-party vendors, albeit for a fee?

A: Yes. Please see answers above.

2. Rule 17g-5 Prohibition on Conflict of Interest Related to Rating an Obligor or Debt Security where Obligor or Issuer Received Ratings Recommendations from the NRSRO or Person Associated with the NRSRO

From page 61 **Conflict of Interest for Issuer-Paid Rating Agencies**
Q: Is this type of conflict one that could be addressed through disclosure and procedures to manage it instead of prohibiting it? Should the Commission, rather than prohibiting it, add this type of conflict to the list of conflicts in paragraph (b) of Rule 17g-5, which, under paragraph (a) of the rule, must be addressed through disclosure and procedures to manage them?

A: We agree with the Commission's statement on page 60 of the proposed rules release that "The information provided by the NRSRO during the rating process allows the arranger to better understand the relationship between model outputs and the NRSRO's decisions with respect to necessary credit enhancement levels to support a particular rating. The arranger then can consider the feedback and determine independently the steps it will take, if any, to adjust the structure, credit enhancement levels, or asset pool. However, if the feedback process turns into recommendations by the NRSRO about changes the arranger could make to the structure or asset pool that would result in a desired credit rating, the NRSRO's role would transition from an objective credit analyst to subjective consultant."

However, we think the preamble to the third question on page 61 addresses this question accurately "The Commission recognizes that the line between providing feedback during the rating process and making recommendations about how to obtain a desired rating may be hard to draw in some cases."

We believe that in practice this separation is extremely difficult to police. There is a fine line between an arranger's receiving advice and receiving multiple rounds of feedback from which "advice" can be derived. At the least this should be prohibited, but even this will only be a partial measure and will not completely insulate the entities from the potential of a conflict.