

THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy



VIA <http://www.sec.gov/rules.shtml>

August 8, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 64514 [File No. S7-18-11] RIN: 3235—
AL15, 76 FR 33420 (June 8, 2011)

Dear Ms. Murphy:

The Financial Services Roundtable (the “Roundtable”) respectfully submits these comments in response to the Securities and Exchange Commission’s (the “Commission”) request for comments on rules (the “Proposals”)¹ to regulate credit rating agencies under Title IX, Subtitle C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).² The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America’s economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

Executive Summary

The Roundtable generally supports the Commission’s Proposals to enhance the regulation, accountability, and transparency of credit rating agencies that are

¹ Nationally Recognized Statistical Rating Organizations, Securities Exchange Act Release No. 64514 [File No. S7-18-11], 76 FR 33420 (June 8, 2011) (the “Proposing Release”).

² *Improvements to the Regulation of Credit Rating Agencies*, Pub. Law No. 111-203, § 931-939H, 124 Stat. 1872-90 (July 21, 2010).

nationally recognized statistical rating organizations. The Proposals would enhance the Commission’s oversight of credit rating agencies, including internal controls, conflicts of interest, professional standards for credit analysts, and credit ratings’ methodology.³ The Proposals also would regulate due diligence reports provided by third parties⁴ to an issuer or underwriter of asset-backed securities (“ABS”) transactions.⁵

The Roundtable’s comments generally address aspects of the Proposals that may have a direct impact on ABS markets. In brief, the Roundtable’s enumerated comments are:

- The Commission should suspend or revoke a credit rating agency’s status as a nationally recognized statistical rating organization only upon a showing that suspension or revocation is necessary to protect investors.
- A credit rating agency should investigate fully any potential conflict of interest relating to its hiring of an analyst *before* taking any action (*e.g.*, a credit watch) affecting a credit rating.
- The Commission should clarify the manner in which changes in methodology should be applied to outstanding ratings.
- A credit rating agency should not apply changes in methodologies to then-current ratings without a change in the performance of those securities.
- Proposed new paragraph (a) of rule 17g-7 should not apply to credit rating agency confirmations.
- We ask the Commission to clarify that the requirement for a “description of the data” relied upon requires only a description of the general type of data and not disclosure of specific data.

³ See, §§ 932-38, 939B, and 939H of the Dodd-Frank Act, Pub. Law No. 111-203, §§ 932-38, 939B, and 939H, 124 Stat. 1872-85, 87, and 90 (July 21, 2010).

⁴ See Proposed new rule 17g-10 under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78oo (2010) (the “Exchange Act”), and proposed new Form ABS Due Diligence-15E. See also, sections 15E(s)(4)(B) and (C) of the Exchange Act, 15 U.S.C. §§ 78o-7(s)(4)(B) and (C) (2010) (mandating written certifications by a third party service provider concerning the conduct of its due diligence on an ABS transaction, and that the Commission establish the format and content of the required certification).

⁵ See Proposed new rule 15Ga-2 under the Exchange Act and proposed amendments to Form ABS-15G. See also, section 15E(s)(4)(A) of the Exchange Act, 15 U.S.C. § 78o-7(s)(4)(A) (2010) (mandating public disclosure of the third party service provider’s due diligence on an asset backed securities transaction).

- We ask that the Commission further revise proposed rule 15Ga-2 to reduce the potential that the timing of a credit rating agency’s “rule 17g-7(a)(1) report” may create an impediment to prompt market access for many issuers.
- The Roundtable asks the Commission to exclude “agreed-upon procedure” engagements from any rules applicable to third-party due diligence procedures.

I. CONFLICTS OF INTEREST RELATING TO SALES AND MARKETING

- A. **The Commission should suspend or revoke a credit rating agency’s status as a nationally recognized statistical rating organization only upon a showing that suspension or revocation is necessary to protect investors.**

The Commission proposed new paragraph (g) to Rule 17g-5 to implement Section 15E(h)(3)(B)(ii) of the Exchange Act. As proposed, the Commission shall suspend or revoke the registration of a nationally recognized statistical rating organization (an “NRSRO”) if the Commission finds that (i) the NRSRO has violated a rule issued under Section 15E(h) of the Exchange Act,⁶ (ii) the violation affected a rating, and (iii) suspension or revocation is necessary for the protection of investors and in the public interest.⁷

The Commission noted that “[t]he first two proposed findings . . . mirror the text of Section 15E(h)(3)(B)(ii) of the Exchange Act. The final finding—that the suspension or revocation is necessary for the protection of investors and in the public interest—is a common finding that the Commission must make to take disciplinary action against a registered person or entity.”⁸ Without the third finding, a mere violation of a rule *that affected a rating* could result in suspension or revocation of NRSRO status, even when a suspension or revocation would lead to significant market instability, thereby adversely affecting investors and harming the public interest.

Furthermore, the Commission noted that a proceeding brought under Section 21C of the Exchange Act⁹ does not require that the violation be willful,¹⁰

⁶ 15 U.S.C. § 78o-7(h) (2010).
⁷ Proposing Release, 76 FR at 33428.
⁸ *Id.*
⁹ 15 U.S.C. § 78u-3 (2010).
¹⁰ Proposing Release, 76 FR at 33427, n. 56.

and could result in a suspension that exceeds 12 months.¹¹ As the Commission stated:

Given that Section 21C of the Exchange Act has lower threshold for the intent to establish a violation, and given the substantial consequences of suspending or revoking a registration, the Commission preliminary believes that the public interest finding would be an appropriate predicate to a suspension or revocation of an NRSRO's registration under Section 21C of the Exchange Act."¹²

The Roundtable agrees with the Commission's rationale.

Thus, a suspension or revocation of an NRSRO's registration is not without cost. We believe the third finding that would be required under proposed new paragraph (g) of Rule 17g-5 would ensure that the registration would not be suspended or revoked without a countervailing benefit (*i.e.*, the protection of investors and the public interest). Therefore, the Roundtable supports the inclusion of the third finding in proposed new paragraph (g) to Rule 17g-5.

II. "LOOK-BACK" REVIEW

A. **A credit rating agency should investigate fully any potential conflict of interest relating to its hiring of a rating analyst *before* taking any action (*e.g.*, a credit watch) affecting a credit rating.**

The Commission proposed paragraph (c) of new Rule 17g-8 under Section 15E(h)(4)(A)(ii) of the Exchange Act, which would implement the requirement that an NRSRO perform a "look-back" review to determine whether a conflict of interest influenced a credit rating.¹³ As proposed, the rule would provide that the NRSRO must maintain policies and procedures reasonably designed to ensure that it will: (1) immediately place the credit rating on credit watch; (2) promptly determine whether the credit rating must be revised so it no longer is influenced by a conflict of interest and is solely the product of the NRSRO's documented procedures and methodologies for determining credit ratings; and (3) promptly publish a revised credit rating, if appropriate, or affirm the credit rating, if appropriate.¹⁴

The Roundtable believes that placing the credit rating on credit watch prior to a comprehensive review would be unnecessarily disruptive to the market and

¹¹ See *id.* at 33428 (citing 15 U.S.C. § 78o-7(d) and 15 U.S.C. § 7u-3).

¹² *Id.*

¹³ Pub. L. No. 111-203, § 932(a), 124 Stat. 1875 (2010).

¹⁴ Proposing Release, 76 FR at 33429.

would harm both investors and issuers. The Commission is proposing many new protections to prevent undue conflicts of interest, including new internal control requirements, which are intended to make it very difficult to influence ratings in an improper manner.

Especially in light of these new protections, the Roundtable believes that the risk of harm from a ratings action (*e.g.*, a credit watch) prior to a determination that a rating was influenced inappropriately would be significantly greater than the risk of a temporary delay in a ratings action. Accordingly, the Roundtable asks the Commission to require that the credit rating agency investigate fully any potential conflict of interest before taking any action affecting a credit rating.

III. CREDIT RATING METHODOLOGIES

A. **The Commission should clarify the manner in which changes in methodology should be applied to outstanding ratings.**

Proposed paragraph (a) of new rule 17g-8 would require that an NRSRO have policies and procedures for credit rating methodologies, including changes to credit rating methodologies. As proposed, the rule does not address whether an NRSRO applying changed methodologies to outstanding ratings must re-rate the transaction based on the information available at the time of the initial rating, or whether the process also should include performance information received after closing. At a minimum, we ask the Commission to require an NRSRO to (i) clarify which approach it has taken, and (ii) distinguish between methodology-based ratings actions and performance-based ratings actions.

B. **A credit rating agency should not apply changes in methodologies to then-current ratings without a change in the performance of those securities.**

Proposed paragraph (a) of new rule 17g-8 would require that an NRSRO have policies and procedures reasonably designed to ensure that (i) any material changes to its methodologies are applied consistently to all credit ratings to which the changed methodologies apply; and (ii) any changes to surveillance or monitoring methodologies are applied to then-current ratings within a reasonable period of time.¹⁵

A credit ratings change on existing securities when there has not been a change in the *performance* of the rated securities has the potential to be very disruptive to the market. Although in some instances NRSROs may choose to re-

¹⁵ *Id.* at 33452-53.

evaluate a rating in light of changes to its methodologies, the Roundtable does not believe they should be required to do so unless there was a change in performance from that anticipated at the commencement of the transaction.

Accordingly, the Roundtable asks the Commission to clarify that the mandated disclosure relates to methodology—not performance—of the securities.

IV. FORM AND CERTIFICATIONS TO ACCOMPANY CREDIT RATINGS

A. Proposed new paragraph (a) of Rule 17g-7 should not apply to rating agency confirmations.

The Proposals would require that an NRSRO publish the items described in paragraphs (a)(1) and (a)(2) of Rule 17g-7 when the NRSRO takes a rating action with respect to an obligor, security, or money market instrument. This extensive disclosure includes

- the symbol, number or score assigned to, and the identity of, the obligor, security, or money market instrument;
- the version of the procedure or methodology used to determine the credit rating; the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating;
- the potential limitations of the credit rating;
- whether and to what extent third-party due diligence services were used by the NRSRO, a description of the information that the third party reviewed, and a description of the third party's findings or conclusions;
- an explanation or measure of the potential volatility of the credit rating;
- information on the content of the credit rating, including the expected probability of default and the expected loss in the event of default;
- information on the sensitivity of the credit rating to assumptions made by the NRSRO; and
- a description of the representations, warranties, and enforcement mechanisms available to investors in ABS transactions, and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities.

The term “rating action” is defined broadly, and includes “an affirmation of an existing credit rating.” The “affirmation” would include affirmations resulting from a “look-back” review. However, it is not clear whether an “affirmation” also would include the common process under which an NRSRO confirms that a particular action will not in and of itself cause a change in the credit rating.¹⁶

The Roundtable believes the requirements of proposed new paragraph (a) of Rule 17g-7 should not be triggered by an NRSRO’s communication indicating that a particular action will not change a credit rating. These confirmations typically are obtained for very minor document changes or in connection with anticipated actions. Thus, compliance with Rule 17g-7 in these circumstances would add little value and may delay critical, time-sensitive confirmations.

B. The Commission should clarify that the requirement for a “description of the data” relied upon requires only a description of the general type of data and not disclosure of specific data.

Proposed new paragraph (a)(1)(ii)(H) of proposed new Rule 17g-7 would require an NRSRO to disclose a description of the data about any obligor, issuer, security, or money market instrument on which it relied to determine the credit rating.

It is unclear whether this rule would require (a) a description of the *general types* of data considered relevant (*e.g.*, “information regarding default rates”), or (b) a description of the *specific* data reviewed (*e.g.*, “information that showed a default rate of [x]”). We believe that investors should obtain this data from the issuer’s offering documents rather than from rating agency disclosures. Disclosures in the issuer’s offering documents are subject to a level of review that might not be applied if an NRSRO were transcribing issuer data. Moreover, the Roundtable is concerned that a requirement to disclose specific data, rather than the relevant categories of data, could lead to disclosure of information provided to an NRSRO on a confidential basis.

¹⁶ An “affirmation” means an NRSRO’s confirmation that a particular action, such as an amendment to an agreement that does not require investor consent or the issuance of new securities from a master trust, will not in and itself cause a downgrade, withdrawal or qualification with negative implications for a credit rating.

Therefore, the Roundtable asks the Commission to exempt from disclosure under the Freedom of Information Act¹⁷ any proprietary data¹⁸ generated pursuant to proposed new paragraph (a)(1)(ii)(H) of new rule 17g-7.

- C. We ask that the Commission further revise proposed rule 15Ga-2 to reduce the potential that the timing of the credit rating agency’s “rule 17g-7(a)(1) report” may create an impediment to prompt market access for many issuers.**

As re-proposed, revised Rule 15Ga-2 would require that an issuer or underwriter of an ABS transaction that is to be rated by an NRSRO disclose on Form ABS-15G the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. However, the issuer or underwriter would not be required to furnish Form ABS-15G if it receives from the NRSRO a representation on which it may reasonably rely that the NRSRO will publicly disclose this information five (5) business days prior to the first sale in the offering.

The Roundtable believes the five (5) business-day delay prior to the first sale in an offering under Regulation AB would be unnecessarily long in many circumstances. We also believe that tying the disclosure of rule 17g-7(a)(1) reports to “the first sale in an offering” may not be practical, and may create an impediment to prompt market access for many issuers.

V. THIRD-PARTY DUE DILIGENCE FOR ASSET-BACKED SECURITIES

- A. The Roundtable asks the Commission to exclude “agreed-upon procedure” engagements from any rules applicable to third-party due diligence procedures.**

The Commission has proposed several rules relating to third-party due diligence services for ABS transactions. It is unclear whether these rules would apply to services provided by accountants pursuant to “agreed-upon procedure” engagements.

Issuers sometimes engage accountants to perform specified procedures associated with the accuracy of information included in ABS transaction offering documents, and the accountants typically report their findings to the issuer and underwriter. These procedures generally consist of tying information back to a

¹⁷ 5 U.S.C. § 552 (2010).

¹⁸ 5 U.S.C. § 552(b)(4) (2010) (exempting from disclosure “trade secrets and commercial or financial information [that is] privileged or confidential”).

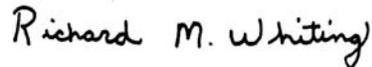
source document, or recalculating information for accuracy. The procedures do not include verification of information in source documents, or providing any evaluation or assurance regarding the credit quality of underlying assets. The procedures are agreed to between sophisticated parties, and each party understands the limits to those procedures.

The Roundtable does not believe it would be appropriate to require public disclosure of such reports, and we understand that the accounting firms that typically provide these reports have significant concerns about doing so. We believe the Commission should clarify that this is not required, and that “due diligence” reports should be limited to those that directly evaluate asset terms and quality.

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The Roundtable and its members appreciate the opportunity to comment to the Commission on the Proposals to regulate credit rating agencies and due diligence reports on ABS transactions provided to issuers or underwriters. If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org. Please also feel free to contact the Roundtable's Senior Regulatory Counsel, Brad Ipema, at Brad.Ipema@fsround.org.

Sincerely yours,



Richard M. Whiting
Executive Director and General Counsel
The Financial Services Roundtable

With a copy to:

The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

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