Morgan Stanley

September 13, 2011

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary

Re: Solicitation of Comment to Assist in Study on Assigned Credit Ratings (Release No. 34-64456; File No. 4-629)

Ladies and Gentlemen:

As noted in our previous letters to the Securities and Exchange Commission (the "Commission") dated November 16, 2010 and March 23, 2011, we continue to appreciate the receptiveness of the staff of the Commission to our comments on rulemaking required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act").

Section 939F of the Act requires the Commission to conduct a study on matters related to the credit ratings process for asset-backed securities, as newly and broadly defined by the Act,[1] as well as structured products "based" on ABS (collectively, "structured finance products"); the conflicts of interest associated with the issuer-pay and the subscriber-pay models; the feasibility of establishing a system in which a specified entity assigns nationally recognized statistical rating organizations ("NRSROs") to determine the credit ratings of structured finance products; and alternative means for compensating NRSROs to create incentives for accurate credit ratings. Section 939F also requires the Commission to submit to Congress, not later than 24 months after the date the Act was enacted, a report containing the findings of its study, together with any recommendations for regulatory or statutory changes that the Commission determines should be made to implement the findings of the study. After submission of the report, Section 939F requires the Commission to establish a system for the assignment of NRSROs to determine the initial credit ratings of structured finance products. The Commission is directed to give consideration to a system that was found in (and removed from) the Senate's version of the Act before it was passed (*i.e.,* Section 15E(w) as it would have been added to the Securities Exchange Act of 1934, as amended, by Section 939D of H.R. 4173 (111th Congress), as passed by the Senate on May 20, 2010) (the "Section 15E(w) System") and, to the extent that the Commission's study does not identify an approach that would better serve the public interest and the protection of investors, to implement the Section 15E(w) System. The Section 15E(w) System would create a Credit Rating Agency Board, which would determine qualification standards for NRSROs eligible to produce initial credit ratings of structured finance products and

[1] Section 3(a)(77) of the Securities Exchange Act of 1934 (the "Exchange Act"), as added by Section 941(a) of the Act.

would assign qualified NRSROs to rate particular transactions upon application by issuers.

The Commission has solicited comments to assist it in carrying out the study required by Section 939F (the "Release").[2] We appreciate the Commission's openness to comments and suggestions regarding these matters, as demonstrated by the Release, and we hope that our thoughts on some of the requests for comment contained in the Release will help the staff of the Commission to better understand the industry's perspectives on the credit ratings process for structured finance products.

We believe the Commission should focus on two fundamental principles in implementing Section 939F. First, the Act specifically requires that any system adopted pursuant to Section 939F be necessary or appropriate in the public interest or for the protection of investors. In our view, the protection of investors is the lynchpin here – the benefits of any system that is adopted should exceed the burden on or detriment to investors, who ultimately use credit ratings as a tool to classify the various risks intrinsic to a security. Second, any such system should not disadvantage any one type of issuer of structured finance products over another. The system adopted should not prevent any type of issuer from accessing the capital markets, if there are other, less restrictive, means of protecting against the perceived conflicts of interest associated with the issuer-pay and subscriber-pay models.

Any Rating Agency Selection System Should Benefit Investors

Section 939F is clearly intended to address "conflicts of interest associated with the issuer-pay and the subscriber-pay models" that Congress believes "impair the accuracy of credit ratings." The Commission may adopt a system for the assignment of NRSROs to produce initial credit ratings of structured finance products, or some alternative system, only if it determines that system is "necessary or appropriate in the public interest or for the protection of investors." Unless the Commission affirmatively determines that a particular credit ratings system that minimizes conflicts of interest would provide investors with benefits that would outweigh any negative consequences, then that system will not be necessary or appropriate for the protection of investors and should not be adopted.

Among the negative consequences that must be considered are the economic costs of such a system, including any unintended economic consequences. As noted by the D.C. Circuit Court of Appeals in *Business Roundtable v. SEC,* in order to satisfy the requirements of the Administrative Procedure Act, the Commission must "adequately assess the economic effects of a new rule" by adequately "fram[ing] the costs and

[2] Solicitation of Comment to Assist in Study on Assigned Credit Ratings, SEC Rel. No. 34-64456 (May 10, 2011).

benefits of the rule, … quantify[ing] the certain costs" thereof and "support[ing] its predictive judgments."[3]

We believe that the Section 15E(w) System, or any other system for the assignment of NRSROs to produce initial credit ratings of structured finance products, would involve many direct and indirect costs and burdens, many of which ultimately would be borne by investors. These costs and burdens should be considered by the Commission in determining which system to adopt. Creating a new organization such as the Credit Rating Agency Board takes substantial start-up time and expense. In addition to the regular, ongoing direct administrative costs of any new system, such as the operating costs of the proposed entity, imposing a new layer of bureaucracy in the credit ratings process is likely to delay transactions and make them more expensive. In addition, as further described below, investors clearly do not consider all NRSRO ratings to be equally valuable, and we believe that investors themselves are in the best position to determine whether an NRSRO's opinion is an effective classification tool for their investments. In short, the Section 15E(w) System, or any other system for the assignment of NRSROs to produce initial credit ratings of structured finance products, would significantly burden the credit ratings process system with increased direct and indirect costs and burdens.

In our previous letter to the Commission dated November 16, 2010, we demonstrated that problems with the securitization markets were focused on categories of products where the pool assets were inherently risky, which were primarily limited to certain specific asset classes and products. In our view, regulatory actions designed to prevent against a recurrence of the credit crisis – including the actions required by Section 939F of the Act – should focus on the asset classes and products where investors in investment grade securities suffered unexpected losses. Because the credit ratings process performed (and continues to perform) well for many other asset classes and ratings of those products continue to be an objective and effective tool for investors, this illustrates that the conflicts of interest perceived by Congress have not impaired the accuracy of those ratings. As described above, the Section 15E(w) System, or any other system that involves the creation of an entity for the assignment of NRSROs to produce initial credit ratings of structured finance product, would impose a significant regulatory burden and significant costs, many of which ultimately would be borne by investors. If there is no commensurate benefit to investors in certain asset classes, then the public interest is not served by subjecting those asset classes to the new system.

Finally, and perhaps most importantly, because investors have specific preferences for the NRSROs they trust to make accurate ratings, we believe that any proposal to arrange for NRSROs to be randomly or arbitrarily assigned by a third party to provide credit ratings for structured finance products will adversely affect investors.

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[3] *Business Roundtable and the Chamber of Commerce of the United States of America v. Securities and Exchange Commission*, __ F.3d. ____, 2011 WL 2936808, at *3 (D.C. Cir. July 22, 2011).

Issuers decide which NRSRO to engage based on a desire to sell the securities into the best possible market. They choose certain NRSROs to rate their securities because they know that investors will put a premium on those assessments. We believe that the Section 15E(w) System, or any other any system that involves the random or arbitrary selection of NRSROs to rate structured finance products, would harm investors by preventing their preferences from being taken into account. In our conversations with investors regarding Section 939F, those investors have universally rejected any system in which NRSROs are randomly allocated to transactions and in which investors would have no direct or indirect input as to the choice of the NRSRO to rate their securities. In some types of structured finance product transactions, investors are involved in the structuring process from the inception of the transaction and often select the NRSRO that will rate the securities which effectively removes the perceived issuer-pay conflict. Even if the Commission adopts the Section 15E(w) System, or some other system that involves the random or arbitrary selection of NRSROs to rate structured finance products, we believe that transactions in which investors directly select the NRSRO rating their securities should be exempt from that system. There is no possible reason to eliminate the ability of an investor to chose an NRSRO to rate the securities that it is purchasing.

Any Rating Agency Selection System Should Not Arbitrarily Disadvantage Certain Types of Issuers

Any system for the assignment of NRSROs to determine the initial credit ratings of structured finance products, or any alternative system, should not arbitrarily disadvantage any one type of issuer of structured finance products from any other.

The rating of a securitized product requires a thorough understanding of the asset type and the structures commonly used in that product. Objectively, it is clear that many NRSROs cannot possibly have the expertise to rate all types of structured finance products. According to the Commission, the three largest NRSROs each employ over 1,000 analysts, and each of the remaining seven NRSROs employs fewer than 150 analysts (with several employing less than 20 analysts).[4] Investors with whom we have spoken are reluctant to accepting ratings made by NRSROs that do not have the requisite expertise to rate the product in question. Many institutional investors even have internal policies that prohibit them from investing in securities unless they are rated by certain NRSROs in which they are confident. Therefore, an issuer that goes into the market with an offering of securities rated by an NRSRO in which a majority of the investors do not have confidence will, at the very least, price those securities significantly worse than an identical offering with a rating from an NRSRO in which investors have confidence. At worst, those securities may not be marketable at all.

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[4] Securities and Exchange Commission, Annual Report on Nationally Recognized Statistical Rating Organizations, at p. 8 (January 2011), available at http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0111.pdf.

Any system in which the NRSROs cannot be chosen by issuers or investors would involve a significant risk that the transaction will be rated by an NRSRO in which investors do not have confidence. As a result, the issuers of structured finance products would be randomly subject to the possibility that their securities would be rated by an NRSRO that would result in significantly worse pricing than optimal, or even a total lack of acceptance by investors. This is manifestly unfair to all issuers, but would be most problematic for issuers affiliated with smaller sponsors that do not have cost-effective alternative sources of funding and therefore rely more heavily on the market for structured finance products to meet their capital needs.

Alternatives to Section 15E(w) System

We agree with and fully support the comment letters that have been submitted by both the Securities Industry and Financial Markets Association ("SIFMA") and the American Securitization Forum (the "ASF") regarding Section 939F of the Act. We agree that the Section 15E(w) System has far too many drawbacks to serve as an adequate alternative to the current system. The investor-owned, user-pay, stand-alone and designation models on which the Commission requests comment in the Release also have significant drawbacks as outlined in the SIFMA and ASF comment letters which, in our view, outweigh any possible benefits to investors or the industry. Of the systems on which the Commission requests comment, the one best suited to fulfill the statutory mandate of Section 939F and address the conflicts of interest inherent in the issuer-pay and subscriber-pay systems is the framework created to comply with Rule 17g-5. We believe that the realistic prospect of a non-hired NRSRO rating or issuing a comment on a transaction will serve to impose more transparency and discipline on both the issuer and the hired NRSRO. To the extent necessary, Rule 17g-5 could be modified in the ways suggested by SIFMA and the ASF in an effort to encourage more participation by non-hired rating agencies. As expressed in the SIFMA letter, no approach to implementing Section 939F can be judged solely by its success in achieving a single objective, such as addressing the perceived conflicts of interest identified in Section 939F. Instead, the success of any such reform ultimately must be measured by its overall effect on the credit ratings system – it is important to address the perceived problems without materially and unnecessarily disrupting the ability of the markets to generate capital. In our view, of the alternatives discussed by the Commission in the Release, Rule 17g-5 is the least disruptive and most effective method of achieving the objectives of Section 939F while having an overall positive effect on the credit ratings system. We believe that it is the only system discussed by the Commission that is likely to receive the support of investors and issuers alike.

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As we stated in our previous letters, revitalization of the securitization markets is critical to providing credit to consumers and businesses and revitalizing the U.S.

economy and the housing market. We agree that there are aspects of the securitization process that did not perform well. These need to be fixed. However, solutions to any problems, including the perceived conflicts of interest identified in Section 939F, should neither cause more problems for investors than they cure, nor should they arbitrarily disadvantage certain issuers. The Section 15E(w) System and all of the other alternatives identified in the Release, save the Rule 17g-5 framework, fail these crucial tests. For this reason, as suggested by both SIFMA and the ASF, we urge the Commission to focus on Rule 17g-5 as the means to address the perceived problems identified by Section 939F.

We greatly appreciate your consideration of the views set forth in this letter, and we would be pleased to have the opportunity to discuss these matters further with you or with any member of the staff of any of the Agencies. Please feel free to contact the undersigned at 212-761-2162, or James Lee at 212-762-6148.

Very truly yours,

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