September 12, 2011

VIA E-MAIL:* *rule-comments@sec.gov

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

Re: Release No. 34-64456; File No. 4-629

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comments regarding Release No. 34-64456; File No. 4-629 (the "RFC"),[2] to assist the Commission in carrying out a study on, among other matters, the feasibility of establishing a system in which a public or private utility or a self-regulatory organization ("SRO") assigns nationally recognized statistical rating organizations ("NRSROs") to determine credit ratings for structured finance products. The study, and a resulting report to Congress, are required by Section 939F ("Section 939F") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which was enacted on July 21, 2010.

ASF supports appropriate reforms within the asset-backed securities ("ABS") market, and we commend the Commission for seeking industry input regarding its study, resulting report and potential rulemaking. Over the past decade, ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to the Commission and other agencies on issues affecting our market. Our views as expressed in this letter are based on feedback received from our broad membership, which includes issuer, investor, ABCP conduit sponsor, accounting firm, law firm and financial intermediary members.

[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and

[2] See http://www.gpo.gov/fdsys/pkg/FR-2011-05-16/pdf/2011-11877.pdf.

Section 939F requires the Commission to perform a study of –

(1) the credit rating process for structured finance products[3] and the conflicts of interest associated with the issuer-pay and the subscriber-pay models;

(2) the feasibility of establishing a system in which a public or private utility or an SRO assigns NRSROs to determine the credit ratings of structured finance products, including—

(A) an assessment of potential mechanisms for determining fees for the NRSROs;

(B) appropriate methods for paying fees to the NRSROs;

(C) the extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government; and

(D) any constitutional or other issues concerning the establishment of such a system;

(3) the range of metrics that could be used to determine the accuracy of credit ratings; and

(4) alternative means for compensating NRSROs that would create incentives for accurate credit ratings.

Section 939F requires the Commission to submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, within 24 months of the Dodd-Frank Act's enactment (i.e., by July 2012), a report detailing the findings of the study together with any recommendations for regulatory or statutory changes that the Commission determines should be made to implement the findings of the study. Section 939F also requires the Commission, by rule, *as it determines is necessary or appropriate in the public interest or for the protection of investors*, to establish a system for the assignment of NRSROs to determine the initial credit ratings of structured finance products, in a manner that prevents the issuer, sponsor, or underwriter of the structured finance product from selecting the NRSRO that will determine the initial credit ratings and monitor such credit ratings. Section 939F requires that in issuing any such rule, the Commission must give thorough consideration to the provisions of Section 15E(w) of the Exchange Act ("Section 15E(w)"), as that provision would have been added by Section 939D of H.R. 4173 (111th Congress) ("Section 939D"), as passed by the Senate on May 20, 2010 (the "Senate Bill"), and shall implement the system described in such Section 939D unless the Commission determines that an alternative system would better serve the public interest and the protection of investors.[4]

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[3] Section 939F defines structured finance products as "asset-backed securities" under the Securities Exchange Act of 1934 (the "Exchange Act") and any structured product based on an asset-backed security, as determined by the Commission by rule.

[4] Section 939F requires that the Commission implement a rulemaking "as the Commission determines is necessary or appropriate in the public interest or for the protection of investors" and "[i]n issuing any rule under this paragraph," must give thorough

Section 939D was included in the Senate Bill but was not ultimately adopted as part of the Dodd-Frank Act. Section 939F of the Dodd-Frank Act was included in its place.

Generally, Section 15E(w) would have established an SRO in the form of a board responsible for assigning a "qualified" NRSRO to provide the initial credit ratings on structured finance products. Section 15E(w) would have precluded issuers of structured finance products from requesting an initial credit rating directly from an NRSRO but would not have precluded an issuer from obtaining other ratings from an NRSRO if the initial credit rating is provided in accordance with the board assignment provisions. The goal of Section 15E(w) was to eliminate the perceived conflict of interest (the "issuer-pay conflict of interest") for NRSROs where an issuer, a sponsor or an underwriter pays the NRSRO to provide a rating on a structured finance product (referred to as the "issuer-pay compensation model") and to remove the possibility of ratings shopping by issuers, sponsors or underwriters.[5]

While other compensation models have been contemplated,[6] none, apart from the model in which the investor pays the rating agency (referred to as the "investor-pay" or "subscriber-pay" compensation model), has been put into practice. Rating agencies initially operated under the investor-pay compensation model, but the vast majority of rating agencies moved to the issuer-pay compensation model during the 1970s.[7] Each compensation model presents its own conflicts.[8] However, given the performance of ratings of certain structured finance products during the credit crisis and that the vast preponderance of NRSROs rely on the issuer-pay compensation model, there has been significant focus on how to address the issues associated with the issuer-pay conflict, ranging from suggestions to eliminate the compensation model as contemplated, in part, under Section 15E(w) to methods to balance and manage the conflict of interest.

As enacted, the Dodd-Frank Act contains a number of rating agency reforms, many of which are aimed at addressing the issuer-pay conflict of interest.[9] Additionally, since June 2008, the

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consideration to the Section 15E(w) system and implement it unless the Commission determines that an alternative system would be more effective. We believe that Section 939F's reference to issuing "any rule under this paragraph" requires that the Commission make a finding that the rule "is necessary or appropriate in the public interest or for the protection of investors" even *prior to* considering whether to implement Section 15E(w) or an alternative. Meaning, the Commission is not required to implement *any system* unless it determines that it would be "necessary or appropriate in the public interest or for the protection of investors."

[5] See 156 Cong. Rec. S3956 (daily ed. May 19, 2011).

[6] See for example, the discussion in "Securities and Exchange Commission: Action Needed to Improve Rating Agency Registration Program and Performance Related Disclosures," GAO Report 10–782 (September 2010)(the "GAO Report") regarding various compensation models.

[7] See "The Rating Agencies: Is Regulation the Answer?" Matthew Richardson and Lawrence J. White, *Restoring Financial Stability; How to Repair a Failed System*, Ed. Viral V. Acharya and Matthew Richardson, 2009 ("Richardson and White") at p.102.

[8] See for example, "Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective, Frank Portnoy for the Council of Institutional Investors" (April 2009) at p.12 (available at http://www.cii.org/UserFiles/file/CRAWhitePaper04-14-09.pdf) discussing certain conflicts related to the investor-pay model. See also "White Paper on Rating Competition and Structured Finance," Jerome Fons, January 10, 2008 (available at http://democrats.oversight.house.gov/images/stories/Hearings/Committee_on_Oversight/Fons_Ratings_White_Paper.pdf) at p.4 discussing the possible divergence between interests of fund advisors and investors in the context of surveillance.

[9] See Subtitle C, Title IX of the Dodd-Frank Act, Public Law 111-203 (July 21, 2010).

Commission has proposed and adopted a series of rating agency reforms aimed at addressing the issuer-pay conflict of interest. Most significantly, in June 2010, the Commission's amendments to Rule 17g-5(a), (b)(9) and (e) under the Exchange Act (the "Rule 17g-5 Program")[10] became effective. Generally, Rule 17g-5 prohibits NRSROs from issuing ratings if certain specified conflicts of interest exist and requires disclosure and written policies with respect to management of other specified conflicts of interests. The Rule 17g-5 Program precludes an NRSRO from rating structured finance products where an issuer-pay conflict exists unless it complies with certain requirements, including the requirement that it obtain from the transaction issuer, underwriter or sponsor (the "arranger") a representation that the arranger will post all of the information provided to a hired NRSRO on a website that is available to other NRSROs. The Commission's goal was to "address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products."[11] Thus, the Rule 17g-5 Program was enacted to address the same issues as Section 15E(w).

While both Section 15E(w) and the Rule 17g-5 Program seek to address the issuer-pay conflict of interest, each uses a different method to accomplish this goal. The Section 15E(w) provisions attempt to achieve this goal by precluding issuers from selecting the NRSRO that will provide the initial credit rating, with the intent that issuers "will not be able to pressure a rating agency into giving a good score in exchange for future business."[12] In contrast, the Rule 17g-5 Program aims at achieving this goal by making "it more difficult for arrangers to exert influence over the NRSROs they hire because any inappropriate rating could be exposed to the market through the unsolicited ratings issued by NRSROs not hired to rate the structured finance product."[13]

Our membership fully recognizes that the credit crisis has necessitated reforms with respect to ratings issued by NRSROs and in particular with respect to structured finance securities. However, reform must be measured by the overall effect on the system that is the subject of the reform – not merely on the basis of whether a single objective has been achieved. While Section 15E(w) might succeed in removing the issuer-pay conflict of interest, it fails in that the cumulative effect on credit ratings and the market would be overwhelmingly negative. We believe that Section 15E(w)'s premise that a board-developed performance measure of NRSROs could successfully replace the market in selecting NRSROs is flawed. We highlight the difficulties in creating such a measure – both as to concept and as to cost – and the anticompetitive effect such a board system would have. Further, we detail practical impediments to implementing such a system and the negative effect it would have on the market. We also raise several negative potential unintended consequences of implementing Section 15E(w), including that an originator's cost of capital (thus its ability to compete) will be arbitrarily determined by the board assignment of NRSROs. We believe Section 15E(w)'s substitution of the board's judgment for that of the market is inappropriate and would lack legitimacy in the market. Finally, Section 15E(w) raises the significant concern that certain investors would rely

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[10] See Commission Release No. 34-61050; File No. S7-04-09, Amendments to Rules for Nationally Recognized Statistical Rating Organizations (Fed. Reg. Vol. 74, No. 232 (Dec. 4, 2009)) 63832 (the "17g-5 Program Adopting Release").

[11] See the 17g-5 Program Adopting Release at p.63844.

[12] See 156 Cong. Rec. S3674 (daily ed. May 13, 2010).

[13] See the RFC at p.28276.

too heavily on credit ratings and that credit ratings would be seen as sanctioned by the United States government through the board system it created. Our assessment, which includes consideration of the factors identified in the GAO Report,[14] identifies these and other issues with Section 15E(w) which make it clear that the Rule 17g-5 Program, with some modifications, coupled with the many other reforms required under the Dodd-Frank Act will better serve the public interest and the protection of investors than implementation of Section 15E(w), which is unworkable.

I. Assessment of the Section 15E(w) Provisions

A. Section 15E(w) is contrary to the Dodd-Frank Act goals and raises concerns relating to the role of the U.S. government in the assignment process.

Under Section 15E(w), the Commission is responsible for: issuing rules that establish the board responsible for assigning NRSROs to provide initial credit ratings; regulating the ongoing activities of the board; and appointing the initial board members. Section 15E(w) provides that the board must determine the method through which NRSROs will be assigned to provide initial credit ratings and in doing so must consider a system that increases or decreases assignments based on past performance. Under Section 15E(w), the board is also required to annually evaluate the performance of each qualified NRSRO.

Not surprisingly, the government's involvement in this endeavor raised considerable concern. For this reason, Section 939F(b)(2)(C) of the Dodd-Frank Act requires that the Commission determine the feasibility of establishing such a system and "the extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government." The Commission highlighted this concern in its RFC and asked a series of pertinent and thoughtful questions about the government's potential involvement.[15] We address several of these questions in the section that follows.

1. Would investors view the board as providing a "stamp of approval" on, or an endorsement of, the credit ratings determined through the assignment process?

We are concerned that creation of a board will further encourage overreliance by investors on credit ratings through the implication that the board has endorsed the ratings of the NRSROs it qualifies to provide initial ratings. The credit crisis resulted in widespread concern regarding investor overreliance on credit ratings. Many of the Commission's reforms have sought to provide investors with additional information about the performance of credit ratings, and proposed reforms seek to increase transparency of NRSRO methodologies and procedures to better familiarize investors with the nature of credit ratings and their limitations. We believe the creation of an oversight authority would undermine the efforts to ensure that investors do not accord credit ratings too much importance, as investors might be less likely to perform

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[14] These factors include: independence; accountability; competition; transparency; feasibility; market acceptance and choice; and oversight.

[15] See the RFC at p.28273.

appropriate analysis and due diligence in the belief that the qualified NRSROs and their ratings have been sufficiently vetted and approved by the government-appointed board.

We believe there is further risk that this endorsement could be attributable to the U.S. government itself in creating such a board. As the Commission correctly acknowledges in its RFC, the federal government's involvement with the board and the Section 15E(w) system could create the perception that the government endorses the NRSROs assigned by the board to provide initial credit ratings and, by extension, the ratings they issue. Under Section 15E(w), the federal government, through the Commission, would be responsible for establishing the board and selecting its initial members who would serve for four years. The government-appointed board would have considerable authority over the ratings process, most importantly the selection of qualified NRSROs, which, under Section 15E(w), will be the only NRSROs an issuer may retain to assign initial ratings. In addition, the board would establish the process through which qualified NRSROs are assigned to provide ratings on a specific transaction and review the performance of qualified NRSROs, at least annually, taking into consideration the "accuracy of the ratings provided" and "the effectiveness of the methodologies used" by such NRSRO.[16] Moreover, while Senator Al Franken (D-MN) is correct in pointing out that, "after the initial appointments, the Board itself will choose its future members,"[17] the critical decisions and planning for the process — the development of criteria for determining qualified NRSROs, the approval of applications for qualified NRSROs and the establishment of an assignment process — will occur during the initial term. This is mandated by Section 15E(w), which requires the Commission to "establish a schedule to ensure that the Board begins assigning qualified nationally recognized statistical rating organizations to provide initial ratings not later than 1 year after the selection of the members of the Board." Thus, while subsequent board members will be selected by current board members, the initial board members, who will be appointed by the Commission, will be the most influential in setting up the system and selecting qualified NRSROs. Further, the Commission's influence on the board would not end with the appointment of the initial members. Prior to the expiration of the initial term, the Commission must establish "fair procedures for the nomination and election of future members of the board" and may also increase the size of the board and the term length of its members. It also has the power, *at any point in time*, to "issue further rules and regulations on the composition of the membership of the board and the responsibilities of the members." We believe this selection and evaluation process will create a perception by investors and other market participants that the qualified NRSROs (and the initial ratings they issue) have been vetted and sanctioned by the government that established this board. We do not believe that the disclaimer required by Section 15E(w) would adequately guard against this risk, given the government-established board is assigning the NRSRO.[18]

[16] Although Senator Franken indicated that the board would not "tell credit rating agencies how to determine their ratings," we believe the board's role in evaluating the methodologies used and determining accuracy of the ratings will have exactly that result. See 156 Cong. Rec. S3674 (daily ed. May 13, 2010). See the discussion below regarding the possible effect of a single performance model.

[17] See 156 Cong. Rec. S3674 (daily ed. May 13, 2010).

[18] Under Section 15E(w)(6) any initial rating issued by a qualified NRSRO assigned by the board is required to include a disclaimer that "[t]his initial rating has not been evaluated, approved or certified by the Government of the United States or by a Federal agency."

2. *If Section 15E(w) would increase investor reliance on credit ratings, what potential impact would such a consequence have on government efforts to reduce investor reliance on credit ratings such as through provisions in Sections 939 and 939A of the Dodd-Frank Act?*

Section 939A of the Dodd-Frank Act ("Section 939A") requires the federal agencies, including the Commission, to review any regulation that requires the use of an assessment of the creditworthiness of a security and contains references to or requirements regarding credit ratings. After this review, the regulators are required to remove these references or requirements and to substitute in such regulations an appropriate standard of creditworthiness. In the words of Senator George LeMieux (R-FL), who introduced the Senate amendment that became Section 939A: "What my amendment will do is take away this sanctioned monopoly that holds out these rating agencies as the entities that determine what is creditworthy."[19] In doing so, LeMieux sought to remove the favored treatment of NRSROs, leaving room for a reliable system for determining creditworthiness to develop.[20] Removing references to NRSRO credit ratings from financial and securities law regulations to reduce their importance to investors has been championed by many commentators who argued that the value accorded to NRSRO ratings in these various statutes created the need for their ratings.[21]

While the removal of credit ratings from various federal regulations and the creation of a board are not necessarily mutually exclusive, we strongly disagree with Senators Franken and LeMieux who stated that the goals of Section 939A and Section 939F were not inconsistent.[22] By creating a government-sanctioned special category of NRSROs that are the only NRSROs that are permitted to issue initial credit ratings to issuers, Section 15E(w) would further entrench certain NRSROs into the system; this is in direct conflict with the Section 939A goal of eliminating what LeMieux referred to as a "sanctioned monopoly" by removing NRSROs as a required element of the market. Further, we believe the selection and evaluation process of qualified NRSROs under Section 15E(w) will create a perception by investors and other market participants that the qualified NRSROs (and the initial ratings they issue) have been vetted and sanctioned by the government, because it established this board. While Section 15E(w) seeks to develop a performance measurement system to fairly allocate the ratings role, removing the selection process from the market and housing it in a government-created board cuts at the very notion of leveling the playing field such that the market can determine the sources of creditworthiness on which it can rely. We recognize that credit ratings will continue to play an important role in the market, even when replaced in the various regulations with a different measure of creditworthiness. Whatever role they play, however, should be dictated by the market and not through the creation and maintenance of a board that will only serve to further entrench qualified NRSROs through their apparent government-sanctioned status.

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[19] See 156 Cong. Rec. S3675 (daily ed. May 13, 2010).

[20] Id.

[21] See for example, Richardson and White at p.110.

[22] See 156 Cong. Rec. S3674-75 (daily ed. May 13, 2010).

3. *Would the board, as a governmental or quasi-governmental entity, be susceptible to political pressure in terms of its assignment of credit ratings to qualified NRSROs or its other responsibilities? In addition, would a qualified NRSRO assigned to determine a credit rating be susceptible to political pressure to issue a credit rating at a level favored by the board in order to obtain additional assignments from the board?*

We are concerned that by creating a board with the authority to determine the performance measurement and the method by which NRSROs would be selected to provide initial credit ratings, Section 15E(w) would create a risk of more pernicious manipulation than the issuer-pay compensation model. We believe the board could be subject to pressure to adjust its methodology to achieve a particular agenda by favoring (or disfavoring) NRSROs whose methodologies or criteria promote (or run counter to) that agenda, such as increased homeownership in particular segments of the country or access for certain borrowers to credit. In other circumstances, it is possible that the basis for the pressure could be more basic – either cronyism or retribution. In this regard, we are concerned that NRSROs could be subject to direct or indirect pressure from the board or the government. NRSROs that rate structured finance products are also in the business of rating other debt, including corporate bonds and the debt of sovereign nations, states and municipalities. On August 5, 2011, an NRSRO lowered the long-term sovereign credit rating of the United States to "AA+" from "AAA."[23] While the merits of the downgrade are not relevant for this comment letter, what followed the downgrade should inform any determination to move decision-making to a government-created board. The downgrade was met with strong criticism from U.S. government officials[24] and reportedly led to inquiries by the Commission to the NRSRO, including a review of the model used to trigger the downgrade and the firm's confidentiality policies, and was followed by an announcement that the Department of Justice was joining an investigation by the Commission against the NRSRO (and others) with respect to ratings on certain structured finance products prior to the credit crisis.[25] We have reservations that political pressure could influence the determination of who was qualified to issue initial credit ratings and the frequency with which qualified NRSROs would receive future business. Separately, we note that the Section 15E(w) board system raises other concerns with respect to conflicts of interest and incentives discussed in more detail below.

B. *Substitution of the market's assessment of NRSRO performance with a third-party assessment is inappropriate and will undermine market acceptance.*

We are concerned with the feasibility of creating a fair and transparent basis for measuring NRSRO performance by a third party in lieu of the market's assessment, particularly where the allocation of rating assignments will be tied to this nascent performance measure. As evidenced by the Commission's request for comment on appropriate bases on which to measure NRSRO

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[23] See http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563.

[24] See for example CNBC interview with Secretary of the Treasury, Timothy Geithner, August 7, 2011, available at http://www.cnbc.com/id/44053113.

[25] See *Wall Street Journal*, "SEC Checks S&P's Downgrade Math," August 13, 2011, available at http://online.wsj.com/article/SB10001424053111904823804576504631278044492.html and *Wall Street Journal*, "Justice Department Joins Probe of S&P, Rivals Over Crisis Era Ratings," August 19, 2011, available at http://online.wsj.com/article/SB10001424053111903639404576516561097613114.html?mod=WSJ_WSJ_US_News_5.

performance, apart from investor acceptance of an NRSRO selected by the issuer, no simple performance measures are accepted across the market. Many of our members believe it would be impossible to develop a model that fairly measures performance, and none support the proposal that an untested performance measure should become the basis for determining which NRSRO will provide the initial credit rating on a transaction.

Additionally, allocating the development and maintenance of a performance measure to a board is inappropriate and could result in a performance measure (or application of that measure, in a manner) that diverges from the market's performance assessment. This divergence could result for a number of reasons: investor representatives on the board are unlikely to be representative of the market as a whole; members of the board and its staff will be subject to conflicts of interest that are not necessarily addressed by the Section 15E(w) conflict of interest provisions; boards are subject to internal dynamics that can influence the decision-making process, thereby diluting market influence; and political and/or funding concerns could influence decision-making by the board or the staff in day-to-day operations.[26] Notwithstanding any divergence between the board's assessment and that of the market, under Section 15E(w), the *board's* performance measure would factor into the method for assigning a qualified NRSRO to provide an initial credit rating *for ultimate use by investors*.[27] We believe this substitution is inappropriate and that issuers should remain free to select NRSROs acceptable to investors in their transactions, particularly as investors could be precluded by private contract or investment guidelines from purchasing a security rated by the assigned NRSRO.[28] We believe market acceptance of the Section 15E(w) allocation system would be severely limited. We do not believe transparency as to the performance measures or the results of the reviews would mitigate the untenable situation where selection by the market is replaced by determination of a government-established board.

We are particularly concerned about the ability to create such a system because uniform information regarding NRSRO performance is currently not readily available.[29] As a result, any performance measurement developed by the board would be without practical understanding of how the measurement would apply to NRSROs or how NRSROs compare. In particular, it would be without any understanding of whether investors' assessments of an NRSRO correspond to the board's performance measure. We are hopeful that the information necessary to compare NRSRO performance will become available to the market through Section 932(a)(8) of the Dodd-Frank Act. The Commission recently proposed regulations that would require NRSROs to make public information regarding their ratings that would allow users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different

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[26] We discuss in more detail below our significant concerns about the ability to appropriately staff and operate the board given the enormity of its responsibilities.

[27] We also question whether the board assignment system could result in certain NRSROs receiving assignments they might not otherwise receive *on the basis of their performance* as it appears NRSROs might continue to receive some assignments even where their performance was poor. Would the system result in issuers and investors being assigned, albeit less often, an NRSRO that proves to be ineffective?

[28] While Section 15E(w) permits an issuer to retain NRSROs to provide subsequent credit ratings, in order to sell securities to investors at the closing of the transaction the securities must have an initial rating acceptable to investors. Therefore obtaining a rating after the closing would not address investors' requirements for particular NRSROs. Even if an issuer were permitted to select one of the NRSROs providing initial credit ratings, the issues discussed below with respect to execution and terms of engagement would still pose significant difficulties.

[29] See the GAO Report at pp. 94-96.

NRSROs.[30] We recognize that development of these rules and the information responsive to the ultimate final rules will not be achieved overnight. We believe it is untenable to tie the selection of the NRSRO that will issue initial credit ratings to an untried performance measure established by a third party and that any such system could face strong market resistance. We believe it is preferable for the market to act on this information when available as it remains free to do under the Rule 17g-5 Program and our investor members strongly support this position.

C. Creating a performance measure will result in NRSROs migrating to similar methodologies and effectively replace NRSROs' opinion of the credit quality of securities with that of the board.

Under Section 15E(w), the board's method of assigning NRSROs to rate a transaction would take into account the NRSRO's performance. We question how the board will evaluate the performance of an NRSRO. If the performance measure relies merely on downgrades to assess performance, NRSROs could be driven to overly conservative initial ratings to lessen the likelihood of a downgrade.[31] Additionally, NRSROs would have the incentive not to downgrade securities to avoid a bad mark on the performance scale. Both of these outcomes are negative for the market.

If, rather than measuring performance on the basis of downgrades, the board analyzed transactions to determine if it assessed the NRSRO's ratings as "accurate," the board would be doing the same thing as the NRSRO – making a determination of the credit quality of the security based on its analysis of the transactions. We view this as problematic in at least three respects. First, we have serious reservations regarding the ability of a board to develop and apply the methodology necessary to undertake such an endeavor. We believe the cost of doing so would be enormous and that staffing will be difficult to find in a highly specialized area where the board would be competing with NRSROs, the Commission and the market for the individuals suitable for these positions. Second, by creating a performance measure, Section 15E(w) would limit development of new methodologies and/or cause NRSROs to migrate to more similar methodologies, i.e., ones that are perceived to be most in line with the board's performance assessment.[32] By tying NRSRO rating assignments to the board's performance measure, the only "accurate" rating system becomes that of the board. In effect, this would replace independent and competitive NRSROs with a monolith rating agency – the board. What practical purpose would NRSROs serve if their role was merely to produce ratings that mirrored the opinion of the Section 15E(w) board? This contrived system would remove all competition among NRSROs to produce credit ratings most valued by the market and instead result in homogenous ratings developed to meet the board's performance measures. Finally, it seems

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[30] See Nationally Recognized Statistical Ratings Organizations, Release No. 34–64514, Fed. Reg. Vol. 76, No. 110 (Jun. 8, 2011) 33420, available at http://www.sec.gov/rules/proposed/2011/34-64514fr.pdf (the "May 2011 SEC NRSRO Release") proposing rules to require NRSROs to publicly disclose certain information as required by Section 932(a)(8) of the Dodd-Frank Act.

[31] Overly conservative levels would unnecessarily inflate the cost of financing to issuers, which is ultimately passed along to consumers. We discuss this in more detail below.

[32] As noted in our letter to the Commission in response to Release No. 34-63573; File No. 4-622, we believe that standardization of methodology and terminology used by credit rating agencies would not be desirable as users of credit ratings, in particular investors, benefit from a diversity of experience and methodologies. See http://www.americansecuritization.com/uploadedFiles/ASF_Letter_re_NRSRO_Standardization-2-4-11.pdf

futile to believe that investors would *not* view these ratings as being endorsed by the board (magnifying further the moral hazard issues discussed above), when the board system dictates what ratings methodologies are acceptable. We believe NRSROs should remain free to develop different methodologies and criteria to assign credit ratings, and that the assessment of those methodologies and criteria should remain with the market.

D. Section 15E(w) provides no method of market oversight of the board and severs NRSRO accountability to the market.

We are unclear how and if Section 15E(w) would be evaluated to determine if it is working for the market. If the market does not approve of the NRSROs that are being assigned, how would the problem be corrected? Or, would investors be forced to accept the board's assessment in place of their own without any means of effective redress? While the Commission has the power to issue further rules and regulations as it deems necessary, what recourse does the market have if the system is failing? Section 15E(w) would create a system in which NRSROs are no longer accountable to the market – the ultimate consumer of the product.[33] In contrast, under Rule 17g-5, while oversight of the Rule 17g-5 Program is housed with the Commission, NRSROs are accountable for their ratings in many ways, including issuer selection, investor influence on issuers regarding the NRSROs hired to rate a transaction and investors' ability to obtain unsolicited ratings from non-hired NRSROs. Further, a number of recent reforms will allow the market to hold NRSROs more accountable. These include Section 932(a)(8) of the Dodd-Frank Act, which requires new disclosures by NRSROs to allow users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different NRSROs.[34] In addition to this increased accountability to the market, NRSROs will be subject to the new conflict of interest provisions under the Dodd-Frank Act and the increased regulatory authority of the Commission to sanction NRSROs.[35]

E. Section 15E(w) will increase cost and could threaten the viability of the securitization markets.

In virtually all structured finance securities transactions, an investor's purchase of the securities is conditioned upon the issuance of a specific rating by an NRSRO. This occurs for many reasons, including the role that ratings play in establishing risk-based capital requirements and conferring benefits or prescribing requirements under various securities laws,[36] or because investors use credit ratings as a supplement to their own credit analysis. Many investors are required through private contract or investment guidelines to purchase securities with minimum

[33] Moreover, by making NRSROs accountable to the board rather than the market, the consequences of poor performance will necessarily lag behind the cause of the poor performance, whereas the market exercises it right to choose very quickly, prompting quicker corrective action on the part of the NRSRO. Since the credit crisis, the number of investors communicating their NRSRO of choice to issuers has increased as have the number of investors who refuse to participate in a transaction if the NRSRO is not of their choice.

[34] Additionally, the Dodd-Frank Act amended various provisions of the Exchange Act to make NRSROs more accountable for their ratings under current securities laws.

[35] See Section 932 of the Dodd-Frank Act and the May 2011 SEC NRSRO Release.

[36] As discussed above, Section 939A of the Dodd-Frank Act requires federal agencies to review and replace references to credit ratings and their regulations with alternative measures of creditworthiness.

ratings issued by specific NRSROs. Moreover, the identity of an NRSRO affects the price the investor is willing to pay for the securities. For these reasons, an issuer must select an NRSRO acceptable to investors and it must consider the effect the identity of the NRSRO will have on pricing.

1. *Ultimate execution in a structured finance transaction influences each step of the securitization process.*

We believe that Section 15E(w) would be extremely difficult to implement in the structured finance markets because NRSRO ratings influence the cost of capital and thus factor into each step of the securitization process. In order to originate or purchase loans or other financial assets, an originator or sponsor of a securitization must know generally the cost of capital from its financing source or sources. When examining securitization as a source of funding for loan origination, the securitizer must look at the net proceeds received on the sale of the securitized assets. The amount of net proceeds drives the price (or terms) at which an originator will make a loan. The lower the net sale proceeds of the structured finance securities for the securitizer, the higher the cost of financing for the originator and the higher the cost of the loan for the borrower. The originator can be expected to seek the lowest cost of financing. Securitization is one method of funding for loan originators to finance their lending operations.

In a securitization transaction, the originator's cost of capital is tied to the NRSRO ratings issued on the securities because these ratings help drive the price investors will pay for the related securities. Both the enhancement levels given by any NRSRO and the market's view of the NRSRO chosen to issue ratings on a securitization will affect the total net proceeds realized, directly affecting the cost of capital via securitization. Generally, the rating assigned to a class of securities drives the price at which the securities can be sold, with higher rated securities being sold at higher prices and lower yields than lower rated securities. In the typical structured finance offering, various tranches of securities (including securities retained by a sponsor) are issued with different credit profiles. Where credit tranching occurs, certain tranches will have higher ratings than others. In a given transaction the sponsor can be expected to attempt to structure the transaction to maximize the principal amount of the higher rated tranches, since the more securities it can issue that have a higher rating, the more proceeds the sponsor can expect to raise through the structured finance transaction (often referred as "execution"), which equates to a lower cost of financing. Generally, NRSROs have criteria with regard to what level of subordination is necessary for a class to obtain a specified rating (often referred to as "enhancement levels").[37]

While exact enhancement levels are not known for any given transaction at the time the underlying assets are originated or purchased, market participants are generally aware of the NRSROs' ratings criteria (through publicly available criteria, prior experience or reverse

[37] Wanting the best execution (i.e., the lowest enhancement levels) should not be mistaken for the situation where an issuer applies influence to achieve enhancement levels that are lower than an NRSRO's methodologies would otherwise produce or where an NRSRO lowers its enhancement levels in order to achieve a competitive advantage. The latter can be characterized as "ratings shopping," the former is simply a borrower seeking the lowest cost of funds. No one would expect a borrower to accept an interest rate of 6% on a loan from a lender when others in the market are offering 5.5%. We believe many commentators miss this distinction and dismiss all efforts by issuers to obtain the best enhancement levels as "ratings shopping."

engineering of public information). As a result, in establishing the terms of loans made to borrowers or in purchases from other originators, market participants make certain assumptions regarding the expected execution in a securitization. If the enhancement levels are not generally known because the identity of the NRSRO or NRSROs that will rate the transaction has not yet been determined, the terms an originator will offer a borrower (or price paid by a purchaser) will likely be determined using the most conservative levels – thereby driving up the costs of the borrowing to the borrower. Alternatively, a sponsor may determine that securitization is no longer a viable method of financing, given the most conservative assumptions. In either case, the efficiency of securitization would be lost and the increased costs would be passed along to borrowers. Similarly, because the identity of the NRSRO affects the price investors will pay for securities, if the identity of the NRSRO that will be assigned to a transaction is unknown, the originator will make the most conservative assumptions regarding execution with the same result.

2. *Investor restrictions or views drive the selection of the issuer-paid NRSRO.*

As discussed above, because the identity of the NRSRO determines if many investors can purchase securities and the price they will pay for the securities, an issuer must select an NRSRO acceptable to investors and will factor the identity of the NRSRO into its execution expectations. Under Section 15E(w), an issuer that is assigned an NRSRO by the board selection process that is unacceptable to or disfavored by investors (whether for business or contractual reasons) might be unable to execute the transaction at all or might have worse execution than if another NRSRO had been selected. This uncertainty could effectively remove securitization as a viable source of financing for sponsors. Moreover, because the Section 15E(w) board system would affect the cost of financing for an originator, it affects the terms on which an originator can make loans. All other things being equal, an originator with a higher cost of funds is at a competitive disadvantage to other originators. We strongly object to this system that would arbitrarily result in certain originators having a higher cost of funds, to their competitive disadvantage, than other originators.

3. *Unless an NRSRO has an existing relationship with an issuer, the speed at which a transaction can come to market can be delayed.*

While the information provided to an NRSRO for a specific asset class might be generally comparable, each NRSRO has different criteria and NRSROs may request supplemental information following delivery of the initial data. Issuers may be unable to comply with a new NRSRO's request for information, or the information may not be readily available to allow the transaction to come to market in the proposed time frame. Additionally, ratings are not merely a function of the underlying assets and bond structure, but also of the originators and servicers of such assets. The level of analysis and review required varies from asset class to asset class, but irrespective of asset type, assigning an NRSRO with no or little information on an originator or servicer will impede an issuer's timely access to the capital markets. To address this, an issuer would be required to keep current all NRSROs that are qualified under the board system to rate structured finance securities, resulting in significant costs to the issuer (and those NRSROs that chose to participate), without any certainty that an NRSRO would be assigned to rate a

transaction or that an NRSRO would in fact accept the ratings assignment. Ultimately, all of these costs would simply be passed onto the consumer in the form of higher rates and fees, with little if any corresponding benefit to the consumer.

4. Enhancement levels are not the only determinant in whether to hire an NRSRO.

Each NRSRO has different criteria regarding the assets underlying a transaction relative to the overall structure of asset-backed securities issued in a transaction. The ratings process varies between each NRSRO and also varies with the different asset classes underlying structured finance securitizations. NRSROs can differ in their criteria with respect to many items, including structural terms, matters related to true sale opinions and contractual provisions. Certain NRSROs do not provide ratings on certain types of securities. In some cases, an issuer may determine that use of an NRSRO is unfeasible given these criteria or limitations.

Additionally, the decision of an issuer not to retain an NRSRO may be unrelated to the transaction and instead relate to the NRSRO's terms of engagement or concerns regarding an NRSRO's practices. Each NRSRO has a different form of engagement letter that sets out the terms of the agreement between the NRSRO and the issuer that hires it. Engagement letters can differ in a number of respects, including terms related to indemnification, compensation and confidentiality. Since 2010, we have seen a number of cases where certain market participants refused to engage an NRSRO based on the terms of engagement letters (and not their ratings methodology or enhancement levels). The source of the disputes frequently surrounded increased and unacceptable liability for issuers as well as safety and soundness concerns of certain bank issuers and underwriters. These issues were so significant that many market participants refused to work with NRSROs with whom they had frequently worked and that the market had long accepted notwithstanding less favorable execution in some circumstances. In other cases, an issuer may choose not to work with an NRSRO due to concerns regarding an NRSRO's practices, such as quality of staffing considerations or policies with regard to confidential information.

Because Section 15E(w) specifically provides that the board, in selecting a method to assign NRSROs, may not use a method that would allow for the solicitation or consideration of the preferred NRSRO of the issuer, there appears to be no basis to address these valid issuer concerns. We appreciate the goal of eliminating the negative effect of ratings shopping, however, we believe certain elements of issuer selection *are appropriate*. Removing any ability of the issuer to set the terms of engagement forces the issuer to choose between a method of financing and otherwise unacceptable terms – whether commercial or legal.

F. Section 15E(w) could limit competition and innovation as well as harm small NRSROs.

Section 15E(w) will lessen competition among NRSROs with respect to fees and could pose additional barriers to entry. Further, as discussed above, Section 15E(w) could limit development of new methodologies and/or cause NRSROs to migrate to more similar

methodologies, i.e., ones that are perceived to be most in line with the board performance assessment.

Under the Rule 17g-5 Program, an NRSRO can compete with other NRSROs through fees. However, under Section 15E(w), fees are not an element for consideration in determining how an NRSRO will be assigned to provide an initial credit rating. As a result, Section 15E(w) may in fact increase the barriers to entry for small or new NRSROs that might otherwise seek to establish or increase their market share by offering lower rates to issuers. Additionally, the Section 15E(w) application and review process to the board presents another hurdle for NRSROs, which are required to present information regarding their institutional and technical capacity as well as any other information the board may require. Depending on the composition of the board, this could work against smaller NRSROs with little or no track record in rating structured finance securities because the investor members of the board might reject smaller NRSROs that such investors are not permitted to purchase under their private contracts or investment guidelines (or are simply unacceptable as a business matter to those investors). Why risk having such an NRSRO assigned? Why not prevent the NRSRO from qualifying to avoid transactions where the investors cannot buy? Similarly, while the Commission is permitted to exempt small NRSROs from certain provisions of the Exchange Act, Section 15E(w) grants the board the authority to refuse to qualify an NRSRO that is exempt from any of the requirements of the Exchange Act. This could prevent small NRSROs from qualifying under Section 15E(w), which in turn would preclude those NRSROs from issuing initial credit ratings. Finally, if the method of allocation to NRSROs must take into account past performance, it is unclear how the board would measure the past performance of an NRSRO that has provided few or no solicited ratings on structured finance products, as could be the case with small NRSROs. Small and new NRSROs struggle against significant barriers to entry. While Section 15E(w) could help to lower these barriers to entry through the allocation of initial credit rating engagements, we question if the system would not in fact raise barriers to entry and remove one of the bases on which NRSROs can compete, namely fees.

We also question whether any NRSRO (large or small) under Section 15E(w) will have the option to provide ratings on newly developed structured finance products. Given that Section 15E(w) requires performance-based measures and will qualify NRSROs in particular structured product categories, it would appear difficult (or impossible) for an NRSRO to be assigned to provide an initial credit rating on newly developed structured finance products. For esoteric asset classes or new structures, this could mean no NRSRO would be available to provide an initial credit rating under Section 15E(w) – essentially stagnating market innovation in structured finance because virtually no deal could be sold without credit ratings.[38]

In contrast, the Rule 17g-5 Program seeks to encourage *multiple* ratings and to "increase the number of credit ratings extant for a given structured finance product"[39] by providing non-hired

[38] We assume that if Section 15E(w) were to be adopted, Rule 17g-5 would be rescinded as the issuer-pay conflict it seeks to manage would be addressed through the board allocation method and thus unsolicited ratings would not be available at closing. We note however, that even if unsolicited ratings were available, no transaction can be sold on the basis of unsolicited ratings alone and the effect would be the same.

[39] See the 17g-5 Program Adopting Release at p.63844.

NRSROs access to arranger websites in order to rate securities on an unsolicited basis. While the goal of the Rule 17g-5 Program has not been fully realized, we believe positive developments have occurred and improvements can be made to the system. We discuss these below. Additionally, the fact that the Rule 17g-5 Program does not exacerbate the barriers to entry or stifle competition stands in sharp contrast to Section 15E(w), which could result in severe impediments to entry.

G. Consequences of Section 15E(w) are not clear at this time.

A number of potential consequences of Section 15E(w) would raise significant issues. While the Section 15E(w) provisions would appear to mitigate the ability of an issuer to influence NRSROs through their selection to provide initial credit ratings, the issuer would remain free to hire NRSROs to provide subsequent ratings and perform other services. Consequently, we question the effectiveness of Section 15E(w) in addressing the issuer-pay conflict of interest, as the initial ratings an NRSRO provides under the Section 15E(w) process could influence an issuer decision to retain the NRSRO for other services. In addition, members of the board (and the staff of the board) will each be subject to their own conflicts of interest that could influence their decision-making and evaluation of NRSROs – both with respect to qualification of the NRSRO and measurement of an NRSRO's performance. Since 2008, the Commission has adopted a series of rules aimed at improving internal controls and conflicts of interest at NRSROs. The Dodd-Frank Act mandated further measures aimed at addressing conflicts of interest within NRSROs. What controls would be necessary to ensure that the board charged with the authority to assess the performance of NRSROs could adequately manage its own conflicts of interest?

We question if Section 15E(w) would result in any meaningful change in the NRSROs assigned to issue ratings. It is not a foregone conclusion that the board allocation method would result in allocation of ratings assignments to smaller NRSROs, either due to investor preference or the lack of performance history. We also question whether smaller NRSROs will have the capacity to provide a meaningful number of ratings during the course of the year.[40] Or will implementation of Section 15E(w) allow the same NRSROs to continue to dominate the market by providing the vast majority of initial credit ratings, eliminate the possibility for smaller NRSROs to compete on the basis of fees, decrease the efficiency of securitization as a source of funding and impose large costs on the industry to fund the board system?

Once NRSROs no longer compete for engagement with issuers, how will fees be determined? Section 15E(w) provides that the fees of the NRSROs must be reasonable and may be determined by the NRSROs unless the board determines it is necessary to issue rules with respect to fees. But who will determine what is reasonable and how will that be judged once NRSROs no longer compete by market standards? Would this result in higher fees from the market-established price with the cost passed along to borrowers?

Finally, what will the relationship be between the board and the Commission? Certain elements of the board's responsibilities, such as evaluation of qualified NRSROs, seems duplicative of the Commission's role. Would the board's assessment influence the Commission or vice versa?

[40] Even under the current system, NRSROs will sometimes decline to rate a transaction if they are too busy.

Would this be appropriate? Given the overlap, is it more efficient to look to reforms of the existing system?

We recognize any reform includes elements of uncertainty; we do not suggest that reforms are not needed in the area of credit ratings. However, we view the high level of uncertainty and the clear negative implications of Section 15E(w) to be unacceptable.

H. Section 15E(w) would be difficult and costly to implement.

Section 15E(w) requires the creation of a board, adoption of new rules, and implementation of a new evaluation system and method for assigning NRSROs to provide initial credit ratings as well as ongoing assessment reviews of NRSROs. All of this would require a significant staff with highly specialized skills for assessing credit ratings of structured finance securities and meaningfully evaluating the performance of qualified NRSROs.

In this respect, we highlight the difficulties the Commission has faced in adequately staffing its own registration and evaluation responsibilities (even prior to its increased responsibilities under the Dodd-Frank Act). As summarized in the GAO Report,

> [A]lthough the SEC has established an [Office of Compliance Inspections and Examinations (OCIE)] branch dedicated to the examination of NRSROs and hired individuals with experience in credit rating analysis and structured finance to fill these positions, OCIE has not completed timely examinations of the NRSROs and has expressed concerns about its ability to meet its planned NRSRO routine examination schedule of examining the three largest NRSROs every 2 years and the other NRSROs every 3 years. While SEC requested additional resources that it anticipated using to fully staff this oversight function, it will likely need to revisit those requests due to the passage of the Dodd-Frank Act, which among other things, requires that each NRSRO be examined every year and that SEC establish an Office of Credit Ratings to carry out these examinations. Formalizing a plan to assess not only the number of staff it needs for this office but also the skills required of this staff would help SEC be strategically positioned to implement the Dodd-Frank Act requirements. SEC may face challenges in meeting the required examination timetable and providing quality oversight over NRSROs unless it develops a plan that ensures SEC has sufficient staff that have the appropriate qualifications and are appropriately trained.[41]

We question the feasibility (and wisdom) of creating an entirely new institution to oversee this element of NRSROs, particularly where the office directly responsible for qualification and oversight of NRSROs is struggling to meet its own staffing concerns.

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[41] See the GAO Report at p.10.

To provide a rough estimate of the cost of establishing and running the board, we use rating agencies fees because the board presumably will need to have the same capacity (both staffing and technological) as the NRSROs it evaluates. Rating agency fees (abstracting from profit margin for simplicity) provide one way to measure the costs necessary to facilitate rating structured finance products on an industry wide scale. These fees are, on average, $200,000 per deal for asset-backed transactions, $700,000 for CMBS transactions and $175,000 for RMBS transactions. Assuming 340, 85 and 1,000 transactions per year in each of these categories (the approximate number of transactions during 2003) or 375, 90 and 1,700 transactions per year in each of these categories (the approximate number of transactions during 2006), the cost of the board would be approximately, $302,500,000 to $435,500,000, without even including costs related to other asset classes such as collateralized loan obligations or asset-backed commercial paper. Separate from these estimates, we stress that any board is susceptible to abuse by its members in determining their own compensation. All of these costs (justified or not) will be borne by the market, even though it will no longer have a direct say in assessing the performance of NRSROs.

We urge the Commission, as part of its study to carefully evaluate whether the adoption of Section 15E(w) will promote efficiency, competition, and capital formation, and to undertake an accurate cost benefit analysis to determine the true economic impact of the proposal. We believe the costs to the market would be significant, both the cost to create and operate the board and the cost in the form of decreased market efficiency. During the last year, the market has expended considerable time and expense to prepare for, and comply with, the Rule 17g-5 Program, which began in June 2010. Under Section 15E(w), the market would be required to fund an entirely new system in which it has no meaningful say. We believe it is better to focus the energy of the market and the Commission on further development of the Rule 17g-5 Program.

II. Assessment of Compensation Models other than Section 15E(w) and the Rule 17g-5 Program

In the RFC, the Commission solicits assessment of three other compensation models other than Section 15E(w) and the Rule 17g-5 Program, namely the stand-alone, designation and user-pay models. In summary, we find the other models unworkable.

A. Stand-Alone Model.

The stand-alone model seeks to achieve a method of compensation that is beyond the influence of issuers and investors (obviating the issuer-pay and investor-pay conflicts of interest). To accomplish this, NRSROs would be paid by the issuer, investors and participants in the secondary market and would receive compensation over the life of the transaction. First, we believe this method of compensation would be difficult logistically because some method of assessing fees from investors and secondary market participants would need to be developed. Second, in general, structured finance securities are more thinly traded than corporate securities, and it would seem difficult, if not impossible, to compensate NRSROs on any meaningful basis through secondary market trading, unless the per transaction fee was prohibitively high or the bulk of the fee was borne by issuers. From an NRSRO perspective, since the amount of compensation an NRSRO will receive on secondary trades will be uncertain (trading volume for

structured finance securities, while never high, varies greatly depending on market conditions), it could create an incentive for an NRSRO to cut costs to produce ratings to maintain overhead. Third, it is unclear in the stand-alone model who selects the NRSRO to rate the transaction. While the fees might be paid in part by investors or participants in the secondary market, if the issuer selects the NRSRO to provide the initial ratings, NRSROs would remain incentivized to court the favor of issuers. We believe the model does little to mitigate the conflict of interest and raises real questions of feasibility with respect to compensation.

B. Designation Model.

In the designation model, issuers would be required to make information on a transaction available to all NRSROs. NRSROs that chose to do so would rate the security at issuance. The issuer would pay the fee for the ratings to an administrator. Upon issuance, investors, on the basis of their proportionate ownership of securities, would designate which one or more NRSROs would receive the fees. After closing, the issuer, through an administrator, would continue to pay the fees to the NRSROs. The proponents of this model believe that it would eliminate the issuer-pay conflict of interest and encourage NRSROs to issue unsolicited ratings because they would receive some portion of the fees so long as investors selected them.

This model raises issues on a number of levels. First, as discussed in the context of Section 15E(w), uncertainty regarding the identity of the NRSROs hired to provide ratings on a transaction can decrease efficiencies at every step in the process of securitization. Additionally, this model would appear to require an issuer to accept an NRSRO even in situations where it might otherwise choose not to – for example, where considerable lead-time would be required to educate an NRSRO or where the NRSRO terms of engagement are unacceptable. Third, it is unclear how the amount of the fee to be divided among the NRSROs would be established. Would the fee be less if only one NRSRO was selected? Would it increase if multiple NRSROs were selected – thereby increasing the cost to the issuer? If the fee were not adjusted to reflect the number of NRSROs, would NRSROs invest the time and money to issue a rating if their fee ended up being quite small? Would any rating agency want to invest the resources to rate a transaction if it might not be selected? Finally, although the system removes the issuer-pay conflict, it surely would create conflicts of its own through allocating the designation to investors. Similar to the stand-alone model, we believe the designation model to be unfeasible with respect to its compensation arrangements while at the same time raising concerns regarding conflicts of interest.

C. User-Pay Model.

Under the user-pay model, NRSRO fees would be paid by the users of credit ratings rather than issuers. "Users" are defined as any entity that included a rated security, loan or contract as an element of its assets or liabilities in an audited financial statement and would include holders of long and short term positions in fixed-income instruments as well as parties that refer to credit ratings in contractual commitments or that are parties to derivative products that rely on rated securities or entities.[42] The user would be required to enter into a contract with the NRSROs

[42] See the RFC at p.28277.

rating the securities and to pay for ratings during the period that it books the related asset or liability.

As discussed above, the user-pay model is subject to its own conflicts of interest and so the proposal would replace one conflict for another. Also, the model attempts to solve the "free-rider problem" (where investors other than those that paid for the rating gain access to the rating without paying the NRSRO that developed the rating) through requiring users to enter into a contract with the NRSRO. As a condition to a user's auditor issuing an audit opinion, the user would be required to demonstrate to its auditor that it had paid the NRSRO's fees. While it is necessary to address the free-rider problem in any system that mandates use of the investor-pay model, we have reservations regarding the effectiveness of the proposed solution and the difficulties surrounding the implementation of such a plan. We believe investor-pay ratings should be freely available to investors who choose to obtain these unsolicited ratings (as is the case under the Rule 17g-5 Program) but do not believe the ratings compensation can or should be shifted entirely to one compensation model.

III. The Rule 17g-5 Program

The Rule 17g-5 Program precludes an NRSRO from rating structured finance products where an issuer-pay conflict exists unless it complies with certain requirements, including the requirement that it obtain from the transaction arranger a representation that the arranger will post all of the information provided to a hired NRSRO on a website that is available to non-hired NRSROs. The arranger must post the information to the website at the same time as it is provided to the hired NRSRO. By allowing non-hired NRSROs access to the same information provided to hired NRSROs, Rule 17g-5 was intended to enable non-hired NRSROs to provide unsolicited ratings at the time a transaction closed. By doing so, the Commission believed it would provide a check on arranger influence over hired NRSROs by exposing inappropriate ratings resulting from undue issuer influence.

A. Assessment of the Rule 17g-5 Program.

We believe the Rule 17g-5 Program to be a more effective compensation model than Section 15E(w) or any other proposed compensation model. Neither Section 15E(w) nor the other proposed models provides a tenable compensation model and each fails to address effectively the issuer-pay conflict of interest. Specifically, as detailed above, we note that Section 15E(w) has significant weakness in five of the seven factors identified by the GAO – accountability; competition; feasibility; market acceptance and choice; and oversight. With respect to the two other factors, transparency and independence, we do not believe that any amount of transparency with respect to the board function or examination results would be meaningful to the market if NRSROs are not accountable to the market. Any divergence from the market perception of an NSRSO's performance is likely to be met with skepticism and resentment at the loss of the market's control, no matter how detailed or voluminous the rules or the information produced to substantiate the conclusions. Finally, with respect to the independence factor, the GAO Report states that this factor seeks assessment of the ability of the compensation model to mitigate conflicts of interest inherent between the entity paying for the rating and the NRSRO. On this basis, we believe that Section 15E(w) fails entirely because its

method of addressing the conflict – i.e., the purported removal of the conflict – creates more problems than it solves. Such an outcome cannot be considered a solution.

In contrast to Section 15E(w), Rule 17g-5 scores well under the factors laid out by the GAO.

Accountability; Oversight: As discussed above, under the Rule 17g-5 Program, NRSROs are accountable for their ratings through issuer selection, investor influence on issuers regarding the NRSROs hired to rate a transaction and investors' ability to obtain unsolicited ratings from non-hired NRSROs. Further, a number of recent reforms will allow the market to hold NRSROs more accountable.

Competition: Unlike Section 15E(w), which could pose significant new barriers to entry and would remove fee competition, the Rule 17g-5 Program enables NRSROs to compete on the basis of fees and enables non-hired NRSROs to gain access to information to issue unsolicited ratings to foster the issuance of additional ratings.

Feasibility; Market Acceptance and Choice: The Rule 17g-5 Program became effective in June 2010. Since then the industry has expended considerable time and expense in adherence to the necessary requirements. We believe the initial hurdles to feasibility and acceptance in the United States have been largely addressed. We offer some suggestions below on how the program might be further improved.

Transparency: Generally, we believe the market understands how the NRSROs obtain ratings business; how ratings fees are determined; how NRSROs are compensated; and how performance is tied to NRSRO compensation. To increase investor awareness, below we propose disclosure to enhance transparency around the engagement of NRSROs that are not ultimately retained to provide a rating on the securities in a transaction.

Independence: We view the independence factor as the overall assessment of how the model addresses conflicts of interest. For the reasons set out above and the fact that Rule 17g-5 seeks to create a framework in which non-hired NRSROs can provide unsolicited ratings to provide a check on the quality of the ratings of hired NRSROs, we believe the Rule 17g-5 Program is far superior to the other models. In addition, we believe the Rule 17g-5 Program will be strengthened by Section 932 of the Dodd-Frank Act, which requires the Commission to adopt rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of ratings by the NRSRO. In May 2011, the Commission proposed Rule 17g-5(c)(8), which would prohibit NRSROs from issuing or maintaining a credit rating where a person within the NRSRO who participates in the sales or marketing of a product or service of the NRSRO also participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative or quantitative models.[43] The prohibition is designed to insulate individuals within the NRSRO

[43] See the May 2011 SEC NRSRO Release. The Commission also proposed Rule 17g-8 to address concerns regarding conflict of interests in situations where a former NRSRO employee responsible for determining the rating of a security or money market instrument is hired by the issuer, underwriter, or sponsor of the security or money market instrument within one year of any ratings action taken by the NRSRO.

responsible for the analytic function from sales and marketing concerns and pressures.[44] This new rule, along with the power granted to the Commission under the Dodd-Frank Act to suspend or revoke an NRSRO's registration if the Commission determines that the NRSRO has violated the Commission's conflict of interest rules and the violation affected a credit rating,[45] the proposed internal control rules[46] and the reforms undertaken since 2008 (both voluntarily by the NRSROs and through Commission rules), will work better to mitigate the risk of the issuer-pay model than the Section 15E(w) provisions.

B. Proposed Improvements to the Rule 17g-5 Program.

While we believe that the Rule 17g-5 Program is superior to Section 15E(w), we propose certain changes to further improve the program and better facilitate the issuance of unsolicited ratings.

Increase transparency to investors. We believe investors would benefit from knowing if an issuer received enhancement levels from multiple NRSROs on a transaction but elected to retain only certain of those NRSROs to issue ratings. This would alert investors to the possibility of ratings shopping. If concerned, an investor could approach the other NRSROs that were engaged for a transaction but ultimately not selected for the transaction to provide an unsolicited rating or seek unofficial comment on the transaction. Because these NRSROs were engaged, they would have some familiarity with the transaction and would incur fewer costs in providing an unsolicited rating than an NRSRO starting from scratch. We propose that issuers would be required to disclose in their offering documents if they had executed a Rule 17g-5 certification in favor of an NRSRO with respect to the transaction but ultimately did not select that NRSRO to issue a final rating on securities in a transaction. We understand that this is common practice in the private CMBS market. We note that any disclosure requirement should not trigger any consent requirement under Rule 436(g) under the Securities Act of 1933.

Lower barriers to access to arranger websites for non-hired NRSROs. While the Rule 17g-5 Program gives non-hired NRSROs access to the same information that was provided to hired NRSROs through the arranger website, to address concerns regarding use of the arranger websites by a non-hired NRSRO for purposes other than issuing ratings, Rule 17g-5 limits a non-hired NRSRO to accessing no more than 10 arranger websites unless the NRSRO issues ratings on at least 10% of the transactions that it accesses.[47] We understand from our NRSRO members that a non-hired NRSRO is most likely to provide an unsolicited rating or unofficial commentary on a transaction when its assessment differs from that of the hired NRSRO to distinguish its view of a transaction from that of the issuer-paid NRSRO. We suggest increasing the threshold number of transaction websites a non-hired NRSRO may access before it is required to rate at least 10% of the securities for which it accesses information to enable non-hired NRSROs to survey more deals in an effort to identify transactions on which their views diverge from the hired NRSROs.

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[44] See the May 2011 SEC NRSRO Release at p.33426.

[45] See Section 15E(h)(3)(B) of the Exchange Act.

[46] See the May 2011 SEC NRSRO Release.

[47] See Rule 17g-5(e) of the Exchange Act.

Additionally, we believe an NRSRO should be able to count towards its 10% ratings requirement any transaction for which the NRSRO provides unofficial commentary. While fostering the growth of unsolicited ratings is still a work in progress, since the Rule 17g-5 Program became effective certain of the NRSROs have provided unofficial commentary on transactions where they disagreed with the rating provided by the hired NRSRO. We believe this type of ratings commentary allows non-hired NRSROs to give their independent views on a transaction, which may differ from those of a hired NRSRO, exposing investors to multiple NRSRO views on the credit quality of a transaction.[48] We suggest that the Commission modify Rule 17g-5(e) to permit NRSROs to count towards its 10% requirement any ratings commentary provided on a transaction at or prior to closing of the transaction. By increasing the number of websites NRSROs may access and permitting ratings commentary to count towards the 10% threshold, smaller or new NRSROs also might more easily develop a track record in ratings commentary than in unsolicited ratings, thereby gaining exposure and credibility with investors and issuers.

We appreciate that this could raise some concerns – such as misuse by NRSROs of ratings commentary in the same manner as unsolicited ratings can be misused. We believe the Commission could protect against this result through an amendment to Rule 17g-6 of the Exchange Act, which regulates prohibited acts and practices of NRSROs. Ultimately, we view the increased dialogue surrounding ratings to be useful to investors and believe the positives of such a development would outweigh the negatives.

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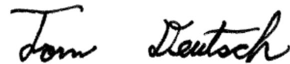
[48] In providing commentary rather than a rating, the non-hired NRSRO alerts the market to its concerns without providing an official rating. We understand from some of our NRSRO members that there are certain practical difficulties in providing unsolicited ratings, including the high cost of rating and monitoring securities.

In conclusion, our membership believes that the most effective manner in which to address the issuer-pay rating conflict and related issues is through the Rule 17g-5 Program as enhanced by the reforms under the Dodd-Frank Act. We believe that in establishing a framework in which non-hired NRSROs could gain access to information to provide unsolicited credit ratings, the Rule 17g-5 Program laid the groundwork for developing greater dialogue around initial ratings. We believe further improvements can and should be made to the Rule 17g-5 Program to ensure that the goal of the program is ultimately fulfilled. Our membership is ready to work with the Commission in this respect and we urge the Commission to consider the concerns expressed in this comment letter. We fully believe that the Rule 17g-5 Program will better serve the public interest and the protection of investors than implementation of the Section 15E(w) provisions or any other compensation model.

ASF very much appreciates the opportunity to provide the foregoing views in connection with the Commission's rulemaking process. We are available at your convenience to discuss our comments and requests. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, Evan Siegert, ASF Managing Director, Senior Counsel, at 212.412.7109 or at esiegert@americansecuritization.com, or ASF's outside counsel on this matter, Giselle Barth of Sidley Austin LLP at 212.839.6749 or at gbarth@sidley.com.

Sincerely,



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