

Claire A. Hill  
Professor and Director, Institute for Law and Rationality  
Associate Director, Institute for Law and Economics  
James L. Krusemark Chair in Law  
University of Minnesota Law School  
229 19th Avenue South  
Minneapolis, MN 55455  
hillx445@umn.edu

September 13, 2011

Re: Request for Comments on Study Required Under Section 939(F) of Dodd-Frank, File Number 4-629

To the Commission:

This letter responds to the request for comments in Release No. 34-64456, File No. 4-629, Solicitation of Comment to Assist in Study on Assigned Credit Ratings.

The SEC has requested comments on the establishment of a system (“System”) in which a public or private utility or SRO assigns NRSROs to determine credit ratings for structured finance products. Structuring such a System would clearly be quite difficult. The difficulties include: a) how to determine the composition of the assigning entity (the “Board”), b) the process by which an NRSRO would be selected in a particular case, c) how fees would be set, and d) market reluctance to accept the rating of the Board-selected NRSRO. The difficulties are significant, but so is the potential payoff: to limit the effects not just of conflicts of interest, but also, of the mindset agencies had in which they worked with their clients, the issuers, to achieve the rating the issuers desired. In my view, commentator accounts of the disastrous subprime securities misratings have focused too much on conflicts of interest, and not sufficiently on the extent to which rating agency employees’ client-focused mindset allowed them to follow their usual practices, such as requiring more collateral or removal of certain loans from a proposed pool, and thereby convince themselves that they were rating appropriately. Attenuating and changing the relationship between the issuer and the rating agency rating an issue could change this mindset into one that is more critical, as the agencies vie for selection under the System. This attenuation could occur consistent with the issuers paying for their ratings, another important benefit of the System given the difficulties of other business models.

Another potential advantage of the System is that it could make the rating agency market more competitive. There is considerable ‘stickiness’ in the practice of market participants, limiting other entrants’ ability to become established in the rating agency market. Some commentators explain the market position of Fitch, S&P and Moody’s by reference to their status as NRSROs -- but there are other NRSROs. Under the System, rating agencies other than those three would presumably sometimes (and perhaps often) be selected, helping market participants become accustomed to the use of such agencies. (I note that the process of removing statutory and regulatory references to NRSROs is continuing; putting aside whether the removal of NRSRO references is desirable, it certainly won’t be done immediately, giving the System a chance to make other agencies better known and better accepted in the market. Given that no obvious well-regarded replacement for the references exists, whatever replaces them is unlikely to make the agencies obsolete or even vastly less influential.) Markets may have considerable difficulty adjusting to the System, and deal volume

may be adversely affected, at least in the short term. To some extent, this is a cost, but the recent past demonstrates that more market wariness is sometimes a good thing.

None of this is to suggest that the System is the only, or even the best, way to proceed. But, unlike many of the other reform proposals, the System could attenuate and change the agencies' client-focused mindset, and improve the competitiveness of the rating agency market. Achieving these ends should be an important goal of any regulatory reform.

Sincerely,

Claire A. Hill