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United States Senate

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November 17, 2011

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Dear Chairman Schapiro:

I write today in response to the SEC's 2011 Summary Report of Commission Staff's Examination of Each Nationally Recognized Statistical Rating Organization (NRSRO).[1] Your report contained findings that are relevant to your Solicitation of Comment to Assist in Study on Assigned Credit Ratings,[2] and confirms the troubling and persistent conflicts of interest in the credit rating industry.

The problems revealed by your report are wide-ranging. Notably, all of the NRSROs failed to follow their ratings procedures in some instances.[3] Most registered agencies "appeared to have some weaknesses with respect to their employee securities ownership policies and procedures," with some policies "poorly documented" and some weaknesses "troubling".[4] Two of the larger agencies, for instance, have issued ratings to issuers that may be significant shareholders.[5] Some ratings agencies were found to have obvious conflict management failures—one even sharing office space with a business unit that provides investment advice.[6] Finally, although each credit rating agency is required to have a designated compliance officer (DCO) manage such conflicts of interest, your report indicates that the role of the DCO at one large agency lacked stability and clarity, and the DCO at several smaller agencies lacked adequate resources to effectively carry out their duties.[7]

It is notable that while your report is evidence of these persistent conflicts of interest in the credit rating industry, several industry representatives submitted comments, in response to the SEC's Solicitation of Comment, dismissing the need for meaningful reform. One belittles the problem, claiming that, "conflicts are inherent in every CRA [Credit Ratings Agency] business model."[8] A common industry tactic is to defend the current system, claiming that the

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[1] SEC, Section 15E Examinations Summary Report (September 2011) [hereinafter *Your Report*].
[2] SEC, Solicitation of Comment to Assist in Study on Assigned Credit Ratings, Release No. 34-64456 (May 10, 2011).
[3] See *Your Report*, at 13.
[4] See *Your Report*, at 14.
[5] See *Your Report*, at 15.
[6] See *Your Report*, at 16.
[7] See *Your Report*, at 19.
[8] Letter from Michel Madelain, President and Chief Operating Officer, Moody's Investors Service to Elizabeth M. Murphy, Secretary, SEC (Sep. 13, 2011).

proposed changes would merely create new potential conflicts,[9] increase costs for investors,[10] or represent government intrusion of the private sector.[11] One representative defends the current system as "the most effective option for managing conflicts in the NRSRO selection process given that it is already producing results, minimizes competitive distortions, builds on existing initiatives and is cost effective."[12] These claims are unconvincing and merely support the status quo.

Finally, I would like to bring to your attention a working paper[13] by researchers at Indiana University, American University, and Rice University, that was released near the end of the comment period for Assigned Credit Ratings. "Credit Ratings across Asset Classes: A ≡ A?" examines the relationship between different asset classes, product performance, and rating agency profits. The paper found that structured finance products, which generate the highest revenues for the rating agencies, received the most "optimistic" ratings, and that corporate and municipal bonds, which generate the lowest revenues, received the harshest ratings. The paper found that "rating standards are inversely correlated with revenue generation." The scholars concluded that their results are best explained by a conflict of interest in the issuer-paid rating agencies. This paper is just one more indication that a quest for profit, not quality, drives the rating agency industry.

To address underlying conflicts of interest, I again recommend that you consider the Franken-Wicker proposal, which would create an independent Credit Rating Agency Board to assign credit rating agencies to provide initial ratings. While I reiterate support for this proposal, I also remain open to similar proposals that would likewise reduce conflicts of interest and protect American investors and consumers.

Sincerely,

Al Franken

Al Franken
United States Senator

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[9] Letter from Patrick Milano, Executive Vice President, Operations, Standard and Poor's Ratings Services to Elizabeth M. Murphy, Secretary, SEC (Sep. 13, 2011).

[10] Letter from Valerie Kay, Managing Director, Morgan Stanly & Co. LLC to Elizabeth M. Murphy, Secretary, SEC (Sep. 13, 2011).

[11] Letter from Richard A. Dorfman, Managing Director, Head of Securitization, & Christopher B. Killian, Vice President of Securitization Group, Securities Industry and Financial Markets Association (SIFMA) to Elizabeth M. Murphy, Secretary, SEC (Sep. 13, 2011).

[12] Letter from Charles D. Brown, General Counsel, Fitch Ratings to Elizabeth M. Murphy, Secretary, SEC (Sep. 9, 2011).

[13] Jess Cornaggia, Kimberly Rodgers Cornaggia, & John Hund. *Credit Ratings across Asset Classes: A ≡ A?* (Working Paper Series, October 30, 2011), *available at* SSRN: http://ssrn.com/abstract=1909091