SFIG
The Structured Finance Industry Group

June 3, 2013

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: File No. 4-661 --- Credit Ratings Roundtable

Ladies and Gentlemen:

The Structured Finance Industry Group, Inc. ("**SFIG**")[1] thanks the Securities and Exchange Commission (the "**Commission**") for its invitation to submit comments on the topics discussed at its Credit Ratings Roundtable held on May 14, 2013, as announced in the Commission's press release 2013-71. The Commission convened the roundtable in connection with its Report to Congress on Assigned Credit Ratings (the "**Report**").[2] The Report is a study required by Section 939F ("**Section 939F**") of the Dodd-Frank Wall Street Reform Act and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**" or "**Dodd-Frank**") enacted in July 2010. The Report is a study on, among other things, the feasibility of establishing an assignment system (defined below) under which a public or private utility or self-regulatory organization assigns nationally recognized statistical rating organizations ("**NRSROs**" or "**rating agencies**") to issue ratings on structured finance securities.

The views expressed in this letter come from our membership, which includes sponsors of structured finance products, investors, financial intermediaries, rating agencies and other market participants. There are views among our membership that differ from the views expressed in this letter. Some of those divergent views have been expressed in letters to the Commission in response to the Commission's request for comments in carrying out the study and are referred to in the Report. We expect that some of those divergent views have been or will be reflected in comment letters from those members in connection with the Roundtable.

[1] Structured Finance Industry Group, Inc. ("SFIG") is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be an advocate for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

[2] http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf

In addition to requiring the Commission to deliver the Report, Section 939F provides that the Commission "… shall, by rule, as it determines is necessary or appropriate in the public interest or for the protection of investors, 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. In issuing any such rule, the Commission shall 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." The system referred to in the prior sentence is referred to in this letter as the "**assignment system**."

Section 939F(c)(2) further requires the Commission to include in the Report "… any recommendations for regulatory or statutory changes that the Commission determines should be made to implement the findings of the study …". The difficulty in making such recommendations is evidenced by the fact that the Report does not make such recommendations, but in large part catalogues the significant and unavoidable negative consequential effects that would result from establishing and operating the assignment system, which we discuss in Section IV. The Report quite properly called for the Roundtable to discuss such issues.

After the Executive Summary immediately below, this letter will first discuss the goal of the assignment system, the guiding principles that we feel should be observed in assessing the assignment system and the applicable statutory restrictions that must be met by any system that might be adopted. In our view, the assignment system does not survive the application of such guiding principles and statutory restrictions. This letter then proposes improvements to Rule 17g-5 that we believe will increase the number of unsolicited ratings and credit commentary available to investors while being consistent with such guiding principles and not violating such statutory restrictions. Finally, we review the principal consequential negative effects of the assignment system.

I. Executive Summary

As discussed in Section IV of this letter, not only would the assignment system not achieve its primary goal of mitigating the potential conflicts of interest in the issuer-pay model, it would bring with it many significant consequential negative effects. In addition, the assignment system would not comply with the statutory restrictions discussed in Section II or be consistent with the guiding principles discussed in that Section. We propose changes to Rule 17g-5 in Section III that are intended to increase the number of ratings and credit commentaries issued in respect of structured securities so that (i) investors will be better able to perform their own credit analyses by reviewing but not adopting or simply relying on the ratings and credit commentaries of rating agencies and (ii) the increased competition among rating agencies arising from the more accommodative access to and use of Rule 17g-5 information will improve the quality of ratings and credit commentaries in general. Our approach in Section III does not bring with it the consequential negative effects inherent in the assignment system.

II. Goal of the Assignment System, Guiding Principles That Should Be Observed and Statutory Restrictions That Must Be Met

1. Goal of the assignment system

The primary goal of the assignment system is to mitigate the effect of the potential conflict of interest faced by a rating agency that is engaged and compensated by the sponsor or issuer of a structured finance security. (The terms "sponsor' and "issuer" are used interchangeably to mean the entity, as applicable, that deals with the rating agency.) The issuer-pay conflict creates the potential that a rating agency will be influenced to issue credit ratings desired by the issuer to the detriment of the objectivity and quality of the credit ratings.

The assignment system does not achieve its primary goal. It is likely that most sponsors will need to continue to engage the rating agency or agencies that they currently engage voluntarily (referred to herein as "hired rating agencies" or "additional rating agencies") in order to access the market. The assignment system does not eliminate or even reduce the potential conflict of interest of the hired rating agencies. However, as discussed in Section IV, the assignment system would cause the assigned rating agency to face two additional conflicts of interest that have the potential to compromise the objectivity of the rating issued by the assigned rating agency.

2. Guiding principles that should be observed in determining regulatory action pursuant to Section 939F

Section 939F requires the Commission to adopt rules " . . . as it deems necessary or appropriate in the public interest or for the protection of investors." This broad language requires the Commission to take regulatory action that promotes and does not violate such principles. Applied to the context of determining what regulatory action of any sort should be taken, we believe such principles should include the following considerations.

Promote high quality of credit ratings. Mitigating a potential conflict of interest in the issuer-pay system is certainly one step in improving the quality of credit ratings. As discussed above and in Section IV, the assignment system does not eliminate or reduce the potential conflicts for the hired rating agencies and instead adds to the rating process the conflicts faced by assigned rating agencies. Increasing competition among rating agencies – i.e., increasing the number of rating agencies issuing a rating or credit commentary – is the primary and most effective way to improve the quality of ratings. When sponsors and investors can review and compare more rating analyses or credit commentaries with respect to a structured product, they will make their own decisions as to quality and thereby cause rating agencies to maintain and improve their quality so as to avoid being disfavored in the market. We feel that our proposal in Section III with respect to Rule 17g-5 will have this effect of increasing the number of rating analyses and credit commentaries and therefore improving the quality of rating analyses and credit commentary.

Market credibility. Changes must be credible to the market participants, or they may leave the market. Sponsors engage a rating agency because of its credit knowledge in respect of the sponsor's assets and transaction structure. At the same time, a sponsor will often engage a specific rating agency because it knows its investors prefer that rating agency. Frequently, this is due to the investor's familiarity with the methodology and criteria of its preferred rating agency. If a system tends to exclude from time to time a rating agency that is preferred by investors, that will cause those investors to pass on the related transaction. At the same time, if the system qualifies a rating agency for a particular category of structured products and the market disagrees with that qualification, the system will lose credibility. In Section IV.3, we discuss the difficulty of a credit rating agency board (the "**Board**") developing evaluation methodologies that will be perceived as reliable by market participants. A government run system that determines qualifications would probably not have market credibility initially because, among other things, it has no track record. Such a system would only develop credibility over time if the Board has sufficient expertise on its staff, a problem we discuss in Section IV.3.

Market participants determine the credibility and reliability of a rating agency on the basis of the rating agency's performance over time and its experience with a sponsor, its assets, and its industry segment. Our proposal in Section III to change Rule 17g-5 so as to foster an increase in the number of ratings and credit commentary will put investors in a better position to determine the performance level of rating agencies. Credibility is not created through a system that assigns rating agencies, randomly or otherwise.

Market liquidity. Any regulation should preserve and in fact enhance market liquidity in the structured finance products market. If ratings by assigned rating agencies are not accepted in the market, investors may decline to invest because they see less liquidity in the secondary market, which will adversely affect secondary market pricing. Secondary market liquidity is especially important in the case of an asset category like residential mortgage-backed securities, which is still in the early stage of coming back from the financial crisis. Any regulation that impairs liquidity will not be in the public interest or for the benefit of investors.

Predictability and stability to the securitization process; effect on general economy and availability of credit. Originators of securitizable assets and sponsors of securitizations require predictability as to the anticipated structure of the securitization and the time needed to complete the securitization. Originators of securitizable assets may price those assets at the time of origination on the basis of their knowledge of how structures used to securitize similar assets will be treated by the methodologies and criteria used by rating agencies. If this predictability could be changed at the time of securitization by the introduction of the methodology of an assigned rating agency, the originator will have to price its originations to the worst scenario in terms of expected rating and related structural features, such as subordination levels. Pricing to the worst scenario will result in one or more of the following consequences: (i) the increased finance costs are passed on to the obligors on the securitized assets, who are often consumers; (ii) the amount of credit available is reduced, which has a negative effect on economic activity in general; and (iii) the increased costs are absorbed by the originator, which ultimately causes the costs to be passed back to the underlying obligors. A regulation that creates such unpredictability and has such negative effects on the economy and availability of credit would not be in the public interest or for the benefit of investors. Our proposal for Rule 17g-5 does not create such unpredictability and related adverse effect on the economy.

Lack of predictability as to the timing of executing a securitization transaction will have a similar adverse effect on pricing. An assigned rating agency understandably may need time to learn about a sponsor, its industry, its assets and its structure. Any assignment rotation system will impair this needed predictability as to timing. Missing a market opportunity because of the extra time needed by an assigned rating agency could have substantial adverse financial consequences for the originators and sponsors.

Promote flow of ratings analyses and credit commentary to investors. An assignment system may increase by one the number of rating agencies rating a transaction if the sponsor continues to engage its historical rating agency or agencies as additional rating agencies as permitted in Section 15E(w). However, this results in increased costs to sponsors and may be especially burdensome for smaller sponsors. We believe that any regulatory approach adopted must have the capacity to increase in general the flow of full ratings or credit commentary in respect of structured products in order to make it more likely that investors will have the opportunity to compare analyses from various rating agencies and, in the end, perform their own credit analysis. Such an approach would be consistent with and promote one of the purposes of Section 939A, which eliminates ratings as an end point. We believe that our suggestions in Section III below with respect to Rule 17g-5 will increase the flow of ratings analyses and credit commentaries to investors without the negative consequences discussed in Section IV.

3. Statutory restrictions that any such regulation must comply with

Section 939A. Section 939A of Dodd-Frank requires each Federal agency to remove from regulations issued by it any reference to or requirement of reliance on credit ratings and to substitute therefor such standard of credit-worthiness as such agency determines is appropriate. The clear intent of Section 939A is to eliminate the Federal government's apparent endorsement of rating agencies and their ratings and to reduce investors' reliance on them. As discussed in Section IV.4, the assignment system would do just the opposite. An assignment system created by the Commission pursuant to Section 939F and, in substance, operated by the Commission will have the effect of the Federal government appearing to endorse each assigned rating agency and its ratings and will result in even greater reliance by investors on those ratings. This is contrary to the goals of making ratings just one analytical tool among others used by investors and reducing the reliance by investors on ratings as ultimate indicators of credit-worthiness.

Section 15E(c)(2). Section 15E(c)(2) of the Securities Exchange Act of 1934 provides that, notwithstanding any provision of law, the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any rating agency determines credit ratings. As discussed in Section IV.3, the evaluation methodology to be developed and applied by the Board to evaluate the qualifications of rating agencies for purposes of qualifying them for participation in the assignment system would have the effect of regulating the substance of credit ratings.

Section 3(f). Section 3(f) of the Securities Exchange Act of 1934 provides that when the Commission is engaged in rulemaking and is required to determine whether an action is necessary or appropriate in the public interest (as is the case with Section 939F as discussed in Section II.2 above), the Commission must also consider, in addition to the public interest and the protection of investors, whether the action will promote efficiency, competition and capital formation. As discussed above in this Section II and in Section IV below, the assignment system adversely impacts efficiency, competition and capital formation.

III. Proposed Approaches to the Goal, While Following Those Guiding Principles and Complying with Those Statutory Restrictions

1. Improvements to Rule 17g-5

Expand permitted use of information obtained on Rule 17g-5 web sites. Rule 17g-5 currently permits non-hired rating agencies to access a Rule 17g-5 web site solely for the purpose of determining or monitoring credit ratings. We propose that Rule 17g-5 be amended to permit non-hired rating agencies to access a Rule 17g-5 web site for the purpose of not only determining or monitoring a credit rating on the related structured security but also for the purpose of issuing a credit commentary on that security or for reviewing and modeling information about the assets and the security so that it is better prepared to timely issue a rating or credit commentary on that sponsor's structured securities in the future. A credit commentary should be less costly to produce than a full rating and yet provide the related rating agency an additional approach for showing its methodologies to the market.

Clarify confidentiality and other arrangements. Several panelists at the Roundtable mentioned that the confidentiality agreement required to be agreed to in order to gain access to a Rule 17g-5 web site presented issues for some rating agencies. One of the fundamental issues is that both the rating agency's annual certification to the Commission under Rule 17g-5(e) and the confidentiality agreements developed by the industry in response thereto may limit the use of the confidential information to the purpose of determining or monitoring credit ratings. As described above, we are proposing an expansion of the permitted uses, and the confidentiality arrangements should be similarly expanded to accommodate those additional permitted purposes as well. This will help level the playing field for non-hired rating agencies by ensuring that non-hired rating agencies can publish ratings or commentary at a time when that information is most relevant to the market. However, as the details of the new confidentiality arrangements are determined, non-hired rating agencies should be held to sponsor-determined standards of confidentiality that are appropriately protective of confidential and commercially sensitive information and are no more restrictive than the confidentiality standards to which the hired rating agencies are held. Among other things, we believe that issuers and other offering participants should continue to control the initial release of information regarding the terms and timing of a particular transaction to the market. SFIG would be happy to work with the Commission in resolving any such confidentiality and related issues (including by participating in a task force created by the Commission for that purpose) so that hired rating agencies and non-hired rating agencies are on a level playing field in this regard.

Increased access to Rule 17g-5 web sites. Access to Rule 17g-5 web sites is permitted to a rating agency only if (i) it determines and maintains ratings for at least 10% of the securities for which it accessed information pursuant to Rule 17g-5 in any calendar year or (ii) it has not accessed information pursuant to Rule 17g-5 10 or more times during the calendar year. That provision has the effect of either (x) forcing the rating agency to access only a few Rule 17g-5 web sites or (y) requiring it to devote enough resources to be able to give a full rating on at least 10% of the securities related to web sites accessed by it, but not get paid for those efforts. The rule as now constituted discourages unsolicited ratings from rating agencies that have not been hired by the sponsor.

We believe that the rule should be revised to permit a rating agency to access any Rule 17g-5 web site without limitation as to number of Rule 17g-5 web sites accessed. The only requirement for access would be that the accessing rating agency would only use the information on the web site for the purposes described above under "*Expand permitted use of information obtained on Rule 17g-5 web sites*" (subject to a confidentiality agreement as discussed above).

This greatly increased accessibility to Rule 17g-5 web sites would have the following positive effects, none of which would be available under an assignment system:

(a) it requires non-hired rating agencies to compete on the strength of the analysis in their ratings or credit commentaries, and not because they were selected under an assignment system;

(b) because credit commentary rather than a full rating may be issued, it is more likely that non-hired rating agencies will participate, thus increasing the number of competing rating agencies with respect to an issuance of a structured security and increasing the flow of credit analyses to investors; under the assignment system, only one additional rating agency, if any, is added in respect of an issuance;

(c) just issuing credit commentary rather than a full rating should be less expensive, resulting in the participation of more non-hired rating agencies accessing Rule 17g-5 web sites;

(d) investors will be able to compare more methodologies of the various participating rating agencies with respect to each rated structured security and make their own determination as to quality; and

(e) to the extent investors appreciate the credit commentary of a non-hired rating agency over time, they can engage it to issue a rating or can ask the sponsor to engage it in the future as a hired rating agency.

We have discussed whether it would be appropriate to require that each qualified rating agency rate (acting as a non-hired rating agency) some minimum number of structured securities annually. We believe that the enhanced ease of access to the Rule 17g-5 web sites due to our proposed changes described above will increase the number of non-hired rating agencies putting out timely ratings or credit commentary so as to make such a requirement unnecessary.

2. Regulations affecting internal control structure and procedures targeted at potential conflicts of interest.

The Commission has already adopted or proposed many regulations applicable to the internal control structure and procedures of rating agencies that relate to the management of potential conflicts of interest. Because of the overwhelming task of processing the regulations required under Dodd-Frank, some regulations related to conflicts management are yet to be proposed. We believe that such targeted regulations are effective and should be given time to show results before a mechanism like the assignment system, with all of its negative effects, should be considered.

IV. Negative Effects That Would Arise From the Assignment System

We believe that the proposals made under Section III will have a substantial positive effect on mitigating potential conflicts of interest in the issuer-pay model. No proposal can eliminate those potential conflicts, as we believe that any business model will present potential conflicts of interest. The important point is, the proposals made under Section III are not accompanied by consequential negative effects. This is in direct contrast to the assignment system, which has many substantial negative consequential effects. Most of these negative effects are set forth in great detail as findings in the Report[3], and we briefly discuss the more important ones below. We agree with these findings and, based on such findings, believe the assignment system in any form should not be adopted. Faced with these findings, it is understandable why the staff of the Commission did not include in the Report any recommendations for regulatory or statutory changes to implement the assignment system, as called for by subsection (c) of Section 939F. In our view, none of the panelists at the Roundtable had solutions for avoiding or even mitigating these negative consequences.

1. The assignment system adds new sets of potential conflicts.

The assignment system does not eliminate the potential issuer-pay conflict of interest faced by the hired rating agency.[4] Instead, it adds two new types of potential conflicts faced by the assigned rating agency. The assigned rating agency will have the same potential conflict that the hired rating agency has, since it too will be influenced by its aspiration to become a rating agency engaged by the sponsor on a future structured products transaction or on securities issued by the sponsor or an affiliate that are not structured products. However, the assigned rating agency will also have a similar conflict of interest in respect of the Board in that it may feel that an inappropriately conservative rating will make its rating performance score better in the Board's evaluation methodology so that the assigned rating agency is more likely to remain a "qualified NRSRO," as defined in Section 15E(w), and therefore qualified to receive future rating assignments from the Board. In addition, the inclination of an assigned rating agency to score well under the Board's evaluation system will discourage the assigned agency from improving its own methodology."[5]

As the Report points out, the Board itself will have potential conflicts of interest. Individuals on the Board or its staff may have interests stemming from their respective backgrounds that influence them.[6]

2. Moral hazard

Investors may perceive both the assigned rating agency and its ratings as having the government's seal of approval because the assigned rating agency is qualified by the Board.[7]

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[3] See the Report at pp. 72-82

[4] See the Report at p. 74, first full paragraph

[5] See the Report at p. 74, first full paragraph.

[6] See the Report at p. 76, last paragraph.

[7] See the Report at p. 77 first paragraph.

This may cause investors to rely entirely on the assigned rating (rather use it as one of several analytical tools), which runs directly contrary to the purposes of Section 939A.[8] As discussed below, the use of "metrics" by the Board in its evaluation process would compound the moral hazard by creating a false impression of effectiveness.

3. The Board's evaluation system poses the potential for doing substantial harm

Under subsection (7)(A) of Section 15E(W), the Board would be obligated to evaluate the performance of each NRSRO that is a qualified NRSRO under Section 15(E)(W). Under Section (7)(B) of Section 15E(W), in conducting such evaluation of a qualified rating agency the Board would be required to consider, among other things, (i) the "accuracy" of the ratings issued by that rating agency as compared to other NRSROs and (ii) the effectiveness of the methodologies used by that rating agency. In the Commission's questions posed at the Roundtable, it asked what metrics could be used by the Board to measure the performance of a rating agency. The use of an evaluation system by the Board and its staff to determine "qualified NRSROs" creates many potential problems:

(a) The Board will need to have a staff that has, in effect, the expertise of a full-time rating agency. The cost of maintaining such a staff will be substantial.[9]

(b) It will be difficult for the staff to keep up with changes in the market since it is not continually rating deals.

(c) We believe that it is not possible to develop an unbiased evaluation model. If it were possible to develop a model that evaluates the effectiveness of the methodology used by every rating agency, then the Board's evaluation model itself would be used to determine ratings and no other methodologies would be needed. A rating issued by a rating agency is an opinion of that rating agency and is not the product of a methodology with which every other rating agency agrees. There is no one "right" way to rate a structured finance transaction. It is the investor's responsibility to review the different methodologies and make a determination based on that review.

Aside from the impossibility of developing metrics to assess the effectiveness of a methodology, it goes without saying that the credit of a transaction can deteriorate because of factors that were either not present or not reasonably detectable at the time of issuance of the rating. For that reason alone, metrics will not be a sufficient evaluator. Moreover, merely comparing the rating of one rating agency to the rating of another rating agency is not appropriate because a rating agency, especially one receiving assignments under the assignment system, may issue inappropriately conservative ratings.

Perception by investors that the Board has "metrics" that discover and eliminate from the assignment system low performing rating agencies significantly compounds the moral hazard problem discussed above.

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[8] Id.

[9] See the Report at p. 74.

The existence of an evaluation model applied by the Board would tend to cause rating agencies to rate so as to score well under that model. The various methodologies of the rating agencies might not be reviewed and improved as frequently as needed. As a result, the assignment system would tend to reduce creativity in the development of new methodology.

(d) A flaw in the evaluation methodology used by the Board or mistakes in the application of such methodology would result in (i) otherwise unqualified rating agencies being assigned and issuing ratings and (ii) otherwise qualified rating agencies being shut out of the assignment system.[10] The adverse effects of an assigned rating agency that was inappropriately qualified but is issuing ratings within the assignment system are incalculable and could be long-term.

(e) If an insufficient number of ratings agencies participate in the assignment system, the Board may not have enough rating agencies available to it for the required assignments.[11]

4. Timely execution of a transaction

Efficient capital markets execution of a transaction requires timely execution. Assigned rating agencies will understandably need ramp-up time to learn about the sponsor, its industry, its assets and its structure.[12] As we discussed in Section II.2, timeliness of execution is very important in the securitization process. Markets can change quickly, so that missing a market opportunity can have significant adverse financial consequences to originators and sponsors.

5. Investor preferences

Investors in structured finance securities generally, and buyers of subordinated structured securities in particular, prefer (or are required to obtain) ratings from a specified rating agency, and sponsors often accommodate investor requests to use a particular rating agency. Consequently, the sponsor will likely be required to engage a rating agency in addition to the assigned rating agency, thus increasing the costs of the transaction. This could be particularly burdensome to smaller sponsors.[13]

6. Negotiating fees and the engagement letter with the assigned rating agency

It is not clear what the sponsor could do if it can't agree with the assigned rating agency on the engagement letter. Does the sponsor then have to leave the market? Does the Board get involved to mediate the issues?

Section 15E(w)(8) is not clear as to how the Board determines fees. If the fee is too low, the assigned rating agency may be disinclined to devote the proper resources to its rating effort. If the fee is too high, sponsors may be discouraged for using structured products.

[10] See the Report at p. 76, first paragraph.

[11] Id.

[12] See the Report at p. 74, second full paragraph.

[13] See the Report at p. 74

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Again, SFIG appreciates this opportunity to express its views on the assignment system and Rule 17g-5. If you have any questions or desire to discuss any issues further, please contact me at 571-296-6017 or [redacted]

Sincerely,

Richard Johns
Executive Director
The Structured Finance Industry Group, Inc.