



March 12, 2007

Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: File No. S7-04-07**

Dear Ms. Morris:

The Association for Financial Professionals (AFP) welcomes the opportunity to comment on the Securities and Exchange Commission's (SEC) proposed rule "Oversight of the Credit rating Agencies Registered as Nationally Recognized Statistical Rating Organizations."

The membership of our Association includes approximately 15,000 financial executives employed by over 5,000 corporations and other organizations. Our members represent a broad spectrum of financial disciplines and their organizations are drawn generally from the Fortune 1000 and middle-market companies in a wide variety of industries, including manufacturing, retail, energy, financial services, and technology. Our members are responsible for issuing short- and long-term debt, and also invest corporate cash and pension assets for their organizations.

On two occasions, AFP surveyed senior-level corporate practitioners such as CFOs, vice presidents of finance, and corporate treasurers regarding the accuracy and timeliness of credit ratings, the role the SEC should take in regulating the credit rating agencies (CRA), and the impact additional competition may have on the marketplace for ratings information. Our research found that many of our members believe that 1) the information provided by credit rating agencies is neither timely nor accurate, 2) the rating agencies are primarily serving the interest of parties other than investors, and 3) the SEC should increase its oversight of rating agencies and takes steps to foster greater competition in the market for credit rating information. The survey also found that the majority of respondents believe that increased competition will improve the quality and timeliness of credit ratings. The Credit Rating Agency Reform Act of 2006 and the SEC proposal implementing the act make significant strides toward removing barriers to competition that the SEC had imposed and addressing many of the unfair and abusive practices in the industry.

AFP believes that the credit rating agencies are vital to the efficient operation of capital markets, and has strongly advocated for major changes in the credit rating industry. AFP has sought additional transparency and competition in the credit ratings market. We are pleased that in many areas the Commission's proposal reflects the recommendations that AFP has been making for several years.

The SEC has asked for comments on a wide range of topics and issues surrounding the oversight of credit rating agencies and the implementation of the Credit Rating Agency Reform Act of 2006 (The Reform Act). Generally, AFP believes that, in keeping with Congressional intent, the SEC has offered a proposal that is narrowly tailored and provides sufficient flexibility that will foster "competition in the credit rating agency business."<sup>1</sup> This competition will ultimately improve the reliability and credibility of credit ratings and restore confidence in the credit rating agency industry.

AFP offers the following comments on specific portions of the proposal.

### **Registration Requirements**

AFP and its members have long sought the termination of the opaque "recognition" process that the SEC has relied on when determining which credit rating agencies were designated NRSROs. The staff no-action letter process erected a regulatory barrier to entry into the credit ratings market that resulted in a lack of competition in the credit ratings market. To foster competition, AFP recommended, in its *Code of Standard Practices for Participants in the Credit Rating Process*, that regulators ". . . establish and clearly communicate specific criteria that CRAs must meet in order to be recognized or approved."<sup>2</sup> The new registration process established by the Credit Rating Agency Reform Act of 2006 combined with the Commission's proposal accomplishes this by eliminating the staff no action letter and establishing a clear path to NRSRO status for those CRAs wishing to secure the designation.

Throughout the entire debate on credit rating agency reform, AFP argued that the single most important factor in determining whether a rating agency should be designated an NRSRO is whether that agency consistently produced credible and reliable ratings. AFP is pleased that proposed rule 17g-1 requires that CRAs seeking the NRSRO designation submit ratings performance statistics, including historical default rates in its registration application. The additional requirement that these performance statistics be part of the public exhibits accompanying the application will assist investors and issuers in determining the accuracy and reliability of ratings provided by any particular CRA. Making the statistics publicly available will also bring an element of market accountability to the CRAs.

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<sup>1</sup> Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S.3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109<sup>th</sup> Congress, 2<sup>nd</sup> session (September 6, 2006).

<sup>2</sup> Code of Standard Practices for Participants in the Credit Rating Process, Association of Corporate Treasurers, Association for Financial Professionals, Association Francaise Des Tresoriers D'Entreprise, page 1 (February 2005).

Further, AFP strongly supports the requirement that each applicant (except those previously designated as NRSROs through the no-action process) provide certifications from ten qualified institutional buyers (QIB). Combined with the publication of performance statistics, the QIB certifications will allow market participants (investors and issuers) to determine which NRSROs are providing credible and reliable ratings.

In its discussion of QIBs, the Commission also requests comment on whether “. . . there should be a requirement for an NRSRO to notify the Commission if a QIB withdraws its certification.” To ensure that NRSROs continue producing credible and reliable ratings, NRSROs should be required to confirm QIB certifications in writing on an annual basis, retain the written confirmations per proposed rule 17g-2, and notify the Commission if a QIB withdraws or does not re-confirm its certification.

The Commission is proposing that, as part of the registration process, applicants provide information regarding the procedures and methodologies they use to determine a credit rating. While AFP supports this requirement, simply publishing those methodologies is insufficient. It is critical that in its oversight role, the Commission ensures that the NRSROs are in fact adhering to their published methodologies. The Reform Act gives the Commission the authority to take enforcement action against an NRSRO that fails to continually meet the registration requirements, including not adhering to its published methodologies. AFP strongly supported granting the Commission this authority and believes that it is an important component of restoring accountability and confidence in the credit ratings market.

### **Record Keeping**

AFP members have consistently raised concerns about the high turnover rate of rating analysts at the credit rating agencies. This turnover rate often leads to inefficiencies and the duplication of much of the work that issuers must undertake to provide adequate and timely information to credit rating agencies. AFP supports the SEC’s proposal regarding the production and retention of the records and work that goes into determining a credit rating. AFP also supports the requirement, under proposed rule 17g-1, that applicants include the “. . . responsibilities, experience, and employment history of its credit analysts and supervisors . . .” We believe that these requirements will help to reduce current inefficiencies and give market participants more information about how and by whom a rating is determined, and will ultimately result in more accurate ratings.

AFP believes that the requirement in paragraph (g) of proposed rule 17g-2 that rating organizations “. . . promptly furnish the commission and its representatives with legible, complete, and current copies of those records . . . required to be retained under this section. . .” will allow the Commission to more effectively perform its oversight role, bringing greater accountability to the credit ratings industry.

Since CRAs currently maintain much of the documentation outlined in the proposal, the records retention requirements should not be overly burdensome nor should they result in significantly increased cost to NRSROs.

### **Annual Audit**

The SEC is proposing that registered rating agencies furnish annual audited financial statements. The proposal states that the audited financial statements would “. . . assist the Commission in monitoring the NRSRO’s financial resources and whether the resources were at a level that would necessitate the Commission taking action.” AFP has previously recommended that regulators “. . . examine whether a credit rating agency soliciting NRSRO recognition has the financial and human resources to adhere to its published methodologies on an ongoing basis, whatever those methodologies may be.”<sup>3</sup> The Commission should avoid a “one size fits all” approach and judge the adequacy of an NRSRO’s resources based on the individual NRSRO’s published methodologies. We believe that providing certified, audited financial statements would accomplish the goal of allowing the SEC to ensure the rating agencies continue to maintain the resources necessary to adhere to their stated methodologies and produce credible and reliable ratings.

AFP believes that the proposed 90-day filing period, with the allowance for an extension, is reasonable.

### **Procedures to Prevent the Misuse of Material, Non-public Information**

Through their Regulation FD exemption, credit rating agencies are privy to non-public information, which is appropriately used to assign a credit rating. Since that information may have a significant impact on issuers and/or the financial markets, credit rating agencies must take steps to prevent its misuse.

The Commission is proposing that credit rating agencies develop written procedures and policies to prevent the misuse of material, non-public information. Without proscribing what the actual policies and procedure must be, the Commission would require that rating agencies develop and enforce policies designed to prevent the inappropriate dissemination of 1) non-public information obtained in connection with the performance of credit rating services; 2) pending credit rating action prior to making the action readily accessible; and 3) prevent persons associated with the rating organization or any member of an associated person’s household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material non-public information obtained in connection with the performance of credit rating services that affects the securities or money market instruments.

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<sup>3</sup> Letter from James A. Kaitz, President and CEO, Association for Financial Professionals, to Jonathan G. Katz, Secretary, Commission (June 7, 2005).

By not prescribing specific procedures, the Commission's proposal would give each credit rating organization the flexibility to design policies and procedures best suited to its business model. AFP supports the Commission's approach, which is consistent with AFP's previous recommendations to the SEC.<sup>4</sup>

### **Management of Conflicts of Interest**

The Commission seeks comment on its proposal regarding the management of and, in some cases, the outright prohibition of certain conflicts of interest. AFP's research revealed that there is a lack of confidence in the credit rating agencies partly because AFP members believe that the ". . . rating agencies are primarily serving the interest of parties other than investors." As such, AFP is pleased that the proposal would require NRSROs to establish and implement policies and procedures to manage conflicts and to disclose relationships between a rated company and the credit rating agency; its directors, management or staff. Further, AFP supports the Commission's proposal to prohibit management and staff from having any business relationship with or interest in any company rated by the NRSRO.

In addition to the conflicts addressed in the proposal, AFP recommends that the SEC add the following to its prohibited conflicts list.

- ◆ NRSROs should be required to establish distinct and absolute separation between rating analysts and credit rating agency staff responsible for generating revenue from credit ratings, rating assessment services, corporate governance reviews, or other ancillary services offered by the credit rating agency.
- ◆ The Commission should bar analyst compensation from being linked in any way to revenue generated from credit ratings or any ancillary services. The potential for a credit rating agency or individual analyst to abuse the market power associated with NRSRO recognition to boost revenue or personal earnings is obvious.

Requiring the disclosure of any conflicts under proposed rule 17g-1 combined with requirements for NRSROs to develop policies and procedures to manage conflicts of interest and the prohibition of specific conflicts will go a long way towards restoring confidence in the credit rating marketplace..

### **Prohibited Unfair, Coercive, or Abusive Practices**

The Reform Act gives the SEC the authority to determine whether certain practices are unfair, coercive, or abusive. If the Commission makes such a determination, those practices must then be prohibited. The Commission is proposing to prohibit five practices that it has determined are

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<sup>4</sup> Letter from James A. Kaitz, President and CEO, Association for Financial Professionals, to Jonathan G. Katz, Secretary, Commission (June 7, 2005).

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unfair, coercive, or abusive. AFP agrees with the Commission's determination that the practices specifically outlined in the statute and proposed rules are unfair, coercive, or abusive, and thus should be prohibited.

It is imperative that the SEC ensure that each NRSRO is, in fact, adhering to and enforcing their stated policies and procedures regarding conflicts of interest, unfair, coercive, or abusive practices, and the protection of non-public information. The proposed record retention rule combined with the requirements to submit audited financial statements and that each NRSRO certify annually that they continue to meet the original registration requirements would allow the SEC to effectively and efficiently execute its oversight role.

### **Effect on Competition**

The Commission asked for comment regarding the effect of the proposed rules on competition, market efficiency and capital formation. AFP is always concerned about the compliance and regulatory burden that is associated with overly restrictive rules. However, AFP believes that the Commission has offered a proposal that is narrowly tailored and flexible, and that the proposal will foster competition and produce more credible and reliable ratings. The elimination of the staff no action process, the establishment a clear registration process, and a prudent oversight regime that imposes a high level of accountability on the registered rating agencies will promote competition and restore confidence in the credit ratings market.

We appreciate the opportunity to comment on the proposal. If you have any questions, please contact Jeff A. Glenzer, CTP, AFP's Director of Treasury Services at 301.907.2862.

Sincerely,

A handwritten signature in cursive script that reads "James A. Kaitz". The signature is written in black ink and is positioned above the printed name and title.

James A. Kaitz  
President and CEO