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By E-Mail: rule-comments@sec.gov

Nancy M. Morris
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-04-07

Dear Ms. Morris:

I am currently the Robert L. Bridges Professor of Law and Professor of Economics at Boalt School of Law, University of California, Berkeley, and Co-Director of the law school's Program in Law and Economics. I have previously served as Deputy Assistant Attorney General for Antitrust in the U.S. Department of Justice. I am a past president of the American Law and Economics Association, and am a fellow of the National Bureau of Economic Research and the American Academy of Arts and Sciences.

In 2002, Fitch Ratings Services, Inc. asked me to analyze the effect on the structured finance credit ratings market of certain practices of Moody's Investors Service and Standard & Poor's, including the practice generally referred to as "notching." Through that project I developed substantial familiarity with the issues that the Securities and Exchange Commission (the "SEC") seeks to address through proposed Rule 17g-6(a)(4). I have since analyzed more recent data published by Moody's, S&P and Fitch at Fitch's request. I am also familiar with the provisions of the Credit Rating Agency Reform Act of 2006 ("Act") that direct the SEC to prohibit unfair, abusive and coercive practices within the credit ratings market, and with the Act's history.

When Congress passed the Act, its express intent was "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[1] To that end, the Act directed the SEC to issue rules that would prohibit "any act or practice relating to the issuance of credit ratings" that it deems "unfair, coercive, or abusive."[2]

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1 Pub. L. No. 109-291, 120 Stat. 1327 (2006) (codified in scattered sections of 15, 20, and 30 U.S.C.)

2 15 U.S.C. § 78o-7(i). Acts and practices that qualify under this characterization include: conditioning or threatening to condition the issuance of a credit rating on an obligor's

Based on my earlier analysis, and my review of data subsequently published by Moody's, S&P, and Fitch, I believe that Moody's and S&P's "notching" practices, as described below, are unfair, coercive, and abusive within the meaning of the Act, and properly prohibited by the SEC in its proposed rulemaking. Although a practice need not violate antitrust law to be deemed "unfair, coercive, or abusive" under the Act, analogies to antitrust law help to illuminate the anti-competitive effects of Moody's and S&P's practices.

Because of regulatory and investor requirements that corporate bonds be publicly rated by two rating agencies, Moody's and S&P's historical dominance of the corporate bond credit ratings market, and significant barriers to entry into the NRSRO business, Moody's and S&P, individually and collectively, wield very substantial market power with respect to new structured finance issues. This market power has allowed Moody's and S&P to impose practices with respect to structured finance credit ratings that are anti-competitive and harmful to competition.

Moody's and S&P both currently require at least 80% of the assets comprising a structured finance vehicle to be individually rated by their agency, and insist on categorically reducing public ratings assigned to securities comprising the vehicle not rated by them by up to four "notches" or grades. I have seen no empirical evidence supporting this practice; indeed ratings studies that I have reviewed make it clear that while there is some variability in the ratings of Moody's, S&P, and Fitch – mainly at sub-investment levels – the ratings of the three largest NRSROs are generally comparable. No one agency's ratings are systematically higher or lower than those of its two closest competitors.[3] Additionally, I am unaware of any data indicating that any one NRSRO's ratings are more accurate than any other NRSRO's ratings.

Current notching practices effectively create an economic tie between Moody's and S&P's ratings of individual assets within an asset pool and the ratings of other assets in the pool. To avoid the tie, the sponsor of a vehicle wishing to include Fitch-rated assets would be forced to increase the equity capital included in the pool, which could significantly increase the vehicle's cost of capital.

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purchase of other services and products; lowering or threatening to lower, or refusing to rate "securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction" unless some of the assets are also rated by the same NRSRO; modifying, threatening to modify, or departing from systematic procedures and methodologies based on whether the obligor purchases the rating or any other service or product from the NRSRO. *Id.*

3 *See, e.g.*, Fitch Credit Market Research Report, "U.S. Structured Finance Rating Comparability Survey" (Mar. 24, 2006); Fitch Credit Market Research Report, "International Structured Finance Rating Comparability Survey" (May 16, 2006); Moody's Special Report, "Comparing Ratings on Jointly-Rated U.S. Structured Finance Securities" (May 25, 2006); Moody's Special Report, "Comparing Ratings on Jointly-Rated U.S. Structured Finance Securities: 2007 Update" (March 30, 2007).

The effect of Moody's and S&P's "notching" policies is to raise costs for debt issuers that wish to hire Fitch and other NRSROs to rate their issues. Under the current system, issuers of underlying securities have an incentive to obtain Moody's and S&P ratings rather than Fitch or other NRSRO ratings, since they will otherwise have difficulty selling their securities to structured finance investment vehicles.

Fitch is the third largest of five government-recognized rating agencies and currently Moody's and S&P's only significant rival. In the market for rating structured finance instruments, Fitch's presence has given Moody's and S&P an incentive to compete on price, levels of service, and innovation. Unfortunately, the response of Moody's and S&P has been to increase Moody's and S&P's already substantial market power.

Whatever their design, Moody's and S&P's anticompetitive notching practices have the potential to substantially hamper Fitch as a competitive force in the credit-ratings market. The risk is great, since, as suggested by the many letters filed with the SEC by active market participants, Fitch delivers a range of services highly valued by the structured finance industry.

The bond market is served by having at least three major rating agencies. To the extent that current and continuing notching practices hinder Fitch's ability to compete, the market faces reduced competition and innovation, as well as a loss of transparency and service. Fitch's continued presence in the ratings markets for structured finance instruments promotes the public's interest in access to quality financial information, new analytic methodologies, independent analysis, and competitive pricing. By arbitrarily "notching" Fitch ratings on a categorical basis, Moody's and S&P jeopardize these interests, unfairly suggesting to the market that Fitch ratings are less than fully reliable, although all empirical evidence shows otherwise.

If you have any questions or would like to discuss my comments further, please do not hesitate to contact me.

Sincerely,

Daniel L. Rubinfeld