July 23, 2008

Filed Electronically

Ms. Florence E. Harmon, Acting Secretary
U.S. Securities and Exchange Commission
100 F St., N.E.
Washington, D.C. 20549


Dear Ms. Harmon:

DBRS appreciates this opportunity to comment on the above-referenced proposal1 to enhance the credit rating agency regulatory regime that the Commission adopted last year pursuant to the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Act"). DBRS is a Toronto-based credit rating agency established in 1976 and still privately owned by its founders. With affiliates located in New York and Chicago, DBRS analyzes and rates a wide variety of issuers and instruments, including financial institutions, insurance companies, corporate issuers, issuers of government and municipal securities and various structured transactions. Registered as a nationally recognized statistical rating organization ("NRSRO") since September 2007,2 the firm maintains ratings on more than 42,000 securities of more than 2300 groups of issuers in approximately 35 countries around the globe.

As the Commission recognizes, the current problems in the global credit markets stem from the market for subprime residential-backed mortgage securities ("RMBS") and RMBS-backed collateralized debt obligations ("CDOs"). These problems have been caused by a complex of factors, including a proliferation of mortgage loans made to less creditworthy borrowers, reduced incentives to maintain high underwriting standards, irregularities in the mortgage origination process and a precipitous decline in housing values. The consequent rise in delinquencies and defaults in the subprime loans

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2 Prior to the implementation of the NRSRO registration scheme, DBRS had been designated as an NRSRO under the prior no-action letter process. See Letter from Annette L. Nazareth, director, Division of Market Regulation, Securities and Exchange Commission, to Mari-Anne Pisarri, Pickard and Djinis LLP (February 24, 2003).
underlying the RMBS and CDOs led to downgrades in the credit ratings of these structured finance products, which in turn caused an erosion of investor confidence in the credit markets generally.

Over the past several months, DBRS has worked with other NRSROs and a number of global and U.S.-based regulatory bodies, financial markets supervisors and trade organizations to restore confidence in credit rating opinions and the credit rating process. Among other things, at the request of authorities and market participants, DBRS participated with certain other NRSROs (hereafter, the "NRSRO Working Group") in developing measures to improve the quality and transparency of credit ratings and the independence of the rating agencies, and in conferring with the Technical Committee of the International Organization of Securities Commissions (IOSCO) on the May 2008 revisions to the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (the "IOSCO Code"). In view of the global nature of the credit markets, DBRS appreciates the Commission's efforts to co-ordinate its proposed regulatory initiatives with the work of IOSCO and other U.S. and international authorities.

GENERAL COMMENT ON THE ROLE OF NRSRO RATINGS IN SEC REGULATION

From a securities law perspective, the NRSRO regulatory regime is unique in that it is completely voluntary. Unlike the laws and rules that apply (in the absence of specific, limited exemptions) to securities issuers, broker-dealers, exchanges, transfer agents, clearing agencies, investment companies and investment advisers, the Rating Agency Act and regulations thereunder apply to only those rating agencies who choose to be bound by them. The purpose of this voluntary regime is twofold: to provide SEC oversight of the nationally recognized agencies whose credit ratings are used for securities regulatory purposes and to provide a more transparent process for acknowledging a rating agency's "national recognition" than the no-action letter process that had been used in the past.

However, shortly after issuing the Proposing Release for the most recent package of NRSRO rules, the Commission proposed to radically overhaul the use of NRSRO ratings for regulatory purposes under the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), the Investment Company Act of 1940 ("Company Act") and the Investment Advisers Act of 1940 ("Advisers Act"). In this

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5 "Security Ratings," SEC Rel. Nos. 33-8940, 34-58071 (July 1, 2008); "References to Ratings of
regard, the Commission proposed to eliminate requirements that issuers, broker-dealers, investment companies and investment advisers rely on credit ratings issued by NRSROs in a variety of situations. Issuers, for example, would no longer be obliged to look to the ratings issued by NRSROs in assessing the availability of short-form registrations on Forms S-3 and F-3, but instead could use credit ratings issued by unregulated parties. When computing their net capital, broker-dealers would be allowed to rely on unregulated service providers or their own subjective, internal assessment of the credit risk attendant to their portfolio securities. Likewise, in making investment decisions, managers of money market funds would no longer need to consider the ratings issued by regulated credit rating agencies.

By permitting, and even encouraging, securities market participants to eschew the credit rating opinions issued by NRSROs in favor of alternative evaluation methods, including those marketed by unregulated parties, the Commission appears to suggest that the regulatory regime established under the Rating Agency Act is not necessary and appropriate in the public interest or for the protection of investors. DBRS does not agree with this suggestion. On the contrary, DBRS believes the Rating Agency Act and its attendant rules have enhanced the quality, independence and objectivity of NRSRO ratings that, since 1975, have played a critical role in protecting the safety and soundness of the securities markets.\(^6\)

A thorough analysis of the Commission’s proposal to virtually eliminate the required use of NRSRO ratings from U.S. securities regulations is beyond the scope of this comment letter. DBRS respectfully submits, however, that should the Commission conclude that the use of NRSRO ratings for net capital computations, money market fund investment selection, short-form securities registrations and the like is not necessary and appropriate in the public interest and for the protection of investors, the Commission will not be able to justify the additional burdens it seeks to impose on NRSROs through its latest package of rating agency rules. Indeed, such a conclusion would call the validity of the entire NRSRO regulatory regime into question.

\(^6\) DBRS finds the Commission’s proposal to minimize the role of NRSRO ratings under the net capital rule particularly puzzling in light of the recent failure of Bear Stearns. This broker-dealer’s collapse was caused, at least in part, by the fact that the firm was able to avoid the haircut provisions of the net capital rule and was permitted to use its own computer models instead of the objective ratings of NRSROs to compute deductions for credit risk. See Order Regarding Alternative Net Capital Computation for Bear, Stearns & Co., Inc., Which Has Elected To Be Supervised On A Consolidated Basis, SEC Rel. No. 34-52857 (November 30, 2005).
On the other hand, if the Commission continues to recognize the salutary role NRSRO credit ratings play in U.S. securities regulation, DBRS agrees that certain steps can be taken to make the quality and transparency of these ratings even better. DBRS generally supports the Commission's efforts in this regard, subject to the important caveats and suggested modifications discussed below.

A. CONFLICTS OF INTEREST - PROPOSED CHANGES TO RULE 17g-5

Section 15E(h) of the Exchange Act requires each registered NRSRO to establish, maintain and enforce policies and procedures reasonably designed to address conflicts of interest that may arise in connection with the rating agency's business. This section also directs the Commission to adopt rules either to prohibit or to require the management and disclosure of NRSRO conflicts. The Commission implemented this statutory provision last year by adopting Rule 17g-5, a rule that requires NRSROs to disclose and manage certain kinds of conflicts and prohibits other kinds of conflicts altogether.

The Commission proposes to amend Rule 17g-5 to add one type of conflict to the "disclose and manage" section of the rule and to ban three additional types of conflicts outright.

1. Additional "Disclose and Manage" Conflict - Condition Imposed on Rating Structured Finance Products Under an Issuer/Arranger-Pay Model

Rule 17a-5 currently requires NRSROs to disclose and manage conflicts arising from being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments those payors issue or underwrite. In order to address what is perceived to be a heightened conflict of interest in the structured finance area, the Commission proposes to add a new subsection to the rule relating specifically to an NRSRO's being paid by the issuer, sponsor or underwriter of a security or money market instrument issued by an asset pool or as part of an asset-backed or mortgage-backed securities transaction (hereafter, a "structured finance product") for rating that security or money market instrument.

However, instead of simply requiring an NRSRO to disclose and manage this type of conflict, the SEC proposes to add a third condition to the NRSRO's issuance of a rating on a structured finance product. This condition would require that the information provided to the NRSRO by an issuer, underwriter, sponsor, depositor or trustee that the NRSRO uses in determining the credit rating must be disclosed through a means

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7 In the Commission's view, a heightened conflict arises from the fact that some arrangers of structured finance transactions repeatedly bring ratings business to the NRSROs, thereby having the potential to exert more influence on an NRSRO than a corporate issuer who generates less ratings business. Proposing Release at 29, 73 Fed. Reg. at 36219.
designed to provide reasonably broad dissemination of that information.\(^8\) For initial ratings, the required disclosure would have to include, at a minimum, information about the characteristics of the assets underlying or referenced by the structured finance product and the legal structure of that product. Where a public offering is involved, this information would have to be disclosed on the date the underwriter and the issuer or depositor set the offering price of the securities being rated. For private offerings and unregistered offshore offerings by U.S. issuers, disclosure would have to be made to investors in the offering and other credit rating agencies (whether registered as NRSROs or not) on the date the offering price of the rated securities is set. Public disclosure would then be required on the first business day after the transaction closes.

A parallel disclosure requirement would be imposed regarding information provided to and used by the NRSRO in undertaking credit rating surveillance on a structured finance product. This information, which would have to be publicly disclosed at the time it is supplied to the NRSRO, would include information about the characteristics and performance of the assets underlying or referenced by the product.

The Commission does not specify who (NRSRO, arranger, issuer, depositor or trustee) must make the 17g-5(a)(3) disclosure, although it notes that the disclosure would likely be made by the arrangers and trustees of structured finance products, in order to avoid making NRSROs civilly liable for the accuracy of information that the arrangers and trustees supply to them and also to avoid running afoul of the complicated disclosure provisions of the Securities Act.\(^9\) In contracting to rate a structured finance product, an NRSRO would require a representation from the issuer, arranger and/or trustee that they would disclose the necessary information in accordance with the rule. Surprisingly, however, the Commission does not propose to furnish a safe harbor for NRSROs in connection with such representations. In effect, this makes the NRSROs accountable for any contractual breaches by issuers, arrangers and/or trustees. If these parties fail to disclose the required information, ratings cannot be released.

According to the Commission, the purpose of the new Rule 17g-5 disclosure requirement is to increase the transparency of the ratings process, thereby making it more apparent if an NRSRO’s objectivity is compromised by business considerations, and to enhance competition among credit rating agencies by facilitating unsolicited ratings.\(^10\) Broad dissemination of information relating to structured finance products is also seen as an antidote to ratings shopping, the practice by which an issuer or arranger selects an NRSRO based on how favorable a credit rating is likely to be.

\(^8\) Proposed Rule 17g-5(a)(3).


\(^10\) Id. at 30 - 32, 73 Fed. Reg. at 36219.
DBRS does not object to adding the potential conflict arising from issuer/arranger-paid ratings of structured finance products to the list of "disclose and manage" conflicts under Rule 17g-5(b). And, as a general matter, DBRS agrees that enhanced public disclosure of information regarding the legal structure of and assets underlying structured finance products will help investors make more informed investment decisions about these products and will discourage ratings shopping. However, DBRS strongly believes that this disclosure burden belongs to the parties who structure, arrange, issue, and administer these products. Shifting the burden to the NRSROs in the manner set forth in proposed Rule 17g-5(a)(3) is insupportable for a host of reasons, including the following:

**Lack of Statutory Authority**

As noted above, Section 15E(h) of the Exchange Act authorizes the SEC to require the disclosure of "any conflicts of interest relating to the issuance of credit ratings" by NRSROs. This statute does not, however, authorize the Commission to require NRSROs to disclose or cause the disclosure of information about the particular securities they rate. At the very least, the sweeping disclosure obligation the Commission proposes is not "narrowly tailored to meet the requirements of" the Rating Agency Act as Section 15E(c)(2) of the Exchange Act requires.

Disclosure of information about the legal structure and underlying assets of a structured finance product is more properly the function of issuers and arrangers pursuant to the extensive disclosure regime established under the Securities Act.

**Chilling Effect on Communications with NRSROs and Burden on Competition**

Tying the requirement to disclose information about a structured finance product to the information disclosed to and used by an NRSRO in rating that product could have a chilling effect on an issuer's or arranger's communications with the NRSRO. In particular, issuers and arrangers may become more reluctant to share information with NRSROs who are known to have more conservative rating styles. If that occurs, Rule 17g-5(a)(3) would impose a burden on competition in the credit ratings market, which is precisely the opposite result from the one the Commission intends.

**Exposing NRSROs to Liability for the Acts of Others**

As the Commission notes, the disclosure proposed to be required by Rule 17g-5(a)(3) (hereafter "Paragraph (a)(3) Information") would also be subject to the disclosure, civil liability and antifraud provisions of the Securities Act. Furthermore, improper disclosure of information relating to private or offshore offerings could jeopardize those offerings'

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11 *Id.* at 43, 73 Fed. Reg. at 36222.
exemptions from registration. The Commission predicts that in order to avoid these compliance risks, NRSROs are likely to refrain from making the required disclosures themselves and instead will contractually obligate the issuers/arrangers to fulfill this obligation.\(^{12}\)

DBRS submits that tossing NRSROs into the treacherous waters of Securities Act compliance and expecting them to find their way to dry land is a poor approach. By making NRSROs responsible for at least contractually requiring Paragraph (a)(3) Information to be broadly disseminated and verifying that this dissemination has, in fact, occurred, the Commission risks making the rating agencies vulnerable to third-party claims in the event of a material misstatement or omission in the disclosed information. Even in the absence of third-party claims, the Commission's approach potentially makes NRSROs suffer the consequences of other parties' misconduct. By declining to provide NRSROs with a safe harbor when they obtain representations that issuers, arrangers, trustees, etc. will satisfy the disclosure obligations, the Commission effectively subjects the agencies’ credit rating opinions to forces over which the agencies may have no control. For example, if an issuer declines to disseminate Paragraph (a)(3) Information on the pricing date, despite a contractual obligation to do so, the NRSRO would be forced to at least delay the issuance of its initial credit rating.\(^{13}\) Likewise, a trustee's failure to publicly disclose surveillance information provided to an NRSRO would preclude the NRSRO from taking any rating action with respect to the subject structured finance product. Prohibiting an NRSRO from publishing a timely downgrade or other change in an instrument's rating in this fashion would interfere with the NRSRO's ability to surveil its ratings and would further harm the public's confidence in the credit rating process.

- **Ambiguous Scope of Required Disclosure**

Although the text of Rule 17g-5(a)(3) generally describes the kind of information that must be disclosed before issuer- or arranger-pay credit ratings can be published, the precise scope of the required disclosure is a matter of conjecture. One source of confusion arises from the use of the term "all information" instead of the words "documents" or "records." Does the Commission intend that information relayed to an NRSRO in an oral communication will be memorialized and disclosed if the NRSRO uses that information in determining a credit rating? If so, who would be responsible for creating the record of the conversation? What liability would ensue if details about a conversation were omitted or inaccurately described?

\(^{12}\) *Id.* at 115, 73 Fed. Reg. at 36234.

\(^{13}\) In fact, read literally, Rule 17g-5(a) would seem to prohibit an NRSRO from *ever* publishing an issuer/arranger-paid credit rating if the disclosure has not been made by the deadlines set out in subsections (3)(i) and (ii).
The Adopting Release has this to say about this issue:

The proposed rule . . . would exclude from disclosure most, if not all, communications between the NRSRO and the issuer, underwriter, sponsor, depositor or trustee to the extent the communications do not contain information necessary for the NRSRO to determine an initial credit rating or perform surveillance on an existing credit rating.\footnote{Proposing Release at 33, 73 Fed. Reg. at 36220.}

Unfortunately, this guidance raises more questions than it answers. First, by speaking in terms of "communications" instead of "documents" or "records" the Commission seems to suggest that at least some oral communications would have to be memorialized and disclosed, which raises all the issues listed above. Moreover, the guidance uses the phrase "necessary for the NRSRO to determine an initial credit rating . . . ," whereas the rule speaks in terms of what the NRSRO "used" in determining or surveilling a credit rating.

Limiting the required disclosure to only a subset of the information supplied to the NRSRO, \textit{i.e.}, the information the NRSRO "used" either in determining an initial credit rating or in surveilling an existing credit rating, is its own source of confusion. Does "used" mean "necessary" for the determination of an initial rating or surveillance, as the Adopting Release suggests? Does it mean what the NRSRO "typically uses" in the rating process? Or does it mean what the NRSRO "actually used" to rate a particular structured finance product? If the term relates to information that was "actually used," how can this information be publicly disclosed at the time such information is provided to the NRSRO (\textit{i.e.}, before the NRSRO has had a chance to use it), as subsection (a)(3)(ii) of Rule 17g-5 would require?

On a more fundamental level, the relevance of the "used in the ratings" limitation in any interpretation of Rule 17g-5 is unclear. If the purpose of disclosing information about structured finance products is to permit other parties to undertake their own credit risk assessments, then a standardized universe of information should be disclosed for each product so that investors and parties wishing to publish unsolicited ratings can determine for themselves what is "useful." Limiting disclosure to the information a paid NRSRO "uses" (regardless of the meaning of that term) might permit other parties to replicate the NRSRO's work, but it would not necessarily permit the kind of diverse analyses that will restore confidence in the credit markets. Finally, DBRS notes that although the purpose behind the disclosure requirement pertains to credit ratings broadly used in the market, the proposed rule makes no exception for private ratings.\footnote{A private rating is prepared for a restricted audience, where the rating, any supporting report and knowledge of the rating are limited in accordance with the terms of the arrangement with the issuer or third party who requested the rating. Private ratings are not disseminated to the public.}
In view of all these problems with the proposed structured finance product disclosure provisions of Rule 17g-5, DBRS respectfully submits that subsection (a)(3) should be eliminated from the proposal altogether. Rather than trying to force disclosure about specific securities and money market instruments into the NRSRO regulatory regime, where it simply does not fit, DBRS urges the Commission to determine what standardized set of information would be relevant to investors and credit rating agencies and then make appropriate adjustments to the disclosure requirements already imposed on issuers under the Securities Act. In this regard, with respect to public offerings, the Commission should consider amending Regulation AB to require issuers to provide comprehensive disclosure, in a standardized manner, about the characteristics of each asset in the asset pool; the structure of the transaction and performance data for each asset in the asset pool; the validation process used to verify the quality of the information provided; and all pertinent representations and warranties, as well as servicer and trustee reports prepared after the issuance of the transaction. Where unregistered offerings are involved, the Commission could amend or adopt rules under the Securities Act conditioning applicable registration exemptions on the issuers/arrangers' making the desired disclosure.

As a simpler alternative, standardized information about all structured finance products as to which a public credit rating is sought could be supplied simultaneously to all NRSROs on a confidential basis.

Either of these approaches would enhance transparency and foster competition in the market for credit ratings of structured finance products. And either would do so by placing the disclosure burdens on the issuers and arrangers who have the first-hand knowledge of the information to be disclosed and the expertise to verify it, instead of on the rating agencies, which have neither.

If, despite the problems discussed above, the Commission decides to retain the structured finance product disclosure provisions in Rule 17g-5, DBRS urges the Commission at least to (i) provide a safe harbor for NRSROs who obtain representations that issuers, arrangers, etc. will make the required disclosures; (ii) confirm that the disclosure requirements relate only to "written communications" directed by the issuer, arranger, etc. to the NRSRO; (iii) eliminate from the scope of Paragraph (a)(3) Information all references to information "used by" the NRSRO in determining or surveilling a credit rating; (iv) confirm that the disclosure provisions do not apply with regard to private ratings; and (v) codify the Securities Act guidance contained in the Proposing Release.

16 This suggestion is consistent with the position advanced by the NRSRO Working Group in the IOSCO Comment Letter, supra n.3, at 6.

17 Under either of the approaches DBRS advocates, NRSROs would disclose the existence of the structured finance conflict of interest on Exhibit 6 of Form NRSRO, and would adopt policies and procedures to manage that conflict, pursuant to Rule 17g-5(a)(1) and (2).
2. Additional Prohibited Conflict - Making Recommendations About Structured Finance Products

As noted above, in addition to adding a new conflict to the "disclose and manage" portion of Rule 17g-5, the Commission also proposes to add new types of conflicts that would be banned outright. The first of these would forbid an NRSRO from issuing a credit rating with respect to an obligor or security where the NRSRO or any of its associated persons made recommendations to the parties responsible for structuring the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. The purpose of this proposal is to address the perception that NRSROs sometimes make proposals or recommendations regarding the creation or design of structured finance products that they subsequently rate. As part of the NRSRO Working Group, DBRS has already committed to incorporate into its code of conduct a prohibition against this type of activity.\(^\text{18}\) Thus, DBRS supports the Commission's proposal in this regard.

The Adopting Release explains that this proposal is not designed to prohibit all interaction between an NRSRO and the parties responsible for structuring a securitized product during the rating process. Recognizing that "the line between providing feedback during the rating process and making recommendations about how to obtain a desired rating may be hard to draw in some cases," the Commission asks whether it should provide more guidance in this area.\(^\text{19}\) DBRS strongly endorses the issuance of such guidance. In particular, we urge the Commission to add the following "Note to paragraph (c)(5):"

In assessing the credit risk of a structured finance transaction, the NRSRO's analysts may properly hold a series of discussions with the issuer or its advisers in order to (i) understand and incorporate into their analysis the particular facts and features of the structured finance transaction, and any modification, as proposed by the issuer or its agents; and (ii) explain to the issuer or its agents the credit rating implications of the NRSRO's methodologies as applied to the issuer's proposed facts and features.\(^\text{20}\)

3. Additional Prohibited Conflict - Fee Discussions

Another change the Commission proposes to make to the conflict of interest rule is designed to separate those involved in fee negotiations on behalf of an NRSRO from

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\(^{18}\) IOSCO Comment Letter at 11.

\(^{19}\) Proposing Release at 61, 73 Fed. Reg. at 36227.

\(^{20}\) See IOSCO Comment Letter at 8.
those involved in the NRSRO's credit rating analytical process. In this regard, proposed Rule 17g-5(c)(6) would prohibit an NRSRO from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed or arranged by a partner, director, officer or other NRSRO employee who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies, including models, used for determining credit ratings. Noting that the purpose of a fee discussion is to generate revenue while the purpose of the analytical process is to produce an accurate credit rating, the Commission opines the potential for conflict where the same person is engaged in both activities is so significant that the conflict should be banned altogether.\textsuperscript{21}

DBRS agrees that a conflict of interest may arise where one person performs both business development and analytical functions. In a rating agency of sufficient size and organizational structure, a complete separation between these functions may be an appropriate way to address this conflict. However, in smaller rating agencies, where executive officers and other senior managers, by necessity, perform a variety of roles, an absolute segregation of duties is not possible. Prohibiting the personnel of small firms from being involved in the determination of credit ratings or the development of credit rating procedures or methodologies if they also play any role in fee negotiations would prevent the best utilization of critical expertise within these entities. In this way, such restrictions would impede the small firms' ability to compete with larger, more well-established rating agencies, thereby defying one of the primary purposes of the Rating Agency Act.

In order to avoid imposing such a burden on competition, DBRS recommends that the fee negotiation conflict be removed from the list of prohibited conflicts in Rule 17g-5(c) and be included in the list of disclose-and-manage conflicts in 17g-5(b) instead. Given the diversity of organizational structures, business models and scope of ratings activities among rating agencies, it is difficult to determine what constitutes a "small" NRSRO based on the number of employees a firm has. Therefore, DBRS further recommends that this approach be available to all NRSROs.\textsuperscript{22}

DBRS believes that there are a range of measures an NRSRO could implement to control the effect of a fee negotiation conflict. Since both the existence of the fee negotiation conflict and the policies and procedures the NRSRO adopts to control the conflict would be publicly disclosed, the users of credit ratings could decide for themselves whether they think this conflict can be adequately managed.


\textsuperscript{22} For example, the staffing needs of a firm that uses only quantitative models to rate only one class of securities from a single office would differ greatly from the staffing needs of a firm with multiple offices that uses qualitative methodologies to rate all asset classes.
Exchange Act Rule 17g-2 describes the recordkeeping obligations of registered NRSROs. The rule is divided into two parts: one part that obligates an NRSRO to make and retain certain kinds of records, and another part that obligates the NRSRO to retain certain records already made in the normal course of its business operations. Among other things, the Commission proposes to add two new requirements to the "make and retain" part of the rule.

1. Record of Rating Actions

The Commission proposes to require NRSROs to create a record showing all rating actions the NRSRO has taken, both with regard to the credit ratings it currently maintains and for all future credit ratings. This record would have to include the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor, as well as every rating action taken with regard to the security or obligor from the initial credit rating through to the present and the dates thereof.

An NRSRO would be obliged to continuously update its ratings record to reflect the complete history of each extant credit rating. In addition, the NRSRO would be required to make this record publicly available on the NRSRO's corporate Web site in an Interactive Data File that uses a machine-readable computer code that presents information in XBRL, no later than six months after the date of the rating action being recorded.

NRSROs already publish extensive performance measurement statistics in Exhibit 1 to Form NRSRO. The purpose of the current proposal is to make it easier for interested parties to analyze raw performance data across the NRSROs, with the ultimate goals of fostering greater accountability by the NRSROs regarding their credit ratings and more competition in the ratings industry.

DBRS does not object to the idea of creating, maintaining and publishing a record of its ratings actions to facilitate a review by interested parties of the quality of its credit ratings. However, DBRS is concerned that the proposal as currently drafted would impose a burden on NRSROs that is neither "narrowly tailored" to meet the purposes of

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23 XBRL, or eXtensible Business Reporting Language, uses data tagging technology and taxonomies to facilitate the retrieval of specific information from a document.

24 As part of the NRSRO Working Group, DBRS has already committed to making its ratings performance data available to regulatory authorities, upon request, to allow those authorities to conduct their own studies of ratings performance. See IOSCO Comment Letter at 13.
the Rating Agency Act nor justified by any benefit to investors or other users of credit ratings. First of all, the universe of ratings actions to be included in the proposed record is far too broad. The capital and credit markets continuously evolve, which means that historical data loses its probative value over time. In the case of DBRS, the current proposal would require the publication of some information that is more than thirty years old. Even if DBRS could reconstruct the history of its ratings actions back that far, investors and other market participants would find that information of little use in making decisions today.

Rather than requiring the creation and publication of a record showing the history of existing credit ratings back to the initial rating, DBRS submits that such records should reflect only the past ten years of ratings history. A requirement of that nature would supply ample information to parties seeking to comparison shop among NRSROs. A maximum ten-year ratings record also would be consistent with the Commission's proposal to define the term "long-term period" for purposes of the performance measurement statistics requirement of Exchange Act Section 15E(a)(1)(B)(i) as ten years.25

Another problem with the ratings record proposal is the requirement that NRSROs publish these records in XBRL Interactive Data Files. In discussing this aspect of the proposal, the Commission opines that this format would enable investors, analysts and SEC staff to analyze ratings data "more quickly and at less of a cost than is possible using another format."26 Absent from this discussion are the countervailing facts that this format would be more costly to the NRSROs than a standard text format and that the data tags needed for this purpose do not currently exist.

As a practical matter, the type of extensive comparative analysis the Commission envisions is far more likely to be undertaken by academics and information vendors than it is by investors and other front-line users of credit ratings. Because DBRS sees no regulatory purpose in requiring the NRSROs to subsidize other commercial enterprises, DBRS submits that any cost savings associated with the use of XBRL formatting would have to substantially outweigh the cost burden imposed on the NRSROs in order justify the proposal. DBRS does not think this is the case. Furthermore, because the burden on smaller NRSROs could be particularly acute, DBRS is concerned that the proposal could do more harm than good.27


26 Id. at 69, 73 Fed. Reg. at 36228.

27 DBRS believes that the Commission's cost estimates are dramatically low. See Id. at 110, 73 Fed. Reg. at 36238. In order to create a comprehensive ratings record back to initial ratings would take multiples of the 30 hours that Commission has estimated.
Consequently, DBRS believes that any use of XBRL formatting in connection with the rating actions records should be on a voluntary pilot program basis, similar to the one the SEC has used in other contexts. The SEC should take the lead in co-ordinating the development of the data tags necessary for XBRL formatting through the existing XBRL committee, in consultation with the NRSROs. Regardless of the format used, DBRS urges the Commission to delay implementation of Rule 17g-2(a)(8) for a minimum of twenty-four months to give NRSROs sufficient time to create the initial historical ratings record.

As for some of the other questions the Commission asks about this proposal:

-- DBRS agrees that published ratings records should be accompanied by cautionary language indicating that because of the time delay in publishing the records, they do not necessarily reflect the NRSRO's current assessment of the creditworthiness of any particular obligor or debt security.

-- DBRS does not believe there is a need for more detailed categories of data than the ones currently proposed.

-- DBRS does not believe that the Commission should require that information regarding the assets underlying a structured finance product proposed to be required under Rule 17g-5(a)(3) should be provided in any special format. For the reasons explained above, DBRS believes that disclosure of this information should be required of issuers pursuant to the disclosure regime established under the Securities Act.

2. Record of Material Deviation from Model Output

The Commission also proposes to require NRSROs to create and maintain a record of the rationale for any material difference between the credit rating implied by a quantitative model and the final credit rating an NRSRO issues, wherever a quantitative model is a substantial component in the process of determining the credit rating.28 The NRSRO issuing the rating would be responsible for deciding what constitutes a "material difference" between the rating issued and the rating implied by a quantitative model. Although the NRSRO also would determine whether a model constituted a "substantial component" of the rating process, the Commission notes that it would consider a quantitative model to be a substantial component of the RMBS and CDO rating processes.29 The Commission indicates that this proposal is designed to facilitate


29 Proposing Release at note 124.
regulatory exams of NRSROs by enabling SEC examiners to "reconstruct the analytical process by which a credit rating was determined." 30

DBRS has three concerns about this proposal. First, DBRS believes that encouraging government examiners to "reconstruct" an NRSRO's "analytical process" entails too high a risk that the government would wind up regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings, in contravention of the Rating Agency Act. 31 Second, DBRS is concerned that the proposal may mislead SEC examiners into believing that models are the primary component of the rating process when, in fact, they are just one tool to getting the rating right. Finally, DBRS is concerned that the proposal may lead to the generalization and simplification of models in order to avoid "material differences" between the ratings implied by the models and the ratings actually issued. Should that occur, the credit rating process would be less transparent, rather than more so.

For these reasons, DBRS urges the Commission to eliminate the proposed modification of Rule 17g-2(a)(2).

C. PROPOSED RULE 17g-7 - STRUCTURED FINANCE SYMBOLOGY

In addition to amending some of the existing NRSRO rules, the Commission also proposes to adopt a new rule pursuant to its authority under the Rating Agency Act. This rule, 17g-7, would require an NRSRO to attach to each credit rating for a structured finance product, a report describing the rating methodology used to determine the credit rating and how that methodology differs from the methodology used to determine ratings for any other type of obligor or debt security. The report also would have to describe how the credit risk characteristics associated with structured finance products differ from those of other types of rated obligors or debt instruments. Instead of attaching this special report to each structured finance product rating, an NRSRO could comply with Rule 17g-7 by using credit rating symbols for structured finance products that are distinct from the symbols used for ratings of other types of obligors or debt instruments. The Commission believes that most NRSROs will chose to change their structured finance symbology rather than publish special reports because the symbology approach would be more efficient and less burdensome than the alternative. 32

According to the Commission, the purpose of the proposed new rule is to alert investors to the fact that structured finance products entail different rating methodologies and risk

30 Id. at 75, 73 Fed. Reg. at 36230.

31 Exchange Act 15E(c)(2).

characteristics from those associated with instruments like corporate and municipal debt, thereby encouraging investors to perform greater levels of internal risk assessment with regard to structured products. DBRS submits that proposed Rule 17g-7 is unnecessary, appears to exceed the scope of the Commission's authority, and has the potential to confuse and otherwise harm the capital markets.

As for the first of these objections, DBRS notes that the market for structured finance products is dominated by sophisticated, institutional investors who are fully capable of determining whether an instrument should be characterized as a structured finance product and are well aware that the risk characteristics of and ratings methodologies for such products differ from those associated with corporate and municipal debt instruments. Furthermore, as the Commission admits, NRSROs already disclose the ratings methodologies they use in issuing different classes of credit ratings, including those for structured finance products. While forcing NRSROs to repackage the same information into a different format is guaranteed to raise NRSROs' costs, it will provide little new transparency for investors.

The fact that an NRSRO could avoid the burden of attaching a special report to each structured finance rating by simply using a different symbol or appendage (such as ".sf") for such ratings is further evidence that the type of disclosure contemplated by the report requirement is unnecessary. Although the custom symbology described in Rule 17g-7(b) would be primarily a cosmetic device that contains none of the information about rating methodology or credit risks that would be required in a structured finance rating report under subsection (a) of the rule, the Commission nevertheless opines that the symbology approach is an "equally effective alternative" means of achieving the rule's purpose. Unfortunately, the customized symbology approach entails its own slate of problems.

The first of these is that requiring such customization appears to exceed, and possibly contravene, the Commission's authority. Although the Commission attempts to justify Rule 17g-7 under the records and reports provision of the Exchange Act, ratings symbology is not really a record or report, but rather a part of the a rating itself. That

33 Id. at 97, 99, 73 Fed. Reg. at 36235, 36236.

34 See e.g., Id. at note 150.

35 Id. at 118-119, 73 Fed. Reg. at 36240; Form NRSRO, Exhibit 2.


37 Exchange Act, Section 17(a)(1.) For the reasons discussed above, DBRS submits that if the Commission determines that the use of NRSRO ratings for regulatory purposes is not necessary and appropriate in the public interest or for the protection of investors, the Commission will not be able to demonstrate that proposed Rule 17g-7 satisfies this test for Section 17(a)(1) purposes either.
being the case, the Commission’s proposal to alter the symbology the NRSROs have developed for their structured finance ratings looks very much like a prohibited regulation of the substance of credit ratings.

Another problem with this approach is that an abrupt, government-driven change in credit rating symbology could lead to market confusion as investors struggle to familiarize themselves with new ratings scales. In some cases, investors may simply map the new symbols back to the ones they have used for years. Moreover, highlighting the market and liquidity risks of structured finance products alone could mislead investors into overrelying on credit ratings in making investment decisions about other types of debt instruments.

In addition to creating market confusion, proposed Rule 17g-7 could have other harmful consequences. Not only have NRSRO ratings been woven into the fabric of U.S. federal securities regulation, but they also play a role in other federal laws and rules, as well as in state pension and insurance regulation. In addition, NRSRO ratings requirements are frequently written into investment guidelines and covenants in legal documents. The use of customized rating symbols for structured finance products could preclude institutional investors from purchasing or holding investment products with a "structured finance" rating until the necessary laws, rules and investment guidelines have been changed. Were that to occur, investors would be forced to dump their structured finance portfolio holdings into an already illiquid market, with disastrous results.

A forced mass change in rating scales would also extract a heavy cost from market participants and intermediaries, as systems related to order management, post-trade processing, clearance and settlement and client reporting would need to be modified to accommodate the new symbology.

Instead of requiring either a special report to accompany each structured finance rating or a new structured finance rating scale, DBRS suggests that the Commission issue guidance encouraging NRSROs to take steps to increase the public’s understanding of the attributes and limitations of all credit rating opinions. These steps could include the disclosure, in a manner reasonably designed to reach the users of credit ratings, of a statement like the following:

Credit ratings are opinions regarding the relative future credit risk of an entity, a credit commitment or a debt or debt-like security. Credit risk is the risk that an entity may not meet its contractual, financial obligations as they come due. Credit ratings do not address any other risk, including but not limited to liquidity risk, market value risk or price volatility. In some cases, structured finance products can display more volatility in terms of ultimate loss and market pricing than other forms of debt do. Credit ratings are not a recommendation to buy, sell or hold any securities. In connection with their
rating analysis, credit rating agencies rely on the information provided to them that is believed to be accurate and reliable, but do not undertake any independent verification of the accuracy of that information.  

D. FORM NRSRO, EXHIBIT 1

The Commission proposes four changes to the instructions to Exhibit 1 of Form NRSRO relating to a registered rating agency's performance measurement statistics. The last of these changes would require an NRSRO's default statistics to include defaults relative to the initial rating and to incorporate defaults that occur after a credit rating is withdrawn. The purpose of this amendment is to prevent an NRSRO from presenting its performance statistics in a misleading manner by not including defaults in a particular category of credit ratings (e.g., AA) because those defaults occur after the rating is downgraded to a lower category or is withdrawn.

DBRS supports this change in principle, but is concerned that the requirement to include defaults occurring after a rating is withdrawn could obligate an NRSRO to monitor securities and obligors for an indefinite period of time after the NRSRO has ceased to rate such instruments and entities. In some cases, the NRSRO may not have access to the information necessary to perform this function after its relationship with the issuer or trustee has ended. In all cases, the passage of time after a rating is withdrawn eventually limits or eliminates the usefulness of including default information in an NRSRO's performance statistics.

In order to address these issues, DBRS suggests that the instructions to Exhibit 1 be adjusted to say:

The default statistics must include defaults relative to the initial rating. They also must incorporate defaults that occur within 24 months after a credit rating is withdrawn, except where the NRSRO is unable to obtain the information necessary to identify such defaults, despite its reasonable efforts to do so.

CONCLUSION

We appreciate the opportunity to comment on this important set of rule proposals. For the reasons explained above, we urge the Commission not to act on these proposals.

38 This language is a slightly modified version of a disclosure statement developed by the NRSRO Working Group. See IOSCO Comments at 12.

until it determines whether requiring the use of NRSRO ratings for regulatory purposes under the Securities Act, the Exchange Act, the Company Act and the Advisers Act continues to be necessary and appropriate in the public interest and for the protection of investors. If the Commission determines that using the credit ratings of regulated entities in this fashion no longer serves a public or investor protection purpose, there will be no need to make the NRSRO regulatory regime more robust.

We would be happy to supply the Commission or the staff with additional information regarding any of the matters discussed herein. Please direct any questions about these comments to the undersigned or to our outside counsel, Mari-Anne Pisarri of Pickard and Djinis LLP. She can be reached at 202-223-4418.

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