Dear Commissioner Stein:

Congratulations on your recent confirmation as Commissioner. I look forward to working with you in your new role while I serve on the House Financial Services Committee. While you will have many important issues to address related to the Dodd-Frank Act and JOBS Act rulemakings, I wanted to highlight a key issue in front of the Commission.

As you know, the credit rating agencies were under much scrutiny for their role in the financial crisis and subsequently are subject to a robust regulatory regime both here in the United States at the Commission and overseas in various jurisdictions. This regulatory function is an important one for markets and investor protection that the SEC should conduct with diligence. The Dodd-Frank-created Office of Credit Ratings inside the Commission and enhanced regulatory regime around the rating agencies are an important component. Additionally, Section 939A sought to end the market's heavy reliance on ratings by requiring every federal agency to review any of their rules that use credit ratings to assess creditworthiness. Those agencies are also required to report to Congress on how the agency modified those references and replaced them with alternative standards of creditworthiness as the agency deems appropriate.

I share the goals of 939A to reduce investor reliance on ratings, to provide incentive for more information and diligence for investors in the market and to increase new participants in the credit rating agency marketplace. However, I want to caution the SEC that implementation of 939A has proved to be confusing to smaller banks and smaller investors. Congress intended 939A to impact the way ratings are used. Instead of as a regulatory mandate, ratings should be used as an indicator of creditworthiness by investors, not the sole indicator. 939A should encourage more diligence in the market.

While I believe that 939A would have a positive effect on transparency for investors, I have concerns that the 939F implementation of a government run mandatory assignment system is contradictory to that positive effect and only further entrenches the government in the business of ratings. While I understand that the SEC was required under Section 939F of Dodd-Frank to study the issue of conflicts of interest associated with the issuer pay model in structured finance,
there are serious concerns regarding the downsides of the proposed government run assignment system. Conflicts are inherent in all business models, but I believe that the proposed assignment system discussed in 939F could have extremely damaging consequences in the market place including a reduction in credit and liquidity in slowly recovering markets. Something as disruptive as a cumbersome and expensive government bureaucracy tasked with handing out business to credit rating agencies on a subjective basis could slow the efficient movement of capital and put US markets at a severe competitive disadvantage. It could also compound moral hazard by creating a false impression of a good housekeeping seal of approval on ratings and take away the investor's own ability to decide who they trust to provide good, high quality information in a specific asset class.

One large investor recently wrote that 939F could, "have serious unintended negative consequences for the structured finance market. In particular, we are concerned about the quality of ratings that would result from a board assigning NRSROs to rate structured finance products. Structured finance products encompass a wide array of securities from pools of residential mortgages, commercial mortgages, home equity loans, auto loans, credit card receivables, student loans, and equipment loans, among others. Analysis of the different types of structured finance products is complex and requires a high level of expertise in each type of collateral. As such, we are concerned that a credit rating assignment system could potentially result in the assignment of an NRSRO that does not have the necessary level of expertise in a particular collateral type to rate a security. Moreover, the system could potentially foster a misalignment of incentives, which could interfere with the efficient issuance of structured products."

The SEC has not completed its work related to 939A, and I would like an update on the status of those efforts and some commentary surrounding what impacts 939A is having on the marketplace within 30 days. Additionally, I would like the agency to consider clarification of 939A to reflect the intent of Congress.

As Congress works to strike the right balance in housing markets, this type of disruption could have serious impacts on Americans' abilities to gain access to credit and own homes. Rating agencies were one of many market participants involved in the lead up to the financial crisis and change was a necessity. However, I remain concerned that the proposed solutions are being driven by politics and punitive, backward looking dynamics. I would urge you, in your new role, to complete the 939A rulemakings and take assessment of the market today before moving towards any unnecessary layering of cumbersome bureaucracy onto our structured finance markets.

Sincerely,

Sean P. Duffy
Member of Congress