

Securities and Exchange Commission
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- **17 CFR Parts 232, 240, and 249, and 249b**
- **File No. S7-18-11**
- **Proposed Rules for Nationally Recognized Statistical Rating Organizations**

Dear Sir,

Thank you for giving us the opportunity to comment on your Proposed Rules for Nationally Recognized Statistical Rating Organizations.

In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and to enhance oversight, you are proposing amendments to existing rules and new rules that would apply to credit rating agencies registered with the SEC as nationally recognized statistical rating organizations (NRSROs). In addition, in accordance with Dodd-Frank, you are proposing a new rule and form that would apply to providers of third-party due diligence services for asset-backed securities. Finally, you are proposing amendments to existing rules and a new rule that would implement a requirement added by Dodd-Frank that issuers and underwriters of asset-backed securities make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

I welcome these proposals as necessary and sufficient in order to improve the veracity of, and the confidence in the credit rating process. The requirements to disclose information in standardised formats should also allow investors to more easily compare information across NRSROs. I will briefly comment on conflicts of interest, reporting and disclosure here.

Conflicts of interest

A conflict of interest can arise when the NRSRO's obligation to act in the best interest of its client / customer conflicts with any of:

- the NRSRO's own interest
- an interest of the rated entity
- the interests of third parties including other clients / customers

Effective rules on conflicts of interest are critical, and these must include a general principle that NRSROs must ensure that their ability to provide objective service is not, and cannot be perceived to be compromised. It is the NRSRO's responsibility to ensure that it is aware of any existing or potential conflicts of interest, and that these are disclosed up-front and documented, and that the NRSRO should disqualify itself from acting in the particular case. Such rules and principle must apply to all NRSROs, and therefore I respectfully disagree with the practical application of proposed § 240.17g-5(f). I would suggest that all NRSROs are large enough such that it is appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities. I would also argue that an exemption from the rules due to small size is not in the public interest.

Disclosure requirements

§ 240.17g-7 proposes significantly greater disclosure requirements. Paragraph (a)(1)(ii)(M) thereunder requires a sensitivity analysis to be disclosed with the publication of a credit rating. For completeness, I would recommend that you propose the following (additional) disclosure which would provide more meaningful information to users of credit ratings:

- 1) the sensitivity of the credit rating to changing individual assumptions (sensitivity analysis as proposed);
- 2) the sensitivity of the credit rating to changing several assumptions at the same time, where the assumptions could reasonably be expected to change together (scenario analysis);
- 3) the dependencies assumed between assumptions.

I do not believe that the additional disclosure would be onerous for NRSROs. I would argue that having a good understanding of your credit rating operational and risk drivers, including their dependencies, is vital to properly manage a credit rating process.

Further disclosures, procedures and methodologies

Proposed § 240.17g-7(a)(1)(ii)(C) on disclosure requirements requires that the form generated by the NRSRO must contain: "The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs". Proposed § 240.17g-8(a)(4)(i) on policies and procedures further requires the NRSRO to publish: "Material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the nationally recognized statistical rating organization uses to determine credit ratings". I support the intention to provide greater transparency and auditability of credit rating procedures and assessments, including allowing longitudinal tracking of the procedure or methodology version used. I would ask for some clarification that the information required here should not include proprietary or confidential information, either about the issuer or the NRSRO itself.

Look-back reviews

Proposed § 240.17g-8(c) covers the policies and procedures with respect to look-back reviews. I would just like to comment that I agree with these proposals. They are not overly excessive or intrusive and will again promote confidence in, and improve the perceived integrity of the rating agency function.¹

Third-party due diligence reports

Proposed § 240.17g-10 concerns the certification of providers of third-party due diligence services in connection with asset-backed securities. This is sufficient to ensure that providers of due diligence services conduct a thorough review of data and other relevant information necessary for an NRSRO to provide an accurate rating. For completeness I would only recommend that you add wording under § 240.17g-10(c)(1)(i) to require the use of statistical analyses, where relevant, to substantiate that any sampling procedures used on asset data are accurate.

Yours faithfully

Chris Barnard

¹ This is also consistent with para. 2.17 of IOSCO's Code of Conduct Fundamentals for Credit rating Agencies: "A CRA should establish policies and procedures for reviewing the past work of analysts that leave the employ of the CRA and join an issuer the CRA analyst has been involved in rating, or a financial firm with which the CRA analyst has had significant dealings as part of his or her duties at the CRA". See: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.