



Via Electronic Delivery

August 8, 2011

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

*RE: Nationally Recognized Statistical Rating Organizations, File Number S7-18-11<sup>1</sup>*

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors (Council), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion.<sup>2</sup> Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers. We appreciate the opportunity to voice our general support for the above-mentioned proposed rule to improve the integrity and increase transparency of the Nationally Recognized Statistical Rating Organizations (NRSRO) industry.

As the leading voice for long-term, patient capital, the Council has taken a keen interest in efforts to reform the practices of the ratings industry. The failure of NRSROs to alert investors to the risks of many structured products leading up to and during the financial crisis underscored the need for significant changes in their regulation.<sup>3</sup> Consistent with the findings of the Investors' Working Group, a blue ribbon panel of independent experts co-sponsored by the Council and the CFA Institute, we believe that the conflicted issuer-pays business model of many NRSROs contributed to their poor track record.<sup>4</sup>

The Council has taken the position that all NRSROs should avoid or tightly manage conflicts of interest,<sup>5</sup> and those operating under the issuer-pays model should be subject to the strictest regulation.<sup>6</sup> Thus, we strongly support the provision of the

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<sup>1</sup> Nationally Recognized Statistical Rating Organizations, 76 Fed. Reg. 33,420 (June 8, 2011), <http://www.gpo.gov/fdsys/pkg/FR-2011-06-08/pdf/2011-12659.pdf>.

<sup>2</sup> For more information about the Council of Institutional Investors (Council) and its members, please visit the Council's website at <http://www.cii.org>.

<sup>3</sup> Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 19 (July 2009), [http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20\(July%202009\).pdf](http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf). Following its issuance, the Investors' Working Group (IWG) Report was reviewed and subsequently endorsed by the Council board and membership. For more information about the IWG, please visit the Council's website at <http://www.cii.org/iwgInfo>.

<sup>4</sup> *Id.* at 20.

<sup>5</sup> Council of Institutional Investors, Statement on Financial Gatekeepers 1 (updated Apr. 13, 2010), <http://www.cii.org/UserFiles/file/Statement%20on%20Financial%20Gatekeepers.pdf>.

<sup>6</sup> IWG at 21.

proposed rule that prohibits NRSROs from allowing sales and marketing considerations from influencing the production of ratings and rating methodologies.<sup>7</sup> The absolute prohibition coupled with the real threat of suspension or revocation of NRSRO status for violations would encourage NRSROs to be more vigilant in establishing, maintaining and enforcing policies and procedures to adequately address and manage conflicts of interest.

As an additional check and balance, NRSROs should be required to provide more complete, prominent and consistent disclosures of conflicts of interest.<sup>8</sup> Thus, we also strongly support the provision of the proposed rule that requires each NRSRO to submit an annual internal controls report to the Securities and Exchange Commission (SEC).<sup>9</sup> We encourage the SEC to include in the final rule robust disclosure requirements and to mandate that NRSROs make the internal controls reports publicly available. Investors and other users of credit ratings would greatly benefit from access to this information, in that it would allow users the ability to evaluate the effectiveness of rating agency's internal control structure and consider what impact, if any, it may have on the quality of the credit ratings the NRSRO produces.

In addition to unchecked conflicts of interest, flawed methodologies and inadequate, inaccurate data were core reasons some NRSROs continued to issue inflated ratings for complex structured finance instruments during the financial crisis.<sup>10</sup> Therefore, increased transparency should extend to rating methodologies and the processes, procedures and inputs used to arrive at individual ratings.<sup>11</sup> In that regard, we strongly support the provisions of the SEC's proposed rule requiring that NRSROs publish a form with each credit rating that includes additional details about the rating, such as the version of the methodology used; main assumptions underlying the methodology; potential limitations of the rating, including the types of risks excluded; information on the reliability, accuracy and quality of the data used; findings of a third-party due diligence service, if used; and information relating to conflicts of interest associated with the rating.<sup>12</sup>

We believe this provision would provide a disincentive for rating agencies from knowingly issuing ratings based on inaccurate models using insufficient, outdated data.<sup>13</sup> The transparency that would result from the robust disclosure provided by the proposed form to accompany each rating would allow investors the opportunity to analyze the assumptions and methodologies an NRSRO used to develop a particular rating, and evaluate whether the rating may be based on insufficient data or influenced

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<sup>7</sup> 76 Fed. Reg. at 33,425-29.

<sup>8</sup> IWG at 21.

<sup>9</sup> 76 Fed. Reg. at 33,421-25.

<sup>10</sup> Staff of S. Permanent Subcomm. on Investigations, 112<sup>th</sup> Cong, Rep. on Wall Street and The Financial Crisis: Anatomy of a Financial Collapse 244 (Apr. 13, 2011), [http://hsgac.senate.gov/public\\_files/Financial\\_Crisis/FinancialCrisisReport.pdf](http://hsgac.senate.gov/public_files/Financial_Crisis/FinancialCrisisReport.pdf).

<sup>11</sup> Statement on Financial Gatekeepers at 1.

<sup>12</sup> 76 Fed. Reg at 33,456-65.

<sup>13</sup> See, e.g., Staff of S. Permanent Subcomm. on Investigations at 289.

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by conflicts of interest. Disclosure of information of this sort would also promote more prudent use of credit ratings by investors.

For all of the above mentioned reasons, the Council generally supports the SEC's proposed rule to improve the integrity and transparency of the credit ratings industry, and we encourage the Commission to take full advantage of the expanded oversight authority granted to it by the Dodd-Frank Wall Street Reform and Consumer Protection Act. If you should have any additional questions or comments, please feel free to contact me at 202.261.7086 or [laurel@cii.org](mailto:laurel@cii.org), or General Counsel Jeff Mahoney at 202.261.7081 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,

A handwritten signature in cursive script that reads "Laurel Leitner".

Laurel Leitner  
Senior Analyst  
Council of Institutional Investors