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Monday, May 23, 2005

Mr. Jonathan G. Katz
Secretary
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, NW
Washington, D.C. 20549-0609

RE: File No. S7-04-05

Dear Mr. Katz:

We understand that the U.S. Securities and Exchange Commission (the Commission) "is proposing to define the term 'Nationally Recognized Statistical Rating Organization (NRSRO)' as:

an entity (i) that issues publicly available credit ratings that are current assessments of the creditworthiness of obligors with respect to specific securities or money market instruments; (ii) is generally accepted in the financial markets as an issuer of credible and reliable ratings, including ratings for a particular industry or geographic segment, by the predominant users of securities ratings; and (iii) uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of nonpublic information, and has sufficient financial resources to ensure compliance with those procedures."

We are writing to provide general comments on the proposed definition and the interpretations. Our comments are structured in two parts. Our initial comments focus on the proposal in general. In Appendix A, submitted below, we respond to the Commission's specific questions.

It is our belief that capital market practices, in general, are deeply flawed. It is our hope that the Commission will begin to review market practices from a systemic, global perspective, since defective practices in one sector have been shown to be linked to faulty practices in other capital market sectors:

- Investment analysts issue biased research reports to curry favor with management.

- NRSRO's issue defective research reports. These institutions are supposed to "base their ratings largely on statistical calculations of a borrower's likelihood of default," but one news report noted that:

  > "Dozens of current and former rating officials, financial advisers and Wall Street traders and investors interviewed by The Washington Post say the (NRSRO) rating system has proved vulnerable to subjective judgment, manipulation and pressure from borrowers. They say the big three are so dominant they can keep their rating processes secret, force clients to pay higher fees and fend off complaints about their mistakes."[1]

- Pension consultants are, also, conflicted and compromised. "Many pension plans rely heavily on the expertise and guidance of pension consultants in helping them to manage pension plan assets," but, according to a Commission report[2],

  > "Concerns exist that pension consultants may steer clients to hire certain money managers and other vendors based on the pension consultant's (or an affiliate's) other business relationships and receipt of fees from these firms, rather than because the money manager is best-suited to the clients' needs."

Together these practices threaten the integrity of securities markets. Individuals and market institutions with the power to safeguard the system, including investment analysts and NRSRO's, have been compromised. Few efficient, effective and just safeguards are in place. Statistical models created by the firm show the probability of system-wide market failure has increased markedly over the past eight years.

Investors and the public are at risk.

Background

William Michael Cunningham registered with the U.S. Securities and Exchange Commission as an Investment Advisor on February 2, 1990. He

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[1] "Borrowers Find System Open to Conflicts, Manipulation" by Alec Klein, The Washington Post, Monday, November 22, 2004; Page A1.

[2] *Staff Report Concerning Examinations of Select Pension Consultants*. The Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission. May 16, 2005.

registered with the D.C. Public Service Commission as an Investment Advisor on January 28, 1994. Mr. Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services.

The firm and Mr. Cunningham have long been concerned with the Commission's "process of determining whose credit ratings should be used and the level of oversight to apply to such credit rating agencies." We base this apprehension on the following:

- In November, 1997 and, again in December, 2003, Mr. Cunningham wrote to the Division of Market Regulation Securities and Exchange Commission, on behalf of Creative Investment Research, Inc. (CIR) to request that CIR be considered a nationally recognized statistical rating organization ("NRSRO"). We requested this status only with respect to rating financial institutions owned by women and minorities. The firm never received a reply from the Commission concerning this matter. We have included a copy of one letter sent to Ms. Nazareth, Director, Division of Market Regulation, Securities and Exchange Commission, as Appendix B.

- On Monday, April 11, 2005, Mr. Cunningham spoke on behalf of investors at a fairness hearing regarding the $1.4 billion dollar Global Research Analyst Settlement. The hearing was held in Courtroom 11D of the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, New York, New York. No other investment advisor testified or provided comments at the hearing, despite the fact that the hearing was open to the public and that a significant percentage of individual and mutual fund investors were impacted by the settlement.

There have been several other incidents.[3]

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[3] From 12/5/2002 to 11/24/2003, Mr. Cunningham forwarded 118 financial market "scam" email messages to the Division of Enforcement of the SEC. It is not clear that the Division took action in any of these cases. Again, the public interest has not been served by this lack of action.

Summary Comments

The Commission "is proposing to define the term 'Nationally Recognized Statistical Rating Organization (NRSRO)' in new Exchange Act Rule 3b-10, and to provide interpretations of that definition. The proposed definition contains three components that must each be met in order for a credit rating agency to be an NRSRO. The Commission is also providing interpretations of the proposed definition of the term 'NRSRO.'"

We appreciate this effort, but note the following:

Repeatedly over the past twenty five years, signal market participants abandoned ethical principles in the pursuit of material well being.[4] By 2005, marketplace ethics reached a new low. The following are the simple facts:

- On April 28, 2003, every major US investment bank, including Merrill Lynch, the aforementioned Goldman Sachs, Morgan Stanley, Citigroup, Credit Suisse First Boston, Lehman Brothers Holdings, J.P. Morgan Chase, UBS Warburg, and U.S. Bancorp Piper Jaffray, were found to have aided and abetted efforts to defraud investors. The firms were fined a total of $1.4 billion dollars by the SEC, triggering the creation of a Global Research Analyst Settlement Fund.

- In May, 2003, the SEC disclosed that several "brokerage firms paid rivals that agreed to publish positive reports on companies whose shares..they issued to the public. This practice made it appear that a

[4] We refer to the following, abbreviated list of market related ethical lapses:

- The National Association of Security Dealers was found by the U.S. Securities and Exchange Commission to be "failing to police wrongdoing the NASDAQ Stock market, the second largest stock market in the world." The Washington Post (August 8, 1996. Page A1.)
- The failure of Long-Term Capital, an investment partnership started in 1994, was "laid on the kind of capitalism .. where a closed, secretive and incestuous elite held absolute sway over politics, the economy and finance, where banks lent to cronies and crooks, and the state miraculously came to the rescue when the time came to balance (or cook) the books." From "LTCM, a Hedge Fund Above Suspicion," by Ibrahim Warde, *Le Monde Diplomatique*, November 1998.

throng of believers were recommending these companies' shares." This was false. "From 1999 through 2001, for example, one firm paid about $2.7 million to approximately 25 other investment banks for these so-called research guarantees, regulators said. Nevertheless, the same firm boasted in its annual report to shareholders that it had come through investigations of analyst conflicts of interest with its 'reputation for integrity' maintained."

- On September 4, 2003, a major investment bank, Goldman Sachs, admitted that it had violated anti-fraud laws. Specifically, the firm misused material, nonpublic information that the US Treasury would suspend issuance of the 30-year bond. The firm agreed to "pay over $9.3 million in penalties." On April 28, 2003, the same firm was found to have "issued research reports that were not based on principles of fair dealing and good faith .. contained exaggerated or unwarranted claims.. and/or contained opinions for which there were no reasonable bases." The firm was fined $110 million dollars, for a total of $119.3 million dollars in fines in six months.

- On December 18, 2003, the Securities and Exchange Commission "announced an enforcement action against Alliance Capital Management L.P. (Alliance Capital) for defrauding mutual fund investors. The Commission ordered Alliance Capital to pay $250 million. The Commission also ordered Alliance Capital to undertake certain compliance and fund governance reforms designed to prevent a recurrence of the kind of conduct described in the Commission's Order. Finally, the Commission found that "Alliance Capital breached its fiduciary duty to (it's) funds and misled those who invested in them."

- On October 8, 2004, the Securities and Exchange Commission "announced..enforcement actions against Invesco Funds Group, Inc. (IFG), AIM Advisors, Inc. (AIM Advisors), and AIM Distributors, Inc. (ADI). The Commission issued an order finding that IFG, AIM Advisors, and ADI violated the federal securities laws by facilitating widespread market timing trading in mutual funds with which each entity was affiliated. The settlements require IFG to pay $215 million in disgorgement and $110 million in civil penalties, and require AIM

Advisors and ADI to pay, jointly and severally, $20 million in disgorgement and an aggregate $30 million in civil penalties."

- On November 4, 2004, the Securities and Exchange Commission "filed a settled civil action in the United States District Court for the District of Columbia against Wachovia Corporation (Wachovia) for violations of proxy disclosure and other reporting requirements in connection with the 2001 merger between First Union Corporation (First Union) and Old Wachovia Corporation (Old Wachovia). Under the settlement, Wachovia must pay a $37 million penalty and is to be enjoined from future violations of the federal securities laws."

- On November 17, 2004, the Securities and Exchange Commission announced "charges concerning undisclosed market timing against Harold J. Baxter and Gary L. Pilgrim in the Commissions' pending action in federal district court in Philadelphia." Based on these charges, Baxter and Pilgrim agreed to "pay $80 million – $60 million in disgorgement and $20 million in civil penalties."

- On November 30, 2004, the Securities and Exchange Commission announced "the filing..of charges against American International Group, Inc. (AIG) arising out of AIG's offer and sale of an earnings management product." The company "agreed to pay a total of $126 million, consisting of a penalty of $80 million, and disgorgement and prejudgment interest of $46 million."

- On December 22, 2004, "the Securities and Exchange Commission, NASD and the New York Stock Exchange announced..enforcement proceedings against Edward D. Jones & Co., L.P., a registered broker-dealer headquartered in St. Louis, Missouri." According to the announcement, "Edward Jones failed to adequately disclose revenue sharing payments that it received from a select group of mutual fund families that Edward Jones recommended to its customers." The company agreed to "pay $75 million in disgorgement and civil penalties. All of that money will be placed in a Fair Fund for distribution to Edward Jones customers."

- On January 25, 2005, "the Securities and Exchange Commission announced the filing in federal district court of separate settled civil injunctive actions against Morgan Stanley & Co. Incorporated (Morgan Stanley) and Goldman, Sachs & Co. (Goldman Sachs) relating to the firms' allocations of stock to institutional customers in initial public offerings (IPOs) underwritten by the firms during 1999 and 2000."

- According to the Associated Press, on January 31, 2005, "the nation's largest insurance brokerage company, Marsh & McLennan Companies Inc., based in New York, will pay $850 million to policyholders hurt by" corporate practices that included "bid rigging, price fixing and the use of hidden incentive fees." The company will issue a public apology calling its conduct "unlawful" and "shameful," according to New York State Attorney General Elliott Spitzer. In addition, "the company will publicly promise to adopt reforms."

Envy, hatred, and greed continue to flourish in certain capital market institutions, propelling ethical standards of behavior downward. Without meaningful reform there is a small, but significant and growing, risk that our economic system will simply cease functioning.[5]

Fully identifiable entities, including NRSRO's, engaged in illegal activities. They have, for the most part, evaded prosecution of any consequence. We note that the aforementioned Goldman Sachs, fined $159.3 million by the Commission for various efforts to defraud investors, subsequently received $75 million in Federal Government tax credits.[6]

We also note that the aforementioned Alliance Capital Management, fined $250 million by the Commission for defrauding mutual fund investors, received a contract[7] in August, 2004 from the U.S Department of the Interior

[5] Proportional hazard models created by the firm and reflecting the probability of system wide market failure first spiked in September, 1998. The models spiked again in August, 2001. They have continued, in general, to increase.

[6] The tax credits were awarded under the U.S. Department of the Treasury New Markets Tax Credit (NMTC) Program. (See: http://www.cdfifund.gov/programs/nmtc/).

[7] Contract number NBCTC040039.

(DOI) Office of Special Trustee for American Indians, to manage $404 million in Federal Government trust funds.[8]

Recently, we have observed several cases where corporate management unfairly transferred value from outsider to insider shareholders.[9] These abuses have been linked to the abandonment of ethical principles noted earlier. Faulty market practices mask a company's true value and misallocate capital by moving investment dollars from deserving companies to unworthy companies.

We understand that, given any proposed rule, crimes will continue to be committed.[10] These facts lead some to suggest that regulatory authorities may have been "captured" by the entities they regulate.[11] We note that under the "regulatory capture" market structure regime, the public interest is not protected.

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[8] The contract was awarded despite the fact that placing Alliance Capital Management in a position of trust is, given the Commission's enforcement action, inconsistent with common sense, with the interests of justice and efficiency and with the interests of Indian beneficiaries. Alliance is also in violation of DOI Contractor Personnel Security & Suitability Requirements.

[9] Including, but not limited to, Adlephia Communications, the aforementioned Alliance Capital Management, American Express Financial, American Funds, AXA Advisors, Bank of America's Nations Funds, Bank One, Canadian Imperial Bank of Commerce, Canary Capital, Charles Schwab, Cresap, Inc., Empire Financial Holdings, Enron, Federated Investors, FleetBoston, Franklin Templeton, Fred Alger Management, Freemont Investment Advisors, Gateway, Inc., Global Crossing, H.D. Vest Investment Securities, Heartland Advisors, Homestore, Inc., ImClone, Interactive Data Corp., Invesco Funds Group Inc., Janus Capital Group Inc., Legg Mason, Limsco Private Ledger, Massachusetts Financial Services Co., Millennium Partners, Mutuals.com, PBHG Funds, Pilgrim Baxter, PIMCO, Prudential Securities, Putnam Investment Management LLC, Raymond James Financial, Samaritan Asset Management, Security Trust Company, N.A., State Street Research, Strong Mutual Funds, Tyco, UBS AG, Veras Investment Partners, Wachovia Corp., and WorldCom. Accounting firms, including Arthur Andersen and Ernst & Young aided and abetted efforts to do so. We believe there are hundreds of other cases.

[10] We assume that "employees are 'rational cheaters,' who anticipate the consequences of their actions and (engage in illegal behavior) when the marginal benefits exceed costs." See Nagin, Daniel, James Rebitzer, Seth Sanders and Lowell Taylor, "Monitoring, Motivation, and Management: The Determinants of Opportunistic Behavior in a Field Experiment, *The American Economic Review*, vol. 92 (September, 2002), pp 850-873.

[11] See George J. Stigler, "The Theory of Economic Regulation," in *The Bell Journal of Economics and Management Science*, vol. II (Spring 1971), pp. 3-21.

We cite the following:

"Falsification and fraud are highly destructive to free-market capitalism and, more broadly, to the underpinnings of our society. Above all, we must bear in mind that the critical issue should be how to strengthen the legal base of free market capitalism: the property rights of shareholders and other owners of capital. Fraud and deception are thefts of property. In my judgment, more generally, unless the laws governing how markets and corporations function are perceived as fair, our economic system cannot achieve its full potential. "

> Testimony of Mr. Alan Greenspan, Chairman of the Federal Reserve Board, Federal Reserve Board's semiannual monetary policy report to the Congress. Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate. July 16, 2002.

We agree.

We favor efforts to increase fairness in our capital markets while opposing reform for reform's sake.

We believe an increase in the number and type of NRSRO-designated firms is warranted. The creation and implementation of market based NRSRO performance standards would also be appropriate. In other words, we believe the Commission should set flexible and accessible NRSRO designation standards and let the marketplace determine whether ratings issued by a designated firm are credible.

Given the above, we suggest the following definition of the term Nationally Recognized Statistical Rating Organization (NRSRO):

"an entity (i) that issues publicly available credit ratings that are current assessments of creditworthiness with respect to issuers of financial obligations, specific securities or money market instruments; (ii) is generally accepted, or is seeking general acceptance, in the financial markets as an issuer of credible and reliable ratings, including ratings for a particular industry or geographic segment, by users of securities ratings; and (iii) uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of nonpublic information."

We look forward to reviewing the Commission's continuing efforts to carry out its mission. We appreciate the time and effort the Commission has devoted to this task. Thank you for your leadership.

Please contact me with any questions or comments.

Sincerely,

William Michael Cunningham
Social Investment Adviser
for William Michael Cunningham and Creative Investment Research, Inc.

Appendix A

How should it be determined whether an NRSRO is making its credit ratings readily available on a widespread basis?

Having ratings available via the internet will insure that an NRSRO is making its credit ratings readily available on a widespread basis.

Should our rule specify the manner and methods that must be used to distribute ratings?

No. Prescribing delivery mechanisms now may require rule changes at some later point, since the Commission cannot now anticipate new delivery mechanisms that might become standard in the future.

Should internet posting itself be sufficient?

Yes.

Should a credit rating agency that does not rate specific securities or money market instruments be included in the definition of NRSRO?

Yes.

If so, under what circumstances?

NRSRO status should be given for firms that rate institutions or security types in general (by asset class) or by specific characteristic (Women and minority-owned firms, for example).

Should the Commission provide additional interpretation regarding what it means for a credit rating agency's credit ratings to be "current assessments"?

Yes. Timeliness is a factor in determining the quality of a rating.

Should the Commission specify the time period?

No. Ratings should be based on data that is, in general, no more than a year old. In certain cases, multi-year data must be reviewed and factored into ratings. In addition, certain data relating to corporate governance practices may only be available on an annual basis. Non financial (social) data will be of increasing importance. The Commission should make no rules that arbitrarily limit data access. We trust users of ratings to be able to determine the frequency they find most relevant, depending on the type of institution or asset under review.

Will the proposed rule's provisions provide sufficient assurance to the markets that ratings are current?

Yes.

How else could the Commission define the term "NRSRO" in order for users of a credit rating agency's ratings to determine whether such ratings are credible and are reasonably relied upon by the marketplace?

We seek open access to the NRSRO designation and market based performance standards. We believe the Commission should define minimum standards for the term NRSRO and let the marketplace determine whether ratings issued by a given firm are credible. In this way, users will determine the extent to which ratings are reasonably relied upon by the marketplace.

Are the approaches discussed above useful for determining whether a credit rating agency meets the second component of the proposed definition?

No. The approaches discussed above are biased and inefficient. They will not lead to a restoration of NRSRO marketplace integrity or to better, more honest and effective issuer ratings.

Are there other types of information that would be appropriate?

Yes.

For example, should the fact that a credit rating agency has many subscribers support a finding that the credit rating agency satisfies the second component?

No. The fact that a credit rating agency has many subscribers is meaningless unless one understands the type of subscribers the agency has and the subscribers' motivation. We can envision a set of subscribers who subscribe because they believe doing so will increase the chance that they might receive a favorable rating.

What types of statistical data could be relied on to determine if a credit rating agency's credit ratings are relied on by the marketplace?

While the number of subscribers is one factor we believe should be considered, we would also like to see the Commission use some type of performance standard to determine if a credit rating agency's credit ratings should be relied on by the marketplace. That is, if the point of having ratings is to determine the probability of default, then rating agencies should be evaluated based on their performance in predicting default. The size of the defaulting organization and its market impact should be a factor.

What standards should be considered to assess such statistical data?

Source of the data - does it come from potential NRSRO's? From third party sources? How independent and unbiased is the data?

Should the views of issuers be a relevant consideration in determining whether a credit rating agency meets the second component of the NRSRO definition?

Yes. The views of issuers are important in determining the extent to which a rating system is "vulnerable to subjective judgment, manipulation and pressure from" issuers, investment banks, borrowers and other interested parties. NRSROs should be required to disclose what recourse an issuer has when they disagree with a rating.

Should a credit rating agency that is recognized by the financial marketplace for issuing credible and reliable ratings within a limited sector or geographic area meet the NRSRO definition only for its ratings within such sector or geographic area, or more broadly?

Yes, a credit rating agency that is recognized by the financial marketplace for issuing credible and reliable ratings within a limited sector or geographic area should be required to meet the NRSRO definition only for its ratings within such a sector or geographic area. There are sectors of the market that require limited and specialized services. We believe it is entirely appropriate to have limited service NRSROs meet investor needs in these areas. For example, as noted above, Creative Investment Research requested NRSRO status with respect to rating financial institutions owned by women and minorities. The firm never received a reply from the Commission. (We have included a copy of our latest request as Appendix B.)

If a credit rating agency meets the NRSRO definition only with respect to its ratings within a particular sector or geographic area, would the NRSRO classification interfere with the credit rating agency's ability to expand its business?

No. It is our belief that new default prediction tools and techniques developed in and for these specialized sectors may, once shown to add value, become generally accepted techniques, thereby improving the performance of NRSROs generally. The development of these new, market validated, value adding tools should improve a credit rating agency's ability to expand its business.

How should ratings from such an NRSRO be identified so that broker-dealers and other users of NRSRO ratings for regulatory purposes can determine which credit ratings from the NRSRO may be used for regulatory purposes?

The Commission should, in granting NRSRO status, designate the scope and scale of ratings an NRSRO is allowed to issue. This designation should be incorporated into the research reports an NRSRO issues. We suggest the Commission issue the following designations:

Class A NRSRO – Full.
Class B NRSRO – Limited. Meets the NRSRO definition only with respect to ratings within a particular sector or geographic area. The particular sector or geographic area should be specified.

The Commission noted that commenters mentioned that it would be difficult for limited coverage NRSROs to provide a full and accurate assessment of credit risks without a broader expertise in credit risk assessment.

We do not believe that it would be difficult for limited coverage NRSROs to provide a full and accurate assessment of credit risks. We believe the marketplace will adequately recognize the scale and scope of limited coverage NRSROs. We believe these concerns are driven by a desire on the part of current NRSROs to protect their status as an oligopoly.

The Commission recognizes that the evaluation of an analyst's experience would involve a degree of subjectivity. The Commission requests comment on the appropriate subjective criteria that a credit rating agency should use in assessing the experience and training of an analyst to meet the proposed NRSRO definition. In addition, what objective criteria are relevant?

We do not believe there is an appropriate subjective criteria that a credit rating agency should use in assessing the experience and training of an analyst to meet the proposed NRSRO definition. Giving additional responsibility to staff based on subjective criteria, like membership in the Chartered Financial Analyst Institute (CFA) will not, in our opinion, be helpful. Current problems are global, systemic and structural issues. After all, giving additional responsibility to CPA's has not served to prevent financial statement manipulation.

What level of importance should be given to the subjective and objective criteria?

None. We believe the introduction of such a standard is problematic and will lead to gender and racial discrimination. We believe default prediction performance is the only relevant criteria.

How can a credit rating agency in seeking to meet the proposed NRSRO definition demonstrate that it has adequate procedures designed to ensure that its analysts are competent?

Standard employment application and review.

What factors should a credit rating agency consider in evaluating the background of its analysts and other members of its staff?

We believe there are four factors a credit rating agency should consider in evaluating the background of its analysts and other members of its staff (in order of importance):

1. Past performance in predicting issuer default.
2. Potential future performance in predicting issuer default.
3. Education.
4. General life experience.

Is the concern that a credit rating agency's ratings may become less reliable as the number of issues rated per analyst increase valid?

Yes.

If so, what type of workload is reasonable for the analytical quality of a credit rating agency's ratings to remain high?

It depends upon the analyst.

Should the Commission specify minimum standards for a credit rating agency's analysts to continuously monitor and assess relevant developments relating to their ratings so that users of the credit

rating agency's ratings can determine whether the credit rating agency meets the NRSRO definition?

No.

If a credit rating agency relies primarily on quantitative models to develop credit ratings, how can such a firm's ratings reflect a thorough analysis of the specific credit characteristics of a particular security?

They cannot, except to the extent that these quantitative models accurately reflect the specific credit characteristics of a particular security or issuer.

Should the Commission require credit rating agencies to disclose the number of credit analysts they employ and the average number of issues rated or otherwise followed by those analysts, as suggested by commenters?

Yes.

Should a credit rating agency be required to test in some way the integrity of information provided directly by issuers (both public and nonpublic) and through third party vendors?

No. A credit rating agency should only be required to explain the basis for assuming data validity, if it does so. A credit rating agency should also be required to describe the sources of information (public, nonpublic and third party vendor) used to determine ratings.

Are there other appropriate objective methods for determining whether a credit rating agency has reasonably tested the integrity of the information on which it bases its ratings?

We suggest the Commission carefully review the experience of the Federal Financial Institution Examination Council (FFIEC) with respect to the implementation of the Home Mortgage Disclosure Act. HMDA requires banks and other financial institutions to report statistics on every home mortgage loan application received. The law requires the FFIEC collect millions of records.

In designing and implementing systematic procedures to ensure credible and reliable ratings, should a credit rating agency seeking to meet the definition of NRSRO address how and the extent to which it involves an issuer's senior management in the rating process?

Yes.

To meet the proposed NRSRO definition, should a credit rating agency's procedures require that the credit rating agency request an issuer's senior management to participate in the credit rating agency's rating process without incurring a fee?

Yes.

Would information on a credit rating agency's organizational structure be useful to users of ratings?

Yes.

If so, what information would be useful?

A. Chart showing credit rating agency ownership.
B. Chart showing credit rating agency organizational structure.
C. Information on analysts: For each analyst show:
    1. Past performance in predicting issuer default.
    2. Potential future performance in predicting issuer default.
    3. Education.
    4. General life experience.

What specific conflicts of interest should be addressed in a credit rating agency's procedures and how should they be addressed?

We suggest the Commission use conflict of interest areas outlined by the NASD. The SEC could then standardize credit rating agency recommendations. For example, assuming only three credit ratings, A (highest), B and C, and three conflict of interest ratings 1 (no conflicts),2 and 3, a rating system could be designed that denotes the conflict of interest level within a given credit rating agency. For example, a "B-1" rating would be issued by a firm with no potential or actual conflicts of interest. Firms with conflicts in, say, 1 to 9 of 18 areas, using the conflict of interest areas outlined by the NASD might issue a "B-2" rating. A firm might issue a "B-3" rating with conflicts in 10 or more areas.

Should a credit rating agency that engages in activities that present potential or actual conflicts of interest be excluded from the definition of NRSRO?

Yes. In the alternative, see above.

Alternatively, is it sufficient for a credit rating agency to impose and implement safeguards to prevent potential conflicts of interest from affecting the quality and independence of its credit ratings?

See above.

Are there other practices that raise concerns similar to those raised by conflicts of interest, for example, those referred to in footnote 93 regarding unsolicited ratings, that should be addressed in a credit rating agency's procedures?

Yes.

As discussed above, to meet the third component of the NRSRO definition, should a credit rating agency demonstrate that it has systematic procedures designed to prevent the misuse of material nonpublic information?

Yes.

What types of procedures are reasonable for a credit rating agency to protect material nonpublic information?

Same privacy standards in use at most financial institutions, including investment advisors, to prevent the misuse of personal financial information.

Should a credit rating agency have personnel dedicated specifically to verifying employees' compliance with such procedures?

Whether or not a credit rating agency should have personnel dedicated specifically to verifying employees' compliance with such procedures will depend upon the scale and scope of the agencies' activities.

Class A NRSRO – Yes.
Class B NRSRO – Will depend upon the scale and scope of the NRSRO's activity.

Should persons performing this function provide ongoing training of employees and act as a resource to answer questions as they arise?

Class A NRSRO – Yes.
Class B NRSRO – Will depend upon the scale and scope of the NRSRO's activity.

Should the procedures provide for a system by which employees can report violations of the controls in place to protect nonpublic information or other inappropriate activities?

We suggest the Commission create a hotline, staffed by Agency personnel, NRSRO employees can use to report violations of the controls in place to protect nonpublic information or other inappropriate activities.

The Commission encourages commenters to provide information on appropriate procedures for receiving and adequately securing material nonpublic information.

Should a credit rating agency make its audited financial statements readily available to users of securities ratings in order for such users to assess whether a credit rating agency has sufficient financial resources to satisfy the third component?

Whether or not a credit rating agency should make its audited financial statements readily available to users of securities ratings in order for such users to assess whether a credit rating agency has sufficient financial resources will depend upon the scale and scope of the agencies' activities.

Class A NRSRO – Yes.
Class B NRSRO – Will depend upon the scale and scope of the NRSRO's activity.

What other types of financial information could a credit rating agency make available to users of securities ratings for purposes of the third component?

None. We believe the third component discriminatory.

Should a credit rating agency provide users of securities ratings with information relating to the percentage of revenue it receives from particular issuers or subscribers as compared to the credit rating agency's total revenues?

Yes.

Should a credit rating agency establish procedures to limit the percentage of revenues it receives from a single issuer or subscriber?

No.

How else can it be determined that a credit rating agency is financially independent of both subscribers and rated issuers?

We believe a through examination, conducted by the Commission, of the financial statements and operations of an NRSRO is the only way to determine that a credit rating agency is financially independent of both subscribers and rated issuers.

Should the Commission continue to rely on existing market-based standards for rating symbols and rating categories, or should

specific standards be incorporated into the definition of the term "NRSRO"? If the latter, what standards are appropriate?

See our comments above. We believe rating symbols and rating categories should be modified to reflect the scale and scope of credit rating agency activities and to reflect the level of current or potential conflicts of interest.

Should a credit rating agency that relies solely or primarily on statistical models be able to meet the proposed NRSRO definition?

Yes.

If so, under what circumstances?

As long as the statistical models are shown to be useful in predicting issuers default.

The Commission also requests comment on guidelines for assessing the relevance and reliability of statistical models used in the ratings process.

See our comments above.

Does the Commission's proposed NRSRO definition and approach for promoting competition address the competitive concerns raised by commenters' supporting provisional NRSROs?

In part. We believe a definition that requires an entity to issue publicly available credit ratings that are current assessments of the creditworthiness of obligors with respect to specific securities or money market instruments and ignores issuers of general ratings of institutions serves to limit competition.

We believe a definition that requires an entity to have general acceptance in the financial markets as an issuer of credible and reliable ratings serves to limit competition. Such a definition does not allow for new entrants.

We believe a definition that allows for industry or geographic specialization serves to increase competition. Such a definition allows new, sector specific tools to be developed.

We believe a definition that requires an entity to have "sufficient financial resources to ensure compliance with those procedures" serves to limit competition.

IV. General Request for Comment

See above.

V. Paperwork Reduction Act

We agree that "Proposed Rule 3b-10 would not impose a new collection of information within the meaning of the Paperwork Reduction Act of 1995."

VI. Consideration of the Costs and Benefits of the Proposed Rule

The Commission is sensitive to the costs and benefits that result from its rules. We have identified certain costs and benefits of the proposed rule and request comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis. The Commission requests data to quantify the costs and the value of the benefits identified. The Commission seeks estimates and views regarding these costs and benefits from market participants who might be impacted by the proposed rule, including credit rating agencies, independent credit analysts, broker-dealers, mutual fund companies, securities issuers, and investors.

A. Benefits

We agree that the proposed modified definition of NRSRO:

"would not impose any burdens on efficiency, capital formation and competition and would, in fact, promote these interests. The proposed definition would provide greater clarity to the process by which credit rating agencies become NRSROs. This would also assist credit rating agencies that are currently NRSROs in understanding how they could meet the proposed definition. For credit rating agencies that are not currently NRSROs, the definition would provide a better understanding of the enhancements necessary to meet the proposed definition. This could reduce concerns regarding barriers to entry for credit rating agencies seeking to become NRSROs. Moreover, concerns about barriers to entry also could be reduced by the component of the proposed definition that would recognize credit rating agencies with an expertise in a particular industry or geographic region. This component could be particularly beneficial to smaller credit rating agencies in their efforts to meet the proposed NRSRO definition.

By lowering any barriers to entry discussed above, the proposed rule could potentially increase the number of NRSROs. Issuers could be provided with more choices in terms of selecting NRSROs to rate their debt securities, which would lower their costs for this service. The greater competition in the market for credit ratings and analysis could provide for more credible and reliable ratings. Greater competition also could stimulate innovation in the technology and methods of analysis for issuing credit ratings, which could further lower barriers to entry."

B. Costs

The Commission poses the following questions regarding the proposed rule:

What are the costs for an entity to operate as a credit rating agency that is recognized on a national level by the predominant users of credit ratings as issuing credible and reliable ratings?

The costs for an entity to operate as a credit rating agency that is recognized on a national level by the predominant users of credit ratings as issuing credible and reliable ratings is minimal.

Most significant are labor costs. Communications, information system and equipment costs as well as credit ratings publishing costs are significant, but subordinate. Costs related to technology have significantly decreased in recent years. Costs related to health care insurance have significantly increased in recent years. Legal costs associated with intellectual property protection have also increased.

Describing, in full, our costs is beyond the scope of this comment. We are happy to provide more detailed cost data to the Commission, if this can be done on a confidential basis.

What are the costs for an entity to enter into the credit rating business with respect to rating securities within a specific industry or geographic segment?

See our comments above.

What additional costs would such an entity incur to achieve national recognition?

Not many. We believe citation in one or more media (newspaper, magazines, television programs with a national reach) outlets is sufficient for one to claim "national recognition."

VII. Consideration on Burden and Promotion of Efficiency, Competition, and Capital Formation

We agree that the modified definition of NRSRO:

"would not impose any burdens on efficiency, capital formation and competition and would, in fact, promote these interests. The proposed definition would provide greater clarity to the process by which credit rating agencies become NRSROs. This would also assist credit rating agencies that are currently NRSROs in understanding how they could meet the proposed definition. For credit rating agencies that are not currently NRSROs, the definition would provide a better understanding of the enhancements necessary to meet the proposed definition. This could reduce concerns regarding barriers to entry for credit rating agencies seeking to become NRSROs. Moreover, concerns about barriers to entry also could be reduced by the component of the proposed definition that would recognize credit rating agencies with an expertise in a particular industry or geographic region. This component could be particularly beneficial to smaller credit rating agencies in their efforts to meet the proposed NRSRO definition.

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We also believe the proposed definition, as modified to eliminate what we regard as unreasonable barriers to entry, could have some positive impact on capital formation, specifically with respect to firms owned by women and minorities.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"160 we must advise the Office of Management and Budget as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

We believe the proposed regulation constitutes a "major" rule, since we believe it will, over time, have an annual effect on the economy of $100 million or more, in the form of an increase.

Creative Investment Research, Inc.
http://www.minorityfinance.com
www.minoritybank.com
http://www.creativeinvest.com

Appendix B

Monday, December 22, 2003

Ms. Annette L. Nazareth
Director, Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Creative Investment Research, Inc.

Dear Ms. Nazareth:

We submit this letter on behalf of Creative Investment Research, Inc. (CIR) to request that the firm be considered a nationally recognized statistical rating organization ("NRSRO") for purposes of paragraphs (c)(2)(vi)(E), (F), and (H) of Rule 15c3-1 under the Securities Exchange Act of 1934 (17 CFR Sec. 240.15c3-1). We request this status only with respect to rating financial institutions owned by women and minorities.[12]

In support of this request, we refer you and your staff to information we have provided[13] establishing that the firm:

1. Is known in the United States as an issuer of ratings of minority-owned financial institutions[14];

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[12] Banks, Thrifts and/or Bank Holding Companies where persons of Asian, Black, Hispanic, Native descent and/or Women own 51% or more of the common stock of the institution.

[13] See:

- http://www.sec.gov//rules/proposed/s73602/wmcunningham1.htm . Comments of William Michael Cunningham and Creative Investment Research, Inc. on S7-36-02.
- http://www.sec.gov//rules/other/s71003/wmccreative050503.htm . Comments of William Michael Cunningham and Creative Investment Research on S7-10-03.
- http://www.sec.gov/rules/proposed/s71403/creativeinv090803.htm. Comments of William Michael Cunningham and Creative Investment Research on S7-14-03.

[14] See:

Black-Owned Banks Emerge as Dealmakers - Loosening up at risk-averse institutions. The American Banker Newspaper. Monday, August 4, 2003. John Reosti.

The Wealth of Possibilities - Black-Owned Bank Draws Big Names, With Bigger Plans. By Krissah Williams Washington Post Staff Writer. Monday, September 29, 2003; Page E01.

A Shaky Pillar in Harlem. Black-Owned Carver Bank Is Resistant to Profitability and Change. The New York Times, Sunday, July 11, 1999. Page C-1. Story by Leslie Eaton.

2. Has the financial resources and staffing to guarantee that it can issue reliable evaluations of the financial and social performance of minority-owned financial institutions. (As recent events have shown, we suggest the ability "to operate independently of economic pressures or control by the companies it rates" is moot. We are a fully independent firm.)

3. Uses a proprietary rating procedure, the Fully Adjusted Return™ Methodolgy, a system designed to ensure reliable and truthful evaluations;

4. Has senior level access at minority-owned financial institutions; and

5. "Has and enforces internal procedures to prevent misuse of non-public information."

In light of the foregoing, we respectfully ask you to grant CIR the NRSRO status requested.

If you need additional information, please contact me.

Thank you,

William Michael Cunningham
Social Investing Adviser