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December 5, 2013

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, N.E.  
Washington, D.C. 20549



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*Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations;  
File No. S7-18-11*

Dear Ms. Murphy:

This letter supplements DBRS'<sup>1</sup> August 8, 2011 comments on the above-referenced rule proposals, in particular, the proposal to incorporate existing Rule 17g-7 under the Securities Exchange Act of 1934 ("Exchange Act") into new rule 17g-7(a)(1)(ii)(N). For the reasons explained below, DBRS submits that the current version of 17g-7 is not working as intended and should be revised in the course of the pending rulemaking.

### ***Background***

Title IX, Subtitle D of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was designed to respond to deficiencies in the securitization process which contributed to the financial crisis.<sup>2</sup> Section 943 of the Subtitle addressed this issue by obligating the SEC to prescribe regulations concerning the use of representations and warranties in the market for asset-backed securities ("ABS"). In this regard, Section 943(1) directs the Commission to require each NRSRO to include in any report accompanying an ABS credit rating a description of the representations, warranties and enforcement mechanisms available to investors and how they differ from the representations, warranties and enforcement

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<sup>1</sup> DBRS is a globally recognized provider of timely credit rating opinions covering a broad range of financial institutions, corporate entities, government bodies and various structured finance product groups. DBRS is registered with the SEC as a nationally recognized statistical rating organization (NRSRO) and is a designated rating organization with the Ontario Securities Commission. DBRS' European affiliate, DBRS Ratings Limited, is regulated solely by the European Securities and Markets Authority.

<sup>2</sup> Senate Committee on Banking, Housing, and Urban Affairs, Committee Report No. 111-176 ("Senate Banking Committee Report") at 35-37 (April 30, 2010).



mechanisms in issuances of similar securities. The SEC fulfilled this directive in January 2011 by adopting new Rule 17g-7.<sup>3</sup>

Tracking the broad language of the statute, the rule requires an NRSRO to include in any report accompanying a credit rating on any Exchange Act-ABS<sup>4</sup> a description of all representations, warranties and enforcement mechanisms (hereafter, "RWEMs") regardless of what those RWEMs relate to. In taking this expansive approach, the Commission rejected public comment suggesting that since the purpose of Section 943 was to improve transparency regarding underwriting in ABS transactions, the rule should be limited to RWEMs relating to the underlying pool assets, and not include other aspects of the transaction, such as corporate or governance matters.<sup>5</sup> The Commission also dismissed commenters' concerns about the anticipated length of the disclosures and rejected the suggestion that NRSROs be allowed to provide the required disclosures by reference to a transaction's offering documents or other materials disclosed by the issuer or underwriter rather than describing each RWEM separately in the rating report.<sup>6</sup>

With regard to the other side of the equation - the RWEMs available in issuances of similar securities - the Commission declined to define the term "similar securities" or to permit comparisons to industry standards. Instead, the Commission directed each NRSRO to draw on its knowledge of industry standards and its experience with previously rated deals to make its own determination as to what constitutes a "similar security" for the purpose of the required comparisons. The Commission suggested that an NRSRO could fulfill this obligation by establishing "benchmarks" for different types of securities based upon a review of previous issues, and revising those benchmarks on an ongoing basis as necessary.<sup>7</sup> The Commission has not provided any subsequent guidance on this issue.

Compliance with Rule 17g-7 was required as of September 26, 2011. Before that date arrived, the Commission proposed to revamp the rule to incorporate a host of

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<sup>3</sup> *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Exchange Act Release No. 63741 (January 20, 2011), 76 Fed. Reg. 4489 (January 26, 2011) ("Adopting Release").

<sup>4</sup> The Dodd-Frank Act added a definition of "asset-backed security" to the Exchange Act and referred to that definition in Section 943. Based on that reference, the Commission made Rule 17g-7 applicable to all ABS securities, whether they are offered in registered transactions or not.

<sup>5</sup> Adopting Release at 48, 53, 76 Fed. Reg. at 4503-04.

<sup>6</sup> *Id.* at 49, 52-53, 76 Fed. Reg. at 4503-04.

<sup>7</sup> *Id.* at 52, 76 Fed. Reg. at 4504.



NRSRO requirements mandated by Title IX, Subtitle C of the Dodd-Frank Act.<sup>8</sup> In this regard, proposed new paragraph (a) of Rule 17g-7 sets forth up to a score of additional items NRSROs would be required to disclose with each credit rating, in accordance with Dodd-Frank Act Section 932(a)(8).<sup>9</sup> The RWEM disclosures of existing Rule 17g-7 would then form just one of the required disclosures, identified as subsection (a)(1)(ii)(N) in the revised version of the rule.

The proposal to amend Rule 17g-7 is still pending, which means that the Commission has the opportunity to examine how the existing rule is working in practice before recodifying the current RWEM disclosure requirements.

Unfortunately, from both the investor and NRSRO perspectives, the current rule is not working well at all.

### ***Rule 17g-7 In Practice***

Requiring disclosure of all RWEMs whether or not they relate to pool assets and whether or not they are material enough to be included in a transaction's offering documents, coupled with requiring the publication of corresponding benchmarks in each report has led to overwhelming 17g-7 disclosures. Two hundred-page RWEM reports are not uncommon, and one recent report DBRS produced [available at <http://dbrs.com/research/262865/csmc-trust-2013-ivr5-dbrs-limited-rule-17g-7-disclosure.pdf>], topped 800 pages. Not only has this process proven enormously costly to the NRSROs,<sup>10</sup> but it is of very little value to investors. According to the feedback DBRS has received from its institutional clients, and an analysis of usage data from our website, these voluminous reports are not being read.<sup>11</sup> We understand

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<sup>8</sup> *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, Exchange Act Release No. 64514 (May 18, 2011), 76 Fed. Reg. 33420 (June 8, 2011) ("Pending Dodd-Frank Rule Proposals Release").

<sup>9</sup> Proposed Rule 17g-7(b) would mandate additional disclosure regarding credit rating histories.

<sup>10</sup> To date, DBRS has spent roughly \$1.1 million to comply with the current version of Rule 17g-7. The cost of producing these reports imposes a particularly harsh burden on the smaller NRSROs, and will balloon when the new version of 17g-7 is adopted.

<sup>11</sup> Our analysis of the top-ten, most viewed US ABS and RMBS credit rating reports on dbrs.com for 2013 indicates that the corresponding RWEM disclosures are being accessed (by investors, issuers, investment banks and others) only between 1.67 and 13.04 percent of the time. For eight of the top-ten, most viewed ratings, the "hit rate" was in the single digits. There is even less demand for this disclosure in connection with Canadian transactions. During 2013, the average hit rate for 17g-7 reports on those transactions has been 2.3 percent.



that the staff of the SEC's Office of Credit Ratings has received similar feedback from the rule's intended beneficiaries.

Although the Commission has refrained from conducting a full cost-benefit analysis on rules mandated by the Dodd-Frank Act,<sup>12</sup> DBRS respectfully submits that clear evidence of costs and benefits supplied by more than two years of Rule 17g-7's operation cannot be ignored.

### ***Revising Proposed Rule 17g-7(a)(1)(ii)(N)***

DBRS submits that the problems with the current rule could largely be addressed by limiting the scope of the RWEMs NRSROs are required to disclose and by modifying the means by which the benchmarks are identified to investors, as described more fully below.

#### *Scope of the RWEMs*

We believe that the purpose of Section 943 can best be achieved by limiting the disclosure required by Rule 17g-7(a)(1)(ii)(N) to RWEMs that:

- relate to the asset pool underlying the ABS transaction in question, *and*
- the issuer has disclosed in the prospectus, private placement memorandum or other offering document for that transaction.

Although the text of Section 943(1) may not be limited in this fashion, the *context* of the provision clearly supports drawing such distinctions among RWEMs for purposes of NRSRO disclosures.

First, as noted above, Congress included this provision in a subtitle of the Dodd-Frank Act that was designed to respond to deficiencies in the securitization process which contributed to the financial crisis.<sup>13</sup> According to the Senate Banking Committee, these deficiencies included the fact that "investors in asset-backed securities could not assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations."<sup>14</sup> The Committee further opined that "[t]he system operated on a wholesale

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<sup>12</sup> The SEC limited its cost-benefit analysis for both the original and revised versions of 17g-7 to areas of discretionary rulemaking. Adopting Release at 68, 76 Fed. Reg. at 4508; Pending Dodd-Frank Rule Proposals Release at 349, 393-96, 76 Fed. Reg. at 33511-12, 33523-24.

<sup>13</sup> Senate Banking Committee Report at 35-37.

<sup>14</sup> *Id.* at 36.



misunderstanding of, or complete disregard for the risks inherent in the underlying assets and the complex instruments they were backing."<sup>15</sup>

A review of other provisions included in Subtitle D of Title IX confirms Congress' intent to enhance material disclosures regarding the underlying assets of ABS. For example, Section 942 of the Dodd-Frank Act requires the SEC to adopt rules requiring ABS issuers to disclose, for each tranche or class of security, *information regarding the assets backing that security*. Likewise, Section 945 of the statute directs the SEC to adopt rules requiring issuers of ABS to perform, and disclose the nature of, a review of the *underlying assets* of the ABS.

The Commission recognized this Congressional intent when it discussed the purpose of Section 943 in the course of adopting the current version of 17g-7:

[I]n the underlying transaction agreements for an asset securitization, sponsors or originators typically make representations and warranties relating to the pool assets and their origination, including about the quality of the pool assets . . . . Upon discovery that a pool asset does not comply with the representation or warranty, under transaction covenants, an obligated party, typically the sponsor, must repurchase the asset or substitute a different asset that complies with the representations and warranties for the non-compliant asset. The . . . lack of responsiveness by sponsors to potential breaches of the representations and warranties relating to the pool assets has been the subject of investor complaint.<sup>16</sup>

The Commission's approach to implementing the credit risk retention provisions of Section 941 of the Dodd-Frank Act is also instructive. Here, the Commission and the federal banking agencies jointly proposed rules providing that securitizers of commercial mortgages can meet the risk retention requirements if they, among other things, disclose to potential investors, "the representations and warranties *concerning the securitized assets*" (emphasis supplied).<sup>17</sup> They took this approach even though the corresponding statutory language refers to "adequate representations and warranties and related enforcement mechanisms" generally.<sup>18</sup>

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<sup>15</sup> *Id.* at 43.

<sup>16</sup> Adopting Release at 6, 76 Fed. Reg. at 4490.

<sup>17</sup> Department of the Treasury, Federal Reserve System, Federal Deposit Insurance Corporation, SEC, Federal Housing Finance Authority, and Department of Housing and Urban Development, *Joint Proposed Rule-Making*, Exchange Act Release No. 64148 at 43-47 (March 30, 2011), 76 Fed. Reg. 24090, 24109-11 (April 29, 2011).

<sup>18</sup> Compare Exchange Act Section 15G(c)(1)(E)(iv) with proposed Rule 17 CFR §246.10(a)(5)(viii).



Limiting 17g-7(a)(1)(ii)(N) to those RWEMs that relate to the pool assets underlying ABS transactions would focus the rule's attention on the central purpose of Section 943. Further restricting the scope of this rule to RWEMs disclosed in a transaction's offering documents would relieve NRSROs of the cost of writing reports about matters that the issuers do not deem to be material. Why should NRSROs have to disclose more than issuers do? Requiring more extensive disclosure of NRSROs than that required of issuers is antithetical to the goal of reducing investors' overreliance on credit ratings. A transaction's offering documents, not a credit rating report, should be the primary source of information supporting an investment decision.

DBRS estimates that only about 25 to 50 percent of the RWEMs currently disclosed in 17g-7 reports are deemed material enough by the issuers to appear in prospectuses or other offering documents. Approximately 50 to 75 percent of these RWEMs relate to pool assets. Thus, revising proposed Rule 17g-7(a)(1)(ii)(N) in the manner suggested herein could result in RWEM reports that are 62.5 to 87.5 percent smaller than they are today. Such a reduction in the size of the reports would benefit investors and NRSROs alike.

#### *The Mechanism for Displaying the Benchmarks*

In order to further increase the likelihood that investors will read the 17g-7 reports, DBRS suggests that the display of the RWEM benchmarks be moved out of the 17g-7 reports and onto a dedicated area of the NRSROs' websites. This would obviate the need to display reams of information about "similar securities" each time an NRSRO issues a credit rating about an ABS transaction. Instead, the NRSRO would update its website in the event a benchmark changed in a material way. In addition, a link to the dedicated website could be referenced in the shortened RWEM reports. An added benefit of this approach would be that an archive of superseded benchmarks could be made available online, thereby allowing investors to see how RWEMs for particular types of securities change over time.

DBRS estimates that making this adjustment could further reduce the size of the 17g-7 reports and result in a substantial additional cost savings to NRSROs.

#### **Conclusion**

DBRS appreciates the opportunity to submit these supplemental comments on the Dodd-Frank Act NRSRO rule proposals, and respectfully asks the Commission to revise proposed Rule 17g-7(a)(1)(ii)(N) as discussed above. We would be happy to supply the Commission or the staff with additional information about this issue.

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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.

Very truly yours,

A handwritten signature in black ink that reads "Daniel Curry". The signature is written in a cursive style with a long, sweeping tail on the "y".

Daniel Curry  
Chief Executive Officer  
212.806.3244

A handwritten signature in black ink that reads "Mary Keogh". The signature is written in a cursive style with a long, sweeping tail on the "h".

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