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BY ELECTRONIC MAIL

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: *Release No. 34-61051; File No. S7-28-09*
Proposed Rules for Nationally
Recognized Statistical Rating Organizations

Dear Ms. Murphy:

Fitch, Inc. ("Fitch") submits this letter in response to the request for comments of the Securities and Exchange Commission ("SEC" or the "Commission") on the *Proposed Rules for Nationally Recognized Statistical Rating Organizations* (Release No. 34-61051; File No. S7-28-09, the "Proposed Rules"). Fitch is a nationally recognized statistical rating organization ("NRSRO").

Set forth below are our comments on the Proposed Rules.

1. Issues Relating to Compliance Officer Report

Relevant Proposed Rule: Amendments to 17g-3

Fitch believes that the proposed requirement for the compliance officer to produce a report each year, describing actions taken by the compliance department, will be useful for the NRSRO. However, we have four recommendations to improve the proposal, triggered by questions posed by the Commission.

First, we believe that there should be a definition of "material compliance matter" that specifically relates to NRSROs. We do not believe that the guidance currently offered, which is based on Rule 38a-1 under the Investment Company Act of 1940, is sufficient for, or adequately specific to, an NRSRO. The rule should define "material compliance matter" to ensure that the compliance officer is only required to address matters that are both material and

germane to credit ratings. The guidance refers to three elements, which we will discuss in turn. The first element is a "violation of securities laws." Section 15E of the Securities Exchange Act of 1934, as well as the proposals to amend Section 15E currently before both Houses of Congress, is quite detailed and the violation of certain aspects of the section may not necessarily have material consequences to the NRSRO or its credit ratings. It is easily foreseeable that a NRSRO could be in immaterial violation of these requirements, or that some of these requirements are not always material to the reliability of credit ratings. The second element is a "failure to adhere to the policies, procedures, or methodologies established, maintained and enforced by the NRSRO." Again, not all violations of an NRSRO's policies, procedures or methodologies are material to credit ratings. The third element highlighted in the guidance is a "determination that there was a weakness in the design or implementation of the policies and procedures of the NRSRO." This provision can be analyzed in a similar fashion to the second element, with similar conclusions.

We therefore propose that the final rule when adopted define "material compliance matter" to include a specific reference that a violation be material to a credit rating. Specifically, we propose that "material compliance matter" be defined as:

> "A material compliance matter means any matter that results in a materially adverse change to any credit rating issued by an NRSRO, and that involves:
>
> - A violation of the Federal Securities Laws or the rules promulgated thereunder,
>
> - A violation of the policies, procedures, or methodologies established, maintained and enforced by the NRSRO to determine credit ratings, prevent the misuse of material nonpublic information, manage conflicts of interest, and comply with Section 15E of the Securities Exchange Act of 1934 or the rules promulgated thereunder, or
>
> - A weakness in the design or implementation of the policies and procedures of the NRSRO."

Our second recommendation relates to a specific question raised by the SEC. We do not believe that it is necessary or appropriate that the NRSRO engage an independent third party to review of the NRSRO's "adherence to its policies and procedures and its compliance with securities laws." We note that the securities laws and the rules thereunder do not mandate such a review for any other entity. Indeed, the only independent third party review of any type, of which we are aware, is the auditing of financial statements by an independent auditor. The type of review contemplated by the question is not at all analogous to a financial audit. Moreover, we believe that Fitch has shown, and the SEC has recognized, that we can and have put in place robust internal audit procedures.

Our third recommendation relates to the practicalities of how the compliance officer will generate their report, especially for NRSROs with global businesses. It is not possible for one individual to have direct knowledge of all the items covered in the report. It is therefore inevitable that the compliance officer will rely on the work of her/his team members to be able to provide the information, and the certification, in the report. We believe the Commission should recognize that, as a practical matter, the compliance officer will typically conduct her/his role by delegating various duties and responsibilities with respect to the compliance function to other members of the compliance team under her/his supervision, and will not be undertaking all the compliance activities herself/himself. We also note that the Proposed Rule provides that the compliance officer certify compliance based on "best knowledge," a standard that differs from the standard used in other certifications such as those by the chief executive officer and chief financial officer under Section 302 of Sarbanes Oxley where the certification is "based on the officer's knowledge." Accordingly, we believe that last clause of Rule 17g-3 (b)(2) as proposed ought to read ". . . to the knowledge of the designated compliance officer, the report fairly presents, in all material respects, steps taken by, or at the direction of, the designated compliance officer for the period presented."

Our fourth recommendation relates to the recipient(s) of the compliance officer's report. We believe the compliance officer should provide the report to the NRSRO's board of directors. This approach, as the SEC points out in footnote 37, is consistent with a similar provision applicable to investment companies under the Investment Company Act of 1940. It would also address the SEC's concern that "key personnel" should receive copies of the report. The Commission, of course, always can request a copy of this report as part of its examination of the NRSRO.

2. Issues Relating to Proposed Revenue-related Disclosures

Relevant Proposed Rule: New Rule 17g-7

We understand the Commission's desire to require each NRSRO to provide information to investors that will assist them in assessing whether they believe such NRSRO is subject to potential conflicts of interest. However, we very strongly believe that the information disclosure requirements under new Proposed Rule 17g-7 are unduly burdensome to the point of being completely unworkable. We also think, in reality, that the information will not be of practical value to investors. In addition, we believe there is a flaw in the proposal in that the Proposed Rule excludes from the requirements any NRSRO that uses the so-called subscription business model. In excluding NRSROs using the subscription business model, the Commission is effectively determining that no potential conflicts relate to such an NRSRO even if most of its revenues come from "subscriptions" to vulture funds, short sellers or other parties that have a clear stake in a desired outcome for the NRSRO's credit ratings. Fitch instead offers below an alternative, simpler proposal, based on the SEC's own proposal for additional disclosures through Exhibit 6 of Form NRSRO, to address all these issues.

The Proposed Rule would require us to prepare a revenue report for "each person that paid [us] to issue or maintain a credit rating that was outstanding as of the end of the fiscal year." At the end of our last fiscal year, we were maintaining coverage of approximately 62,000 issuers and transactions in total. This consisted of 5,500 financial institutions, including over 3,200 banks and 1,100 insurance companies, with finance and leasing companies, broker-dealers, asset managers, managed funds and covered bonds making up the remainder of Fitch's financial institution coverage. Also included in this overall total were more than 1,700 corporate issuers, 100 sovereigns, 200 sub-sovereigns, 300 global infrastructure ratings and 45,000 U.S. municipal transactions, as well as over 6,900 U.S., 1,500 European and 600 Asian structured finance transactions. Most issuers and transactions on which we maintain coverage have multiple ratings associated with them. For example, a given financial institution could have long-and short-term issuer default ratings, individual and support ratings, and ratings assigned to individual long-term, hybrid, medium-term, bank loan and commercial paper issues or programs. A typical structured finance transaction normally has multiple tranches in its capital structure, all or most of which would have tranche-specific ratings based on our opinion of the relative credit risk of the tranches. Logically, this implies a significantly greater number of individual ratings. Fitch was paid to issue and maintain the vast majority of all of these ratings. Therefore, the number of "persons" with whom we have fee arrangements totals in the tens of thousands. The work that would need to go into producing the consolidated report is staggering. Moreover, given the size of the report, it would be too cumbersome to be of value to investors.

The ranking system proposed by the Commission – top 10%, top 25%, top 50%, bottom 50% or bottom 25% – seems to us to be unnecessarily complicated. We believe investors would be more interested in knowing what entities, on an aggregated basis, pay the most to NRSROs.

As mentioned above, we object to a system of required disclosure that does not treat all NRSROs equally. That would be the outcome of this Proposed Rule, with so-called subscriber based NRSROs exempt from compliance. Moreover, the SEC's proposal contradicts its own stated position of what constitutes a conflict of interest: Rule 17g(5)(b)(4) specifies as a conflict of interest being paid by subscribers for access to ratings and other services and Exhibit 6 to Form NRSRO requires subscriber-paid NRSROs to disclose such a conflict. We think investors would find it very material to know if a relatively small number of subscribers accounted for a large share of the revenue of such an NRSRO, especially if the interests of those subscribers are in opposition to their own.

Given the very serious issues raised by the Proposed Rule, we think the SEC can better achieve its goals in the following way: Each NRSRO, regardless of its business model, would be required to disclose publicly a list of the persons that provide the largest share of such NRSRO's aggregate global net revenue. The number of persons on the list would be determined on a sliding scale, based on the aggregate global net revenue of the NRSRO. For example, NRSROs with aggregate global net revenue of less than $100 million would disclose the top 20 revenue providers; those with aggregate global net revenue equal to or greater than $100 million, but less than $500 million would disclose the top 50 revenue providers; and those with aggregate global net revenue equal to or greater than $500 million would disclose the top 100 revenue

providers. Aggregate global net revenue should include all net revenue, of whatever type, earned by the NRSRO and any other entity under common control with the NRSRO (which would include, for example, sister subsidiaries), from credit rating services, including subscription revenue, and non-credit rating services. "Non-credit rating services" should be defined as any other financial services related businesses, including, without limitation, financial consulting and advisory work.

The concept "revenue provider" should be clearly defined to require that all parties under common parentage – that is, the parent and its subsidiaries – must be aggregated together as one "revenue provider." In the case of structured finance, the "revenue provider" with respect to credit rating services should be the financial institution originating or purchasing the assets, or owning (directly or indirectly) the issuer of the securities being rated. If there were no financial institution in such role, then the "revenue provider" would be the primary sponsor/arranger of the structured finance transaction. We think this is more meaningful for investors – potential influence will come from the aggregated purchasing power of a group of buyers, not from each individual buyer.

For each revenue provider on the list, the NRSRO should be required to provide its share (expressed as a percentage) of the NRSRO's aggregate global net revenue – that is, the numerator of the fraction would be the aggregate global net revenue paid by the revenue provider (as defined), and the denominator would be the NRSRO's aggregate global net revenue (as specified above). We believe it would be anti-competitive to require disclosure of fees on an entity-by-entity basis; such information is highly commercially sensitive. However, we do not think competitive issues would arise through the aggregated disclosure we are advocating for each revenue provider.

NRSROs should also be required to disclose publicly a second list. This list would again provide the 20, 50 or 100 top revenue providers (in accordance with the approach described above), but the revenue calculation would be made with respect to non-credit rating services – that is, the numerator of the fraction would be the aggregate global net revenue paid by the revenue provider for non-credit rating services and the denominator would be the NRSRO's aggregate global net revenue (as specified above).

Fitch's proposal includes and expands upon the additional disclosures through Exhibit 6 of Form NRSRO that the Commission would like to introduce.

The Commission also asks a series of questions (pages 56-57) about whether NRSROs should make certain further disclosures. Generally, most of these disclosures are already incorporated in the IOSCO Code of Conduct for credit rating agencies ("CRAs"), and therefore in the NRSROs' own codes of conduct, and/or will be applicable to CRAs that choose to register under the new European Union Regulation (the "EU Regulation"). However, the language used in the questions posed is often different from that in the IOSCO Code of Conduct or the EU Regulation. Given that our business is global, and that we therefore apply our policies and procedures globally, we strongly urge the SEC, should it decide to require any of these disclosures, to ensure that its rules are consistent with the IOSCO Code of Conduct and with the EU Regulation.

We also have two specific comments. First, the SEC asks whether the NRSRO should provide a description of relevant data relied on for the rating. We already provide the key rationale for each rating (and will be required to do so under the EU Regulation), which typically includes reference to non-confidential information; therefore this point is already being addressed. To the extent the Commission is looking to NRSROs to provide additional disclosure about a registrant or its securities, we think it is misplaced to put that obligation on NRSROs; if the Commission believes additional disclosure is necessary, it should use its rule-making powers to require such disclosure by registrants. Second, the SEC goes on to ask if NRSROs should disclose whether material nonpublic information was used to determine the rating, and if NRSROs should disclose "in general terms" the type of confidential information used and the impact on the rating. We are concerned that any requirement that involves disclosure related to confidential information could cause us to violate confidentiality arrangements with issuers and/or the laws of other jurisdictions, including the countries of the European Union.

Finally, the SEC asks whether these revenue lists should be based on a longer period than one year, to capture longer-term trends. We think it would be easier, and more meaningful for investors, for the NRSRO to maintain, on its website, the revenue lists for the preceding two fiscal years, as well as the current year. Of course, this would be done on a going-forward basis from the date the new Rule comes into force.

3. <u>Comments with respect to the Differentiation of Structured Finance Ratings</u>

We believe that structured finance ratings are broadly comparable to corporate finance ratings. It is important to note that our credit ratings, whether structured finance or corporate finance ratings, provide an opinion on the relative ability of an entity or transaction to meet certain financial commitments, such as interest payments, repayment of principal, insurance claims or counterparty obligations. Credit ratings do not address risks such as pricing, market risk or currency or interest rate risk. (It is also important to note that, given that credit ratings are inherently a prediction about the future, they can be neither accurate nor inaccurate.) Thus, our credit ratings are designed to allow a comparison, for example, of the relative vulnerability to default of a corporate issuer with that of a structured finance instrument. We use our default and transition studies to test that aim of broad comparability of relative default experience. Structured finance ratings have historically displayed aggregate default rates comparable to those shown by corporate ratings; if they do not, that is a signal for us to review the relevant criteria. For example, our default and transition studies have recently shown that comparability breaking down with respect to ratings on US RMBS and CDO securities issued in 2006 and 2007. As a result, Fitch re-examined and amended its criteria for these assets to bring future default rates back into line with the long-term averages.

We have also noticed different patterns in rating migration between structured finance and corporate finance ratings. A greater proportion of the risk in granular structured finance pools stems from systemic or macroeconomic risks relating to an asset class-wide downturn rather than from the idiosyncratic risk of a particular borrower. This is likely to lead to the performance of different structured finance securities being more correlated than the performance of different corporate issuers. In addition, because of this reduction in idiosyncratic risk, the propensity for an upgraded or downgraded rating to be upgraded or downgraded again

in successive periods is notably stronger for structured finance ratings. Finally, as corporate issuers repay maturing debt and new debt is issued, the issuer rating remains outstanding. In contrast, a structured finance vehicle typically has a finite life after which the debt is repaid, or defaults, and the rating is withdrawn. This closed-end nature of structured finance ratings versus the perpetual nature of corporate ratings can influence rating transitions both positively and negatively.

We note that the SEC makes no proposals about how to differentiate structured finance ratings from corporate finance ratings. It does, however, criticize the use of a "distinct symbol or identifier" for structured finance ratings. As the SEC and its staff are no doubt aware, the EU Regulation requires CRAs that are registered thereunder to "ensure that rating categories that are attributed to structured finance instruments are clearly differentiated using an additional symbol with distinguishes them from rating categories used for any other entities, financial instruments or financial obligations." As part of our compliance with the EU Regulation, Fitch will be adding a modifier to all its structured finance ratings globally. It would be extremely problematic for Fitch and other global NRSROs if the Commission were to take a different view than that expressed in the EU Regulation.

We have also added increased disclosure around individual structured finance ratings, including the following:

- Launch of loss severity ratings, providing additional information on the thickness of a tranche and therefore the severity of loss given default;

- Re-launch of structured finance recovery ratings, which address loss given default for distressed tranches;

- Global application of rating outlooks in structured finance, providing an indication of the direction a rating is likely to move over a one- to two-year period;

- Additional disclosures in our pre-sale reports for structured finance ratings, providing more information about rating sensitivities, increased disclosure with respect to the data used and its limitations, if any, and more information on the methodologies/criteria used in determining the rating (including any exceptions to such methodologies/criteria);

- With respect to different asset classes, publication of stress test results – that is, the impact on ratings within such asset class in the event certain "what if" economic scenarios were to happen; and

- Increased market commentary, ranging from short and timely credit news analyses with respect to specific events, to sector reviews.

We have received positive feedback from investors on these transparency initiatives. We believe it is more meaningful to investors to provide disclosure that is specific to

the rating in question. We think that "boilerplate" disclosure is not helpful. In addition, the actions we have taken will also assist us in complying with the requirements of the EU Regulation.

We believe that this enhanced disclosure addresses the concerns expressed by the SEC with respect to the ratings of structured finance products. To the extent the SEC determines that additional disclosure about such products themselves is necessary, we again think that the most appropriate way to accomplish that goal would be for the SEC to enact new rules imposing such disclosure requirements on the registrant, as the creator of the product.

Finally, the SEC asks how to encourage non-hired NRSROs to rate existing structured finance products – that is, with respect to such products issued before the compliance date of the amendments recently made to Rule 17g-5. We continue to believe that it is not the role of the NRSRO to disclose information produced by third parties. The SEC can best encourage non-hired NRSROs by imposing disclosure requirements on the issuer, sponsor or underwriter as the party responsible for such information. We note also that Rule 17g-5 provides that, once the NRSRO assigns a rating, the NRSRO no longer needs to list the relevant transaction on its website; we agree with that approach, which leads to the conclusion that any disclosure required for existing transactions should be made by the issuer, sponsor or underwriter.

Thank you for giving us the opportunity to provide our comments. We hope you find them useful, and that you will give them due consideration. Please call me at (212) 908-0626 with any questions that you might have concerning our comments or if you wish to discuss this matter further at your convenience.

Very truly yours,

Charles D. Brown
General Counsel