MOODY'S
INVESTORS SERVICE

7 World Trade Center
250 Greenwich St
New York, NY 10007
www.moodys.com

**February 5, 2009**

**By Electronic Mail**

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

**Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations (File No. S7-28-09) (the "Release")**

Dear Ms Murphy:

## I. Introduction

Moody's Investors Service ("**MIS**") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("**Commission**") on the proposed amendments ("**Proposed Amendments**") to existing rules and forms implementing the Credit Rating Agency Reform Act of 2006 ("**Rating Agency Act**"). We support the Rating Agency Act's purpose of improving ratings quality for the protection of investors and in the public interest by fostering accountability, transparency and competition in the credit rating agency ("**CRA**") industry, and we recognize the Commission's ongoing efforts through this and other rule-making initiatives to enhance confidence in the credit rating process.

We do not object in principle to the proposed requirement that the designated compliance officer of a Nationally Recognized Statistical Rating Organization ("**NRSRO**") furnish an annual report on a confidential basis to the Commission. As we discuss in Section II below, however, we have a few significant concerns about certain aspects of proposed rule 17g-3(a)(7) and have suggested alternative language to address these concerns. We also have set out in an Annex to this Comment Letter some technical comments and requests for clarification on several other, important issues.

While we do not object to the proposed amendments to Exhibit 6 of Form NRSRO, we have fundamental concerns about proposed rule 17g-7. We believe that requiring NRSROs to disclose publicly information about revenues attributable to persons paying for credit ratings could jeopardize the independence of the rating process by undermining the firewalls that the Commission previously required NRSROs to establish to bolster analytical independence. The Commission and other authorities have stressed the importance of insulating rating analysts and committees from commercial influences. Publicly disclosing a list that ranks all entities that pay for credit ratings according to the revenues attributable to them would expose analysts and rating committees to more commercial information about rated issuers than they have ever had before. We discuss these concerns in Section III below, while the Annex includes technical comments.

## II. Proposed Rule 17g-3(a)(7): Annual Report from Designated Compliance Officer

### A. "Ensuring" Compliance Is Inconsistent with the Function of an Independent Compliance Officer

Proposed sub-paragraph (a)(7)(i)(B), if adopted, would require an NRSRO's designated compliance officer to prepare and certify a report describing the steps taken during the year to "ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E" of the Securities Exchange Act of 1934 ("**Exchange Act**"). We acknowledge that the term "ensure compliance" is used in subsection (j) of Section 15E. Nevertheless, we believe it is inappropriate to require NRSROs' designated compliance officers to certify that they have "ensured compliance" with laws or regulations for the following reasons. Compliance officers can establish policies and procedures designed to promote compliance by the NRSRO and its employees with applicable laws and other requirements. They also can exert their best efforts to encourage employees within the lines of business to do what they are obliged to do. They can take steps designed to deter non-compliance. If there is non-compliance, they can seek to detect and report non-compliance to the appropriate persons internally (such as senior management or the board) or to the authorities, as required and permitted by law. They also can recommend to the appropriate persons internally that appropriate disciplinary action be taken. Compliance officers, however, cannot be expected to act as guarantors of compliance. All that they can be expected to do is act diligently to implement, monitor and report on steps reasonably designed to achieve compliance by the NRSRO with applicable laws.

We recommend, therefore, that proposed paragraph (a)(7)(i) of proposed rule 17g-3 be redrafted to provide that the NRSRO shall furnish:

> "An unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to:
>
> (A) Administer the policies and procedures that are required to be established pursuant to paragraphs (g) [prevention of misuse of confidential information] and (h) [management of conflicts of interest] of Section 15E of the Exchange Act (15 U.S.C. 780-7(g)); ~~and~~
>
> (B) ~~Ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.~~ Establish, maintain and review policies and procedures reasonably designed to achieve compliance with Section 15E and subsection (a)(1) of Section 17 of the Exchange Act and the Commission rules and regulations promulgated thereunder;
>
> (C) Modify such policies and procedures as business, regulatory and legislative changes and events dictate; and
>
> (D) Test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which are reasonably designed to achieve continuing compliance with Section 15E and subsection (a)(1) of Section 17 of the Exchange Act and the applicable Commission rules and regulations promulgated thereunder.

We believe that the functions described in suggested sub-paragraphs (B), (C) and (D) are more consistent with the role of an independent compliance officer. The language proposed above is based on Rule 3130

adopted by the Financial Industry Regulatory Authority. Consequently, the suggested language has a relatively well-understood meaning within the U.S. financial sector. Employing similar language would promote certainty in the Commission's supervision of NRSROs.

### B. Inappropriate to Require Certifications with Respect to All Securities Laws

Subsection (j) of Section 15E of the Exchange Act requires an NRSRO to designate a compliance officer responsible for "administering the policies and procedures that are required to be established pursuant to subsections (g) and (h) [of Section 15E]" and "ensuring compliance with the securities laws and regulations thereunder …." We do not believe that Congress intended that NRSROs' designated compliance officers be required to report on steps taken to achieve compliance with *all* securities laws. In its capacity as an NRSRO, a CRA is not acting as an issuer, underwriter, investment adviser, broker-dealer or investment company. Therefore, there is no need for the compliance officer's annual report to speak to matters arising under the Securities Act of 1933, the Investment Company Act of 1940, the Investment Advisers Act of 1940 and many provisions of the Exchange Act. It also would be inappropriate for the compliance officer's annual report to speak to matters arising under foreign securities laws.

Moreover, if NRSROs' designated compliance officers were required to provide reports addressing compliance matters arising under these U.S. and foreign securities laws that do not apply specifically to CRA activities, they would need to:

- establish, maintain, review and modify as necessary policies and procedures designed to define and prohibit the NRSRO and its employees from engaging in activities that have nothing to do with its business as an NRSRO and that it is not even authorized to pursue;
- test the effectiveness of such policies and procedures at deterring the NRSRO and its employees from engaging in these prohibited activities (which have nothing to do with the NRSRO's business); and
- report on compliance with policies having nothing to do with the NRSRO's business.

We also believe that the appropriate scope for an NRSRO compliance officer's report extends only to the U.S. securities laws that apply the NRSRO's activities as a CRA. We recommend, therefore, that the Commission clarify the scope of proposed sub-paragraph (a)(7)(i)(B) of proposed rule 17g-3 by indicating that the compliance report need only address matters relating to Section 15E and subsection 17(a)(1) of the Exchange Act and the regulations and rules adopted by the Commission thereunder.

### C. Compliance Report Should Remain Confidential

Rule 17g-3 was adopted by the Commission pursuant to subsection (k) of Section 15E of the Exchange Act, which requires NRSROs to furnish to the Commission on a confidential basis financial statements and information about their financial condition. The Commission is proposing to amend this rule to require NRSROs to furnish an annual compliance report to the Commission. It has indicated that it expects that such reports would be furnished on a confidential basis. We understand, however, that Congress is considering amendments to subsection (k) that could delete the phrase "on a confidential basis". This raises a question about whether compliance reports furnished by NRSROs to the Commission pursuant to a rule adopted under subsection (k) could be kept confidential.

There are strong policy reasons for keeping NRSRO compliance reports confidential. For example, some of the information contained in an annual compliance report could constitute personal

information (*e.g.*, about an employee)[1] or material, non-public information about a market participant. Some of the information also might constitute commercially sensitive information about the NRSRO, and disclosure of this information could affect the NRSRO's ability to compete. For these reasons, compliance reports of other regulated entities typically are not made public.[2] We would be very concerned if the proposed compliance report were to be made public. Accordingly, we request that, to the extent the governing legislation continues to permit the Commission to treat the compliance officer's report as confidential, that the Commission make clear in any rule it adopts on this matter that the report will be treated as confidential and exempt from disclosure under the Freedom of Information Act.

## III. Proposed Rule 17g-7: Public Disclosures about Revenues

### A. Revenue Disclosures Attributable to Named Entities Would Undermine Firewalls Designed to Promote Analytical Independence

The Commission and other authorities have stressed repeatedly the importance of insulating rating analysts and committees from commercial influences. Consistent with the revised IOSCO Code and recently adopted Commission rule 17g-5(c)(6), MIS prohibits anyone who participates in determining or monitoring credit ratings or developing or approving rating methodologies from participating in discussions regarding the fees paid for the rating. A separate team within MIS handles discussions about fees and payment of fees for rating services, relationships with rated issuers and commercial strategy, while Moody's Analytics ("**MA**"), a separate legal entity affiliated with MIS, sells MIS's credit ratings and research to subscribers. These arrangements are intended to bolster analytical independence and ensure that rating quality is not diminished by commercial interests. The extension, strengthening and ongoing maintenance of these firewalls have involved a significant investment of time and resources.

If, however, proposed rule 17g-7 is adopted, information about the proportion of revenues received for credit rating services and non-rating services from each person that paid the NRSRO to issue or maintain a credit rating (a "**Payor**"), as well as the relative importance of each such Payor as a contributor to the NRSRO's net revenues, would become publicly available in a consolidated report on each NRSRO's website. In particular, the prescribed report would disclose, for each Payor:

- the Payor's relative standing in terms of the amount of the Payor's contribution to the NRSRO's net revenue for the fiscal year (*i.e.*, top 10%, top 25%, top 50%, bottom 50% or bottom 25%); and
- the percentage of net revenue earned by the NRSRO for providing non-rating services and products to the Payor.

Compiling and publicly disclosing this information would expose our analysts and rating committees to more commercial information about rated issuers than they ever had before. Access to such information would undermine our efforts and those of regulators globally to shield analysts from such information in order to promote independence in the credit rating process. Accordingly, we strongly oppose any rule requiring public disclosure of the relative ranking of Payors as contributors to an NRSRO's revenues. We would have similar objections to a rule requiring disclosure of the dollar value or proportion of revenues attributable to named entities.

---

[1] See also the discussion in Subsection 1.D of the Annex.

[2] For example, registered investment companies and registered broker-dealers must provide annual compliance reports to the board or senior management, respectively, but do not have to furnish such reports to the Commission or publish them.

As an alternative to the proposed rule, we would not object to a requirement that we furnish to the Commission on a confidential basis information comparable[3] to that called for in proposed rule 17g-7. Providing this information to the Commission could assist it in its supervision of NRSROs without undermining the firewalls NRSROs have established to shield analysts and rating committees from commercial information. We also would not object to a requirement to disclose publicly the percentage of net amounts billed to each Payor that represent amounts billed for non-rating services

### B. If a Revenue Disclosure Rule Is Adopted, It Should Be Aligned with Existing Disclosure Requirements

For the reasons set out in subsection III.A above, we are strongly opposed to rules that would require us to publish information that would enable our analysts to determine who contributes the most to MIS's revenues. We acknowledge, however, that certain foreign regulations, *e.g.*, the European Regulation on Credit Rating Agencies ("**EU Regulation**"), call for some disclosures of this type. If the Commission decides to require NRSROs to publish some information about the largest contributors to their revenues, we recommend that the Commission adopt rules that are more closely aligned with existing requirements for CRAs. For example, the Commission could adopt a rule that requires NRSROs to publish the names of rated entities from which the NRSRO receives more than 5% of its annual revenues.

This approach would promote international convergence in regulatory standards for CRAs, prevent potential confusion in the market that could result from disclosures made according to slightly different requirements, and enhance the ability of market participants to compare the disclosures by NRSROs with those of non-NRSRO European CRAs. It also could facilitate international cooperation in supervision of CRAs and reduce the regulatory burden for NRSROs that also operate in Europe, thereby facilitating competition in the CRA industry.

Once again, we appreciate the opportunity to comment on the Release. We would be pleased to discuss our comments further with the Commission or its staff.

Sincerely,

Michel Madelain
Chief Operating Officer
Moody's Investors Service

[3] Please see our technical comments on the proposed rule in section 2 of the Annex, where we raise some concerns about the types of information that would have to be collected and disclosed.

# Annex - Technical Comments on the Proposed Amendments

## 1. Proposed Rule 17g-3(a)(7): Annual Report from Designated Compliance Officer

As noted above, MIS does not object in principle to providing the Commission with a confidential, annual report describing compliance activities and matters. As we discuss in more detail below, however, we believe that the proposed rule could be improved by clarifying and/or refining certain concepts.

### A. Focus Should Be on Significant Compliance Reviews

Proposed sub-paragraph (a)(7)(ii)(A) would require the prescribed report to describe "any compliance reviews" of the NRSRO's activities undertaken during the year. Technically, any inquiry made by compliance staff (even a five-minute telephone call) could be considered a "compliance review". We believe this is an overly broad and unnecessarily burdensome reporting requirement since, on its face, it would require the designated compliance officer to report every single review, no matter how small or routine, undertaken during the year.

We recommend, therefore, that the Commission limit the types of compliance reviews that must be reported. For example, instead of requiring a description of every compliance review, the Commission could require: (i) a general description of the types and scope of routine compliance reviews conducted during the year; and (ii) a more detailed discussion of any changes made to the type and scope of routine compliance reviews conducted during the year. These disclosures would supplement the disclosures of any "material compliance matters" as required by the sub-paragraph (a)(7)(ii)(B) of the proposed rule.

### B. Overly Broad Definition of "Material Compliance Matter"

Proposed sub-paragraph (a)(7)(ii)(B) would require the report to disclose the number of "material compliance matters" identified during "each review" and briefly describe each such matter. Proposed sub-paragraph (a)(7)(ii)(C) would require the report to describe any remediation measures implemented to address material compliance matters. While "material compliance matter" is not defined in the proposed rule, we understand that the Commission preliminarily intends that this term would mean:

> "a determination by the NRSRO or a person within the NRSRO that there has been a violation of the securities laws or the rules thereunder or a failure to adhere to the policies, procedures or methodologies established, maintained and enforced by the NRSRO to, for example, determine credit ratings, prevent the misuse of material nonpublic information, manage conflicts of interest and comply with the Commission's NRSRO rules. A material compliance matter also would include a determination that there was a weakness in the design or implementation of the policies and procedures of the NRSRO." (Release at 63870)

In the interests of certainty and transparency in regulation, we believe that the Commission should expressly define "material compliance matter" in the proposed rule and provide guidance on the meaning of the term. We also believe that the Commission's intended scope for this term is far too broad and should be refined in three important respects, as follows:

- First, the definition should, as the term "material compliance matter" itself calls for, incorporate a concept of materiality. Not all failures to adhere to policies, procedures or methodologies are of

equal significance. For example, an NRSRO likely has policies that do not relate to the ratings process. Congress cannot have intended for the designated compliance officer to report on matters such as an employee's failure to comply with the NRSRO's sick leave policy or its dress code. While it can be inferred from the passage from the Release quoted above that Commission staff likely would not consider such failures to be "material compliance matters", we believe the Commission should provide formal, explicit guidance in this regard. Factors such as whether the breach or failure was an isolated occurrence or part of a pattern, the significance of the provision that was not complied with and its relationship to the quality, integrity or transparency of the rating process, the severity of the breach or failure, the consequences of the breach or failure and whether the breach or failure was intentional or inadvertent are some of the factors that could be relevant to an assessment of materiality. Likewise, not all weaknesses in the design or implementation of policies and procedures are of equal significance.

- Second, it should be made clear that the securities laws whose breach could give rise to a material compliance matter are U.S. legislation, regulations and rules that apply specifically to NRSROs and their employees in the context of the NRSRO's credit rating businesses, *e.g.*, Section 15E or Subsection 17(a)(1) of the Exchange Act and the associated regulations and rules. It also should be made clear that the only policies and procedures whose breach could give rise to a material compliance matter are those the NRSRO is required to establish and maintain pursuant to Section 15E or Subsection 17(a)(1) and/or that are of the type described in subparagraphs (B)(ii), (iii) and (v) of subsection (a)(1)(A) of Section 15E.
- Third, we believe the Commission should clarify that updates to policies, procedures and methodologies in the ordinary course of business do not, in themselves, constitute material compliance matters or evidence of material compliance matters.

### C. Reporting Requirement Should Not Apply Where There is a Conflict of Law

MIS is a globally active CRA and lists as CRA affiliates on its Form NRSRO a number of entities that are subject to foreign laws. It is very likely that certain laws, such as privacy laws, in some jurisdictions where MIS operates would prohibit MIS from disclosing to the Commission and/or the public some types of information in certain circumstances. For example, French law would not permit a designated compliance officer to disclose certain information about French employees in the proposed compliance report. Accordingly, we recommend that the proposed rule indicate that a compliance matter does not have to be described in the compliance report to the extent such disclosure could reasonably be considered to violate applicable laws, including foreign laws.

### D. Disclosure of Individual Names

Sub-paragraph (a)(7)(ii)(D) of proposed rule 17g-3 provides that the report should include a "description" of the persons within the NRSRO who were advised of the results of the reviews. It is unclear whether the proposed rule would require an NRSRO to disclose such individuals' names or simply to describe their roles within the NRSRO. It also is unclear whether the required description of a material compliance matter and the remediation steps taken to address it would require the disclosure of a perceived violation of the MIS Code of Professional Conduct by a named individual or whether the report could refer to the individual's role instead, *e.g.*, "a senior analyst in the Financial Institutions Group."

Consistent with the discussion in Subsection II.C of our Comment Letter, we would be very concerned if NRSROs were required to disclose individuals' names in a report that was made public. It would be particularly problematic to publicly disclose the names of employees in circumstances where the designated compliance officer believed there had been a violation of laws or policies but where no final determination of the matter had been made by a court. Such disclosures could have significant adverse consequences for the named individuals, make it much more difficult to identify and remediate compliance matters, and expose NRSROs to substantial liability risk for claims made by named individuals. The increase in liability risk would substantially increase the NRSRO's legal costs in the absence of a compelling regulatory reason for doing so.

We also question the need to disclose every person advised of the results of each compliance review. Any material compliance matter and the related remediation steps would be disclosed in the annual report and this disclosure necessarily would include some description of the key people involved in the remediation process. We believe that a requirement to describe all of the people to whom the results of all compliance reviews were reported could create disincentives for people to become involved in the remediation process, out of a concern that their names would appear in a report that later became public.[4]

## E. Third Party Review Would Not Enhance Accountability

The Commission has asked whether, as an alternative to requiring an NRSRO's designated compliance officer to furnish an annual compliance report, the Commission should require an independent third party to perform a review of the NRSRO's adherence to its policies and procedures and its compliance with securities laws. We do not believe that such a third party review would be more effective at achieving the Commission's regulatory objectives than the Commission's current proposal.

First, we understand that a key purpose of the compliance officer's report is to improve the efficiency of the Commission's examinations of NRSROs. Since an outside party (Commission staff) will be reviewing the NRSRO's policies, procedures and compliance with applicable securities laws, the need for another outside party to conduct a review in advance of the Commission staff's review would seem to be unnecessary and disproportionately burdensome.[5]

Second, this type of outside review typically has been reserved for use in enforcement matters, where there has been a finding of wrongdoing and the Commission has required the retention of an independent third party to conduct a compliance review. Requiring all NRSROs to have their annual compliance reviews conducted by third parties would, in effect, equate NRSROs with wrongdoers. It would be unprecedented for the Commission to introduce third party compliance reviews on a routine basis for an industry, especially where a compelling regulatory need for such an approach has not been established.

Third, an NRSRO's designated compliance officer is expected to have extensive knowledge about the NRSRO's operations and its compliance processes and practices. An outside reviewer would be much

---

[4] We note that, even if the Commission adopted a rule providing for the compliance report to be filed on a confidential basis, there is always a risk that material filed with the Commission could be made public. For example, a court could order the release of records pursuant to a request under the *Freedom of Information Act*.

[5] In addition, NRSROs that are affiliates of U.S. publicly traded issuers already are subject to the Sarbanes-Oxley Act of 2002, which requires subject firms to have a robust, independent, internal audit function that conducts internal audits of the lines of business as well as the compliance function itself.

less familiar with the NRSRO and consequently, its review initially would be less well-informed. It would have to spend significant time and resources to develop a thorough understanding of the NRSRO's operations. This would be very costly for the NRSRO to fund and could lead an NRSRO to allocate fewer resources to its internal compliance function.

### F. Compliance Officers Should Be Able to Rely on Sub-Certifications

If the Commission adopts the proposed rule, we expect that designated compliance officers of NRSROs likely would introduce a sub-certification process to facilitate preparation and completion of the prescribed report. A formal sub-certification process would communicate to employees that the NRSRO takes its compliance policies and practices seriously, further raise awareness among NRSRO employees that they are responsible for compliance with applicable laws and policies, and promote greater accountability for compliance matters among employees and the NRSRO itself. As a practical matter, a sub-certification process provides greater assurance that the matters that should be addressed in the annual compliance report have been identified and accurately described. Also, because the designated compliance officer may not have personal knowledge of every fact included in the compliance report, permitting him or her to rely upon sub-certifications is essential.

### G. Does Paragraph (a)(7) Belong under Rule 17g-3?

Subsection 15E(k) of the Exchange Act authorizes the Commission to adopt rules requiring NRSROs to furnish to the Commission "financial statements" and "information concerning [their] financial condition." In our view, the proposed annual report on compliance activities and matters does not appear to fall within the scope of "financial statements" or information concerning an NRSRO's "financial condition". Instead, it seems to fall more appropriately within the scope of the Commission's authority under Subsection 17(a)(1) of the Exchange Act, which authorizes the Commission to adopt rules requiring, among others, NRSROs to make and keep records for prescribed periods and furnish copies thereof to the Commission. It would seem more appropriate, therefore, for this record to be provided for under rule 17g-2, which sets out NRSROs' record-keeping requirements.

## 2. Proposed Rule 17g-7 and Proposed Revisions to Exhibit 6 of Form NRSRO

### A. Proposed Amendments to Exhibit 6 of Form NRSRO

The Commission is proposing to require NRSROs to disclose on a new Part B of Exhibit 6 to Form NRSRO the percentage of net revenue attributable in the aggregate to the twenty largest users of the NRSRO's credit rating services. MIS would not object to such a public disclosure requirement, provided that this information could be disclosed without publicly identifying the twenty largest users (either in this part of Exhibit 6 or in another publicly available document). We also would not object to a requirement that an NRSRO disclose on Exhibit 6 the percentage of its revenues[6] that were attributable to services and products other than credit rating services. Considered together with the disclosures each NRSRO already is required to make about the nature of the potential conflicts it faces, the proposed disclosures in Exhibit 6 could assist investors in dimensioning such potential conflicts. At the same time, such disclosures would

[6] See, however, our recommendation in subsection 2.C below that the Commission revise the definition of "net revenue" to permit NRSROs to calculate and disclose net revenues using amounts received, billed or earned.

not undermine the firewalls we have established to insulate analysts and rating committees from commercial influences because entity-specific information about revenues would not be published.

### B. How Data Currently Are Entered and Stored at MIS

Proposed rule 17g-7 would require NRSROs to compile data and publish a consolidated report that would attribute to each Payor: (1) a list of credit ratings that the Payor had paid to have issued or maintained, together with the name of the obligor, the name of the security or money market instrument, and, as applicable, the CIK number, CUSIP or ISIN; and (2) the associated net revenues (calculated in accordance with accounting conventions) for such credit ratings. The Commission has asked how NRSROs currently enter and store such data. To assist the Commission in its analysis of the proposed rule and to provide background information for our discussion below, we set out here a streamlined explanation of how information relating to credit rating services typically is entered and stored at MIS. As we describe in more detail below, our information systems currently do not capture all of the data requested. Moreover, the information that is stored in our systems could not be extracted in a manner that would enable us to generate the report on an automated basis.

At MIS, information relating to the provision of credit rating services, invoicing for those services and calculation of revenue attributable to those services is entered by several different teams and stored in a number of systems and databases. For example, rating analysts or other personnel enter certain data about the proposed assignment of a credit rating into a system called AccuRate, which is used to assign and publish credit ratings, credit rating announcements and research. For example, they may enter data about the issuer or obligor and the security name (although the security name can evolve as a deal evolves). Because each credit rating is given a unique identifier by AccuRate, data such as the CUSIP or ISIN are not always obtained and entered in the system and MIS never captures CIK numbers in its systems. Moreover, analytical personnel do not have access to fee data and therefore do not enter this type of information in AccuRate. A completely separate division within MIS (the Commercial Division) handles, among other things, fee discussions with issuers and the execution of rating applications.

When a credit rating is published through AccuRate, this rating action flows into the billing system and triggers an "invoicing event". When this occurs, the Billing Team enters data into another information system through a combination of automated and manual processes. The Billing Team reviews fee schedules to select the appropriate fee and fee code[7] and then enters this information into the system, where the information becomes associated with the rating identifier. There are some additional data fields containing, for example, the name of the entity that is to be billed for the assignment of the rating. This entity, however, is not necessarily the obligor and we do not capture data that indicates the capacity in which the person billed for the rating is acting.[8] Moreover, the person who ultimately pays for the rating to be issued or maintained is not always the entity that is billed. For example, an invoice might be

---

[7] The fee codes incorporate revenue recognition rules. For example, one fee code may provide that 50% of the amount billed is recognized immediately while the remainder is recognized gradually over a specified period of time. Another fee code may provide that 20% of the amount billed is recognized immediately while the remainder is recognized over a different period of time. The fee amount and the fee code are entered into a third system which calculates revenue based on the revenue recognition rules embedded in the fee codes.

[8] Rating fees (and other transaction fees for a debt issuance) often are paid from an account into which the proceeds of issuance are paid. The account owner is not always the same type of participant (*e.g.*, the issuer or trustee) in the transaction.

addressed to Abc Ltd. (Delaware) but another entity within the group, such as ABC Inc., or DE Ltd. as trustee for another, may pay the invoice. Our systems do not track who paid for a rating because this information is irrelevant for analytical, billing and financial reporting purposes.

For financial reporting purposes, MIS calculates revenues attributable to credit rating services according to applicable revenue recognition rules. Our systems calculate revenues at a macro level (*e.g.*, revenues accrued for ratings assigned for a particular product or sector, such as U.S. insurance or Asia-Pacific mortgage-backed securitizations), rather than by the entities billed for credit rating services.

To generate the data used in Exhibit 10 (List of the Largest Users of Credit Rating Services) on Form NRSRO, a number of labor-intensive manual steps must be taken. For example, the Billing Team must research the billed entities and group them by organizational structure. The research, which is conducted in respect of the forty largest groups that pay for credit ratings to be assigned or maintained, is painstaking. Furthermore, MIS is not always provided with all of the relevant data for this purpose, in part because some of this information is unnecessary for credit analytical or billing purposes. The research must be updated every year because organizational structures change. It takes approximately two to three weeks for one person to update this research every year for the forty largest groups that pay for credit ratings to be assigned or maintained.[9] Once this research is completed, the relevant invoices must be associated with the groups and then the billings attributable to these groups can be calculated. This takes one person approximately two weeks each year.

### C. Definition of "Net Revenue" Should Be Revised to Accommodate NRSROs' Different Customer Accounting Systems

Proposed rule 17g-7 would require NRSROs to calculate net revenues, *i.e.*, revenues earned in a fiscal year from providing any products or services to a Payor, net of any rebates and allowances paid or owed to the Payor. This definition mirrors the definition of "net revenue" in the existing instructions for Exhibit 10 to Form NRSRO and rule 17g-3.

The proposed definition would require an NRSRO to calculate revenue using amounts collected from a particular Payor rather than the amounts billed to the Payor or the earned revenue attributable to such Payor. We believe that the Commission should revise the definition used in proposed rule 17g-7, Form NRSRO and rule 17g-3 to allow any of these approaches to accommodate different customer accounting systems that NRSROs may use, provided that the NRSRO discloses the measurement approach being used and the reason for using it. This recommendation is consistent with MIS's comments on the Commission's request for comment on the initial set of NRSRO rules it proposed in 2007.[10]

When it adopted the final rules, the Commission stated that, by using the term "net revenue", it intended that applicants and NRSROs apply their standard accounting conventions for recognizing revenue. While it may be appropriate and practicable for an NRSRO to use generally accepted accounting principles ("**GAAP**") to report revenues at a macro level, it may be impracticable and exceptionally costly for the NRSRO to use GAAP-based accounting conventions to calculate revenues at a micro (*i.e.*,

---

[9] We carry out this analysis for more groups than we have to list on Exhibit 10 in order to ensure that we have correctly identified and ranked the top twenty. At least with respect to these large groups, there usually is publicly available data about organizational structures. The same cannot be said for thousands of persons who pay for credit rating services.

[10] See *MIS Comment Letter re Proposed Rules Regarding Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations (File No. S7-04-07)*, March 2007, available at moodys.com.

customer) level. Moreover, we believe that as long as the NRSRO discloses its method for calculating revenues, the information disclosed publicly will be meaningful.[11] Consequently, we recommend that the Commission revise the definition of "net revenue" in paragraph (c)(2) of proposed rule 17g-7 and add a new paragraph (d) as follows:

> "(c)(2) The term net revenue means revenue received, billed or earned for any type of service or product provided to a person, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person."
>
> "(d) The NRSRO shall disclose in the consolidated report referred to in paragraph (a)(1) whether net revenue is based on amounts received, billed or earned and the reasons for relying on the selected method."

Similar changes should be made to the definition of "net revenue" used in other NRSRO rules and forms.

### D. Concept of "Payor" Should Not Require Aggregation of Revenues across Entities

The Release does not define what we refer to as the Payor, *i.e.*, the "person that paid the nationally recognized statistical rating organization to issue or maintain a credit rating." As we explained in Subsection 2.B of this Annex, the entity that we bill is not necessarily the entity whose name appears on the check and both of those entities could be different from the rated issuer. Moreover, the entity that pays for the rating may not be part of the same group as the rated issuer. For example, an entity may pay for a rating in its capacity as trustee or underwriter.

We could publish a report that, for example, ranked the entities that are billed for a rating (in whatever capacity) but did not aggregate amounts billed to entities that are connected to each other, *e.g.*, within a corporate family. This type of report would be relatively straightforward to produce because our billing system can be sorted according to entities billed.[12] Such a report, however, might be of somewhat limited value to market participants because management of the billed entity, such as a special purpose vehicle ("**SPV**") or a subsidiary within a corporate group, might not include the individuals who typically make decisions for the group about which CRA or CRAs to retain to provide ratings.

If we had to aggregate revenues attributable to a group of entities related to each other within a corporate group or similar structure, the resulting report might in theory provide a more meaningful picture of the largest contributors to our revenues for credit rating services.[13] In practice, however, that report necessarily would contain less reliable information because we are not in a position to know with certainty what all of the relevant organizational relationships are. Issuers, for example, currently are not required to provide us with complete organizational charts. While some information about organizational structures is available for a number of the largest issuers we rate, many issuers do not publicly disclose such

---

[11] While disclosures based on any of the methods described above would be meaningful, we believe that the most useful measure is amounts billed. If the purpose of the report is to show which entities potentially have the most economic influence, amounts billed would show this more directly and more quickly than, *e.g.*, revenue earned. For example, if there were a sudden increase or decrease in an entity's demand for credit rating services from an NRSRO, this change would appear almost immediately in billings, whereas the change would show up more gradually in reports of accrued revenues.

[12] It would not be straightforward to rank the entities that actually pay for a rating because our systems do not capture this information in a database. This is because the relevant question is whether an invoice is paid, and not who paid the invoice.

[13] If, however, NRSROs were required to attribute revenues both to an underwriter and a rated issuer, this report could be confusing or misleading as it would require NRSROs to "double-count" revenues.

information. Moreover, there likely would be some variability across the NRSROs' reports with respect to their interpretation of "person who paid" to issue or maintain a rating. For these reasons, we recommend against any interpretation of proposed rule 17g-7 that would require us to aggregate revenues (or amounts billed) across entities.

### E. Disclosure Requirements Should Extend Only to the NRSRO and Its Credit Rating Affiliates

If the Commission decides to adopt proposed rule 17g-7 despite the concerns we have raised in our Comment Letter, we believe it should require disclosure only about revenues earned by an NRSRO and the credit rating affiliates listed under Item 3 of its Form NRSRO. Other affiliates of the NRSRO may be engaged in totally different lines of business, and the NRSRO is supposed to have robust firewalls to prevent such entities from having any influence on the rating process. Ironically, requiring NRSROs to collect and publish information about revenues earned by these other entities from persons that pay for ratings to be issued or maintained could undercut the firewalls that NRSROs have invested substantial time and resources to establish.

Furthermore, we believe that disclosing information about revenues earned by non-credit rating affiliates of NRSROs could give market participants an inaccurate impression about how the NRSRO manages conflicts of interest. We believe that a more appropriate regulatory approach would be to focus regulatory resources on the assessment of NRSROs' firewalls between their rating business and their non-credit rating affiliates.

### F. Disclosures about Security Names and Identifiers Such as CUSIPs

Sub-paragraph (a)(3)(iii) of proposed rule 17g-7 would require an NRSRO to "identify by name of obligor, security or money market instrument and, as applicable, CIK number, CUSIP or ISIN each outstanding credit rating generated" as a result of the Payor paying for a rating to be issued or maintained. We believe that this is an unnecessarily prescriptive and burdensome requirement because it would require NRSROs to capture and disclose information that they do not need for rating analytical, billing or financial reporting purposes. As discussed in Subsection 2.B of this Annex, MIS's AccuRate system generates a unique rating identifier for each rating assigned by MIS and that rating identifier, together with the obligor name, become associated with the entity billed in our billing system. However, we do not always capture in the relevant systems all of the information referred to in sub-paragraph (a)(3)(iii) and/or associate that information with the entity billed. As we explain in Subsection 2.G.a.2 below, it would be very costly and time-consuming to backfill this data, which is not relevant to our activities.

Also, if NRSROs had to include CUSIPs in the prescribed report whenever a CUSIP was assigned to a security, NRSROs would have to renegotiate their existing licenses with the CUSIP Service Bureau. This is because the proposed disclosure rule would require NRSROs to redistribute the CUSIP Service Bureau's data to the public. In our experience, the usage of CUSIPs contemplated by the proposed rule is associated with the highest level of licensing fees typically charged by the CUSIP Service Bureau. Therefore, if NRSROs were required to disclose CUSIPs in the proposed report, we would incur both transaction costs to amend our license and a potentially much higher, annual licensing fee consistent with such usage of CUSIPs. Moreover, it is quite possible that the CUSIP Service Bureau would be unwilling to grant the requested license at any price.

If the CUSIP Service Bureau were willing to renegotiate the license, our ability to negotiate reasonable license fees for the required use would be significantly compromised because the CUSIP Service Bureau is the only provider of CUSIPs. In addition, since the CUSIP Service Bureau is operated by an affiliate of a large NRSRO, other NRSROs could be at a significant disadvantage in negotiating the cost of their licenses, as compared with the affiliated NRSRO.

Therefore, if the Commission decides to adopt the proposed rule despite the concerns we have raised in our Comment Letter, we recommend that it revise sub-paragraph (a)(3)(iii) so that it gives the NRSRO the flexibility to decide which identifying data it discloses about ratings associated with a particular Payor, provided that the information disclosed enables a market participant to look up the listed ratings on the NRSRO's website. For example, proposed sub-paragraph (a)(3)(iii) could be revised to require the NRSRO to "identify each outstanding credit rating generated by reference to information that would be sufficient to enable a person to look up the relevant rating on the NRSRO's website."

## G. Estimated Recordkeeping and Compliance Burdens

### (a) Proposed Rule 17g-7

In the Release, the Commission estimated that it would take an NRSRO approximately 100 hours on a one-time basis to: (i) develop the calculations necessary to generate the percentages required to be reported; (ii) populate the proposed report with the required data; and (iii) develop and draft the report. The Commission estimated that the annual hour burden associated with proposed rule 17g-7 would be approximately 50 hours per year. We believe this significantly underestimates the amount of time it would take, on a one-time basis and an ongoing basis, to produce the proposed report.

As we explained above in subsection 2.B of this Annex, MIS does not routinely receive and store some of the key information that would be needed to implement the proposed rule because that information is not relevant for analytical, billing or financial reporting purposes. To implement and comply with the proposed rule, therefore, we would have to collect, organize and store data that we do not currently need. Therefore, the estimated compliance burden for the proposed rule would be much higher than the Commission has anticipated. To provide rough estimate of this burden, we have considered three scenarios:

1. "Payor" means the entity that is billed for a credit rating service and no aggregation of invoices is required across multiple entities. NRSROs can elect to calculate net revenues on the basis of revenue received, billed or earned.
2. "Payor" requires aggregation of the revenues attributable to entities that are related to each other in a corporate or similar organization through direct or indirect control. NRSROs can elect to calculate net revenues on the basis of revenue received, billed or earned.
3. NRSROS must calculate net revenue on the basis of accrued revenues associated with particular entities.

#### *(1) Scenario 1*

To implement the proposed rule, MIS would have to take the following steps. First, we would have to generate a report listing all the entities billed for credit rating services in a fiscal year and the invoices associated with those entities. Some manual adjustment of the list likely would be required in order to correct minor transcription errors in entity names since, to date, the precise legal name of entities

has not been key information for analytical, billing or financial reporting purposes. In the first year or two, it probably would be necessary to contact the billed entities to confirm certain data.

It would be a relatively straightforward to: (1) calculate "net billings" per billed entity, aggregate "net billings" and the proportion of total "net billings" attributable to each billed entity; (2) rank billed entities according to the proportion of total "net billings" they represented; and (3) assign them to the top 10%, top 25%, top 50%, bottom 50% and bottom 25% buckets. We estimate that it could take 200-250 hours to develop a calculation tool, generate the data, draft this part of the report and have it reviewed.

For the reasons mentioned in footnote 12 above, it would take more time to produce the report if we had to determine "net billings" per paying entity, as opposed to billed entity. We would have to modify our database to capture data about which entity paid a particular invoice and associate that data with the billed entity on a going-forward basis. We estimate that it could take 80-120 hours to modify our database. We issued approximately 35,000 invoices in 2009. Even if it took one additional minute per invoice to collect and enter data into the new field in the database, this new recordkeeping burden would require approximately 580 hours (or 14.5 weeks) of effort per year.

For the reasons set out in Subsection 2.B of this Annex, it would require significantly more time to collect the information listed in sub-paragraph (a)(3)(iii) of proposed rule 17g-7 and associate it with the entities billed. This is because some of this information currently is not captured in our billing systems and sometimes is not captured in AccuRate, the information system through which ratings are assigned and published. In many instances, we would have to backfill gaps in the data, *e.g.*, with respect to CIK numbers, CUSIPs or ISINs, and/or scrub some of the data to reflect, for examples, changes in the name of a rated security. In the first year, it could take several thousand hours to collect this data, organize it and incorporate it into our systems and the prescribed report.

Also, as discussed above, if NRSROs were required to publish CUSIPs whenever a CUSIP was assigned to a security, NRSROs would have to incur transaction costs to try to renegotiate their licenses with the CUSIP Service Bureau. If the CUSIP Service Bureau were willing to amend the licenses, NRSROs likely would have to pay a potentially much higher, annual licensing fee consistent with the usage of CUSIPs contemplated by the proposed rule.

In addition, an NRSRO would have to develop compliance policies regarding this data collection and reporting process and have those policies approved. It also would have to introduce compliance and internal audit processes to confirm that the data were being collected and the report was being generated in a timely and accurate way. We anticipate that this would take an additional 100 hours to develop a compliance policy and have it approved, 20-50 hours to train staff on the new reporting requirements and 50 hours to develop and approve compliance and internal audit processes for the new reporting requirement.

*(2) Scenario 2*

If NRSROs were required to aggregate revenues attributable to entities that are related to each other in a corporate or similar organization, the data collection, recordkeeping and other compliance burdens associated with the proposed rule would be substantially higher by several orders of magnitude. For example, in addition to the steps described in Scenario 1 above, we would have to obtain complete details of the organizational structures for all the entities we bill. If we conducted the research ourselves, the work would be extraordinarily time-consuming and difficult. As noted above, we are not always

provided with the relevant data needed to construct complete organizational charts because some of this information is irrelevant for credit analytical, billing or financial reporting purposes.

In 2009, MIS billed approximately 15,000 different entities for credit rating services. We would have to research each of these entities in order to assign them to the appropriate Payor group. As noted above, it takes one person four to five weeks per year to update the organizational charts for forty groups and associate the relevant invoices with those groups. While we would expect that many Payor "groups" would include only one or a few billed entities, there also would be many Payor "groups" with complex organizational structures. Moreover, there could be limited, reliable publicly available information about such organizational structures. If MIS had to conduct this research itself, we estimate that it could easily take 10,000 hours or more each year to complete this step. We also would have to create or acquire a database to organize and store the information.

Clearly, it would not be practicable to conduct this research ourselves. Alternatively, we could contact all of the entities we bill in a year and ask them to provide us with complete organizational charts. While this would shift the research and presentation burden to the billed entities, it would take time to contact all of them to request the information, follow up on missing or incomplete responses and spot check the data provided to us. It also might be possible to acquire data products or analytical tools that could assist us in conducting our own research or spot checking the data provided to us by billed entities. While these options could reduce to some extent the burden hours associated with completing this step, we estimate that it could still take several thousand hours in the first year to collect the required information. We also would incur costs and have to spend time to identify, purchase and implement new tools and databases in our environment.

Once the Payor "groups" were determined, we would have to identify the relevant invoices and associate the amounts billed to the Payor group. We likely would have to modify our systems to perform this function and make the required calculations. This could take several hundred additional hours in the first year to modify our systems, plus at least another several hundred hours to enter the relevant data into the system, run the calculations and check the report. For each subsequent year, data about the relevant Payor "groups" would have to be updated in the system before the calculations were made because organizational structures change over time.

As in Scenario 1, we would have to introduce compliance and internal audit processes to confirm that the data were being collected and the report was being generated in a timely and accurate way. Similar to our estimate for Scenario 1, we anticipate that this would take 100 hours to develop a compliance policy and have it approved and 20-50 hours to train staff on the new reporting requirements. It is likely, however, that it would take 100-200 hours to develop compliance and internal audit processes for this type of reporting requirement because of the new data collection requirements.

*(3) Scenario 3*

If the term "net revenue" were interpreted to mean net revenues calculated in accordance with accounting conventions for revenue recognition applied at an entity level, then the data collection, record-keeping and other compliance burdens associated with Scenario 1 or Scenario 2 would be substantially higher. This is because, as discussed above in Subsection 2.C of this Annex, MIS's systems are designed to calculate accrued revenues at a macro level, not an entity level. We would have to modify our billing and accounting systems to generate the required information. Since this modification would affect several of

our core information systems in a very fundamental way, it would be a substantial and costly undertaking that would have to be properly sequenced and prioritized within our overall information systems plan and approved at the highest levels of the organization.

### (b) Exhibit 6 of Form NRSRO

The Commission estimated that the average, one-time burden for an NRSRO to complete the additional disclosures called for in the proposed amendments to Exhibit 6 would be 750 hours. The Commission also estimated that, on an ongoing basis, the average annual burden to complete an annual certification would increase by 60 hours. We do not disagree with these estimates of the incremental burden.

We note, however, that, when it adopted the first set of NRSRO rules in 2007, the Commission estimated that it would take an NRSRO approximately ten hours per year to complete its annual certification on Form NRSRO. Our experience in preparing Exhibit 10 of Form NRSRO indicates that the Commission significantly underestimated the burden hours associated with this certification requirement. As described above in subsection 2.C of the Annex, it takes one person approximately four to five weeks (*i.e.*, 160-200 hours) to collect the information needed to produce Exhibit 10, and further time is needed to generate the report and have it reviewed and finalized. We believe the Commission should take this information into account in its consideration of proposed rule 17g-7 and any proposed amendments to Form NRSRO.

## H. Revenue Disclosure Rules Should Not Apply Retrospectively

If the Commission decides to adopt proposed rule 17g-7 despite the concerns we have raised in our Comment Letter, we strongly believe that NRSROs should not be required to disclose information about years preceding the adoption of the rule and that they should be given sufficient time to collect the relevant data before the reporting rule applies. As we have explained above, the proposed rule calls for disclosure of certain types of information that MIS does not routinely capture and/or store because it is irrelevant for credit analytical, billing and financial reporting purposes. If NRSROs had to backfill gaps in the required data, the compliance cost could be extraordinarily high. Moreover, it might be practically impossible to obtain some of the required information (*e.g.*, information which entities paid for a rating, as opposed to the entities that were billed, and historical organizational structures).

## 3. Specific Information to Be Reported When a Credit Rating Is Made Publicly Available

Although it is not proposing any rules at this time, the Commission has asked for feedback on whether it should require NRSROs to report specific information (*i.e.*, more than a generic statement of where information can be located) when a credit rating action is made publicly available. Our comments on a number of the specific disclosure items being considered by the Commission are set out below:

- **Disclosure of the information proposed to be included in the consolidated report prescribed in proposed Rule 17g-7:** For the reasons set out in subsection III.A of our Comment Letter, we strongly oppose any rule requiring public disclosure of the relative ranking of Payors as contributors to an NRSRO's revenues. We would have similar objections to a rule requiring disclosure of the dollar value or proportion of revenues attributable to named entities.

- **Disclosure of the principal procedures and methodologies used to determine the credit rating:** We would not object to a requirement to identify in the credit rating announcement the principal methodology (or methodology version) used to determine a credit rating. MIS already includes such information in its credit rating announcements pursuant to provision 3.6 of the MIS Code, which implements provision 3.3 of the IOSCO Code. It is somewhat unclear, however, what is meant by the term "principal procedures". If the Commission is referring to the rating procedures an NRSRO uses in determining a rating, we do not believe a specific reference is needed since MIS uses essentially the same procedures in all of its ratings and those procedures are described in our annual report on Form NRSRO (especially Exhibit 2). We would not object to a requirement to include in a credit rating announcement a reference to the location on our website where an interested person could find a general description of our rating procedures.
- **Disclosure about key assumptions used and models, if any, employed in determining credit ratings:** We would not be opposed to a requirement that NRSROs describe any quantitative model used in their rating analysis if the model in question is a substantial component in the process of determining the credit rating. Describing the model without having to disclose the model itself could provide more information to users of ratings about how the rating was determined while protecting our property interest in our models so that incentives for NRSROs to invest in model development remain. Limiting the disclosure requirement to models that are a substantial component of the rating analytical process would reduce the risk of users over-emphasizing the role of models in the rating process.
- **Disclosure about whether a credit rating action is being taken as a result of: (1) a change to a procedure or methodology; or (2) an error identified in a rating procedures or methodology:** We would not object to such disclosure requirements, although we believe a better approach would be to adopt a more generally worded rule requiring the NRSRO to disclose the rationale, or key factors, leading to the rating action.
- **Disclosure about: (1) the limitations of the credit rating, including information about the reliability, accuracy and quality of the data relied on in determining the credit rating; and (2) the extent to which key data inputs for the credit rating were reliable or limited, including limitations on the historical data and on the availability and completeness of other relevant information:** We believe that such disclosure requirements would be inappropriate. MIS already includes in its credit rating announcements and research the following statement about the nature and limitations of our credit ratings:

  > "Credit Ratings are MIS's current opinions of the relative future credit risk of entities, credit commitments or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit Ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit Ratings are not statements of current or historical fact. Credit Ratings do not constitute investment or financial advice, and Credit Ratings are not recommendations to purchase, sell, or hold particular securities. Credit Ratings are not a comment on the suitability of an investment for any particular investor. MIS issues its Credit Ratings with the expectation and understanding that each investor will make its own study and evaluation of each security that is under consideration for purchase, holding, or sale."

We do not believe a statement about these types of limitations tailored to a particular credit rating would be helpful since these types of limitations are relevant across the range of credit ratings we issue.

With respect to the accuracy of data used in the rating process, NRSROs do not have the expertise or capacity to verify the accuracy of the information that issuers and other third parties provide to them. Other specialists in the market already are responsible for verifying and certifying the accuracy of the data, are compensated for that function and are better-positioned to perform it. NRSROs repeatedly have stated publicly that they do not, and currently are not appropriately staffed to, verify the accuracy of information or due diligence results provided to them. We are concerned that a rule requiring NRSROs to comment on the accuracy of data used to assign a credit rating could be interpreted by others as a data verification requirement. It also could inappropriately encourage investors to rely on NRSROs and their credit ratings, rather than issuers and their disclosure documents, as the main source of factual information about a particular issuance.

We also believe that a generally applicable requirement for NRSROs to comment on the extent to which key data inputs were reliable or limited is inappropriate. MIS does not rely on data that it considers to be unreliable and it does not issue or maintain ratings in circumstances where it believes it lacks sufficient information to maintain a credible rating. Requiring an NRSRO to express an opinion on the reliability of key data inputs would not enhance the quality or integrity of the rating process. NRSROs likely would respond by establishing two categories of data: (1) data that had been audited and verified by qualified professionals and therefore could be considered "reliable"; and (2) all other data, which would be labeled "unreliable". In other words, we would not be in a position to opine on the various degrees of reliability. Moreover, requiring NRSROs to comment on data quality would convert them from providers of credit opinions into data verifiers and could inappropriately encourage market participants to rely on NRSROs instead of issuers for factual information.

- **Disclosure describing the relevant data about the obligor, issuer, security or money market instrument being rated that was used and relied on for the purposes of determining the credit rating:** We believe that such a disclosure requirement is unnecessary and inappropriate. Consistent with provision 3.8 of the MIS Code, which implements provision 3.6 of the IOSCO Code, MIS already discloses in its credit rating announcements the key elements underlying the credit rating. Therefore, key information about the obligor and obligation already is disclosed because of its connection to our rating opinion. This type of disclosure is consistent with our function as CRAs, which is to provide an opinion about the relative future creditworthiness of an issuer or obligation. A requirement to describe the relevant data that was used and relied on to determine a credit rating risks converting ratings into substitutes for disclosure by issuers. Moreover, a requirement to disclose "relevant" data used in the rating process, instead of the "key elements" underlying a rating opinion, could require NRSROs to incorporate extensive, immaterial disclosures into their credit rating announcements. This would make it more difficult for users of credit ratings to determine which factors the NRSRO considered most important in formulating its credit opinion. If the Commission decides that it is appropriate to adopt rules regarding disclosure in credit rating announcements, we believe a more appropriately worded rule would require the NRSRO to disclose the "key elements" underlying its credit rating opinion.
- **Disclosure of whether material nonpublic information was used in determining the credit rating:** Some of the information that MIS uses in the credit rating process may constitute material non-public information. Assessing materiality is a nuanced, fact-specific exercise that the issuer and its securities

counsel, rather than NRSRO credit analysts, are in the best position to make. Accordingly, we do not believe it is appropriate to require NRSRO credit analysts to specify whether or not they used material, non-public information in determining a particular credit rating. We would not object, however, to a requirement to include a generally worded disclosure, if appropriate, that the NRSRO sometimes receives some non-public information as part of the credit rating process and may use such information to determine a credit rating if the information is relevant to its credit opinion.

- **Disclosure in general terms of the type of confidential information used and the impact this information had on the credit rating action:** We believe that such a disclosure requirement, even if it only required a general description of the types of confidential information used and how it affected the credit rating, would have a chilling effect on issuers and discourage them from sharing all relevant information with NRSROs. Accordingly, we would be opposed to such a disclosure requirement.

## 4. Differentiating Structured Finance Ratings

In the Release, the Commission indicates that it is deferring consideration of action with respect to a proposed rule on structured finance ratings that it had published for comment in June 2008.[14] The Commission is now seeking feedback on whether the goal of that proposed rule (*i.e.*, enhancing investor understanding of the differences in risk characteristics and credit ratings between structured finance products and other class of debt instruments) could be achieved through other measures.

The G-20 Heads of State, as well as the International Organization of Securities Commissions ("**IOSCO**"), have agreed that registered CRAs should differentiate their structured finance credit ratings from other credit ratings.[15] In response to regulatory initiatives and market feedback, MIS has taken and is taking the following steps. First, we have introduced two new risk measures for new structured finance credit ratings: V Scores and Parameter Sensitivity Analyses. Second, we announced a preliminary plan to add an indicator to our structured finance ratings as early as the second quarter of 2010 and sought market feedback on the plan. The indicator, if applied, would only denote that the rating is on a structured finance security; it would not otherwise change the meaning of the rating. Currently, we are considering whether the indicator would be introduced only in certain regions or on a global basis. While we have concluded that we should introduce these measures, we do not have a position on whether these or other measures should be mandated by the Commission.

## 5. Measures to Facilitate Unsolicited Ratings of Existing Structured Finance Products

Although it is not proposing any rules at this time, the Commission has asked whether it should adopt measures to enhance NRSROs' ability to determine unsolicited credit ratings for structured finance products that were issued before the compliance date of the recent amendments to rule 17g-5. As we have stated in other comment letters and publications,[16] we believe that one of the most significant steps that

---

[14] If adopted, that rule would have required an NRSRO either to: (i) include, each time it published a credit rating for a structured finance product, a report describing how credit rating procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments; or (ii) use distinct rating symbols for structured finance products to differentiate them from other types of credit ratings.

[15] In addition, the EU Regulation requires CRAs that register in Europe to differentiate their structured finance ratings through the use of an additional symbol.

[16] See, *e.g.*, *MIS Comment Letter re Credit Ratings Disclosure (File No. S7-24-09)*, December 2009; *Statement of Raymond McDaniel for the Securities and Exchange Commission Roundtable on Credit Rating Agencies*, April 2009; and *MIS*

could be taken to restore confidence in the structured finance market, promote appropriate use of credit ratings and facilitate well-informed, unsolicited credit ratings is for the Commission to revise the existing mandatory disclosure regime applicable to issuers of structured finance products in registered offerings.

Unlike in the corporate market, where investors and other market participants can reasonably develop their own informed opinions based on publicly available information, in the structured finance market there is insufficient public information to do so. Disclosure requirements for publicly offered securities do not require the public dissemination of sufficient information about the structure or underlying assets of a securitization to make reliable analysis possible. Indeed, under this limited information disclosure model, NRSROs and other CRAs must ask for additional information to analyze and rate securities.

In the absence of sufficient data, investors cannot conduct their own analysis and develop their own independent views about potential or existing investments. Also, non-NRSRO CRAs and other market commentators are practically unable to offer unsolicited research, which has the effect of restricting information available to investors and increasing the potential for rating shopping by issuers. Finally, since they are not subject to a similar degree of public scrutiny as corporate issuers, structured finance issuers may feel less responsibility for the quality of information related to their securitized products.

To address these problems, we recommend that the Commission revise the mandatory disclosure regime for issuers of structured finance products in registered offerings to require them to disclose the necessary information for investors to conduct a thorough analysis of the principal risks of the securities. In our view, updating the disclosure regime will yield three principal benefits:

- **Giving investors access to more information would reduce the risk of over-reliance on credit ratings.** Such access also would have the effect of enhancing investors' ability to meaningfully assess the work of NRSROs.
- **Embedding enhanced information requirements in offering documents and ongoing performance documents intended for investors likely would improve the information about structures and assets.** This approach, which is analogous to that taken in corporate debt markets, aligns responsibility for information quality with the party that: (i) has the greatest control over the information in the first place; and (ii) will gain the benefit from access to the securities markets.
- **Making more information available to investors would broaden the range of opinions and analysis available, including from all CRAs.** If sufficient information is made available to investors, then it necessarily is available to those CRAs not selected to rate a securitization. As a result, all CRAs (as well as a host of other market commentators) would be in a position to offer ratings and research, which would broaden the range of information available to investors.

---

*Comment Letter re Re-proposed Rules for Nationally Recognized Statistical Rating Organizations* (File No. S7-04-09), March 2009, all of which are available on moodys.com.