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

Re: Release No. 34-61051; File No. S7-28-09

Dear Ms. Murphy,

We are submitting these comments on our own behalf, based on research that we have conducted on SEC Release No. 34-61051.

I. Scope

Our comments are limited to the proposal "to amend the Instructions to Exhibit 6 to Form NRSRO to require a credit rating agency applying to be registered as an NRSRO or an NRSRO providing its annual update to Form NRSRO to publicly disclose … the percentage of the revenue of the applicant/NRSRO attributable to services and products other than credit rating services." [1]

[1] SEC Proposed Rules: Release No. 34-61051; File No. S7-28-09, pg. 6. We are not submitting comments concerning the other criteria that the SEC will also institute for NRSROs.

II. Basic Position

We agree with the SEC's position that NRSROs should be required to disclose the percentage of revenue received from services and products other than credit ratings in Exhibit 6 of the form NRSRO.[2] We feel receiving fees for services other than credit ratings may lead to a potential conflict of interest for NRSRO companies and disclosure will allow consumers of ratings to better understand the extent of these conflicts. We believe that this disclosure issue is similar to that of fee disclosures required of firms being audited by public accounting firms leading to detailed fee disclosure in 2000.

In the text of our comment, we argue that the SEC's proposed rule will be similar to that of auditing firms and lead to reducing the fees paid to NRSROs for non-credit rating services. We feel that by disclosing this percentage, the public will be able to see to what extent credit rating agencies are receiving revenue from services and products other than that for which they are publicly known. Additionally, we feel this will cause NRSROs to begin to rely much more heavily on their credit rating services and products for the majority of their revenue.

We believe that this scenario will mirror the effect on public accounting firms when companies were required to disclose the extent of fees paid to external auditors for non-audit services. We analyzed revenue data of public accounting firms from both auditing/tax, and non-auditing/tax services. We document a severe decline in the percentage of revenue coming from services other than auditing and tax for the public accounting firms in our data set for the years 2000-2008. By making a potential conflict of interest public, the proposed rule will encourage firms to reduce or eliminate potential conflicts of interests at NRSROs and/or reduce the amount of revenue from non-rating services and products. In the audit fee data sample it appears that firms chose to reduce or eliminate their potential conflicts of interest arising from non-audit/tax revenue rather than disclose them.

We believe it is crucial that investors receive as much information as possible about conflicts of interest among credit rating agencies so as to get the most impartial analysis of risky securities. In a recent release of proposed and final amendments for NRSROs the SEC stated; "In the *June 2008 Proposing Release,* the Commission cited concerns about the integrity of NRSROs' credit rating procedures and methodologies in light of the role they played in the credit market turmoil."[3] In the wake of the sub-prime mortgage crisis, NRSROs need to be held to higher standards in their ratings, and this means eliminating, or at the very least disclosing any conflicts of interest possibly affecting their ratings.

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[2] Credit rating agencies registered with the SEC are known as Nationally Recognized Statistical Rating Organizations (NRSROs). NRSROs include A.M. Best Company Inc., DBRS Ltd., Egan-Jones Rating Company, Fitch Inc., Japan Credit Rating Agency Ltd., LACE Financial Corp., Moody's Investors Service Inc., Rating and Investment Information Inc., Realpoint LLC, and Standard & Poor's Rating Services.

[3] Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59343 (February 2, 2009), 74 FR 6456 (February 9, 2009) ("February 2009 Proposing Release"), pg. 1.

III. The SEC's Proposal

In an effort to eliminate conflicts of interest the SEC has proposed amending Exhibit 6 of Form NRSRO to require firms to disclose the percentage of revenue earned from services and products other than credit ratings. After the collapse of subprime mortgages, the SEC looked into the actions of credit rating agencies to highlight issues in rating practices, specifically of collateralized debt obligations ("CDOs") and residential mortgage-backed securities ("RMBS"), and any conflicts of interest that have failed to be addressed.[4] This disclosure requirement is one step the SEC is proposing to deal with issues it has identified. Similar proposed and accepted actions are discussed later.

IV. Our Research

A. Method

We believe that people will act very differently if they are required to disclose their actions than if they are allowed to act in secret. Therefore, by requiring NRSROs to disclose their sources of revenue, we believe there will be a significant decrease in the revenue coming from services and products other than credit ratings. This is based on the data analysis of a similar situation concerning public accounting firms over the last decade. The evidence shows that when firms are required to disclose potential conflicts of interest created by competing revenue sources, companies appear to have chosen to reduce non-audit/tax revenue sources instead of disclosing it.

We examine data disclosed by publicly traded companies relating to the amount of monies paid to their public accounting firm. After 2000, each firm was required to disclose fees paid to the firm providing their external audit. The disclosures separate external auditor fees into three main categories; audit services, tax services, and non-auditing/tax services.[5] From this we calculated the percentage of non-auditing/tax services to the total amount of revenue for each firm for the years 2000-2008. Our data sample focused on audit fees, audit related fees, tax fees, and total fees for each fiscal year.

B. Description of Data

We seek to show a parallel between the case of public accounting firms and NRSROs. Our data represents approximately 330 different firms[6] including the "Big Four" auditing firms.[7] The firms we chose were those that presented complete sets of data so as to be able to give us the most comprehensive data analysis possible free of any survivor biases.

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[4] <u>Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies</u>, Staff of the Office of Compliance Inspections and Examinations, July 2008. pgs. 1.
[5] For our calculations we defined auditing services as including audit related services and tax services.
[6] We deleted firms that did not have complete data from 2000-2007 to avoid the extent possible any survivor biases that might exist with firms entering or exiting the dataset.
[7] "Big Four" refers to Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and Pricewaterhouse Coopers LLP.

Table 1 displays the data in our full sample. It is important to note that from 2000 through 2006, the total fees for all the firms increased from $5.14 billion to just over $12 billion. This is almost surely due to the passage of the Sarbanes-Oxley legislation in 2002 that required significantly more auditing work to be done by the external auditor. In 2007, however, total revenues went down slightly and in 2008 there was a sharp decrease. At the same time, non-audit/tax fees decreased significantly from $3.1 billion in 2000 to just under $88 million in 2008. Even before the recession took place in late 2007, the non-audit/tax revenues had fallen to $220 million in 2006; a severe decline from the $3.1 billion in 2000. Specifically, from 2002 to 2003, these fees drop from $1.99 billion to only $662 million. Meanwhile, from 2000 through 2006 total audit and tax fees are increasing to make up for the lost revenue from other sources.

In addition, Table 1 shows the aggregate percentage of revenue coming from non-auditing/tax services for all the accounting firms we analyzed. For the sample as a whole, the percentage of non-audit/tax revenue to total revenue is 61.05% in 2000 and 43.68% in 2001. The year 2000 likely represents the best picture of the situation prior to 2000 as auditing firms were not able to immediately change the non-auditing and tax service provided before the disclosure was required. Table 1 also shows that by 2003 the percentage of non-audit/tax fees as a percentage of total fees dropped to 6.96%, and dropped to less than 2 percent in the latter half of the decade. We believe that this is in part due to disclosures required of publicly traded companies and, beginning in 2004, a requirement in SOX to eliminate certain kinds of services being offered by a firm's auditing firm.

Table 2 shows that three of the "Big Four" firms had more than 60% of their revenue coming from sources other than auditing and tax services in 2000. Ernst & Young was the only firm below 60% with only 48.35% of revenue coming from non-audit/tax services. By 2002, the largest percentage was 29.41%, and by 2004 all four firms were below 5% of total fees going to non-audit/tax fees. Specifically, Pricewaterhouse Coopers, which in 2000 had the largest percentage of revenue coming from other services for all of the firms in the "Big Four," dropped from 28.44% in 2002 to only 5.95% in 2003. Since 2004, the percentages have leveled off for all four firms, with each firm below 1.50% in 2008.

Next, we turn to all firms that had over 60% of their revenue in 2000 coming from services other than auditing and tax. These firms are listed in Table 3 and they include three of the "Big Four" public accounting firms. By 2004, eight of these nine firms have below 15% of their revenues coming from other sources. Turlington and Company had nearly 70% of their revenue in 2000 coming from non-auditing/tax services, but between 2002 and 2003 this percent fell from 68.32% to 17.37%. This considerable plummet seems to be clear evidence of the significant influence of requiring a disclosure of conflicts of interest for this accounting firm. Other services continues to be a diminishing source of revenue for accounting firms in the last few years as all of the firms in Table 3 have below 9% of their revenue coming from other sources in 2007, the last year data was available for all of the firms in Table 2. In most cases the effect of the new law can be seen almost immediately, although it seems to take a few years before the full effect is felt, and the statistics begin to level off.

Graph 1 compares the "Big Four" accounting firms with the aggregate percent of all firms in the sample. In 2000, three of the "Big Four" firms are above the aggregate percent of 61.05%. By 2003 only Deloitte & Touche is above the aggregate percent and since 2003 the "Big Four" and aggregate are very close to one another. All five data points seem to decrease at a similar rate from 2000 through 2003, at which point they all seem to level off at close to 2%.

Our data clearly shows the effect of what happens when firms are required to disclose information about potential conflicts of interest for services provided by their external auditing firm. Over the last decade the firms in our analysis decreased the percentage of fees paid to the external auditor for non-auditing/tax services by a significant amount. This can be seen most clearly in the data of the four largest public accounting firms; the "Big Four." These firms work with large companies, and had the most revenue of all firms in our analysis. In 2000 these firms ranged from 48.35% to 68.11%. However, by 2004, the "Big Four" firms' revenue from non-audit/tax services ranged from 1.73% to 4.37%.

V. Implications

In the case of NRSROs, services other than credit ratings include advice on how to structure complex financial products as well as shopping around for a "preliminary rating." These non-rating services create a potential conflict of interest if the arrangers or managers of securities then pay the same firm to issue a rating. There are likely other services that NRSROs perform that are not disclosed, but may make up a large portion of the total revenue of an NRSRO. Failing to disclose this may obfuscate potential conflicts of interest for NRSROs.

Investors rely heavily on these agencies to provide independent and objective assessments of credit quality that are not influenced by conflicts arising from side payments or other activities for which they are compensated. Rating agencies are supposed to be independent, but when this independence and objectivity are compromised, due to conflicts of interest, the quality of ratings may deteriorate and lead to misinformation about the credit quality of a security. This goes directly against the purpose of credit rating agencies, which is to provide quality unbiased information for investors to make informed market decisions.

Auditors of publicly traded firms have a fiduciary duty to inform the board of directors and represent the interests of shareholders to evaluate the financial statements of the firms they audit. Accounting firms perform audits of firms to certify the financial data and information provided to investors by the managers of those firms. If there is a lack of objectivity by the auditor, there may be a conflict of interest that can change the ability of investors to rely upon the information managers provide to investors. According to the data, once the new disclosures were required, auditors received far less in fees described as "other," which could influence auditing services. Once they stopped receiving money that could influence their judgment, they might be deemed more objective and therefore more trustworthy in terms of their auditing services. If this proposed rule is enacted and NRSROs are required to disclose their sources of income causing conflicts of interest, the increased transparency should result in changes that provide increased trust in the objectivity and independence of their analysis.

We believe the SEC's proposed rule for NRSROs will have a similar effect on the revenue sources of NRSROs as the audit fee disclosure on accounting firms. In the case of firms that hire public accounting firms, they appear to eliminate the fees paid for non-audit/tax services rather than disclose them. NRSROs have a similar interest in being objective and un-biased. NRSROs rate securities and mortgages and if there is a loss of confidence in a rating agency's work, arrangers or managers will not have their securities rated by that company for fear that the public will not invest. Additionally, the public will not subscribe to receive ratings if they are not confident in the agency's independence. Therefore, we feel that NRSROs will act in a similar manner as the accounting firms did. We expect that if this proposed rule is passed, over the next few years NRSROs will severely decrease the amount of revenue they receive from services and products other than providing credit ratings.

VI. Other Concerns

The SEC has passed several other new regulations in the past year trying to combat conflict of interest problems of NRSROs. In response to SEC reports including the one looking into issues affiliated with rating RMBS and CDOs, the SEC approved new rule amendments that create additional disclosures of conflicts of interest requirements on NRSROs. One such amendment will increase the requirements of the rules for NRSROs to make publicly available records of credit rating histories. This will allow investors and others to review and compare the performance of credit ratings by showing how NRSROs originally rated a security and how they eventually adjusted those ratings. The SEC also re-proposed an amendment requiring NRSROs hired to perform credit ratings for structured finance products to release, on a password-protected web site, the deals for which they have been employed.[8] The proposed rule we are commenting on takes a different angle on this issue.

In both of these other proposed rule amendments rating agencies are being required to disclose more information. As more information is disclosed it becomes easier to identify any conflicts of interest that are not being addressed by the NRSROs themselves. Although these steps and the proposed rule in this letter are a good start, we feel there is more the SEC needs to address.

For example, another topic the SEC must address is conflicts of interest of the individuals making the actual ratings. In the SEC report looking into issues affiliated with rating RMBS and CDOs the commission staff found several issues in the supervision of conflicts of interest. Of the three rating agencies that were examined, only one actively supervises for compliance with its procedures for prohibiting analysts from participating in fee negotiations with issuers. The report also states that "rating agencies do not appear to take steps to prevent considerations of market share and other business interests from the possibility that they could influence ratings or ratings criteria."[9] Analysts and others involved in making rating decisions were well aware of the effects their ratings might have on the company business and/or market share, creating a clear

[8] Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59343 (February 2, 2009), 74 FR 6456 (February 9, 2009) ("February 2009 Proposing Release"), pg. 1, 3, 12.
[9] Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies, pg. 24-25.

conflict of interest. The report contains several email excerpts that effectively show the impact of this knowledge on the rating practices and criteria of those making rating decisions. We hope the SEC looks into this problem as it has done with the proposed rule amendment we are commenting on.

Please do not hesitate to contact us if we can be of any further service to you. We look forward to providing you with whatever assistance you would find helpful,

Very truly yours,

Dr. James F. Cotter   Grant W. Forstall

Dr. James F. Cotter is the Thomas S. Goho Chair of Finance at Wake Forest University's Schools of Business.
Mr. Grant W. Forstall is a sophomore in the Calloway School at Wake Forest University's Schools of Business.

Table 1 Aggregate Totals of all Data Used									
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total Audit Fees (millions)	1,839.58	2,911.00	5,406.03	6,896.92	9,859.41	10,413.16	10,733.92	10,404.03	6,613.88
Total Tax Fees (millions)	162.65	852.45	1,557.71	1,959.98	1,703.11	1,258.88	1,047.52	1,057.67	710.40
Total Audit + Tax Fees (millions)	2,002.23	3,763.45	6,963.75	8,856.89	11,562.51	11,672.04	11,781.44	11,461.70	7,324.28
Total Other (Total - Audit – Tax) (millions)	3,137.89	2,918.69	1,993.94	662.22	325.57	231.97	220.27	231.61	87.63
Total Fees (millions)	5,140.13	6,682.14	8,957.68	9,519.12	11,888.08	11,904.01	12,001.72	11,693.31	7,411.90
Other as Percent of Total	61.05%	43.68%	22.26%	6.96%	2.74%	1.95%	1.84%	1.98%	1.18%

Table 2 Percent of Revenue from Non-Audit/Tax Services for “Big Four”									
Auditor Name	2000	2001	2002	2003	2004	2005	2006	2007	2008
Deloitte & Touche LLP	64.82%	46.88%	29.41%	13.22%	4.37%	3.06%	2.67%	2.65%	1.32%
Ernst & Young LLP	48.35%	29.35%	14.08%	4.35%	1.73%	1.21%	1.29%	1.40%	1.07%
KPMG LLP	61.95%	30.67%	12.37%	4.23%	2.48%	1.48%	1.37%	1.18%	1.06%
PricewaterhouseCoopers LLP	68.11%	54.18%	28.44%	5.95%	2.24%	1.84%	1.84%	2.44%	1.14%

Table 3 Percent of Revenue from Non-Audit/Tax Services of Firms Starting Over 60%									
Auditor Name	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Shatswell MacLeod & Company PC	70.76%	33.19%	9.14%	2.93%	0.00%	0.00%	32.83%	6.53%	0.00%
Turlington and Company LLP	69.95%	68.13%	68.32%	17.37%	14.82%	20.47%	17.20%	8.30%	No Data
PricewaterhouseCoopers LLP	68.11%	54.18%	28.44%	5.95%	2.24%	1.84%	1.84%	2.44%	1.14%
Tait Weller & Baker	66.19%	68.61%	20.06%	1.56%	0.58%	1.55%	1.31%	0.27%	0.47%
Ehrhardt Keefe Steiner & Hottman PC	64.98%	25.29%	31.18%	4.42%	4.69%	2.91%	2.47%	1.66%	0.41%
Deloitte & Touche LLP	64.82%	46.88%	29.41%	13.22%	4.37%	3.06%	2.67%	2.65%	1.32%
Crowe Chizek & Company LLC	62.34%	59.90%	49.23%	14.77%	10.38%	4.45%	4.64%	4.53%	0.00%
KPMG LLP	61.95%	30.67%	12.37%	4.23%	2.48%	1.48%	1.37%	1.18%	1.06%
Thigpen Jones Seaton & Co	60.52%	49.62%	45.22%	16.96%	36.01%	12.51%	9.76%	5.59%	No Data

Graph 1 Chart of “Big Four” Relative to Aggregate Total of All Data