The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 25403

August 11, 2011

ICI Files Letter Concerning Nationally Recognized Statistical Rating Organizations

[25403]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 32-11
EQUITY MARKETS ADVISORY COMMITTEE No. 52-11
FIXED-INCOME ADVISORY COMMITTEE No. 61-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 50-11
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 40-11
SEC RULES COMMITTEE No. 70-11 RE: ICI FILES LETTER CONCERNING NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

ICI has filed a comment letter supporting the Securities and Exchange Commission's ("Commission") proposed new rules and rule amendments to implement certain provisions of the Dodd-Frank Act and enhance existing Commission rules governing credit ratings and Nationally Recognized Statistical Rating Organizations ("NRSROs"). [1] The proposal, which is intended to increase transparency and improve the integrity of credit ratings, also would implement Dodd-Frank Act provisions related to third-party due diligence services for asset-backed securities. ICI's comment letter is attached and briefly summarized below.

Summary

ICI's letter begins by stating that the proposal—shaped in large part by specific requirements in the Dodd-Frank Act—appears designed to promote goals that ICI members strongly support, including enhancing disclosure and transparency, addressing potential conflicts of interest, and increasing the accountability of an NRSRO for its credit ratings.

In particular, the letter supports the proposed enhancements for additional disclosure and reporting requirements regarding ratings performance, ratings methodologies, and other qualitative and quantitative information about ratings as a means to further improve investors' access to information about the quality and credibility of NRSROs and their ratings. It explains that ICI has supported many of these types of measures in the past

because they improve the ability of investors to analyze and compare credit rating performance. For example, the letter supports the proposed standardization of performance measurement statistics to facilitate the comparability of measurement statistics across all NRSROs. The letter voices disappointment, however, that the proposal would maintain the current 12-month (issuer-paid credit ratings) and 24-month (subscriber-paid credit ratings) time lags for making ratings history disclosure public and reiterates ICI's concern that such delay is excessive and severely diminishes the usefulness of the information.

With respect to ratings methodologies, ICI's letter emphasizes that the proposed rules must be mindful to avoid unintentionally regulating the substance of credit ratings or otherwise creating undue burdens for NRSROs that could lead firms to exit (or not enter) the business, which would result in fewer NRSROs, less competition, and less pressure to ensure the quality of ratings. It specifically supports requiring that an NRSRO's policies and procedures with respect to the procedures and methodologies used to determine credit ratings be reasonably designed to ensure that an NRSRO promptly publishes on an easily accessible portion of its corporate Internet website: (1) material changes to the procedures and methodologies, the reason for the changes, and the likelihood the changes will result in changes to any current ratings; and (2) significant errors identified in a procedure or methodology that may result in a change in current credit ratings. The letter explains that it is critical that NRSROs communicate this information to investors and users of credit ratings in a timely manner and that use of an NRSRO's Internet website for this purpose should facilitate prompt disclosure.

ICI's letter supports the Commission's proposal to require an NRSRO to publish certain qualitative and quantitative information about credit ratings whenever it takes a rating action because such information should allow investors to more effectively evaluate a rating agency's capability and operations and the integrity and quality of the rating. In addition, the letter recommends that the Commission explicitly state, if it adopts the proposal, that the proposed disclosure regarding rating actions identifies the minimum information that must be provided by rule, but NRSROs are encouraged to provide additional information as they deem appropriate.

The letter also supports the Commission's proposed disclosure requirements relating to third-party due diligence service providers. With respect to proposed Form ABS Due Diligence, ICI's letter states that the proposed disclosures should help to ensure that providers of third-party due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating for an Exchange-Act ABS. [2] Further, the information should be useful to investors in gauging the accuracy of information being analyzed by an NRSRO and, thus, the NRSRO's ability to assess the creditworthiness of an Exchange-Act ABS.

ICI's letter also supports the re-proposal of rules related to Form ABS-15G, which would require an issuer or underwriter of an Exchange-Act ABS to make publicly available on Form ABS-15G the findings and conclusions of any third-party due diligence report relevant to the determination of an Exchange-Act ABS credit rating. It acknowledges that the proposed changes may better reflect the intent of the Dodd-Frank Act provisions for disclosing due diligence reports related to NRSRO ratings than the original proposal. Even so, the letter calls for continued improvements to disclosure for Exchange-Act ABS and supports Commission efforts in this area.

The letter raises concerns with the proposed application of the requirement to complete Form ABS-15G to a municipal entity that sponsors or issues Exchange-Act ABS. It notes that

ICI has previously cautioned the Commission against imposing any of its newly proposed ABS disclosure requirements on this portion of the municipal securities markets until such time as the Commission completes its staff report on the municipal securities market and the GAO completes its studies on municipal securities mandated by the Dodd-Frank Act. [3] The letter recommends that at this time the Commission expressly exclude municipal securities from the proposed ABS disclosure requirements to avoid creating confusion for investors and issuers if different classes of municipal securities are subject to different disclosure requirements.

Finally, ICI's letter supports the Commission's proposal to require NRSROs to submit Form NRSRO and the information and documents contained in Exhibits 1 through 9 through the EDGAR system if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g-1 (i.e., an update of registration, an annual certification, or a withdrawal from registration). It states that it will be beneficial to investors and other users of credit ratings to have this information available—in electronic format—immediately and in one location.

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Attachment

endnotes

[1] See Memorandum 25266, SEC Proposes Rules to Enhance Regulation of Credit Rating Agencies (June 9, 2011), available at http://www.ici.org/my_ici/memorandum/memo25266.

[2] Section 941 of the Dodd-Frank Act amended the Securities Exchange Act of 1934 by adding a definition for "asset-backed security." An "Exchange-Act ABS" would include "a fixed-income or other security collateralized by any type of self-liquidating asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset." See Section 941 of the Dodd-Frank Act, which adds new subsection (77) to Section 3(a) of the Exchange Act.

[3] If the Commission proceeds to adopt the proposed disclosure requirements for Exchange-Act ABS and determines to apply the requirements to a municipal entity that sponsors or issues Exchange-Act ABS, ICI's letter recommends that, at a minimum, the Commission should postpone the compliance period to further evaluate the appropriateness of that application.