

MEMO# 24122

February 2, 2010

ICI Files Letter on SEC Proposal to Add Additional Requirements on Credit Rating Agencies

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 10-10
EQUITY MARKETS ADVISORY COMMITTEE No. 3-10
FIXED-INCOME ADVISORY COMMITTEE No. 2-10
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-10
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 3-10
SEC RULES MEMBERS No. 14-10 RE: ICI FILES LETTER ON SEC PROPOSAL TO ADD
ADDITIONAL REQUIREMENTS ON CREDIT RATING AGENCIES

As you know, the Securities and Exchange Commission is proposing rule amendments and a new rule that would impose additional requirements on nationally recognized statistical rating organizations (“NRSROs”). [\[1\]](#) The SEC also is soliciting comments regarding measures to improve disclosure about credit ratings and the ratings process and measures that could be taken to differentiate NRSROs’ structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information. The Institute has prepared a comment letter, which is attached and briefly summarized below.

Annual Compliance Report for NRSROs

The SEC is proposing an amendment to Rule 17g-3 under the Securities Exchange Act of 1934 to require an NRSRO to furnish a new unaudited annual report to the SEC describing the steps taken by the NRSRO’s designated compliance officer during the fiscal year to fulfill the compliance officer’s responsibilities under Section 15E(j) of the Exchange Act.

Although the Institute believes that requiring an NRSRO's designated compliance officer to prepare an annual compliance report would encourage a more rigorous compliance program and, thereby, promote the identification and prompt remediation of compliance failures and weaknesses in the NRSRO's policies and procedures, the letter questions the proposed requirement that the report be submitted to the SEC. The letter notes that such a requirement could have a chilling effect on even the most compliance-oriented organization to perform a comprehensive and in depth review of the NRSRO's activities, policies, and procedures, or to identify material compliance matters. Instead, the letter recommends that NRSROs be required to prepare annual compliance reports that are made available to the SEC when it conducts its examinations.

Disclosure Relating to Sources of Revenue

The letter supports the SEC's proposal to amend the instructions for Exhibit 6 of Form NRSRO to require a credit rating agency in an application for registration as an NRSRO or an NRSRO providing its annual update to disclose: (1) the percentage of the net revenue of the applicant/NRSRO attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and (2) the percentage of the net revenue of the applicant/NRSRO attributable to services and products other than credit rating services. By requiring the inclusion of this information on Form NRSRO, the letter notes that investors will have a better understanding of the relationship between the largest users of credit ratings and the rating agency, including areas in which conflicts of interest may be present.

New Rule 17g-7—Credit Rating Reports on Revenue

The letter supports the proposed new Rule 17g-7 that would require annually an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO and, if applicable, its affiliates as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. The letter states that this information would provide users of credit ratings with information to assist them in evaluating the potential risk to the integrity of a credit rating that arises from the conflict inherent when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

Improve Disclosure about Credit Ratings and the Ratings Process

In connection with the proposal, the SEC also requests comment as to whether it would be appropriate to require that specific information be reported when a credit rating action is made publicly available (i.e., more than a generic statement of where relevant information can be located). The letter notes that on a number of occasions, the Institute has made specific recommendations on improving disclosure about credit ratings and the ratings process.

The letter also states that equally important to improved disclosure about credit ratings and the ratings process is a requirement that credit rating agencies conduct better due

diligence and verification. To address these concerns, the letter notes that we have recommended in the past that credit rating agencies be required to conduct due diligence on the information they review to issue ratings.

Differentiating Structured Finance Credit Ratings

The SEC is deferring consideration of action with respect to a proposed rule that would have required an NRSRO to include, each time it published a credit rating for a structured finance product, a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments, or alternatively, to use distinct ratings symbols for structured finance products that differentiate them from the credit ratings for other types of financial instruments. The SEC, however, is soliciting comments on how the risk characteristics of structured finance products and credit ratings differ from the risk characteristics of corporate, municipality, and sovereign nation debt instruments and their credit ratings.

The letter notes that we support further examination of these issues, but suggests that the SEC's disclosure requirements be sufficiently comprehensive and flexible to address concerns that may arise in the future relating to other debt instruments as well. The letter also includes our belief that issuers, in addition to credit rating agencies, have a role to play in the effort to increase transparency and disclosure about structured finance products, as well as for other debt instruments. To this end, the Institute has supported efforts by the SEC to enhance such disclosure by amending rules under the Securities Act of 1933. Similarly, to truly improve disclosure in the municipal securities market, the letter states that we also have called for steps to be taken to improve the content and timing of required issuer disclosure for municipal securities.

Jane G. Heinrichs
Senior Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) See *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-61051 (November 23, 2009), 74 FR 63866 (December 4, 2009).