

MEMO# 22740

July 28, 2008

ICI Comment Letter on SEC Amendments to NRSRO Rules

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 34-08
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 29-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 20-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 15-08
FIXED-INCOME ADVISORY COMMITTEE No. 21-08
SEC RULES MEMBERS No. 69-08 RE: ICI COMMENT LETTER ON SEC AMENDMENTS TO
NRSRO RULES

As we previously informed you, the Securities and Exchange Commission proposed amendments to the rules it adopted pursuant to the Credit Rating Agency Reform Act of 2006. [\[1\]](#) The first part of the proposal would impose additional disclosure, reporting, and recordkeeping requirements on NRSROs. The second part of the proposal would require NRSROs specifically to identify structured finance products by attaching a modifier to the rating for the security or issuing a report with the rating. The Institute's comment letter generally supports the first part of the Commission's proposal, making additional disclosure recommendations, but it raises several concerns with the second part of the proposal. The letter is attached and summarized below.

Conflicts of Interest

The Institute's letter supports requiring NRSROs to disclose information regarding the conflict of being paid by certain "arrangers" to rate structured finance products. It states that such information should assist investors in performing an independent assessment of these products and promote the issuance of more accurate, high-quality ratings because of the increased transparency surrounding NRSROs' management of this

conflict of interest. The Institute also makes the following recommendations:

- the proposed disclosures be expanded to include issuers of municipal securities;
- the Commission require additional disclosures by NRSROs including: (1) any material ancillary business relationships between the NRSRO and an issuer, (2) the number of other products rated by an NRSRO for a particular arranger, (3) information regarding the separation of NRSROs' consulting and rating activities, and (4) the fees paid for a rating (within ranges);
- NRSROs be the party that is responsible to disclose the required information and that this requirement be expanded to include all of the information that NRSROs are provided to aid in their determination of an initial credit rating and to perform credit rating surveillance (as opposed to disclosure of only the information NRSROs use);
- the Commission require issuers, underwriters, and sponsors of structured finance products to perform due diligence reviews (and disclose the steps taken to investors and NRSROs); and
- the Commission require NRSROs to have policies and procedures to assess the credibility of this information and to disclose the steps (and results of the steps) undertaken to verify information about the assets underlying a security.

The Institute's letter also supports the proposed prohibitions on issuing ratings relating to conflicts of interest arising from fee discussions and gifts, and recommends the prohibition relating to fee discussions be extended to cover supervisory personnel. It states that these prohibitions would address concerns relating to, most significantly, the objectivity of an NRSRO and improper incentives for NRSRO personnel when issuing and maintaining ratings. The Institute's letter recommends that the proposed prohibition relating to recommendations by an NRSRO about the structure of a product be addressed instead through disclosure and procedures to manage that conflict. It explains that NRSROs often play a gatekeeping role in the development of a structured product. Thus, eliminating the interaction and information exchange between the NRSRO and the issuer, underwriter or sponsor could be counterproductive.

Recordkeeping Requirements

In the letter, the Institute supports the proposed amendments to require NRSROs to make and retain records of: (1) material deviations from the credit rating implied by a model and the final credit rating issued; and (2) any complaint regarding the performance of a credit rating analyst in determining credit ratings, and recommends that the Commission expand the scope of the proposal to require that both of these records be publicly disclosed. The letter states that these records should aid the Commission in fulfilling its oversight function and should assist users of ratings in evaluating the operation, integrity and compliance efforts of NRSROs.

The Institute also supports the proposed amendment to require NRSROs to make public a record showing all of their ratings actions but opposes the proposed six-month delay before requiring disclosure of such information. The letter explains that the delay significantly diminishes the value of this information to investors. It also questions whether XBRL is the best format for providing the required information to a broad spectrum of potential users. The letter further notes the uncertainty regarding whether the most

commonly cited benefits of interactive data, such as the ability to extract and sort data, would be useful in this context, and urges the Commission to consider whether another data format might be appropriate.

Form NRSRO

The Institute's letter supports the proposed amendment to enhance disclosure regarding rating performance measurement statistics and recommends that the Commission expand the disclosure to include policies and procedures articulating how and when NRSROs conduct downgrades and the potential severity of downgrades. The Institute also recommends that the Commission adopt standardized performance measurement statistics to facilitate comparability across all NRSROs. The letter explains that such disclosure, particularly in a standardized format, would facilitate the evaluation of the quality of a rating and NRSROs' ability to assess the creditworthiness of debt.

The Institute's letter also supports the proposed amendment to enhance disclosure surrounding the methodologies an NRSRO uses to determine credit ratings and recommends that the proposed disclosures be required for types of debt other than structured finance products. In addition, it recommends the Commission require NRSROs to disclose additional information regarding staffing issues, including personnel turnover and resource levels.

Differentiating Credit Ratings for Structured Finance Products

In the letter, the Institute supports the proposed report that would describe how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments. The Institute opposes the proposed alternative to a report, i.e., requiring NRSROs to use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities. The letter states that the modifier proposal would not add to the quality, integrity or clarity of a structured finance product credit rating and could hurt the market for structured finance products.

Increase Municipal Securities Disclosure

The Institute's letter recommends that the Commission increase disclosure for municipal securities. The letter explains that the current municipal securities disclosure regime is inadequate, primarily because of limitations imposed on the Commission's authority in this area pursuant to the Tower Amendment. Thus, the Institute recommends that the Commission improve municipal securities disclosure within the current regulatory regime (e.g., Securities Exchange Act Rule 15c2-12), by modifying the material events disclosure, requiring issuer financial information be provided more frequently, and establishing an outside deadline for the timing of such disclosure. The Institute also recommends that Congress consider imposing certain disclosure requirements directly on municipal issuers, and that Congress clarify the legal responsibilities of officials of municipal

issuers for the disclosure documents they authorize.

Unified Ratings Scale

In the letter, the Institute questions the practicalities, benefits and timing of regulatory, legislative and other proposals that would have NRSROs adopt a single ratings scale for municipal and corporate debt securities. The Institute recommends that the disclosure inadequacies in the municipal securities market be resolved before adoption of any proposals that would have NRSROs employ a single ratings scale for municipal and corporate debt securities.

Heather L. Traeger
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[Attachment](#)

[\[1\]](#) See Proposed Rules for Nationally Recognized Statistical Ratings Organizations, SEC Release No. 34-57967 (June 17, 2008), 73 FR 36212 (June 25, 2008).

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