

MEMO# 22712

July 18, 2008

Draft ICI Comment Letter on SEC Amendments to NRSRO Rules; Conference Call Scheduled for July 22

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TO: SEC RULES COMMITTEE No. 50-08
EQUITY MARKETS ADVISORY COMMITTEE No. 31-08
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 27-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 13-08
FIXED-INCOME ADVISORY COMMITTEE No. 19-08 RE: DRAFT ICI COMMENT LETTER ON
SEC AMENDMENTS TO NRSRO RULES; CONFERENCE CALL SCHEDULED FOR JULY 22

As we previously informed you, last month the Securities and Exchange Commission proposed amendments to the rules it adopted pursuant to the Credit Rating Agency Reform Act of 2006.* The proposed amendments are designed to improve disclosure and transparency surrounding an NRSRO's policies and procedures for issuing ratings. The first part of the proposed amendments would impose additional disclosure, reporting and recordkeeping requirements on NRSROs. The second part 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 draft letter is attached and summarized below.

Comments on the proposed amendments are due to the SEC by July 25. We have scheduled a conference call for Tuesday, July 22, at 2:30 p.m. Eastern time to discuss the Institute's draft letter. The dial-in number for the conference call will be 1- 888-677-1820 and the passcode for the call will be 61102. If you plan to participate on the call, please contact Jennifer Odom by email at jodom@ici.org or by phone at 202-326-5833. In the meantime, if you have any views on any of the issues discussed below, please contact Heather Traeger by email at htraeger@ici.org or by phone at 202-326-5920.

The draft letter generally supports the first part of the Commission's proposal, imposing additional disclosure, reporting and recordkeeping requirements on NRSROs. The letter raises concerns, however, with the second part of the Commission's proposal, relating to the ratings symbology for structured finance products.

Conflicts of Interest

The draft letter supports the proposed requirement for NRSROs to disclose and manage the conflict of interest of being paid by issuers and sponsors, among others, 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 an NRSRO's management of this conflict of interest. The letter recommends that the proposed disclosure be extended to the issuers of corporate and municipal securities where appropriate.

The draft letter also recommends several additional disclosures that the Institute believes are necessary to provide users of ratings with an understanding of an NRSRO's conflicts of interest and management of those conflicts. They include:

- any material ancillary business relationships between the NRSRO and an issuer;
- the number of other products rated by an NRSRO for a particular issuer;
- information regarding the separation of an NRSRO's consulting and rating activities; and
- the fees paid for a rating (within ranges).

The draft letter recommends that an NRSRO be responsible for disclosing all information that is used by the NRSRO in determining its initial credit rating or in undertaking credit rating surveillance. The letter further states that the NRSRO should not be held accountable for the accuracy of the information it passes to the public via this disclosure. Instead, it recommends that the NRSRO be required to disclose information about the steps, if any, that it has taken to verify information about the assets underlying a structured finance product, and the results of those actions. In addition, the draft letter recommends that NRSROs be required to have policies and procedures in place to reasonably assess the credibility of this information, and to disclose these policies and procedures to facilitate understanding of an NRSRO's actions in this area.

The draft letter further recommends that the Commission require the issuers, underwriters and sponsors of structured finance products to take reasonable steps to ensure that information provided to NRSROs and investors is accurate and robust, and that these steps are disclosed to investors.

The draft letter supports the three proposed prohibitions relating to the issuance of

ratings due to conflicts of interest, and recommends that the proposed prohibition on the participation of certain NRSRO personnel in fee discussions be extended to cover personnel with supervisory authority over the identified personnel.

Recordkeeping Requirements

The draft letter supports the proposed amendments to require NRSROs to make and retain additional records, including (1) a record of the rationale for any material differences between a credit rating implied by a model and the final credit rating issued and (2) a record of any complaint regarding the performance of a credit analyst in determining credit ratings. The letter states that these records should aid the Commission in fulfilling its oversight function to ensure that an NRSRO complies with its stated practices and procedures for issuing ratings and addressing conflicts of interest. The draft letter recommends that the reports be made public to assist users of ratings in evaluating the operation, integrity, and compliance efforts of NRSROs.

The draft letter also supports the proposed requirement that an NRSRO disclose its ratings actions as described in the proposal but recommends that the six-month delay in providing the information to investors be shortened to preserve the value of the information.

Form NRSRO

The draft letter supports the proposed amendments to enhance disclosure surrounding performance statistics. It states that such disclosure, particularly in a standardized format, would facilitate the evaluation of the quality of a rating and the NRSRO's ability to assess the creditworthiness of debt.

The draft letter also supports the proposed addition of three additional areas of disclosure regarding the procedures and methodologies an NRSRO uses to determine credit ratings, including (1) the verification performed on underlying assets, (2) assessments of the quality of originators of underlying assets, and (3) surveillance procedures for existing ratings. It recommends that the disclosure requirement for the first two items be extended to other types of rated debt securities. The draft letter states that investors would benefit from the increased transparency and explanation of the methodologies used to evaluate the material risks involved with various types of financial instruments.

Differentiating Credit Ratings for Structured Finance Products

The draft letter supports the goal of increasing transparency in the ratings process for structured finance products by requiring NRSROs to publish a report describing how the credit ratings procedures, methodologies, and credit risk characteristics for structured finance products differ from those of other types of rated instruments. It opposes, however,

the alternative proposal that NRSROs attach a special identifier or symbol to the rating of a structured finance product. The draft letter states that the modifier proposal will not add to the quality, integrity or clarity of a structured finance product credit rating but it could hurt the market for structured finance products. The letter concludes that the modifier proposal would not satisfy the Commission's stated goal of spurring investors to perform more rigorous internal risk analysis on structured finance products.

Increase Municipal Securities Disclosure

The draft letter recommends that the Commission increase disclosure for municipal securities. It 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. Within the current disclosure regime, the draft letter recommends the Commission modify the material events disclosure under Rule 15c2-12. The letter also recommends that issuer financial information be provided more frequently than is currently required under Rule 15c2-12 and that an outside deadline is placed on the timing of this disclosure. Finally, it recommends that Congress clarify the legal responsibilities – related to disclosure obligations – of the parties involved in a municipal offering.

Municipal Securities Ratings Scale

The draft letter recommends that the disclosure inadequacies in the municipal securities markets be resolved prior to or in coordination with any determination regarding a single ratings scale for municipal and corporate debt securities. It explains that disclosure requirements for both sets of issuers must be similar for comparative purposes. Further, the draft letter states that a single scale may create confusion for retail investors.

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[Attachment](#)