MEMO# 25208

May 20, 2011

SEC Seeks Comment for Study on Assigned Credit Ratings for Structured Finance Securities; Conference Call June 9

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 13-11
EQUITY MARKETS ADVISORY COMMITTEE No. 27-11
FIXED-INCOME ADVISORY COMMITTEE No. 41-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 33-11
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 28-11
SEC RULES COMMITTEE No. 54-11 RE: SEC SEEKS COMMENT FOR STUDY ON ASSIGNED CREDIT RATINGS FOR STRUCTURED FINANCE SECURITIES; CONFERENCE CALL JUNE 9

As required by Section 939F of the Dodd-Frank Act, the Securities and Exchange Commission ("SEC") is conducting a study on the credit rating process for structured finance products, after which the SEC is required to submit a report to Congress regarding its findings and any recommendations for regulatory or statutory changes that it determines should be made to implement those findings. Specifically, the study must address matters relating to assigning credit ratings for structured finance products and the conflicts associated with the "issuer-pay" and the "subscriber-pay" models for rating securities. To assist it in carrying out the study, the SEC has published a request for comment ("Request"). [1] Comments are due to the SEC by September 13, 2011.

We have scheduled a conference call for Thursday, June 9 at 2 pm Eastern to discuss the request for comment and ICI's comment letter. If you would like to participate, please contact Ruth Tadesse (rtadesse@ici.org or 202/326-5836) for the dial-in information. If you cannot participate, please provide comments to Heather Traeger (htraeger@ici.org or 202/326-5920).

The SEC Request notes that 10 credit rating agencies are currently registered as nationally recognized statistical rating organizations ("NRSROs"), eight of which are registered in the class of credit rating for issuers of asset-backed securities. The SEC estimates, however, that 94 percent of the outstanding credit ratings for structured finance products were determined by the three largest NRSROs. With that backdrop, and the mandate to explore conflicts of interest associated with the existing NRSRO models, the SEC seeks comment on the feasibility of a system in which a public or private utility or a self-regulatory organization (“SRO”) would assign an NRSRO to determine credit ratings for structured finance products (“Assignment System”).

The Assignment System contemplated by the Dodd-Frank Act would require the SEC to establish a Credit Rating Agency Board (“CRA Board”) – be it an SRO, private utility or public utility – and select the initial members of the CRA Board. [2] The SEC also would be required to establish a schedule to ensure that the CRA Board begins assigning qualified NRSROs (i.e., those determined to be qualified by the CRA Board) to provide initial ratings not later than one year after the selection of the members of the CRA Board. An issuer of a structured finance product would be required to submit a request for an initial credit rating to the CRA Board and could not request a rating directly from an NRSRO. The method of selecting a qualified NRSRO to provide the initial rating would be based on an evaluation by the CRA Board of a number of alternatives designed to reduce the conflicts of interest that exist under the issuer-pays model, including a lottery or rotating assignment system.

With respect to the Assignment System, the SEC specifically seeks comment on:

- An assessment of potential mechanisms for determining fees for NRSROs for structured finance products;
- Appropriate methods for paying fees to NRSROs to rate structured finance products;
- The extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government; [3] and
- Any constitutional or other issues concerning the establishment of such a system.

The SEC also seeks comment on whether the concerns raised in relation to the rating of structured finance securities are unique to such securities and whether the concentration of underwriters and sponsors of structured finance products make any conflicts more acute in this class of securities. Further, the SEC requests comment on how the Assignment System would affect the securitization markets.

In addition to questions about the Assignment System, the SEC seeks comment on the range of metrics that could be used to determine the accuracy of credit ratings for structured finance products and alternative means for compensating NRSROs that would create incentives for accurate credit ratings for structured finance products. To assist with the latter question, the SEC identifies several alternative models for rating securities, including the investor-owned credit rating agency model, the stand-alone model, the designation model and the user-pay model. For each model, the SEC seeks comment on whether the model would be a reasonable alternative to the Assignment System, how the model would be implemented, and what costs and benefits are associated with the model.

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endnotes

[1] See SEC Release 64456, 76 FR 28265 (May 16, 2011), available at http://www.sec.gov/rules/other/2011/34-64456.pdf.

[2] In the Request, the SEC explains that of the members initially selected to serve on the CRA Board: (1) not less than a majority of the members would need to be representatives of the investor industry who do not represent issuers; (2) not less than one member would need to be a representative of the issuer industry; (3) not less than one member would need to be a representative of the credit rating agency industry; and (4) not less than one member would need to be an independent member.

[3] In the Request, the SEC seeks comment on whether the Assignment System would cause investors and other users of credit ratings to increase their reliance on credit ratings for structured finance products, particularly in light of government efforts to reduce investor reliance on ratings as mandated by the Dodd-Frank Act.
