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July 24, 2008

Ms. Florence E. Harmon, Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: *Proposed Rules for Nationally Recognized Statistical Rating Organizations*,
Securities Exchange Act of 1934 Release No. 57967 (June 16, 2008)
File No. S7-13-08

Dear Ms. Harmon:

Standard & Poor's Ratings Services ("Ratings Services"), a nationally recognized statistical rating organization ("NRSRO") registered under Section 15E of the Securities Exchange Act of 1934 (as amended, the "Exchange Act") and a business unit of Standard & Poor's, itself a division of The McGraw-Hill Companies, Inc., welcomes the opportunity to comment on the proposed rules, rule amendments and form changes contained in the proposing release referenced above (the "Proposing Release").

Ratings Services looks forward to the prompt adoption of those aspects of the proposals that would have the potential to enhance investor understanding of the role of credit ratings and NRSROs in the securities markets, further counteract the potential influence of conflicts of interest in the credit rating business and strengthen competition in the market for credit ratings. However, in some respects the proposals would, if adopted, exceed the Commission's constitutional authority, as well as the express limits on Commission authority established by Congress under the Credit Rating Agency Reform Act of 2006 and primarily embodied in these twin principles:

- First, the Commission's rules, as they apply to NRSROs, must be narrowly tailored to meet the Exchange Act's requirements:

"The rules and regulations that the Commission may prescribe pursuant to this title, as they apply to nationally recognized statistical rating organizations, shall be narrowly tailored to meet the requirements of this title applicable to nationally recognized statistical rating organizations." (Exchange Act § 15E(c)(2).)

- Second, the Commission's rules may not regulate the substance of credit ratings or the process by which they are determined:

“Notwithstanding any other provision of law, neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any nationally recognized statistical rating organization determines credit ratings.” (Exchange Act § 15E(c)(2).)

In most cases, the problematic proposals can readily be modified to ensure their compatibility with constitutional and statutory limits on Commission authority while still preserving the benefits that the Commission intends to achieve. See, for example, the discussion below regarding proposed rules 17g-5(a)(3) and 17g-5(c)(5). In some cases, however, the limits on the Commission’s rulemaking authority preclude the Commission from adopting final rules. See the discussion below regarding proposed rule 17g-7. Beyond the fundamental issue of the Commission’s authority, we believe that some aspects of the proposals require modification or clarification, and we also believe that certain of the assumptions made by the Commission in its cost-benefit analysis merit reconsideration. Our comments on the proposals follow.

A. Proposed Rule 17g-2(a)(2)(iii)

Where “a quantitative model was a substantial component in the process of determining the credit rating,” proposed rule 17g-2(a)(2)(iii) would require an NRSRO to make a record “of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued.”

As explained by the Commission:

“This proposal is designed to enhance the recordkeeping processes of the NRSROs so that Commission examiners (and any internal auditors of the NRSRO) could reconstruct the analytical process by which a credit rating was determined. This would facilitate their review of whether the NRSRO followed its disclosed and internally documented procedures for determining credit ratings. . . . In the absence of such a recordkeeping requirement, there may be no way to determine whether an analyst modified the requirements for obtaining a certain category of credit rating (e.g. AAA) as indicated by the model results by applying appropriate qualitative factors permitted under the NRSRO’s documented procedures or because of undue influence from the person seeking the credit rating or other inappropriate reasons such as those prohibited by Rule 17g-6.” (Proposing Release at pp. 74-77.)

At Ratings Services, rating opinions are a result of qualitative and quantitative factors, which may or may not include models, that support rating opinions. Where models are used, modeling results are one factor among many that may be taken into account by the individuals participating in a rating decision. Each rating committee brings to bear its own subjective knowledge, experience, insight and judgment in analyzing all aspects of the available mix of data, including fast-changing conditions in an industry or the global economy. Thus, it may sometimes be difficult to capture each and every “rationale” that demonstrates why a rating implied by a model is not the precise rating ultimately assigned to the security (indeed, in any given analytical process multiple models may be used). In order to account for the subjective and qualitative nature of the rating process, we suggest that the Commission provide guidance in the final rulemaking to the effect that the rule requires a record of the general factors taken into consideration by the rating committee in assigning a rating that materially differs from the model-implied rating. Alternatively, the Commission could reflect this concept in the rule text, as follows:

“(iii) If a quantitative model was a substantial component in the process of determining the credit rating, a record that generally reflects the factors that account ~~of the rationale~~ for any material difference between the credit rating implied by the model and the final credit rating issued; and”

To make the final rule consistent with the narrow-tailoring requirement of Exchange Act § 15E(c)(2), the Commission should consider applying this provision solely to structured products. We believe that tailoring the requirement to structured products is essential because the Commission has not indicated that its concerns are motivated by practices outside the structured product market, and therefore has not laid the groundwork necessary for demonstrating that its proposed rule, as it applies to NRSROs and the other securities they rate, is narrowly tailored to meet the requirements of the Exchange Act applicable to NRSROs.

While it will be difficult to define “material” because rating analysts use qualitative as well as quantitative factors to determine ratings, we also believe that the Commission should provide guidance to confirm that a “material difference” between the credit rating implied by the model and the final credit rating issued means a difference of at least one full rating category (i.e. AAA versus AA). We suggest that “material difference” be interpreted to mean a difference of at least one rating category in order to prevent the proposed rule from having an unintended substantive impact on the rating process, which would be contrary to the requirements of Exchange Act § 15E(c)(2). If a rating committee is required to document the rationale for every notch of difference between a model-implied rating and the rating that the committee believes, in the exercise of professional judgment, is the most appropriate for the security, we are very concerned that there would be an overwhelming tendency for rating committee members to conform their ratings to those implied by the model. In other words, the “observer effect” that is well known to students of quantum physics could be equally

applicable here. We believe that the effect would be to homogenize outputs from the rating process by discouraging the exercise of analytical judgment, which would lead to diminished rating quality.

Finally, if proposed rule 17g-2(a)(2)(iii) were to be adopted, we request Commission clarification that it applies only to rating actions taken after the compliance date, as it may not be possible to reconstruct each and every “rationale” for past rating actions.

B. Proposed Rule 17g-2(a)(8) and Amendment to Rule 17g-2(d)

Proposed rule 17g-2(a)(8) would require an NRSRO to make a “record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor.” In addition, the proposed amendment to rule 17g-2(d) would require that these records “be made publicly available on the corporate Web site of the NRSRO in an XBRL Interactive Data File that uses a machine-readable computer code that presents information in eXtensible Business Reporting Language in electronic format no later than six months after the date of the rating action.”

Ratings Services is fully committed to the principle of transparency of rating actions and already makes its public rating opinions available on its website for a period of time at no charge. We believe that broad dissemination of rating opinions improves efficiency in the market and enables ratings comparability. A requirement to format all rating actions in XBRL format and then make the formatted data available without restriction would, however, unnecessarily interfere with an NRSRO’s ability to capitalize on and protect its intellectual property. We think the proposed rule can be narrowly tailored to avoid this result while still furthering the policy objectives of proposed rule 17g-2(a)(8) and the proposed amendment to rule 17g-2(d).

1. *The proposed amendment to rule 17g-2(d) would unnecessarily interfere with NRSRO intellectual property rights and should be narrowly tailored to avoid this result*

The Commission stated that “[t]he proposed six-month time lag for publicly disclosing the updated record . . . is designed to preserve the revenues that NRSROs operating using the issuer-pay model derive from selling download access to their current credit ratings.” (Proposing Release at p. 70.) We do not believe that the rule, as proposed, will enable these NRSROs to preserve the revenues that they derive from selling download access to their current credit ratings. Rating action data that is six months old continues to have substantial commercial value, and therefore even with the six-month delay contemplated by rule 17g-2(d), a requirement to post rating actions in XBRL format for unrestricted use free of charge by market participants and competitors would severely damage Ratings Services’ ability to

capitalize on and protect its intellectual property. In addition, third parties may own intellectual property rights in data that would be required to be publicly disseminated by the proposed amendment to rule 17g-2(d), and third parties may also have confidentiality and other contract rights that would prevent an NRSRO from publicly disseminating some of the data. We do not believe that anything in the Credit Rating Agency Reform Act authorizes the Commission to effect a taking of private property without compensation by requiring an NRSRO to distribute a proprietary database of rating actions free of charge and without usage restrictions on the recipients of the database, or authorizes the Commission to require that an NRSRO publicly disclose data in violation of existing agreements, at least where the Commission's objectives can be accomplished through more narrowly tailored means as required by Exchange Act § 15E(c)(2).

The Commission explained that the intent of the XBRL disclosure requirement is "to tap into the expertise and flexibility of credit market observers and participants to create better and more useful means to compare credit ratings." (Proposing Release at p. 68.) While we agree with this objective, we also believe that this objective can be achieved without forcing NRSROs and others to give up their right to compensation for their intellectual property. For example, credit market observers and participants could enter into license and sub-license agreements with NRSROs to obtain this data, in line with current market practice. Without an evidence-based finding that credit market observers and participants would be unable to access this data on reasonable terms and conditions, it cannot be the case that a requirement for NRSROs to relinquish the right to receive compensation for their intellectual property and the intellectual property of third parties is narrowly tailored as it applies to NRSROs, as required by Exchange Act § 15E(c)(2).

We believe this problem could be addressed, and the goals of proposed rule 17g-2(d) could be achieved, by requiring NRSROs to format their rating actions in XBRL but then leaving it to the marketplace to determine the terms and conditions on which rating actions and the other data required in the rule 17g-2(a)(8) record would be made available. To that end, we suggest revising the text of proposed rule 17g-2(d) as follows:

“(d) * * * In addition, the records required to be retained pursuant to paragraph (a)(8) of this section must be made ~~publicly available on the corporate Web site of the NRSRO~~ available by the NRSRO to licensees, on such terms and conditions as the NRSRO in its discretion may agree with such licensees (including without limitation payment terms and restrictions on republication and redissemination), in an XBRL Interactive Data File that uses a machine-readable computer code that presents information in eXtensible Business Reporting Language in electronic format no later than six months after the date of the rating action.”

2. *Compliance date for proposed rule 17g-2(a)(8)*

If proposed rule 17g-2(a)(8) were to be adopted, we request Commission clarification that it applies only to rating actions taken after a compliance date no earlier than 36 months after issuance of the final rule. If the Commission declines this request, the Commission should provide NRSROs with a 36-month period to code rating actions taken prior to the compliance date. A 36-month compliance period is necessary not only to enable NRSROs to enhance their own internal client-facing, operational and feed systems, but also to allow their customers and other market participants to adjust their client-facing and downstream operational systems, and then migrate their systems to the new data feed formats. In addition, the Commission should clarify that rating actions that predate the compliance date by at least 10 years need not be coded. A 10-year look-back requirement would be consistent with the proposed amendment to Exhibit 1 to Item 9 of Form NRSRO relating to performance measurement statistics.

3. *The Commission has greatly underestimated the costs of the proposed amendments to rule 17g-2*

The Commission did not provide an analysis of each element of its proposed amendments to rule 17g-2, the NRSRO recordkeeping rule, and instead estimated that all amendments to rule 17g-2 would result in an average one-time cost per NRSRO of \$7,350. (Proposing Release at p. 136.) We have analyzed how much it would likely cost Ratings Services in order to build systems that will enable compliance with each proposed amendment to the recordkeeping rule, and have concluded that these new requirements would result in one-time costs to Ratings Services of approximately \$10,860,000, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$3,260,000. We would be happy to provide the Commission or the staff with a detailed break-down of this figure pursuant to a confidential submission in order to protect our proprietary cost models.

Apart from the systems costs described in the preceding paragraph, the proposed amendment to rule 17g-2(d) would cannibalize certain existing Ratings Services businesses. Specifically, while Ratings Services already makes its public rating opinions available on its website for a period of time at no cost, it also compiles historical data and information on rating actions and licenses that information to customers for a fee. This value-added information represents Ratings Services' intellectual property and Ratings Services should be entitled to compensation for compiling, updating and maintaining this information and providing it in an accessible format. We would be happy to provide the Commission or the staff with information on this revenue stream pursuant to a confidential submission. This foregone revenue should be treated as an incremental cost in the Commission's analysis of the costs and benefits of the proposal.

C. Proposed Amendment to Rule 17g-2(b)(7)

The Commission proposes to revise the phrase “maintaining, changing” in rule 17g-2(b)(7) to read “maintaining, monitoring, changing.” We agree with the Commission that the term “monitoring” better reflects industry usage to describe the process, after a rating is issued, of periodically evaluating whether the prior rating decision continues to be justified in light of intervening events.

We support deleting the term “maintaining” from the rule because it would be superfluous if the Commission adopts the proposed amendment.

D. Proposed Rule 17g-2(b)(8)

Proposed rule 17g-2(b)(8) would require an NRSRO to retain “[a]ny communications that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.” In proposing this rule, the Commission noted that:

“The Commission preliminarily believes the proposed new recordkeeping requirements . . . would assist the Commission in reviewing how NRSROs address conflicts interest that could impair the integrity of their credit rating processes. For example, an NRSRO might respond to complaints from issuers that an analyst is too conservative by removing the analyst from the responsibility of rating the securities of those issuers and assigning a new analyst that is more willing to determine credit ratings desired by the issuers.” (Proposing Release at p. 79.)

We support the Commission’s proposal, but would appreciate clarification on three points. First, we understand the Commission to be focused on complaints made by issuers or arrangers who are paying for a credit rating, and not complaints made by persons within the NRSRO or other third parties. This is because only complaints made by a party who is in a position to award business to the NRSRO would potentially give rise to the risk that an NRSRO would “remove an analyst responsible for rating the structured finance products these arrangers bring to market if they complained about how the analyst was determining credit ratings and implied that they might take their business to other NRSROs.” (Proposing Release at p. 80.) We suggest that the language be tailored to address the Commission’s specific concern.

Second, as the Commission is aware, privacy and labor laws in a number of non-U.S. jurisdictions would prevent or restrict an NRSRO from monitoring electronic communications of either their employees or third parties regarding analyst complaints. We therefore request that the Commission clarify that an NRSRO will not be required to make, retain or disclose

any records pursuant to proposed rule 17g-2(b)(8), to the Commission or otherwise, except in accordance with applicable law. Without such an exception, NRSROs with non-U.S. operations would potentially be subject to conflicting legal and regulatory obligations. Given that the Commission's primary concern is the protection of U.S. investors, such an exception would also be consistent with the narrow tailoring requirement of Exchange Act § 15E(c)(2).

Third, we also request that the Commission confirm that, in the case of oral communications (including telephonic communications), the requirement to retain communications will be satisfied by making a written record of the oral communication.

In order to more narrowly tailor the proposal to the Commission's concern, we would suggest the following language for proposed rule 17g-2(b)(8):

“(8) Any written communications, and summaries of any oral or telephonic communications, that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating, to the extent received from an obligor, issuer, sponsor, or underwriter of a security then rated by such nationally recognized statistical rating organization, except where prohibited by applicable law.”

Finally, if proposed rule 17g-2(b)(8) were to be adopted, we request Commission clarification that it applies only to communications received after a compliance date no earlier than 12 months after issuance of the final rule, in order to give NRSROs adequate time to establish and test appropriate retention procedures.

E. Proposed Rule 17g-3(a)(6)

Proposed rule 17g-3(a)(6) would require an NRSRO annually to report to the Commission “[t]he number of credit rating actions taken during the fiscal year in each class of credit ratings identified in section 3(a)(62)(B) of the [Exchange Act] for which the nationally recognized statistical rating organization is registered with the Commission.” Because spikes in rating actions can be driven by many different factors, including macroeconomic trends and trends affecting some industries or issuers and not others, we agree with the Commission's conclusion that this raw data should be furnished confidentially to the Commission rather than disclosed publicly.

The Commission observed in footnote 143 to the Proposing Release that “[a]n applicant can request that the Commission keep this information confidential,” and provided citations to Section 24 of the Exchange Act, rule 24b-2, 17 CFR 200.80 and 17 CFR 200.83. We note that the reference to rule 24b-2 appears to be incorrect, since that rule, by its terms, applies to information “filed” with the Commission under the Exchange Act. By contrast,

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information is “furnished” to the Commission pursuant to paragraphs (b) and (k) of Section 15E of the Exchange Act and rule 17g-3. This is an important distinction because the procedures for requesting confidential treatment of information provided to the Commission vary depending upon whether that information is “filed,” and subject to rule 24b-2, or not “filed,” and therefore subject to the somewhat different procedures set forth in 17 CFR 200.80 and 17 CFR 200.83, and because paragraph (a) of rule 24b-2 provides that “[t]he procedure provided in this rule shall be the exclusive means of requesting confidential treatment of information required to be filed under the Act.” As a result, we request that the Commission clarify in the final rulemaking that rule 24b-2 is inapplicable to requests for confidential treatment of information furnished pursuant to rule 17g-3.

The Commission estimated that the cost of compliance with proposed rule 17g-3(a)(6) would be *de minimis*. (Proposing Release at p. 140.) Our best estimate is that it would cost Ratings Services approximately \$300,000 to build and test the systems needed to comply, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$70,000. We would be happy to provide the Commission or the staff with a detailed breakdown of this figure pursuant to a confidential submission in order to protect our proprietary cost models.

F. Proposed Rules 17g-5(a)(3) and 17g-5(b)(9)

Proposed rule 17g-5(b)(9) identifies, as a conflict of interest in the credit rating business, “[i]ssuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.”

Proposed rule 17g-5(a)(3) provides a set of procedures for managing the conflict of interest identified in proposed rule 17g-5(b)(9). Paragraph (i)(A) of proposed rule 17g-5(a)(3) would require the disclosure, “through a means designed to provide reasonably broad dissemination,” of:

“All information provided to the nationally recognized statistical rating organization by the issuer, underwriter, sponsor, depositor, or trustee that is used in determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument.”

In addition, paragraph (i)(A) of proposed rule 17g-5(a)(3) would require that, in an offering registered under the Securities Act of 1933 (as amended, the “Securities Act”), such

information (the “paragraph (a)(3)(i)(A) information”) be publicly disclosed “on the date the underwriter and the issuer or depositor set the offering price of the securities being rated.”

Paragraph (i)(B) of proposed rule 17g-5(a)(3) would require that, in an offering not registered under the Securities Act, including transactions conducted pursuant to rule 144A or Regulation D under the Securities Act, Securities Act § 4(2) private placements and offshore transactions, the paragraph (a)(3)(i)(A) information “be disclosed to investors and credit rating agencies on the date the underwriter and the issuer or depositor set the offering price of the securities being rated, and disclosed publicly on the first business day after the transaction closes.”

After pricing, paragraph (ii) of proposed rule 17g-5(a)(3) would require the disclosure, “through a means designed to provide reasonably broad dissemination,” of:

“All information [together with the paragraph (a)(3)(i)(A) information, the “paragraph (a)(3) information”] provided to the nationally recognized statistical rating organization by the issuer, underwriter, sponsor, depositor, or trustee that is used by the nationally recognized statistical rating organization in undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument, with such information to be disclosed publicly at the time such information is provided to the nationally recognized statistical rating organization.”

Proposed rule 17g-5(a)(3) does not specify which party is required to publicly disclose the paragraph (a)(3) information. Although the Commission indicated that an NRSRO may require a representation from the issuer or another party to the transaction that the required information had been publicly disclosed in accordance with the proposed rule, the Commission made clear that:

“the proposed rule does not provide a safe harbor for an NRSRO arising from such a representation. Consequently, an NRSRO would violate the proposed rule if it issued a credit rating for a structured finance product where the information is not disclosed notwithstanding any representations from the arranger.”
(Proposing Release at p. 31.)

Proposed rule 17g-5(a)(3) would represent a radical reordering of the roles and responsibilities of the parties involved in a securities offering, would sweep much more broadly than is necessary to achieve the Commission’s objectives, and therefore is not narrowly tailored as it applies to NRSROs to achieve Exchange Act requirements, as required

by Exchange Act § 15E(c)(2). As discussed below, however, we believe that the Commission could adopt a series of rule amendments that would not raise these fundamental concerns but that would nevertheless allow the Commission to achieve its principal objectives.

1. *Proposed rule 17g-5(a)(3) would represent a radical reordering of the roles and responsibilities of the parties involved in a securities offering*

By failing to specify which party has the burden to publicly disclose the paragraph (a)(3) information – the NRSRO or one of the “arrangers” (i.e., the issuer, underwriter, sponsor or depositor) – and by not providing a safe harbor to an NRSRO that obtains an undertaking from an arranger to disclose the information in accordance with the rule, the proposal would leave the disclosure burden squarely on the shoulders of the NRSRO and risk involving the NRSRO more fully in the “working group” for each structured product transaction. It is unclear how else the NRSRO would know when the transaction was scheduled to price, or close, so that it would be able at a moment’s notice to publicize the paragraph (a)(3) information. It is also unclear how else the NRSRO would know who the “investors” are in an unregistered transaction. Transaction timetables often change unexpectedly and it is not reasonable to assume that the NRSRO will know when pricing has occurred or when it has been delayed unless the NRSRO becomes much more involved in the offering process than has heretofore been deemed necessary or appropriate. If one of the Commission’s goals in the proposals set forth in the Proposing Release is to enhance the independence of the credit rating analyst (see, e.g., the discussion of proposed rule 17g-5(c)(5) at pp. 58-60 of the Proposing Release), then rule 17g-5(a)(3), as proposed, works at cross-purposes with this goal. We believe the Commission could have found a more narrowly tailored way to achieve the objectives of proposed rule 17g-5(a)(3).

In no other public offering context has Congress or the Commission placed an affirmative disclosure obligation on a party that is neither a seller nor a person identified in Securities Act § 11. This is particularly puzzling given that the Commission has previously made clear that NRSROs are not parties subject to Section 11. Rule 436(g) specifically provides that “the security rating assigned to a class of debt securities . . . by a nationally recognized statistical rating organization . . . shall not be considered a part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Act,” and the Commission has recently proposed to broaden the coverage of this rule to protect all credit rating agencies, not just NRSROs. (See *Security Ratings*, Securities Act Release No. 8940 (July 1, 2008).)

Moreover, in no previous private placement or offshore transaction context has Congress or the Commission placed an affirmative disclosure obligation on any party, much less a party that is neither an issuer, seller or underwriter, and certainly has never required the disclosure of information to parties that are not investors. While certain non-exclusive safe harbors to the Securities Act § 5 registration requirement (e.g. rule 144A and Regulation S) have conditions that include limited information and notification requirements, the burden for

complying with these requirements falls on those who otherwise would have a Section 5 prospectus delivery requirement, not third parties.

Once an offering is completed, proposed rule 17g-5(a)(3) would create an ongoing public disclosure obligation for NRSROs. This too is unprecedented. In no other context has Congress or the Commission required a party other than an issuer and its security holders to provide information about a security to the market on an ongoing basis.

As a result, proposed rule 17g-5(a)(3) would, if adopted, effect a substantial reordering of the traditional roles and responsibilities of securities market participants, and therefore raises the question of whether, insofar as it applies to NRSROs, it is “narrowly tailored to meet the requirements of [the Exchange Act] applicable to nationally recognized statistical rating organizations,” as required by Exchange Act § 15E(c)(2). Also, by effectively prohibiting an NRSRO from publishing its rating opinions until it has first determined that all underlying data required by paragraph (a)(3) has been disclosed, the proposal would likely violate the First Amendment protections that courts have repeatedly applied to rating agencies such as Ratings Services.

Could the objectives of the proposed rule have been met in a manner that is substantially less restrictive and less burdensome to NRSROs? We believe the answer is unequivocally yes. The objectives of proposed rule 17g-5(a)(3) could have been substantially achieved, with minimal disruption to the securities offering process, by leaving the disclosure burden with the parties who already have it and who create, collect and/or own the information to be disclosed – issuers, underwriters and the other parties referred to in Securities Act § 11. For registered offerings, the Commission could require the paragraph (a)(3) information to be disclosed pursuant to Regulation AB under the Securities Act, or otherwise as a requirement pursuant to Securities Act § 10(c). For private offerings and offshore transactions, the Commission could condition the various Section 5 safe harbors on the issuer’s ongoing public disclosure of the paragraph (a)(3) information, in much the same way that rule 144A contemplates that the issuer will make available financial information to holders and prospective purchasers.

The Commission’s announced goal for the rulemaking – “to expose an NRSRO that was unduly influenced by the “arranger-pay” conflict into issuing higher than warranted ratings” – could readily be achieved without analyzing the NRSRO rating on every single structured product offering. (Proposing Release at p. 31.) While amending the existing non-exclusive safe harbors may not provide universal coverage of all structured product offerings, everywhere in the world, in which an NRSRO is paid to assign a rating, never before has the Commission considered it essential to its regulatory program that it regulate every single offering of a security, regardless of the level of sophistication of the targeted investors, and regardless of whether the issuers, underwriters and investors have any connection whatsoever to the United States. It is difficult to believe that Congress had in mind any such expansion of the Commission’s role in private and global securities markets when it passed the Credit Rating

Agency Reform Act. Certainly nothing in the Credit Rating Agency Reform Act envisioned that credit rating agencies would become so directly involved in the offering disclosure and ongoing reporting system. To the contrary, any rule to that effect would plainly run afoul of the “narrow tailoring” requirement of Exchange Act § 15E(c)(2).

2. *There should be an explicit safe harbor for NRSROs*

If despite the compelling reasons for not doing so, the Commission nevertheless imposes a public disclosure burden on NRSROs for the paragraph (a)(3) information, the Commission should provide an explicit safe harbor for an NRSRO that agrees with another party to the transaction that such party will undertake the rule 17g-5(a)(3) public disclosure obligation. Without such a safe harbor, NRSRO involvement in the securities offering process will likely necessarily increase, contrary to the goal of promoting greater NRSRO independence from the process. This involvement could include setting offering timetables and interacting with the underwriter’s sales force and their customers to ensure that the paragraph (a)(3) information was disclosed at the right time and to the right accounts. Not only would this involvement be highly disruptive to the offering participants, it could potentially confuse investors about the role of the NRSRO in the transaction and encourage the undue reliance on credit ratings that the Commission seeks to counteract.

Such a safe harbor could be an element of proposed rule 17g-5(b)(9), and read as follows:

“(9) Issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset backed or mortgage backed securities transaction an asset-backed security that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument, unless the nationally recognized statistical rating organization discloses, or contracts with such issuer, sponsor or underwriter, or with the depositor or trustee with respect to such security, for such issuer, sponsor, underwriter, depositor or trustee to disclose, the information required by paragraph (a)(3) of this section in accordance with the requirements of paragraph (a)(3) of this section; provided that in any case where a nationally recognized statistical rating organization contracts with an issuer, sponsor, underwriter, depositor or trustee to disclose such information, such nationally recognized statistical rating organization shall not be responsible for any failure by such issuer, sponsor, underwriter, depositor or trustee to comply with its contractual obligations.”

If the Commission declines to adopt a safe harbor for NRSROs, or an NRSRO would otherwise have any residual responsibility for disseminating paragraph (a)(3) information,

then consistent with Exchange Act § 15E(m)(2), the Commission should provide explicitly, by rule, that the only party that bears liability for such information pursuant to Securities Act § 12 and the antifraud provisions of the federal securities laws is the party that provided that information to the NRSRO.

3. *Proposed rules 17g-5(a)(3) and 17g-5(b)(9) raise a number of other issues that should be addressed in the final rulemaking*

Although we believe that it is critical that the final rulemaking resolve the issues discussed above that directly implicate the Commission's rulemaking authority, there are a number of other issues with proposed rules 17g-5(a)(3) and 17g-5(b)(9) that also should be considered.

a. *Definition of "security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction"*

While the Commission's concerns appear to relate principally to residential mortgage back securities (RMBS) and collateralized debt obligations (CDOs) linked to subprime loans, the Commission's use of the phrases "asset pool" and "asset-backed or mortgage-backed securities transaction" in proposed rule 17g-5(b)(9) appear to sweep more broadly than intended by the Commission. For example, a registered investment company could be considered to be a pool of assets. Certain securities issued in municipal finance transactions, such as special revenue bonds, would arguably fall under the category of "asset pool." In addition, many common types of securities that ordinarily would not be considered part of the structured products market and that are used in financing transactions for corporate issuers, such as trust preferred securities, may inadvertently be caught by the proposed phrasing. The Regulation FD concerns discussed below would be particularly acute if proposed rules 17g-5(a)(3) and 17g-5(b)(9) did not clearly except from their scope securities issued in transactions involving corporate issuers. We therefore suggest substituting the phrases "asset pool" and "asset-backed or mortgage-backed securities transaction," as used throughout the Proposing Release, with the term "asset-backed security" as defined in Regulation AB, or perhaps use that defined term as a building block for what the Commission intends to cover.

b. *Whether information is "used in" determining a rating or "used by" an NRSRO in undertaking rating surveillance*

There are at least two fundamental difficulties created by the way proposed rule 17g-5(a)(3) defines the content of paragraph (a)(3) information.

First, unless the Commission clarifies that only written information provided to the NRSRO (including via email) is covered by paragraph (a)(3), then the proposed rule will for all practical purposes halt or substantially impede and chill the normal (and beneficial)

iterative process between a rating analyst and a sponsor in developing a structured product rating. We do not believe that this could have been the Commission's intent, since throwing such hurdles into the rating formulation process could reasonably be expected to result in an overall decline in rating quality. Therefore we request that the Commission clarify that proposed rule 17g-5(a)(3) covers written information only.

Second, information may be provided to an NRSRO by an arranger or trustee and not ultimately used by the NRSRO in formulating or surveilling a rating. The arrangers and trustees may or may not be aware of which information is not used and therefore extraneous to the paragraph (a)(3) information, and given the volume of information covered by the paragraph (a)(3) requirement, the global scope and breadth of the businesses impacted by the requirement and the strict time limits that apply for disclosure, it would be extremely burdensome and impractical to require the NRSRO to sort through the information provided by arrangers and trustees and determine which bits of data were "used" and which were not. As a result, it should be permissible for the disclosing party to disclose this extraneous information along with the paragraph (a)(3) information without potentially running afoul of the general solicitation or directed selling efforts proscriptions in rule 144A, Regulation D, Regulation S or otherwise. We request that the Commission make this clear in the form of guidance in the final rulemaking.

- c. *Disclosure "on the date the underwriter and the issuer or depositor set the offering price of the securities being rated"*

The Commission's statement that paragraph (a)(3) information is subject to the antifraud provisions of the Securities Act raises the question of whether paragraph (a)(3) information is material to an investment decision and therefore must be made available to investors at or prior to the time of sale pursuant to rule 159 under the Securities Act. Given the significant volume of paragraph (a)(3) information, underwriters may be reluctant to confirm sales of securities if that information is not available to investors for some period of time. This, in turn, could unintentionally create a "speed bump" for executing asset-backed securities offerings. To avoid this, the Commission should allow paragraph (a)(3) information to be disclosed to the public (in the case of a registered offering) and to investors and credit rating agencies (in the case of an unregistered offering) before the pricing date as well as on the pricing date.

Alternatively, the Commission could provide guidance to the effect that as long as the paragraph (a)(3) information is properly disclosed on the pricing date, and all other information material to an investment decision has been conveyed to investors in accordance with rule 159, underwriters may properly confirm sales before or after the disclosure of the paragraph (a)(3) information.

The Commission asked in the Proposing Release whether it would "be more appropriate to require NRSROs hired by the arranger to wait a period of calendar or business

days (e.g., 2, 4, 10 days) after the asset pool is settled upon by the arranger before issuing the initial credit rating in order to provide other NRSROs with sufficient time to determine an unsolicited rating?” (Proposing Release at p. 40.) Although such a requirement would primarily be of concern to participants in the structured products market, we believe that such a delaying requirement would introduce a substantial element of risk into the process of underwriting structured products, and therefore increase underwriting costs and reduce investor returns if those costs are passed along to the market. We also believe the Commission should consider that because proposed rule 17g-5(a)(3) would apply to securities offerings around the world, any rule that purports to regulate offering timetables would severely harm an NRSRO’s ability to compete in foreign markets against rating agencies who are not subject to comparable requirements.

Moreover, any proposal that would require an NRSRO to delay the issuance of a rating in order to permit other rating agencies to issue their own unsolicited ratings, would involve the Commission in the rating process contrary to existing law, and would also raise serious constitutional concerns. The First Amendment does not permit the Commission to restrain the publication of rating opinions, even if only for a short period of time, and even if such restraint is intended ultimately to increase the number of rating opinions available to the market.

d. *Disclosure to “investors”*

In an unregistered transaction, the paragraph (a)(3) information would be disclosed to “investors” on the pricing date. Underwriters should not be required to disclose their proprietary customer lists to NRSROs, and NRSROs should not be put in the position of needing to communicate in any way with an underwriter’s customer. Beyond the proprietary nature of the underwriter-customer relationship and the potential liability reasons for not encouraging direct communications between an investor and an NRSRO, the amount of coordination that would need to take place between underwriters and NRSROs to ensure that the paragraph (a)(3) information was delivered to the correct accounts at the right time could, as noted above, force the NRSRO to become more involved in the deal team. The proposed requirement that information be made available to “investors” in an unregistered transaction therefore reinforces the argument set out above that the disclosure burden must remain with the parties who currently bear it; alternatively, the above suggestion that the Commission create an explicit safe harbor for NRSROs in proposed rule 17g-5(b)(9) could address this problem.

e. *Disclosure to “credit rating agencies”*

Paragraph (i)(B) of proposed rule 17g-5(a)(3) requires the disclosure of paragraph (a)(3) information to “credit rating agencies,” including those not registered as NRSROs. The proposal would appear to require disclosure to any and all credit rating agencies, even those that had not previously identified themselves to the NRSRO or to the arrangers. There is

simply no way for an NRSRO, an issuer or an arranger to know whether an unregistered entity in fact:

- (i) is “engaged in the business of issuing credit ratings on the Internet or through another readily accessible means,”
- (ii) issues its credit ratings “for free or for a reasonable fee,”
- (iii) is not “a commercial credit reporting company,”
- (iv) employs “either a quantitative or qualitative model, or both, to determine credit ratings,” and
- (v) receives “fees from either issuers, investors, or other market participants, or a combination thereof,”

and therefore meets the definition of “credit rating agency” set forth in Exchange Act § 3(a)(61). If paragraph (a)(3) information is provided to a non-accredited investor (within the meaning of Regulation D), or to a U.S. person (within the meaning of Regulation S) and that entity is not in fact a statutory credit rating agency, the issuer and the underwriter may lose the ability to rely on their intended exemption from the registration requirements of Securities Act § 5.

NRSROs, issuers and underwriters should not be put in the untenable position of potentially violating proposed rule 17g-5(a)(3) by not disclosing information to a person or entity that claims to be a statutory credit rating agency, and potentially violating Securities Act § 5 by disclosing offering information to a person or entity that is not an accredited investor, or that happens to be a U.S. person. Moreover, issuers and underwriters that make a good faith effort to comply with the Commission’s disclosure rules relating to paragraph (a)(3) information should not be in jeopardy of incurring Securities Act § 12(a)(1) liability if an entity to whom paragraph (a)(3) information is provided turns out not to be a statutory credit rating agency. The Commission should therefore limit the disclosure obligation in paragraph (i)(B) of proposed rule 17g-5(a)(3) to other registered NRSROs, or alternatively should provide that the only non-registered credit rating agencies to which paragraph (a)(3) information need be made available are those that notify the issuer or underwriter that they wish to receive paragraph (a)(3) information and that publicly certify to the Commission that they meet the requirements of Exchange Act § 3(a)(61). NRSROs, issuers and underwriters should be able to rely conclusively on such public certifications for purposes of compliance with the Commission’s guidance with respect to applicable Securities Act § 5 safe harbors.

f. *Disclosure on “the first business day after the transaction closes”*

Paragraph (i)(B) of proposed rule 17g-5(a)(3) seeks to harmonize Commission guidance regarding what constitutes impermissible advertising in a private offering or directed selling efforts in an offshore transaction, on the one hand, with the requirement that paragraph (a)(3) information be broadly disclosed, on the other, by providing that paragraph (a)(3) information need not be publicly disclosed until the business day after the transaction closes. Since a private offering may still be in distribution after the closing date, the Commission should provide an explicit safe harbor from Securities Act § 5 in the event that the distribution is ongoing when the paragraph (a)(3) information is required to be disclosed.

Such a safe harbor could be an element of proposed rule 17g-5(a)(3)(i)(B), and read as follows:

“(B) In offerings that are not registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.), the information in paragraph (a)(3)(i)(A) of this section must be disclosed to investors and ~~credit rating agencies~~ nationally recognized statistical rating organizations on the date the underwriter and the issuer or depositor set the offering price of the securities being rated, and disclosed publicly on the first business day after the transaction closes (and any such disclosure shall be deemed not to constitute an offer for purposes of the Securities Act of 1933, a general solicitation or general advertising within the meaning of Rule 502(c) under the Securities Act of 1933 (17 CFR 230.502(c)) or directed selling efforts within the meaning of Rule 902(c) under the Securities Act of 1933 (17 CFR 230.902(c)); and”

g. *Regulation FD implications*

The Commission asked whether it needed “to give more guidance on the relationship between the proposed disclosure requirements regarding information about the underlying assets provided to, and used by, the NRSRO to perform ratings surveillance and the requirements of Regulation FD? If commenters believe that the proposed requirements are not consistent with Regulation FD, they should provide a detailed explanation as to why not.” (Proposing Release at p. 49.)

It is fairly clear that for structured products issuers, proposed rule 17g-5(a)(3) would nullify paragraph (b)(2)(iii) of rule 100 of Regulation FD, which permits issuers to disclose material nonpublic information to “an entity whose primary business is the issuance of credit ratings,” without complying with the simultaneous public disclosure requirement of rule 100(a)(1) of Regulation FD.

The Commission originally provided the credit rating agency exception to Regulation FD because it understood that credit rating agencies often obtain nonpublic information in the course of their rating work. The Commission stated however, that it was:

“not aware of any incidents of selective disclosure involving ratings organizations. Ratings organizations, like the media, have a mission of public disclosure; the objective and result of the ratings process is a widely available publication of the rating when it is completed. And under this provision, for the exclusion to apply, the ratings organization must make its credit ratings publicly available. For these reasons, we believe it is appropriate to provide this exclusion from the coverage of Regulation FD.” (*Final Rule: Selective Disclosure and Insider Trading*, Securities Act Release No. 7881 (August 15, 2000), text at note 30.)

When it adopted Regulation FD, the Commission clearly understood the risk of interfering with full and frank communications between issuers and rating agencies. While it may be within the Commission’s discretion to require that issuers publicly disclose any information they provide to NRSROs, the Commission should be mindful that such a requirement could easily have the unintended consequences of causing issuers to substantially limit the amount of information they provide to NRSROs, and of causing issuers to delay providing such information to NRSROs so that it can be vetted for public consumption, consequences which cannot be expected to improve rating quality.

h. *Encouraging unsolicited ratings*

In the 2007 Adopting Release, the Commission expressed reservations about unsolicited ratings, noting that “unsolicited ratings may be used to coerce issuers and obligors into ultimately paying the credit rating agency to determine and maintain the credit rating.” (2007 Adopting Release at p. 49.) Ratings Services believes that NRSROs should be entitled to issue unsolicited ratings, but sees no reason why they should receive a regulatory subsidy. Proposed rule 17g-5(a)(3) would of course act as a subsidy to credit rating agencies that are in the business of issuing unsolicited ratings, with the potential to create unintended consequences of the sort the Commission highlighted in 2007.

i. *Compliance date*

Given the market-wide changes that would be necessitated by proposed rule 17g-5(a)(3), the Commission should provide an extended period of time for NRSROs, arrangers and trustees to develop and implement the tools, systems and procedures that would be necessary in order to comply with the rule if it is ultimately adopted. We do not think it would be reasonable to expect market participants to be in a position to comply with the rule as proposed without 36 months’ lead time from the adoption of a final rule.

4. *The Commission has greatly underestimated the costs of proposed rule 17g-5(a)(3)*

The Commission estimated an average one-time cost of \$65,850 to each NRSRO and other “respondent” for developing a system, as well as policies and procedures, to support the ongoing disclosure of paragraph (a)(3) information. (Proposing Release at p. 142.) We have analyzed the rule’s requirements which, as proposed, would require Ratings Services to be in a position to capture and disclose, on a moment’s notice, information that may have come to it in a variety of different formats (e.g., electronic, email, paper and voice), and to sort through what information was “used” and what information was not “used” in formulating a rating. Our bottom line estimate is that it would cost Ratings Services approximately \$29,750,000 to build, test and deploy a system that would allow Ratings Services to comply with the proposed rule, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$8,210,000. We would be happy to provide the Commission or the staff with a detailed break-down of this figure pursuant to a confidential submission in order to protect our proprietary cost models.

G. Proposed Rule 17g-5(c)(5)

Proposed rule 17g-5(c)(5) would ban an NRSRO from issuing or maintaining a credit rating “with respect to an obligor or security where the nationally recognized statistical rating organization or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security.”

1. *The conflict of interest identified in proposed rule 17g-5(c)(5) should be managed by NRSROs pursuant to their policies and procedures, rather than be subject to an outright ban*

Ratings Services agrees with the principle that a credit rating agency should not structure the products that it rates. However, given the complexity of determining what a prohibited “recommendation” is, and precisely when, in the words of the Commission, “the NRSRO’s role would transition from an objective credit analyst to subjective consultant,” we believe that this conflict is one that is best managed through an NRSRO’s policies and procedures, rather than through an outright, and imprecise, ban. (Proposing Release at p. 60.)

Our suggestion that the conflict of interest inherent in structuring be managed by an NRSRO’s policies and procedures rather than an absolute ban is motivated by our great concern about the chilling impact that proposed rule 17g-5(c)(5) would have on communications between rating analysts and the issuers of rated securities. The Commission noted that it “recognizes that the line between providing feedback during the rating process and making recommendations about how to obtain a desired rating may be hard to draw in some

cases.” We think this understates the problem with this proposal, and believe that there is a significant risk that the proposed ban would inhibit communications between NRSROs and issuers of rated securities to the point where issuers would have difficulty understanding what criteria they are being measured against. For example, if a rating analyst informs a corporate issuer that the issuer’s long-term debt rating is under review because of its increased exposure to a given line of business, would the Commission consider this a prohibited “recommendation” about the “activities” in which the issuer should engage or refrain from engaging? Similarly, if an analyst told a rated financial institution that its current ratings could be lowered as a result of significant recent losses, barring a significant infusion of equity capital, would this be a prohibited “recommendation” about the issuer’s corporate structure, assets or liabilities? To avoid these ambiguous outcomes, analysts and issuers may err on the side of not speaking at all, or otherwise dramatically limit the scope of their communications. Such a development could only hurt the quantity and quality of information available to NRSROs in the rating process, and as a consequence diminish rating quality.

In many respects the broad ban on “recommendations” in proposed rule 17g-5(c)(5) calls to mind the difficulties encountered by companies, their external auditors, the Commission and the Public Company Accounting Oversight Board following the PCAOB’s adoption of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of the Financial Statements*, which was later superseded by Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*.

Auditors, like NRSROs, must take an objective and professionally skeptical approach to the task of analyzing their clients’ financial statements and capital structure. Following the adoption of Auditing Standard No. 2, many companies observed that it had a chilling effect on communications with their auditors concerning topics such as the proper application of accounting standards, and issuers complained that they were unable to ask their auditors for advice and assistance out of concern that the provision of such advice or assistance would lead the auditor to conclude that the company lacked adequate internal controls, or would compromise the auditor’s independence with respect to the audit client. In a similar vein, auditors sometimes refrained from engaging in dialogue with their audit clients in order to avoid compromising their independence. The Commission worked hard to reverse these misconceptions, for example releasing the following statement:

“We encourage frequent and frank dialogue among management, auditors and audit committees with the goal of improving internal controls and the financial reports upon which investors rely. Management of all companies – large and small – should not fear that a discussion of internal controls with, or a request for assistance or clarification from, the auditor will, itself, be deemed a deficiency in internal control. *Moreover, as long as management determines the accounting to be used and does not rely on the*

auditor to design or implement the controls, we do not believe that the auditor's providing advice or assistance, in itself, constitutes a violation of our independence rules. Both common sense and sound policy dictate that communications must be ongoing and open in order to create the best environment for producing high quality financial reporting and auditing; communications must not be so restricted or formalized that their value is lost." (Commission Statement on Implementation of Internal Control Reporting Requirements, Release No. 2005-74 (May 16, 2005) [italics supplied].)

The PCAOB similarly sought to reassure issuers and auditors that an auditor could provide advice to its audit clients without violating professional standards:

“[W]e are concerned about a misconception that, as a result of Auditing Standard No. 2, companies may no longer look to their auditors for advice on difficult accounting and internal control issues. This misconception appears to manifest itself in two particularly problematic ways. First, we have heard at the Roundtable and elsewhere that auditors have been unwilling to provide accounting advice to their audit clients; second, auditors have apparently encouraged audit clients to finish their assessments of internal control and their financial statements before the auditor begins audit work to attest to the fairness of those assessments and financial statements. Such practices are neither necessary nor advisable.

“Auditing Standard No. 2 provides that an auditor's detection of a material misstatement in financial statements is a “strong indicator” of a material weakness in internal control. In addition, longstanding rules on auditor independence prohibit the auditor from preparing a client's financial statements and from making financial reporting decisions on behalf of management. *The prospect of PCAOB inspectors examining for compliance with these independence rules seems to have led some to conclude that management and the auditor should not consult on accounting and internal control questions or that the auditor should not review draft financial statements that, because they are not finished or complete, may contain misstatements or misapplications of Generally Accepted Accounting Principles (“GAAP”). When auditors are unwilling, or believe that they are unable, to provide advice on accounting or internal control, management may be forced to retain other accounting experts, or to make accounting*

decisions without the benefit of access to the auditor's technical knowledge.

“Nothing in Auditing Standard No. 2 requires this result. Determining when it is appropriate for the auditor to provide accounting advice requires professional judgment and common sense. Auditors may not, of course, make accounting decisions for their clients, and management may not abandon its responsibility for quality financial reporting and simply rely on auditors to catch errors. Where management makes its own informed decisions regarding how applicable accounting principles apply to its company's circumstances, however, the auditor may discuss freely with management the meaning and significance of those principles.

* * *

“Auditors may also provide audit clients technical advice on the proper application of GAAP, including offering suggestions for management's consideration to improve disclosure and financial statement quality and giving updates on recent developments with accounting standards-setters. In addition, management may provide and discuss with the auditor preliminary drafts of accounting research memos, spreadsheets, and other working papers in order to obtain the auditor's views on the assumptions and methods selected by management. Although the auditor may determine that some of these communications need to be made in writing, timely and open communication will often be best accomplished orally.

“For example, a company that is contemplating a transaction may ask the auditor for assistance in determining the proper accounting for the transaction. *In this situation, the auditor may provide substantial help, including explaining how applicable accounting principles apply to the transaction, offering sample journal entries, and reviewing management's preliminary conclusions.* This is very different from a situation in which the auditor identifies a potential misapplication of applicable accounting principles in connection with a transaction that the auditor learns of outside of the consultation process, such as during a quarterly review, or after management has completed its financial statements and disclosures, in which case the auditor would have to consider whether management's failure to recognize the potential misapplication of applicable accounting principles constitutes a

significant deficiency or material weakness.” (*Policy Statement Regarding Implementation of Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, PCAOB Release No. 2005-009 (May 16, 2005) [italics supplied; footnotes omitted].)

Just as the Commission and the PCAOB understood that an auditor should be able to provide “advice and assistance” to an audit client without compromising the auditor’s independence “as long as management determines the accounting to be used and does not rely on the auditor to design or implement the controls,” we believe that a rating analyst ought to be able to engage in a robust dialogue with issuers or obligors seeking ratings, as long as the issuer or obligor, and not the rating analyst, makes all of the business decisions concerning the “corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security.” Since it is entirely appropriate for an auditor to “provide substantial help, including explaining how applicable accounting principles apply to the transaction, offering sample journal entries, and reviewing management’s preliminary conclusions,” we think it should similarly be appropriate for a rating analyst and an issuer to engage in a comparable iterative process. As a result, if the Commission adopts rule 17g-5(c)(5) as proposed, we expect the Commission and its staff to be tasked in the near future with issuing modifications and clarifications of what the rule is intended to ban, just as the Commission and staff were required to do following the adoption of Auditing Standard No. 2, in order to mitigate the unintended consequence of severely curtailing critical ratings-related communications.

2. *Proposed rule 17g-5(c)(5) should be limited to structured products*

In addition, we note that proposed rule 17g-5(c)(5) does not appear to be limited to structured products, and apparently would apply to communications between NRSROs and the issuer or obligor of any rated security. Given that the Commission’s discussion of proposed rule 17g-5(c)(5) focused exclusively on the process of rating structured finance products, we question whether the Commission may have intended to limit its scope to such products. (See Proposing Release at pp. 58-61.) If not, and it was the Commission’s intent to apply the proposed rule to all communications between an NRSRO and issuers or obligors, it is not clear how the proposed rule is narrowly tailored to meet the requirements of the Exchange Act applicable to NRSROs, as required by Exchange Act § 15E(c)(2). In other words, if the Commission does not suspect that any investor harm may have occurred from interactions between an NRSRO and, for example, the issuer of a corporate debt security, then the Commission would not appear to have a basis under Exchange Act § 15E(c)(2) for regulating that conduct.

3. *Proposed rule 17g-5(c)(5) should not apply to associated persons of an NRSRO if an NRSRO has adopted adequate policies and procedures to wall off associated persons*

Moreover, a rule that banned “associated persons” of an NRSRO from providing such consulting services under all circumstances would not be narrowly tailored to meet the requirements of the Exchange Act applicable to NRSROs, as required by Exchange Act § 15E(c)(2). An NRSRO that is part of a larger organization should be able to adopt policies and procedures that apply to the NRSRO only, and do not limit the activities of associated persons of the NRSRO, as long as the NRSRO does not pay compensation tied directly to the revenues of the consulting business to employees who participate in determining or approving the credit rating of a security whose issuer engaged the consulting business.

4. *Compliance dates*

The Commission should clarify in the final rulemaking that this proscription applies prospectively only. If the proscription were to apply to “recommendations” that were made prior to the rule’s effectiveness, NRSROs may be required to withdraw existing ratings on some securities, which could have profound negative consequences for investors in such securities.

If proposed rule 17g-5(c)(5) were to be adopted, we request Commission clarification that it applies only to “recommendations” made after a compliance date no earlier than 12 months after issuance of the final rule, in order to give NRSROs adequate time to establish and test appropriate compliance procedures. If the final rule extends to associated persons of an NRSRO, NRSROs and their associated persons may need substantially longer than 12 months to ensure that activities outside of the NRSRO conform to the rule’s requirements, as the rule could force associated persons to divest or restructure ongoing business operations.

5. *The Commission has greatly underestimated the costs of the three proposed amendments to rule 17g-5(c)*

The Commission estimated that the three proposed amendments to rule 17g-5(c) would impose *de minimis* costs on NRSROs. (Proposing Release at p. 143.) Ratings Services has analyzed what it believes it would be required to spend in personnel time, systems modifications and training in order to comply with the three new prohibited conflicts, and believes that the aggregate cost to Ratings Services would be approximately \$7,830,000, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$2,250,000. As mentioned above, we would be happy to provide the Commission or the staff with a detailed break-down of this figure pursuant to a confidential submission in order to protect our proprietary cost models.

H. Proposed Rule 17g-5(c)(6)

Proposed rule 17g-5(c)(6) would ban an NRSRO from issuing or maintaining a credit rating “where the fee paid for the rating was negotiated, discussed, or arranged by a person within the nationally recognized statistical rating organization who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.”

We agree with the basic principle embodied in proposed rule 17g-5(c)(6), which is that the individuals who determine ratings should not be the same individuals who negotiate fees for those ratings. However we have two concerns with the rule as proposed.

First, the proposed rule would ban mere “discussions,” and by its terms would appear to apply even to *internal* discussions. If the rule is only intended to ban discussions between NRSRO analysts, on the one hand, and the issuer, arranger or subscriber paying for the rating, on the other, this restriction is appropriate and should be clarified in the rule text.

However, if the rule is intended to ban all *internal* discussions among NRSRO personnel about fees, we are concerned both that the rule would interfere with legitimate internal communications, and that the consequence of an isolated violation of the rule would be excessively harsh for issuers and investors. While Ratings Services’ policy bans analysts from negotiating fees with rated entities, certain normal course internal business conversations necessarily involve a discussion of fees. For example, analysts may be asked to provide information to commercial personnel that those personnel consider in arranging fees, such as the complexity of the deal and the time required to complete the rating process. It is also possible that analysts may hear about fees charged for ratings they worked on, or may make an occasional reference to the fact that the customer is paying a fee. Analysts are aware, after all, that they work in the private sector. If a reference to fees in these contexts were deemed to be prohibited “discussions,” and as a consequence the NRSRO were forced to withdraw a rating, the trading market for the rated security could be severely disrupted to the detriment of the issuer and its investors. As a result, we believe the rule should not ban the mere discussion of fees as long as those discussions are internal in nature.

Second, the proposed rule is overbroad insofar as it would cover NRSRO personnel beyond those involved in specific rating decisions, and include personnel, such as senior management, with responsibility for “developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.” This language could sweep up members of management who need to be able to deal directly with customers of the business. We believe that the formulation the Commission has proposed for rule 17g-5(c)(7), focusing on personnel involved in rating actions, would appropriately cover the individuals whose rating decisions might otherwise be shaded by irrelevant factors.

We would propose that the rule read as follows:

~~“The nationally recognized statistical rating organization issues or maintains a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by between an obligor, issuer, sponsor, or underwriter of the rated security, on the one hand, and a rating analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating, on the other. a person within the nationally recognized statistical rating organization who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models”~~

Alternatively, we believe that the formulation recently adopted by the Technical Committee of the International Organization of Securities Commissions (IOSCO) in its “Code of Conduct Fundamentals for Credit Rating Agencies” would be a useful model for Commission action:

“A [credit rating agency] should not have employees who are directly involved in the rating process initiate, or participate in, discussions regarding fees or payments with any entity they rate.”
(Final Report: The Role of Credit Rating Agencies in Structured Finance Markets, Technical Committee of the International Organization of Securities Commissions (May 2008), Annex A, Code of Conduct Fundamentals for Credit Rating Agencies, at paragraph 2.12.)

In addition, as with proposed rule 17g-5(c)(5), we believe that the Commission should clarify in the final rulemaking that this ban applies prospectively only, so that NRSROs are not forced to withdraw existing ratings on securities, to the detriment of investors in such securities.

I. Proposed Rule 17g-5(c)(7)

Proposed rule 17g-5(c)(7) would ban an NRSRO from issuing or maintaining a credit rating “where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than \$25.”

We believe it is the Commission's intent, and would appreciate clarification in the form of guidance in the adopting release, that proposed rule 17g-5(c)(7) does not impose a lifetime limit of \$25 on gifts or entertainment provided by obligors, issuers, underwriters or sponsors of rated securities. In other words, if a rating analyst attends ten business meetings with an underwriter over the course of two years, the rating analyst can accept "gifts, including entertainment" worth up to \$25 at each such meeting.

We also believe that the rule should exempt the receipt of gifts, including entertainment, in connection with normal business activities that are conducted outside of the United States with obligors, issuers, underwriters or sponsors whose principal place of business is outside of the United States. Alternatively, the rule could provide a much higher dollar threshold for such normal business activities, such as \$250. The purpose of such an exemption (or higher dollar threshold) would be to permit NRSROs with operations outside the United States to conduct their normal business activities in accordance with local business customs. Since such an exemption (or higher dollar threshold) would only apply to activities with no direct U.S. nexus, the risk to U.S. investors would appear to be minimal and such an exemption (or higher dollar threshold) would help to ensure that proposed rule 17g-5(c)(7) is narrowly tailored to the purposes of the Exchange Act.

Apart from the concerns noted above, Ratings Services supports proposed rule 17g-5(c)(7). However, as with proposed rules 17g-5(c)(5) and 17g-5(c)(6), the Commission should clarify in the final rulemaking that this ban applies prospectively only, so that NRSROs are not forced to withdraw existing ratings on securities, to the detriment of investors in such securities.

J. Proposed Rule 17g-7

Proposed rule 17g-7 provides that:

"(a) A nationally recognized statistical rating organization must attach a report each time it publishes a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that describes the rating methodology used to determine such credit rating and how it differs from the determination of ratings for any other type of obligor or debt security and how the credit risk characteristics associated with a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction differ from those of any other type of obligor or debt security.

"(b) Exemption from attaching report. A nationally recognized statistical rating organization is not required to attach the report

each time it publishes a credit rating as prescribed by paragraph (a) of this section if the credit rating symbol used by the nationally recognized statistical rating organization to indicate the credit rating identifies the credit rating as relating to a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction as distinct from a credit rating for any other type of obligor or debt security.”

In the cost-benefit analysis of proposed rule 17g-7 mandated by the Paperwork Reduction Act of 1995, the Commission said that it “believes . . . that most, if not all, NRSROs would opt to differentiate their ratings . . . rather than publish a report. . . . The Commission believes that an NRSRO would choose to employ this symbology approach because it would be more efficient and less burdensome than ensuring that the appropriate report was published along with the credit rating.” (Proposing Release at p. 121.) It is clear, therefore, that the intent of proposed rule 17g-7 is to cause NRSROs to change their rating symbols for structured products.

Under either paragraph (a) or paragraph (b) of the proposed rule, the Commission would be dictating the substance of the rating in violation of Exchange Act § 15E(c)(2). The Commission seemed to acknowledge this in the Proposing Release, which queries whether the Commission has “legal authority” to prohibit a common set of symbols for different types of obligors and debt securities. (Proposing Release at p. 101.) This proposal not only violates the commands of Congress, but also well-settled First Amendment protections. State and federal courts have consistently recognized that rating opinions deserve a high level of First Amendment protection in a wide array of circumstances. This is based on the reality that, at their core, rating agencies perform First Amendment functions by gathering information on matters of public concern, analyzing it and disseminating opinions about it to the general public. These First Amendment protections insulate rating agencies from governmental intrusion into the rating process and, we believe, were a main source of the limitations imposed by Congress in Exchange Act § 15E(c)(2). By compelling NRSROs to speak a certain way with respect to their ratings on structured products, proposed rule 17g-7 would place the Commission in the role of determining the content of NRSRO speech, which would constitute a plain violation of these protections.

The proposed rule could also have other unintended consequences. NRSROs have intellectual property rights in their rating symbols, and implementation of the proposed rule may not be as simple as attaching a common suffix or other signifier to existing scales. Because NRSROs may seek to preserve exclusive intellectual property rights in their respective rating symbologies, proposed rule 17g-7 could end up producing as many new and different symbol scales for structured products as there are NRSROs. It is difficult to see how multiplying the number of rating scales for a particular security would lead to increased investor understanding about the security’s risks; we believe this could just as easily lead to increased investor confusion about the security.

If proposed rule 17g-7 were to be adopted despite these serious concerns, then the issues highlighted in our comments on proposed rules 17g-5(a)(3) and 17g-5(b)(9) (see Part F.3.a above) regarding uncertainty over the scope of the term “security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction” apply equally to proposed rule 17g-7.

In addition, if proposed rule 17g-7 were to be adopted, the Commission should provide NRSROs with at least a 24 month period to comply. Such a timeframe would be necessitated by the market-wide changes that would be driven by the proposed rule, including the need for institutional investors to review and potentially amend their investment guidelines, and the need for market data vendors and others to undertake necessary system and software changes.

The Commission did not estimate the costs to NRSROs (or to the market in general) of changing NRSRO symbol scales for structured products. (Proposing Release at pp. 145-148.) It is not clear why the Commission has not provided such an estimate, since, as noted above, elsewhere in the Proposing Release the Commission stated that it expected most, if not all, NRSROs would choose the symbology alternative. (E.g., Proposing Release at p. 121.) We question whether the Commission can proceed to a final rule in the absence of such an estimate. We have attempted to quantify our own costs of implementing the provisions of proposed rule 17g-7(a), and we estimate the one-time cost to Ratings Services would be approximately \$1,190,000, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$290,000.

However, since the Commission believes that most NRSROs would choose to comply with proposed rule 17g-7(b), we believe the Commission should consider the costs to other market participants and the market as a whole, which are likely to greatly exceed the costs to individual NRSROs. We understand that the necessary system and software changes would likely be costly for third parties to implement. Based on feedback we have received from institutional investors, the primary market for structured products and therefore the presumed beneficiaries of this proposal, we believe that most are overwhelmingly opposed to it out of concern that the benefits will be modest and far outweighed by the implementation costs. We trust that the Commission is seeking input on this point from investors, market data vendors and other market participants who would be directly affected by the proposed rule.

K. Proposed Amendments to Exhibit 1 to Item 9 of Form NRSRO

The Commission proposes to amend Exhibit 1 to Item 9 of Form NRSRO in order to include performance measurement statistics of the credit ratings separately for each class of credit rating for which the NRSRO is registered, and any other “broad class of credit rating” issued by the NRSRO. The performance measurement statistics must at a minimum show the performance of credit ratings in each class over one year, three year and 10 year periods through the most recent calendar year-end. An NRSRO registered in asset-backed securities

must include “credit ratings of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction for purposes of reporting the performance measurement statistics for this class.” The NRSRO must provide “default statistics that include defaults relative to the initial rating and must incorporate defaults that occur after a credit rating is withdrawn.” Finally, an NRSRO must provide the Web site address of the XBRL record of its credit rating actions contemplated by proposed rule 17g-2(d).

Ratings Services generally supports the proposed amendments to Exhibit 1 to Item 9 of Form NRSRO, with three exceptions.

First, an NRSRO may not be able to provide statistics with respect to defaults that occur after a credit rating is withdrawn. Once an NRSRO withdraws a credit rating, the NRSRO may no longer receive notice of defaults from the issuer of the rated security, and therefore would not be in a position to include such defaults in its statistics. This is particularly a concern with issuers who do not continue to be subject to, or current in, ongoing reporting obligations under the Exchange Act, such as many foreign issuers of rated securities. Therefore, the relevant sentence of the proposed amendment should be revised as follows:

“The default statistics must include defaults relative to the initial rating and must incorporate defaults that occur after a credit rating is withdrawn if the issuer or obligor of the relevant security has notified the NRSRO of such default in accordance with the method of notification followed by the issuer or obligor prior to withdrawal of the rating.”

Second, as discussed above in our comments on proposed rule 17g-2(d), Ratings Services does not believe that NRSROs should be required to release their proprietary intellectual property to the public on an unrestricted basis, and therefore objects to any requirement to include in Form NRSRO the Web site address of the XBRL record of credit rating actions contemplated by proposed rule 17g-2(d).

Finally, we would appreciate clarification on two points. The Commission should clarify that statistics need not be compiled for ratings withdrawn before September 24, 2007. This is necessary because NRSROs were not theretofore subject to a requirement to retain the relevant information. In addition, the Commission should clarify whether statistics are to be provided for the most recent one, three and 10 year periods, or whether it is seeking data that is an average of performance over multiple one-year, three-year and 10-year periods covering as many years as possible.

The Commission did not analyze the costs of each element of its proposed amendments to Form NRSRO, and instead estimated that all amendments to Form NRSRO

would result in an average one-time cost per NRSRO of \$12,740. (Proposing Release at p. 134.) We have analyzed how much it would likely cost Ratings Services in order to build systems that will enable compliance with each proposed amendment to Form NRSRO, and have concluded that these new requirements would result in one-time costs to Ratings Services of approximately \$6,710,000, exclusive of ongoing costs. We estimate that annual ongoing costs would be approximately \$1,860,000. We would be happy to provide the Commission or the staff with a detailed break-down of this figure pursuant to a confidential submission in order to protect our proprietary cost models. In addition, it is not clear why the Commission chose to use the nine currently registered NRSROs as a basis for the cost estimate for these Form changes, and not the 30 NRSROs the Commission used elsewhere (see e.g., Proposing Release at footnotes 251, 252, 255, 256 and 262).

L. Proposed Amendments to Exhibit 2 to Item 9 of Form NRSRO

The Commission proposes to amend Exhibit 2 to Item 9 of Form NRSRO in order to require NRSROs to disclose:

- “whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings;
- “the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings; and
- “procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings.”

Ratings Services generally supports the proposed amendments to Exhibit 2 to Item 9 of Form NRSRO. However, as discussed above, we would appreciate clarification of the term “asset pool,” and alternatively would suggest replacing the phrase “security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction” with “asset-backed security” as defined in Regulation AB.

July 24, 2008

We at Ratings Services appreciate the opportunity to comment on the proposals and look forward to working with the Commission in moving towards final rulemaking. Please feel free to contact me or Rita Bolger, Senior Vice President and Associate General Counsel, Global Regulatory Affairs, at (212) 438-6602, with any questions regarding our comments.

Sincerely yours,



Vickie A. Tillman
Executive Vice President
Standard & Poor's Ratings Services

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Hon. Paul S. Atkins, Commissioner
Hon. Kathleen L. Casey, Commissioner
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