SIFMA™
Securities Industry and
Financial Markets Association

March 12, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC Proposed Rules Implementing Provisions of the Credit Rating Agency Reform Act

Dear Ms. Morris:

On behalf of the Securities Industry and Financial Markets Association ("SIFMA"),[1] SIFMA is pleased to submit this comment letter to the Securities and Exchange Commission (the "SEC" or the "Commission") in connection with the Commission's proposed implementing provisions of the Credit Rating Agency Reform Act (the "Credit Agency Reform Act") contained in Release No. 34-55231 (such provisions, the "Proposed Rules" or the "Proposal").

SIFMA fully and actively supports the Commission's efforts to encourage open and fair competition among rating agencies. Given the critical role that the rating agencies play in numerous aspects of the capital markets, it is essential that the lack of market competition that has at times existed among Nationally Recognized Statistical Rating Agencies (each, an "NRSRO") not lead to unfair or abusive practices in assigning ratings, charging anti-competitive rates in the rating process, or implicitly requiring additional purchases of ratings services in connection with the issuance of a particular rating. It is also critical that market power not be used to preclude the entrance of qualified new entrants into the ratings business. Availability of a choice in rating agencies to all market participants and the promotion of genuine competition to act as a check on what could otherwise be undue market power is essential to promoting fair and accurate credit assessments from the NRSROs.

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

SIFMA applauds the Commission's careful implementation of the terms of the Credit Agency Reform Act and appreciates the detail and precision of the Proposed Rules in general. It also appreciates the balance the commission has struck between its mandate to prohibit unfair, coercive or abusive practices among NRSROs in assigning ratings in an industry which currently exists as an oligopoly with genuine market power concentrated in two major firms, and the requirement imposed by the Credit Agency Reform Act not to interfere unduly in the rating process or the construction of credit ratings.

There is one area of the rules, however, we think should be both clarified and altered. That is the section dealing, in the context of structured products, with the concerns over NRSRO "notching" practices and contained in Section 17g-6 of the Proposed Rules.

When rating a CDO or other similar structured product, the risk of each underlying asset is critical to the credit assessment of the structured notes. If a rating agency refuses to take into account the credit assessment of other NRSROs on underlying assets for which it has not issued a rating, the NRSRO, if it has market power, may effectively delay the rating of the transaction until it has rated the underlying asset, thus increasing its market share and rating fees. Such an NRSRO may also effectively coerce issuers into using its ratings despite preferences in the market not to directly use that NRSRO in rating notes or other assets that already have obtained or could obtain a credible risk assessment from another NRSRO, thereby reducing legitimate competition for rating services.

The risk of a rating agency's improperly exercising market power to coerce ratings of underlying assets in structured transactions was noted the Credit Agency Reform Act. The Credit Agency Reform Act also indicated that under some conditions to be prescribed by rule an NRSRO should be prohibited from issuing a lower rating on a structured product simply because it did not rate a specified portion of the structured product's underlying assets. The Senate Report did note that there may be occasions when issuing a lower a rating or refusing to rate may be for reasons that are not unfair, coercive or abusive. The Commission proposed Rule 17g-6(a)(4) in response to the Credit Agency Reform Act's request to balance the very real threat to competition that could exist in structured products through refusal to rate a securitization if an NRSRO had not rated all of the transaction's underlying risks with the need to allow legitimate differences in opinions among NRSROs. We think the manner in which the Commission has balanced the competing requirements contained in the Credit Agency Reform Act concerning structured products, while generally sound, could be further clarified and expanded in the interest of increased market efficiency and competition.

We note that the Commission, in the Proposal, has made a general preliminary determination that it "would be unfair, coercive or abusive for an NRSRO to issue or threaten to issue a lower credit rating, lower or threaten to lower an existing credit rating, refuse to issue a credit rating, or to withdraw a credit rating with respect to a structured product unless a portion of the assets underlying the structured product are also rated by the NRSRO." This determination subject to one exception is embodied in Proposed Rule

17g-6[2]. The single exception states that "[t]he prohibition on refusing to issue a credit rating or withdrawing a credit rating shall not apply if the rating organization has rated less than 85% of the market value of the assets underlying the asset pool or the asset-backed or mortgage-backed securities."

A couple of points remain perhaps unclear in the proposed language. The first is what is meant by prohibiting an NRSRO from issuing a "lower" rating unless a portion of the assets which comprise the asset pool are rated by the NRSRO. It is unclear whether the language means: (1) lower than the rating that would be obtained if the NRSRO had used a credit rating of another NRSRO that had rated the underlying assets comprising the asset pool that were not rated by the NRSRO assigning the structured rating; (2) lower than what the agency would have issued had it rated all of the underlying assets; (3) lower than what the agency would have rated had it employed its standard procedures of estimating risks for which it has not issued a full rating, including notching down another NRSROs rating or assigning a highly conservative credit estimate; or (4) something else entirely. For the benefit of the market we would urge the Commission to clarify what it means by "lower" in this context.

In particular, we would like the Commission to clarify whether, if an NRSRO chooses to rate a transaction, and certain assets are not rated by such NRSRO, the NRSRO is permitted to "notch", or lower the ratings credit for, the assets in the pool that it has not rated, and if so, whether there are limitations to that approach. We propose that in the above situation, if an NRSRO chooses or is required to rate a transaction for which it has rated at least 85% of the underlying assets, with respect to each asset in the pool not rated by such NRSRO, where at least one other NRSRO has rated such asset, the NRSRO will be subject to a rebuttable presumption that it is acting anti-competitively in a manner that would be unfair, coercive or abusive if it assigns a rating or employs a credit assessment that is more than one notch lower (i.e. more than from BBB to BBB-) to the underlying asset. If the NRSRO's scale does not permit such a small reduction in rating then the NRSRO should not be allowed to lower the other agency's assigned rating without becoming subject to this presumption.

Such a rule would allow a dominant rating agency complete freedom in designing the content of its ratings, subject only to the requirement that its notching of competitors' ratings be justifiable analytically, while focusing attention on cases where potentially unjustified and anti-competitive departures from the risk assessment of a competitor could have the largest effect on the risk assessment of individual assets.

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[2] Proposed Rule 17g-6, following the above mentioned preliminary determination, states in relevant part that it would be unlawful for a nationally recognized statistical rating organization to engage in certain unfair, coercive or abusive practices one of which is "[i]ssuing or threatening to issue a lower credit rating, or lowering or threatening to lower a credit rating or refusing to issue a credit rating or withdrawing a credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets which comprise the asset pool or the asset-backed or mortgage-backed securities also are rated by the rating organization."

In addition, we would like the Commission to clarify the situation where an assigning NRSRO has employed "shadow ratings," summary credit evaluations or model-based ratings to evaluate assets in the pool that it does not rate. SIFMA understands that such shadow or model-based ratings generally result in a lower "rating" than that which would have obtained had a full rating of the asset been performed, due to the assigning rating agency's lack of information relating to the assets and the transaction that would have been available to it had it been retained to issue a formal rating on the asset. We propose that the Commission clarify in the final rules adopting the Proposal that in such cases, the assigning NRSRO may use such proprietary assessment of credit if no other NRSRO has rated such asset. However, where one or more other NRSROs have rated such asset, and such shadow rating or internal credit assessment is more than one ratings notch below the rating of such other NRSRO, the rebuttable presumption described above will apply, and such NRSRO will be required to similarly document such decision.

In particular, there is the question of what the prohibition on issuing a "lower" rating means in the case where the NRSRO has rated less than 85% of the pool but still chooses to rate the transaction. If the language simply means there is a prohibition on issuing a rating lower than what the agency would have assigned following its ordinary procedures, we think the language does not go far enough in preventing anti-competitive behavior. In fact we think Congress drafted the statute as it did to require evaluation and increased ongoing scrutiny of notching practices so the predominant rating agencies could not merely continue current practice without examining whether those practices abused market power and stifled competition. Even if two other credit rating agencies with limited market power had rated each asset in the pool AAA or its equivalent, an agency with market power that had only rated 10% of the pool would be free to rate the remaining 90% of the transaction CCC or its equivalent—effectively putting tremendous pressure on a transaction's sponsor to purchase additional ratings that it otherwise would not need from an agency with market power in order to issue a rating on the transaction. We think the rule should be that the agency either chooses to rate the pool and accept another agency's assessment of risk with respect to all but 15% of the pool, for which the above rules would apply, or chooses not to rate the transaction.

Finally, we would urge the Commission to consider clarifying explicitly whether the NRSRO must issue a rating if it has rated at least 85% of the underlying assets in a structured transaction. The language permits the NRSRO to refuse to rate or withdraw a rating if it rates less than 85% of the underlying assets, but does not permit the NRSRO to issue a lower rating or lower an existing rating on that basis. We think the clear inference is that the NRSRO should be required to issue a rating if it has rated at least 85% of the underlying assets, but to avoid confusion that has arisen in discussions with industry participants, we would urge the Commission to make even more explicit this reasonable inference.

SIFMA appreciates the Commission's consideration of the points raised in this comment letter. We think it is critical that any approach to notching should preclude anti-competitive behavior within this highly concentrated industry where two firms have predominant market power, provide operational efficiency for a majority of transactions and preserve a rating agency's ability to construct its ratings according to its own standards. We think the above proposal balances those interests appropriately. Should you have any questions about the comments in this letter, please contact Robbin Conner at 646-637-9228 or by email at rconner@sifma.org.

Very truly yours,

Robbin W. Conner
Vice President and Assistant General Counsel
SIFMA