July 24, 2008

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: **Proposed Rules for Nationally Recognized Statistical Rating Organizations**
Release No. 34-57967, File No. S7-13-08

Dear Ms. Harmon:

The Securities Industry and Financial Markets Association ("SIFMA")[1] Credit Rating Agency Task Force (the "Task Force")[2] is pleased to have the opportunity to comment, on behalf of SIFMA, on the recently proposed rule amendments for nationally recognized statistical rating organizations ("NRSROs") under the Securities Exchange Act of 1934, as amended.

The Task Force recognizes the importance to global financial markets of both the quality of NRSRO credit ratings and investor confidence in these ratings. In light of the recent market turmoil, particularly in markets relating to residential mortgage-backed securities ("RMBS") collateralized by subprime mortgages and collateralized debt obligations ("CDOs"), the Task Force supports efforts by the Securities and Exchange Commission (the "SEC") to address the issues relating to NRSRO ratings of these and other types of structured finance products, as well

[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 DC, and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. More information about SIFMA is available on its website at *www.sifma.org.*

[2] The Task Force is a global, investor-led industry member task force formed to examine key issues related to credit ratings and the credit rating agencies. It is comprised of 37 individuals from the US, Europe, and Asia and includes asset managers, underwriters, and issuers. The Task Force members include experts on structured finance, corporate debt, municipal debt, and equity issues. It has been designated by the President's Working Group on Financial Markets (the "PWG") as the private-sector group to provide the PWG with industry recommendations on credit rating matters. More information on the Task Force, including a roster of Task Force members, can be found at *www.sifma.org/capital_markets/cra-taskforce.shtml*.

as the issues relating to the ratings process in general.[3] The SEC has responded to concerns about the integrity of the NRSRO ratings process by proposing rules intended to increase the transparency of, manage the conflicts of interest related to, and improve the accuracy of the ratings process.[4]

The Task Force broadly supports the SEC's proposed rule amendments, and welcomes the SEC's emphasis on the need for greater disclosure from NRSROs and increased transparency of the credit rating process. The Task Force, however, encourages the SEC to give further thought to the points discussed below.

I. Enhanced Disclosure Requirements

A. Enhanced Disclosure of Information Used in the Rating Process, and Enhanced Disclosure of the Rating Process Itself

The Task Force agrees with the SEC that fostering transparency in the credit rating industry should be a primary goal of any additional regulation of NRSROs. The Task Force supports proposed new Rule 17g-5(a)(3) requiring broad disclosure of information used in the credit rating process, but notes certain issues that should be addressed. The Task Force recommends, at the same time, that the SEC foster the goal of transparency by focusing new NRSRO disclosure requirements on the credit rating process, specifically NRSRO models and methodologies.

1. Task Force Findings

Ratings of structured securities have been a particular source of controversy during the ongoing market turmoil. The Task Force found that ratings of structured securities were generally based largely on NRSRO statistical models that predicted future performance of the assets which collateralized the rated securities, based on the past performance of apparently similar assets.

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[3] The Task Force notes the SEC's primary focus appears at points to be on securities relating to the mortgage markets, and in responding to the proposal the Task Force has therefore prepared portions of this comment letter to address specifically issues that relate to mortgage-backed and related securities. The Task Force notes as well that the definition of "structured finance product" (set forth in footnote 15 of the proposal) is broad enough to cover asset-backed securities other than those related solely to mortgages.

[4] *See* Proposed Rules for Nationally Recognized Statistical Rating Organizations, 73 Fed. Reg. 36211, 36218 (June 25, 2008) ("The Commission, in light of its experience since the final rules became effective, is proposing amendments to those rules and a new rule with the goal of further enhancing the utility of NRSRO disclosure to investors, strengthening the integrity of the ratings process, and more effectively addressing the potential for conflicts of interest inherent in the ratings process for structured finance products.").

The Task Force determined that these quantitative, model-driven analyses assisted arrangers, underwriters, and securitization issuers by facilitating pricing consistency and predictability between the primary/origination market and the secondary/securitization market. A number of models, particularly many relating to RMBS, proved to be based on overly optimistic assumptions about asset performance, however. This was likely due to their reliance on a data set of past performance that generally looked back only to the relatively recent years for which performance data was available, without sufficiently accounting for the possibility of shifts in the economy and significantly changed market conditions, and which analogized the future performance of new assets to past assets, without sufficiently accounting for qualitative differences between the assets.

The Task Force found that NRSROs publish general descriptions of their structured security rating methodologies, and in some instances license their statistical models to paying subscribers. The Task Force determined, however, that this information was generally insufficient for investors to understand NRSRO rating methodology with respect to particular structured securities, even if they licensed the models. For example, even if an investor could license the NRSROs' models and obtain all the data inputs to run the model for a particular security, the investor could not determine what assumptions and adjustments the NRSROs employed in determining their final assigned rating. Therefore, investors generally did not understand the method by which NRSROs determined ratings for particular structured securities, could not on their own determine the potential flaws in the NRSROs' analyses, and were unable to monitor the performance of the securities (some of which proved to be more susceptible to ratings volatility than traditional rated corporate debt) in comparison to the assumptions underlying the NRSROs' ratings.

In light of these findings, the Task Force supports the SEC's goal of increasing transparency to help investors and other users of credit ratings to perform their own analysis and to more clearly understand the bases and limitations of a rating.

2. Task Force Recommendation - Proposed Rule 17g-5(a)(3) - Disclosure of Information Used in the Rating Process

To address the "arranger-pay" conflict that may arise when an NRSRO issues or maintains 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 "ABS") that was paid for by the issuer, underwriter, or sponsor of the ABS, proposed new Rule 17g-5(a)(3) would require broad disclosure of all information provided to the NRSRO by the issuer, underwriter, sponsor, depositor, or trustee that is used by the NRSRO either to determine the initial credit rating or to undertake credit rating surveillance of the ABS. The SEC believes that the proposed rule would encourage unsolicited credit ratings of structured finance product by NRSROs that are not hired by the arranger. These unsolicited ratings are intended both to expose any NRSRO that allows the "arranger-pay" conflict to unduly influence the credit ratings it issues, and to serve as a source of independent comparison and competition for the ratings produced by the NRSRO retained by the arranger.

The Task Force believes greater clarity may be necessary in the proposed rule, both in the use of the term "credit rating" and in the definition of the structured products covered by the disclosure requirement. For example, this disclosure requirement should be narrowed to exclude synthetic CDOs, repackaged products, and private structured credit deals. Similarly, the term "credit rating" should not include shadow or other non-public ratings.

The Task Force supports the SEC-proposed disclosure, subject to the following. The Task Force recognizes that this disclosure may enable NRSROs to provide "unsolicited" ratings and may provide added benefits.

The Task Force notes, however, that the proposal raises the following important issues. Some information is proprietary and/or confidential (*e.g.*, information regarding underlying obligors in the context of asset-backed commercial paper), and limitations on the ability to disclose such information would have to be addressed. The Task Force believes that disclosure of information used by the NRSRO either to determine the initial credit rating or to undertake credit rating surveillance of ABS should be limited to the extent that the information is valuable proprietary information or private, confidential information. For example, some information required by proposed Rule 17g-5(a)(3) would include asset-specific information, novel legal structures, and proprietary data prepared at substantial cost and representing substantial value to the preparers. Under the new rule, the creator of a unique securitization structure or the originator of an asset pool could: (i) lose all value in that creation immediately upon closing, when they would be forced to disclose the underlying make-up and structure of the creation to the public or to NRSROs for any competing issuer to duplicate; and (ii) be reluctant to disclose sensitive and proprietary information about its business or assets that may put it at a disadvantage with its competitors.[5] This, in turn, could well stifle innovation in the development of new structured finance products for sophisticated institutional investors, and discourage issuers from seeking public ratings for their products.

Further, it is important that such disclosure requirement not "chill" appropriate business communications, for example, by requiring that all oral communications between an issuer and NRSRO be reflected in writing. The Task Force is concerned that Rule 17g-5(a)(3) as currently proposed may have a chilling effect on the iterative give-and-take between issuers and NRSROs in the credit rating process given the questions concerning liability the proposed Rule raises. Concerns regarding the potential for liability for information disclosed to the NRSRO (and possibly the public) may act as a disincentive to free and open communication between the NRSRO and the parties to the transaction. As discussed in Section I.A.4 below, the Task Force's view is that such disclosure should not serve to expand the liability of an issuer or underwriter.

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[5] Certain securitization transactions involving assets or collateral that have historically involved business-sensitive or proprietary information include equipment and auto lease deals, whole business or corporate securitizations, franchise loans deals, and tax-based securitizations, most of which have primarily been done on a private/Rule 144A basis.

The Task Force also notes that there are varying opinions among Task Force members regarding to whom the proposed disclosure under Rule 17g-5(a)(3) should be disseminated. Some members support the information being made broadly to the general public, other members suggest that it be made both to NRSROs seeking to issue unsolicited ratings and to permitted investors (in the context of private deals), and still others support it being made solely to NRSROs seeking to issue unsolicited ratings.

Finally, the Task Force cautions that if unsolicited ratings are published, they should be published in a manner that makes quite clear to the market the unsolicited nature of the rating. That is because unsolicited ratings will necessarily be issued on the basis of less information, and lack the robust iterative communications with the issuer's management and on-site visits that attend solicited ratings. Investors should therefore be made aware of the unsolicited nature of the rating, so that they can properly consider the weight that they wish to give such ratings.

3. Task Force Recommendation - Disclosure of the Rating Process Itself

The Task Force believes that increased disclosure of the rating process undertaken by the NRSRO once it receives this data would be the disclosure of greatest value. Information about the rating process itself and what the rating means is not generally available to investors, despite the fact that investors are dependent upon the ratings provided by NRSROs to comply with both regulatory requirements and often their own investment guidelines. In addition, the Task Force believes information regarding the ratings process and what a rating represents can be conveyed in clear, concise, and standardized disclosure. Further, such disclosure of the ratings process by an NRSRO to the investors and other market participants actually using its credit ratings is the most effective way to minimize the perceived "arranger-pay" conflict of interest the SEC seeks to address with proposed Rule 17g-5(a)(3).

The SEC has already taken an important step to achieve this kind of disclosure through its proposal to amend Rule 17g-2(a)(2) to require a record for each credit rating of the rationale for any material difference between the rating issued and the rating implied by the quantitative model, if a quantitative model is a substantial component in the rating process. The Task Force supports this proposed amendment and believes this element of disclosure is an integral part of the overall disclosure of credit rating methodology necessary for market participants to understand and use credit ratings appropriately in their own independent risk analysis. The Task Force believes this overall disclosure should include the method by which they determine ratings for securities, and structured securities in particular. This will enable investors to better understand and evaluate the NRSRO analysis, and monitor the performance of the rated securities in comparison to the rating analysis over time.

The Task Force concluded that it would be preferable for NRSROs to adopt the practice of providing clear and concise disclosure, preferably in the form of a "pre-sale report," rather than overwhelm investors with large quantities of raw information pertaining to the model. This disclosure, above and beyond current practice and sufficient to enable the market to understand what a rating means and how it was derived, should include:

i. a description of the NRSRO model and model outputs (including cumulative collateral loss expectations relative to the pre-securitized assets and loss curve over time, bond-level loss coverage, and credit enhancement requirements);

ii. inasmuch as ratings are not purely model-driven, where appropriate, a description of material deviations from the rating or credit enhancement analysis called for by the NRSRO model, any adjustments to the model for the purpose of the subject rating, and the reasons for such deviations/adjustments;

iii. a description of qualitative factors relied upon by the NRSRO in its analysis; and

iv. a description of the risks and sensitivities of the rating to changes in key variables, such as external changes that could cause a rating to change (*e.g.*, a decline in home prices), including any stress test results.

Each rating should be developed from a general model or criteria that has been published by the NRSRO. To the extent that general model information is already published by an NRSRO, the NRSRO should, in its pre-sale report for a rated security or in such other place as is reasonable, reference such information and indicate where this information can be found.

The provision of this kind of additional specific information by NRSROs could be used by investors as they develop their independent investment decision analytics and for enhanced, better-informed risk control decisions. In addition, such greater disclosure would highlight the key distinctions between, and different risk characteristics of, certain structured products and corporate bonds. This additional transparency would at the same time obviate the need for rating modifiers to distinguish between broad categories of issue types.

While this disclosure should be appropriately concise, a level of helpful detail is called for. Simply sharing numerical scores that weigh and aggregate information, such as “volatility scores” or “stress test scores,” would by itself be of limited use to investors conducting their own risk analyses. This increased transparency of the ratings process would enhance the ability of investors and other market participants to understand and use credit ratings as just one of many inputs and considerations in their own independent risk analyses. In addition, a clearer understanding of the NRSRO assumptions and inputs used to calculate a rating allows investors to more adequately conduct their own surveillance of existing ratings.

4. Responsibility for Additional Disclosure, and Potential Liability

The Task Force recommends that the SEC require NRSROs to provide additional disclosure for the rated security, rather than require the filing of the information. The Task Force is concerned that, if the SEC were to decide upon broad public disclosure of the information, a filing requirement, in contrast to a public disclosure requirement, may have a chilling effect on issuers or sponsors and NRSROs in terms of the communication between these parties in the rating process. The filing of the disclosed information, and the accompanying potential for liability, may lead to an overly formalized exchange of information during the rating analysis, which could, in turn, lower the quality and quantity of information on which the NRSROs rely. If the SEC were to decide upon broad public disclosure of the information, the Task Force believes that public disclosure would achieve the goals of the SEC without the unnecessary requirement of filing and the potential problems associated with the imposition of liability for the information filed.

In the alternative, if the SEC determines this information should be filed, the Task Force recommends that the NRSRO be the party responsible for filing such information. If the SEC adopts the Task Force's recommendation regarding disclosure of rating methodology, the NRSRO is the appropriate party to file the information, given that this disclosure speaks directly to the NRSRO's own processes and models.

The Task Force strongly supports increased ratings transparency. If the SEC adopts proposed Rule 17g-5(a)(3) in its current form to require the disclosure of all information used in the ratings process, the Task Force recognizes that there are two views as to who should disclose the information. The Task Force understands that a number of NRSROs are of the view that they should not be the parties tasked with disclosing such information. Rather, they suggest, other parties, as the "owners" of the information, should be responsible for its disclosure.

On the basis of three reasons, the Task Force believes, however, that the NRSRO is the party best suited to disclose the information that the NRSRO used in issuing its rating. First, the NRSRO is the party that actually relied upon the information, and determined that the information was both used by the NRSRO in arriving at its rating and of sufficient quality to support the NRSRO's rating. Second, the NRSRO's view as to what information is necessary to determine an initial credit rating or to maintain surveillance on an existing credit rating can be applied in a consistent manner by the NRSRO across various issues rated by the NRSRO. Finally, while such information may come from multiple sources (including the issuer, underwriter, sponsor, depositor, and trustee), the NRSRO is the centrally situated repository of all information used by the NRSRO (in the formation of its opinion leading to the NRSRO's rating), and therefore uniquely situated to provide "one-stop-shopping" and disclose the information most efficiently.

The Task Force believes any final rule or rule amendment in this area should provide the following clarification concerning potential issuer and underwriter liability, under Sections 11 and 12 of the Securities Act of 1933, as amended, or Rule 10b-5 under the Securities Exchange

Act of 1934, as amended, for any information disclosed by an NRSRO. In general, an issuer or underwriter should not be subject to any liability under the securities laws for information disclosed by an NRSRO. Specifically, the Task Force recommends that the SEC should not treat information disclosed by an NRSRO in a pre-sale report or otherwise as a prospectus, communication, or report or valuation used in connection with a registration statement. The Task Force also recommends that the SEC provide a carve-out from issuer and underwriter liability under Rule 10b-5 for disclosures by an NRSRO.

B. Enhanced Disclosure of Diligence and Surveillance Performed By NRSROs

The Task Force strongly supports the SEC's proposed amendments to the instructions for Exhibit 2 to Form NRSRO, and agrees that enhanced disclosure regarding: (i) the verification performed on underlying assets; (ii) assessments of the quality of originators of underlying assets; and (iii) surveillance procedures for existing ratings will foster investor evaluation of the quality of NRSRO ratings. The Task Force recommends that these new disclosure requirements be expanded as discussed below to ensure users of credit ratings are fully aware of the diligence review and surveillance procedures of NRSROs.

1. <u>Task Force Findings</u>

The Task Force finds that NRSROs have in recent periods generally performed only limited (and, in some instances, do not perform any) independent review or due diligence to confirm the accuracy of data provided to them in connection with the assets underlying structured securities, and limited independent confirmation of asset origination standards. Instead, perhaps in part because some NRSROs have not seen it as their role to do more, they have substantially relied on publicly available information and/or the representations of other parties to the transaction with regard to the reliability of the data presented to the NRSROs. The post-mortems of the recent subprime mortgage crisis suggests that this reliance by NRSROs on other parties to verify the quality of assets underlying certain structured securities being rated by the NRSROs, which was combined with only a limited understanding by some market participants as to the level of this reliance, may have led to ratings that were inaccurate reflections of the default risk of such structured securities (as, for example, such ratings neglected to take into account the higher incidence of mortgage fraud). In addition, there are indications that some NRSROs may at times have relied on information that may have been questionable, taking into account market changes at the time.

Similarly, the Task Force finds that more timely and diligent NRSRO surveillance of rated structured securities would decrease the incidence of significant delays between deteriorating asset performance and related ratings downgrades, alleviate uncertainty regarding potentially impending downgrades, and contribute to stabilization of the credit markets. Uncertainty regarding the continued accuracy and reliability of ratings of certain structured securities has been a primary factor leading to investors' increased reluctance to invest in structured securities. This, in turn, has exacerbated the recent liquidity crunch experienced by the markets.

2. Task Force Recommended Disclosure of Examination Performed on Underlying Data, and Asset Origination Standards

With regard to the review of underlying data and asset origination standards, the Task Force believes that NRSROs should disclose, at a minimum:

i. whether and to what extent the NRSRO has conducted any independent examination and/or review to confirm the accuracy of underlying data and asset origination standards relating to a security;

ii. if the NRSRO relied on the due diligence or examination of another (such as an issuer, underwriter, or third party) with respect to the rating of a security, who conducted the due diligence or examination, what their relation is to the transaction, and the extent to which such due diligence or examination was relied upon;

iii. what the due diligence analysis entailed (*e.g.*, data accuracy, origination standards and processes, loan level due diligence, credit, or value);

iv. with regard to asset-backed securities, what due diligence was conducted on the individual securities or assets in the collateral pool underlying the structured deal, and what if any individual components did not receive any due diligence review; and

v. the results of the due diligence review, including what exceptions were noted.

For the reasons set forth in Section I.A.4 above with regard to disclosure of the rating process, the Task Force finds that the NRSRO is the party best suited to disclose the due diligence and examination information that the NRSRO relied upon in issuing its rating. If an NRSRO does not undertake an independent examination of the underlying data and asset origination standards, the Task Force believes the NRSRO should satisfy itself that some reasonable minimum level of examination has been undertaken by other parties to the transaction to ensure that the information underlying each NRSRO rating and opinion is of sufficient quality to support a credible rating. For example, NRSROs should question issuers to satisfy themselves that thorough underwriting due diligence, including data verification, has been performed by reputable parties.

Where the diligence disclosure reflects that a given security has a limited amount of historical data upon which to base a rating, as may be the case with newer structured finance securities, the NRSRO should prominently disclose the limitations on available data and the resulting rating's limitations and augmented risks.

The Task Force does not, however, recommend a blanket prohibition on the issuance of a rating on a structured product where there is limited information available on the underlying assets. In the instance of new structured products, there may be little or no historical information relating to the underlying assets, but the underlying assets may be comparable to, or a variation on, assets previously incorporated into structured products as to which there is an adequate amount of data available. A broad prohibition on the ability of NRSROs to rate new kinds of issues would stifle innovation, both in the creation of new kinds of issues and in the ratings process. To ensure transparency of the unique considerations and risks related to the rating of a new kind of security, the Task Force recommends that NRSROs prominently and with an appropriate level of detail disclose: (i) that there is limited information available regarding the assets underlying the security being rated; (ii) the methodology used by the NRSRO to rate the new structured product in the absence of extensive information; and (iii) the attendant risks involved.

This disclosure would not only provide additional information to investors regarding the level of examination underlying a given rating, but also serve as an impetus to NRSROs to make substantive improvements to their examination process.

3. Task Force Recommended Disclosure of Surveillance Procedures

With regard to surveillance, the Task Force believes that NRSROs should disclose how a rating will be handled on a going-forward basis following issuance of the rating, and the nature and extent of surveillance that will be performed by the NRSROs to ensure the rating remains current and reliable. NRSROs should also regularly disclose when this process has been completed with regard to individual transactions and ratings. The Task Force anticipates that this increased disclosure will incentivize NRSROs to implement improved targeted procedures and allocate sufficient resources to surveillance of existing ratings.

This disclosure should at a minimum include:

i. how frequently the NRSRO will review the rated security, and how often the rating will be updated, if circumstances warrant an update;

ii. whether the timing and nature of a surveillance review will depend on external factors (*e.g.*, the frequency and quality of updated data received from the issuer or servicer of the security);

iii. how soon after the NRSRO receives updated data it will review the data and, if appropriate, act upon the new information by updating or confirming a rating;

iv. the extent of the surveillance review (*e.g.*, review of a particular security, a particular sector, or type of transaction);

v. what the surveillance review will entail (*e.g.*, a quarterly assessment comparison to initial collateral loss expectations, periodic or event-driven sector analyses);

vi. if the issue is a structured finance security, whether its rating will be periodically updated based on a re-analysis of the underlying assets or securities and, if so, how often this re-analysis will be conducted, and how this will affect the surveillance of the structured finance security;

vii. whether the team or analyst conducting the surveillance is different than the party who was involved in assigning the initial rating, and if so why;

viii. whether different models are used for rating surveillance than for initial ratings, and whether changes made to rating models and methodologies, including their criteria and assumptions, are retroactively applied to existing ratings; and

ix. the status of current surveillance for each rating.

Surveillance should be conducted with sufficient frequency to allow market participants to take into account on a real-time basis the underlying market changes and issue- or issuer-specific events having an effect on rated securities. This ongoing analytical process should also work to incorporate qualitative marketplace factors into the ratings (*e.g.*, shifts in the housing market). In instances in which the frequency and quality of surveillance is dependent on information received from issuers of securities, or servicers of the assets underlying such securities, NRSROs should disclose that they lack the information necessary to update a rating, or may not be able to update a rating in a timely fashion. Similarly, if the frequency and quality of surveillance for the rating of a CDO or RMBS is dependent on the NRSRO's reanalysis of the underlying assets or updating of the rating of the underlying ABS, the NRSRO should disclose this factor and describe in detail the potential effects and delays on surveillance of the structured product.

The Task Force believes that increased surveillance, and investor awareness of the nature and extent of the surveillance being conducted, is central to investor confidence in the reliability of ratings over time.

II. Rating Recommendations and Interaction Between Arrangers and NRSROs

A. Proposed Rule 17g-5(c)(5) - Prohibition on Ratings Where NRSRO Made "Recommendations"

Proposed Rule 17g-5(c)(5) prohibits the issuance of a credit rating with respect to an obligor or security where the NRSRO or person associated with the NRSRO made "recommendations" to the party or parties responsible for structuring the security concerning the "corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security."

While the Task Force agrees with the SEC that NRSROs should not be rating their own work, the Task Force notes that care should be taken to ensure that this proposal does not undermine the necessary interaction that occurs between an NRSRO and the issuer, underwriter, or sponsor of a security during the rating process. Both the SEC and the Task Force recognize that the iterative process, whereby issuers, arrangers, underwriters, and NRSROs exchange information concerning the models, assumptions, and rationales behind ratings decisions, actually enhances the transparency of the ratings process. The iterative process provides the issuers, arrangers, and underwriters of RMBS and CDOs, in addition to the issuers of corporate securities, with information that is essential to the structuring and/or offering of these securities. In fact, investors sometimes approach underwriters with concepts for products that they want to purchase, but which first must be made to fit within their asset-management guidelines. The Task Force is concerned that a broad interpretation of "recommendations" could exclude this necessary interaction between issuers, arrangers, and NRSROs. Proposed Rule 17g-5(c)(5), for example, may force issuers to create structured products without the benefit of that information, or simply to desist from creating them altogether. Alternately, enforcement of the proposed rule may require an NRSRO to withdraw an already issued rating because the SEC later determines that an interaction that the parties did not consider a recommendation actually was a prohibited recommendation.

B. Task Force Recommendation - Prohibition of "Consulting" and "Advisory" Services

In place of a broad prohibition on "recommendations," the Task Force would recommend regulation that prohibits a clearly defined set of "consulting" or "advisory" services by NRSROs. Such "consulting" or "advisory" services should be distinguished from acceptable "core" and "ancillary" services provided to issuers and intermediaries in the ordinary course of business.

The Task Force views the NRSROs' permissible "core" services as including: the assignment and monitoring of public, private, and private placement ratings; issuance of credit estimates and hypothetical ratings, including requested Rating Evaluation Services and Rating Assessment Services (RES/RAS) regarding issuer-proposed structures of hypothetical securities, indicative, or preliminary ratings, and impact assessments; hybrid assessment services; internal assessments; ratings coverage of project and infrastructure finance transactions and hybrid securities; dissemination of press releases and rating reports (that include the rating opinion); research reports and other publications, including methodologies, models, newsletters, commentaries, and industry studies; regular verbal and written dialogue with issuers, intermediaries, investors, sponsors, regulators, legislators, trade organizations, and the media; and conducting and participating in conferences, speaking engagements, and educational seminars. In particular, the Task Force believes that these "core" services include the iterative process that occurs between an issuer and an NRSRO during the rating of a security.

The Task Force believes there is a misperception by some that this type of "core" interaction is essentially a consultation service by NRSROs which gives rise to an insuperable conflict of interest, and which undermines the integrity and reliability of the resulting rating. As described above, the process of rating a security necessarily involves an iterative give-and-take, however, between the issuer, arranger, underwriter, and NRSRO as part of the "core" services performed by the NRSRO.

In light of this, the Task Force does not recommend placing limitations on this iterative process. Rather, the Task Force recommends that NRSROs maintain an adequate governance structure that includes policies, procedures, mechanisms, and firewalls designed to minimize the likelihood that conflicts of interest will arise, and to manage the conflicts of interest that do arise.

Similarly, "ancillary" services, in the view of the Task Force, are permissible rating-related services that are generally segregated by the NRSRO into separate business groups. The Task Force views examples of "ancillary" services as including, among others, market implied ratings (MIRS), KMV credit risk management, data services, credit risk solutions, and indices.

III. NRSRO Performance

The Task Force broadly supports the proposed amendments to Rule 17g-2 requiring that each NRSRO retain and make public a record of its rating actions. The Task Force, however, would encourage the SEC to consider the following changes to the disclosure requirements of proposed Rule 17g-2(d) to ensure this information is accessible to market participants in a timely and easily comparable manner.

First, to facilitate comparison of NRSRO rating performance over time, the Task Force recommends that the rule require NRSROs to sort the credit ratings contained on the record by asset class. In addition, the Task Force believes this information should be made accessible on a central database created by the SEC specifically to house this information so that market participants may more easily draw direct comparisons between NRSROs, without having to collect rating action information piecemeal from different sources. The Task Force would also recommend that the SEC reduce to one or two months the timeframe for disclosure of ratings actions under proposed Rule 17g-2(d), as a six-month delay would render the data provided less useful for the purposes of assessing NRSRO performance in a timely fashion.

The Task Force also welcomes and supports the SEC's efforts to increase and refine the performance information available to investors and other users of credit ratings by prescribing in greater detail the performance statistics to be provided by NRSROs. The proposed amendments to Form NRSRO would require an NRSRO to provide separate sets of ratings transition and default rate statistics for each asset class for which the NRSRO is registered, broken out over 1-, 3-, and 10-year periods. The Task Force believes that NRSROs have not routinely published historical performance data regarding their ratings that is easily verifiable and comparable. Consequently, performance data that has been disclosed has been of limited utility to market participants seeking to compare the performance of different NRSROs.

The Task Force recommends that NRSROs publish verifiable, quantifiable historical information about the performance of their ratings in a format that facilitates the ability of investors and others to compare the performance of different NRSROs directly. Specifically, NRSROs should disclose a minimum level of transparent historical ratings migration and default performance by asset class on a directly comparable basis (*i.e.*, a common approach regarding cohort treatment, treatment of withdrawn ratings, and structured finance sector definitions, etc.). The common performance metrics chosen should not interfere with the unique rating process of each individual NRSRO, but should encourage increased surveillance by the NRSROs and allow for ease of comparability by investors and other market participants.

As an additional enhancement to the information provided, the Task Force believes that the SEC should require performance statistics to be grouped into more narrowly defined asset classes, such as CDOs and RMBS. Specifically delineated performance statistics allow investors and other users of credit ratings to more easily compare the performance of NRSROs in particular sectors of interest.

IV. Proposed New Rule 17g-7, and Rating Modifiers

Proposed new Rule 17g-7 would require NRSROs to distinguish credit ratings for structured finance products by publishing a report to accompany each such rating. The report would describe the rating methodology used to determine the credit rating, how the methodology for rating structured finance products differs from the methodology used for other ratings, and how the risks associated with a structured finance security differs from the risks associated with other products. The SEC has further proposed, however, that an NRSRO would be exempt from attaching this report if it differentiates its rating symbols or adds a rating modifier to identify structured finance products.

The Task Force considers the clear and concise disclosure of rating methodologies the most important aspect of the effort to foster transparency and allow independent evaluation of investment risk. The Task Force believes that the current ratings turmoil arose in large part from the inability of investors to independently assess the validity of assumptions underlying statistical models and the bases of these models, the reliability of asset pricing, and the limitations and risks inherent in structured finance credit ratings. Requiring enhanced disclosure of the rating methodology for different classes of assets allows investors to make these critical assessments while preserving the effectiveness of the NRSRO rating system.

The Task Force believes, however, that exempting an NRSRO from the proposed disclosure requirements if it differentiates its rating symbols or adds a rating modifier to identify structured finance products would not lead to greater transparency. The Task Force is concerned that this proposed change could further damage our already unsettled capital markets, impair capital raising (for student loans, auto loans, credit cards, mortgages, and the like), and lead to the sudden sale of structured finance securities at fire-sale prices, into an already highly illiquid market at a time when our financial markets can ill afford such an unnecessary shock to their system. The Task Force recommends therefore that NRSROs not use ratings modifiers, but instead provide greater transparency and disclosure regarding the models, inputs, and assumptions underlying any given rating, as described elsewhere in this letter.

The Task Force believes that the use of credit rating modifiers to distinguish structured finance securities would at best be a cosmetic solution to the credit rating problems. Given that most investors in structured finance issues are highly sophisticated Qualified Institutional Buyers, with $100 million or more of assets under management, they are unlikely to gain any new information from an appended "SF."

In addition, the Task Force believes that this proposal could have several negative unintended consequences.

First, the existing rating categories are embedded in investment guidelines for asset managers. Under the modifier approach, those same "AAA" securities would now be referred to by a new symbol (*e.g.*, AAA.SF) that does not explicitly appear in any existing guidelines.

The addition of a modifier to existing ratings might force asset managers working within existing carefully worded investment guidelines that mandate that purchases consist of particularly rated securities, such as "AAA" securities, to sell off structured finance securities now rated under a new symbol into an already illiquid market (depending, of course, on the specific wording of the guidelines). It may well also restrict future purchases of such securities, while the asset manager undertakes a lengthy guideline-revision process.

This problem is not restricted to investment guidelines. Asset managers and other parties would face also considerable difficulties given what the Task Force believes are easily tens of thousands of laws, regulations, corporate documents, and bilateral contracts embedded with existing rating symbols, among them state insurance and other regulations, pension legislation, SEC rules, ERISA, Basel II, compliance programs, board of directors minutes, and other US and non-US laws and regulations.

The time it can take to change State laws in the 50 States of the US is considerable. For example, while the investor-protection Uniform Securities Act has enjoyed widespread consensus support by the National Conference of Commissioners on Uniform State Laws and others, only 14 of the States in the US have adopted it since it was introduced 6 years ago. Similarly, it took the better part of a decade for all 50 of the States in the US to adopt the broadly supported revisions to Article 8 of the Uniform Commercial Code. In light of this, it is unlikely that this problem would be addressed during even a reasonably lengthy "burn-in" period for implementation of the modifier proposal, if the proposal were adopted.

Second, attaching a modifier to all structured products ratings may lead to the impairment of structured products that have thus far performed well and avoided the precipitous rating downgrades experienced by sub-prime RMBS and CDOs of asset backed securities, such as credit card, auto loan, and prime mortgage asset-backed debt. By applying a blanket modifier to securities with a variety of types of underlying collateral, the proposal would hinder the ability of investors to differentiate between such structured finance securities, and may even increase the possibility that investment boards of institutions such as pension plans and foundations might group these types of securities together as "problem" securities and react by instituting a blanket policy to not own any securities with an SF modifier. The result could be a substantial reduction in liquidity for credit card, auto loan, prime mortgage, and other asset-backed debt–resulting in higher borrowing rates to consumers.

Third, the modifier proposal raises systems and cost issues. Financial firms rely on extensive compliance and other systems that have been set up to handle the existing ratings. The firms' computer fields can accommodate the current ratings. Firms involved in securities issuance, underwriting, investment, and custody may, however, not have systems capable of accepting and interpreting the new ratings that are being considered, with fields wide enough to handle the extra characters that such a new, expanded rating scheme would require. Similar major industry systems concerns, such as Y2K systems disruptions, have of course been averted, but only at considerable expense. To quantify the cost of the modifier proposal, in terms of the otherwise unnecessary refitting of current systems that implementation of the proposal would require, SIFMA polled a number of industry firms of various sizes. The Task Force found that the cost to engage in such refitting to avoid systems disruptions would be significant, and in a number of instances that it would be millions of dollars per financial firm.

Given that there is little benefit to be realized from this proposal, and that the Task Force can anticipate significant negative consequences and needless costs, the Task Force strongly suggests that the modifier proposal not be adopted – even in the alternative. The Task Force, therefore, strongly recommends that the SEC adopt its proposed Rule 17g-7 requiring a report reflecting the specific credit rating methodology and attendant risks related to structured finance products without the proposed alternative of a differentiated symbol for structured finance products. Enhanced disclosure of NRSRO credit rating procedures and methodology and the credit risk characteristics of structured products is central to the goals of increased transparency and a reduction in excessive investor reliance on ratings. The Task Force finds that the proposed alternative of differentiated ratings or a rating modifier, however, will not further these goals. It may, instead, reduce the value of credit ratings to investors, while imposing serious burdens on both investors and arrangers of securities.

V. Conclusion

The Task Force appreciates the opportunity to comment. We support the efforts by the SEC to promote investor confidence in credit ratings, increase accountability in the rating process, and reduce conflicts of interest in the ratings process. The recent market turmoil has revealed a crisis in investor confidence in NRSRO ratings of structured securities. The lack of transparency concerning information made available to NRSROs, rating methodologies, the inputs and assumptions underlying such methodologies, the level of examination of underlying data, and the ongoing surveillance process hinders investors in their ability to utilize credit ratings as part of an independent, comprehensive approach to risk assessment. Similarly, the lack of easily accessible, comparable performance information prevents users of credit ratings from evaluating the rating performance of different NRSROs. Accordingly, the Task Force believes that the proposed requirements for increased disclosure under Rule 17g-2 and Form NRSRO discussed above are an appropriate step in light of the overall goal of increased transparency and will both allow investors to rely on NRSRO ratings with a fuller understanding of the bases and limitations of such ratings and encourage NRSROs to improve their rating processes. In order to make additional strides toward these goals, however, we hope that the SEC will take steps to further enhance and revise these proposed amendments along the lines we recommend in this letter.

While the Task Force strongly supports increased ratings transparency, at the same time it believes that the proposed amendment to Rule 17g-5 requiring disclosure of all information submitted to an NRSRO used in the rating process raises issues regarding proprietary information and potential liability for issuers and underwriters that should be noted and addressed. We encourage the SEC to review this proposed amendment in light of these concerns.

We also encourage the SEC to consider reformulating its proposed prohibition on ratings issued by NRSROs who have offered recommendations related to the rated security as a prohibition on “advisory” or “consulting” services, in order to avoid hindering the necessary iterative give-and-take between an issuer and the NRSRO during the rating process.

Lastly, we request that the SEC take note of the substantial repercussions of the use of differentiated symbols for structured products, and weigh them against the limited benefit of a modifier that provides no substantive additional information to the user of the rating. The arguments of the Task Force presented herein on the issue of rating modifiers echo the sentiments previously articulated in our letter dated June 10, 2008, to Chairman Cox, Commissioner Atkins, and Commissioner Casey. The Task Force continues to believe that the need for enhanced disclosure and transparency cannot be met by differentiated rating symbols — even as an “alternative” solution, with a “burn-in” period — without triggering significant unnecessary costs and harmful unintended consequences.

The Task Force appreciates your consideration of our views.

Sincerely yours,

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