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Providing timely, accurate credit ratings to Institutional Investors

July 25, 2008

Secretary
U.S. Securities & Exchange Commission
100 F St., NE
Washington, DC 20549-1090

RE: File No. S7-13-08

Dear Sir or Madam:

Pursuant to notice published in the Federal Register of June 25, 2008, Egan-Jones Ratings Co. takes this opportunity to submit the following comments on the proposed rules for Nationally Recognized Statistical Rating Organizations ("NRSROs"). Founded in 1995, Egan-Jones is an NRSRO which rates a wide range of corporate and other issuers of debt obligations. The company's revenues are totally derived from investors who subscribe to its services.

These comments are filed against the backdrop of a massive failure on the part of Moody's, Standard & Poor's, and Fitch, the major credit rating agencies, to fulfill their stated mission of providing investors with timely and accurate information about the ability of the debt issuers to meet their scheduled payments. Credit markets have not recovered from the 2007 collapse, and the IMF now estimates that credit defaults in this cycle will be approximately \$1 trillion worldwide. Market observers are unanimously of the view that the inflated ratings of the major credit rating agencies lie at the heart of this debacle.

For the last 10 years, Egan-Jones has been advising public policy makers that the business model of the major credit rating agencies, which purports to be for the benefit of investors but is financed by the issuers of securities, suffers from an inherent and irreconcilable conflict-of-interest. In this regard, the Commission is to be commended for proposing a new Paragraph (17g-5(b)(9)) which would specifically add "[i]ssuing or maintaining a credit rating ... that was paid for by the issuer, sponsor, or underwriter of the security or money market fund" to the list of NRSRO conflicts. However, the proposal proceeds from there on the flawed premise that the major credit rating agencies can adequately manage this conflict.

The data referenced in the preamble to the supplementary information to the proposed rule, including that Moody's has had to downgrade 94.2 percent of all the subprime residential mortgage backed securities it rated in 2006, should compel a fundamental reevaluation of this premise. The proposal's dependence on additional disclosure, reporting requirements, intra-corporate firewalls, etc. is a facially inadequate response to the enormous economic disruption directly

attributable to defective debt ratings provided under the “issuer-pay” business model.

This proposal constitutes a revision to rules first put in place in June 2007 in order to implement the Credit Rating Agency Reform Act of 2006 (the “Act”). The Commission properly perceived that a major goal of that legislation was the improvement of ratings quality through increased competition in an industry where the three major credit rating agencies control over 90 percent of total revenues. It is noteworthy that two of the five new rating agencies to receive the NRSRO designation since the passage of the Act utilize the subscriber or “investor-pay” business model.

The proposal, however, would bring the progress that has been made to date to a halt by mandating in the proposed amendment to Rule 17g-2(d) that all NRSROs make their ratings publicly available within six months of the rating action. This proposition, while arguably feasible for the issuer-pay business model, is incompatible with the concept of investor-supported rating agencies, which, as acknowledged by the Commission in fn. 122 of the proposal, are to be “encouraged” under the terms of the Act. Egan-Jones and other companies like it are able to produce independent and reliable bond-rating analysis because certain investors are willing to pay for it.

Subscribers to its services rightly believe that the information for which they are paying is not made available to non-subscribers. In the ratings business, six months is a negligible time period when the bonds being analyzed can have maturities of 10, 20 or even 30 years. For example, it was in late 2002 when Egan-Jones first noted to its subscribers that the so-called monoline insurance companies such as MBIA did not warrant the “AAA” rating ascribed to their debt by the major credit rating agencies. The broader market came to this realization in 2007, but Egan-Jones subscribers were able to have the benefit of a contrary view for a number of years. The major credit rating agencies, it might be noted, did not lower the monolines from AAA status until just recently.

Not only would the proposed disclosure requirement undermine the investor-pay business model, the mandate to make proprietary information freely available to the public may well constitute a form of government taking.

Egan-Jones supports the requirement of new paragraph 17g-5(a)(3) that potential issuers publicly disclose all relevant credit information which is provided to any NRSRO that is to be used in determining the initial credit rating for the security or money-market instrument. However, the usefulness of this issuer disclosure is largely undermined by delaying this disclosure until the offering has been priced. At that point in the offering process, it is too late for other companies to do their analysis in time to be of any use to initial investors who have already committed to the issue.

To be of any use in improving rating agency practices, this requirement must take effect at least two weeks in advance of the offering date which will allow other rating agencies and perhaps even individual investors to formulate their own credit ratings or credit assessments. The current system which allows only issuer-chosen NRSROs access to material nonpublic information is a form of

information monopoly which the Commission would never tolerate on the stock side of the investment business. This special treatment should be ended in order to ensure the uniform release of credit information to all market participants or, at a minimum, to all NRSROs.

Egan-Jones also takes issue with the implied premise underlying the current proposal which would apply only to credit ratings involving asset-based securities. This ignores the lessons which should have been learned from Enron, WorldCom, Global Crossing, Delphi, etc., not to mention the more recent equity and credit market losses attendant to the demise of New Century, Countrywide, Bear Stearns, and IndyMac. These are all examples of straightforward corporate obligations where the major credit rating agencies consistently erred on the side of overly optimistic analysis and only issued downgrades at that point in the process when doing so was useless to investors.

Finally, we would point out that the issuer-pay business model has also produced distortions in the municipal bond rating business where the major credit rating agencies have consistently erred by underrating state and local obligations in terms of both the likelihood of default and the likelihood of non-payment in the event of a default. The reason is that underrating proposed governmental issues promotes the use of bond insurance from MBIA and Ambac which then produces a situation where the major rating agencies are paid twice; once by the public issuer and secondly by the bond insurer.

While recognizing, of course, that it would be impractical to prohibit the industry standard of issuer paid credit ratings, it is important for the Commission to acknowledge that the predominant credit rating agency business model has produced severe market dislocations and financial losses which, at this time, remain open-ended. This proposal, while no doubt well-intentioned, moves in the wrong direction by failing to put forth meaningful reforms affecting the issuer-pay business model and affirmatively impairing the investor-pay alternative.

Respectfully submitted,

Sean J. Egan
President