REGIONAL
BOND DEALERS
ASSOCIATION

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July 25, 2008

Secretary
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549

Transmitted by email

In regard to File Number S7-13-08

Dear Commissioners,

The Regional Bond Dealers Association (the "RBDA") is pleased to comment on the Commission's proposed rule (File Number S7-13-08) published in the Federal Register on June 25, 2008 (the "rule proposal release"). The RBDA is an organization of regional securities firms and banks active in the fixed income markets. Our members underwrite and trade municipal, corporate, agency, mortgage- and asset-backed and government securities as well as money market instruments and other fixed-income products.

We commend the Commission for its leadership in addressing conflicts of interest involving nationally recognized statistical rating organizations ("NRSROs" or "rating agencies"). We agree with the Commission that "conflicts of interest inherent in the process of rating RMBS and CDOs" between issuers or arrangers of securities and rating agencies were a likely factor in trends that led to the severe downturn in subprime-related credit products. We believe that many of the rule changes proposed by the Commission would draw new competitors into the rating agency business, and that this competition would improve the quality of ratings and impose a new level of market discipline on rating agencies in general. We also believe that many of the Commission's proposed rule changes—such as the proposal to require the public disclosure of the information a credit rating agency uses to determine a rating on a structured product, including information on the underlying assets—would open opportunities for rating agencies to further develop business models other than "issuer-pays." This would have the effect of reducing conflicts and improving the quality of ratings.

However, we also suggest that the proposed rule changes do not go far enough in addressing conflicts involving rating agencies, in part because the scope of many of the proposed rule changes is limited to structured credit products such as asset-backed securities ("ABS") and collateralized debt obligations ("CDOs"). We also believe that the economic incentives inherent in the "issuer-pays" business model are a factor not just in the markets for ABS and CDOs but in the markets for more traditional debt products as well. We are concerned that the rule changes

the Commission has proposed will not be sufficient to curb the conflicts inherent in the "issuer-pays" model and that these conflicts could continue to taint the rating process going forward.

"Issuer-pays" results in inherent conflicts

The Commission's rule proposal release correctly recognizes that under the "issuer-pays" business model employed by the major rating agencies, "the arranger [or issuer] has an economic interest in obtaining the highest credit rating possible for each security issued…and the NRSRO has an economic interest in having the arranger select it to rate the next RMBS or CDO brought by the arranger to market." The Commission also recognizes that those incentives came into play during the rapid growth in the CDO and ABS markets in the period 2000-2006, and that those incentives are not as influential in the market for more traditional debt products like municipal, corporate and sovereign bonds. However, the relationship between rating agencies and issuers in the markets for traditional debt products is qualitatively and fundamentally no different than that relationship in the markets for ABS and CDOs. Issuers pay rating agencies for ratings in the corporate and municipal bond markets, and the same economic incentives come into play. The opportunity to adjust the structure of a bond issue to meet the requirements of rating agency criteria exists—albeit not to the same extent as with CDOs and ABS—and issuers have the opportunity to "shop" for ratings.

The importance of traditional sectors of the credit markets

Rapid growth in the markets for ABS, CDOs and other structured products is a thing of the past. Global issuance of CDOs in the first half of 2008 was nearly 90 percent lower than in the first half of 2007. Issuance of CDOs backed by "structured finance" collateral, which refers largely to subprime-backed ABS, was off nearly 95 percent in the first half of 2008.[1] Issuance of asset-backed securities overall in the first quarter of 2008 was down 82 percent from the first quarter of 2007.[2] The market for structured credit products will not recover in the near to medium term. Issuance will remain anemic relative to recent experience. While it is certainly important to address regulatory shortcomings related to structured products, this sector will not pose the same systemic threat to the financial system going forward that it did when issuance was booming. Issuance in the markets for municipal and corporate bonds, on the other hand, while down significantly from 2007 levels, will remain much more robust going forward. Arguably, it is as or more important to address potential conflicts in the markets for traditional debt products than for structured products, since traditional sectors of the credit markets will remain an important component of the financial system.

[1] Securities Industry and Financial Markets Association, "Global CDO Market Issuance Data," July 21, 2008, www.sifma.org/research/pdf/SIFMA_CDOIssuanceData2008q2.pdf.
[2] Securities Industry and Financial Markets Association, Research Quarterly, May 2008, page 1, www.sifma.org/research/pdf/RRVol3-6.pdf.

Comments on selected specific rule proposals

Addressing the "issuer-pays" conflict

Section II. A. a. of the Commission's rule proposal release describes a rule change that would address conflicts associated with the "issuer-pays" model. It would require rating agencies to disclose and manage the conflict of "repeatedly being paid by certain arrangers to rate structured finance products." The proposal would also specifically identify the "issuer-pays" conflict and, to address the conflict, would require that information provided to a rating agency for the purpose of rating a structured finance product also be publicly disseminated.

RBDA supports the Commission's proposed rule changes regarding "issuer-pays." While we recognize that the proposal is designed to encourage "unsolicited ratings" by rating agencies not being compensated by an issuer, the proposal would also have the effect of generally improving the level of transparency in the structured products market. However, we feel the proposal regarding public dissemination does not go far enough. First, we believe that the requirement regarding the public dissemination of information provided to a rating agency for the purpose of rating a structured credit transaction be applied to other credit market sectors—such as the municipal and corporate bond markets—as well. This type of transparency would improve the functioning of other sectors of the credit markets and would provide the marketplace with information that is often necessary for the purpose of valuing securities. For example, one subsector of the bond market that is still significantly crippled as a result of the broad downturn in the credit markets is auction-rate securities ("ARS") backed by student loans. One key factor preventing a return to normalcy for student loan-backed ARS is a lack of access to information regarding the performance of the underlying pool of student loan assets. This information is generally provided to the rating agencies but not to the market broadly.

Moreover, we encourage the Commission to consider whether the conflict identified in section II. A. 1. a. of the rule proposal release—issuing or maintaining a credit rating for a security or money market instrument…that was paid for by the issuer, sponsor or underwriter—should be reclassified as a conflict that is prohibited outright as those in paragraph (c) of Rule 17g-5, and whether this prohibition should be applied to traditional as well as structured credit products. We believe the "issuer-pays" model presents inherent conflicts that may not be able to be adequately managed through disclosure, dissemination and competition.

Addressing the conflict related to rating agencies structuring transactions

Section II. A. 2. of the rule proposal release describes a rule change designed to address the conflict related to a rating agency providing structuring advice for a security which it also rates. The proposal would classify this conflict as a prohibited conflict in paragraph (c) of Rule 17g-5 and would prohibit rating agencies from providing advice or recommendations to issuers, sponsors or underwriters on structuring a transaction that the rating agency also rates.

RBDA supports the Commission's proposal. We believe that conflicts arising from rating agencies providing advice on structuring securities which they also rate is not a conflict that can be adequately managed through disclosure, transparency and other means should be prohibited.

Moreover, we urge the Commission to consider extending this prohibition to traditional credit products in addition to structured credit products.

Disclosure of rating transitions

Section II. B. 1. of the rule proposal release describes a rule change that would require rating agencies to publish, in eXtensible Business Reporting Language ("XBRL") format, the initial rating and all subsequent rating changes for each security the rating agency rates. RBDA strongly supports this proposal.

Credit ratings are integral descriptors of a debt securities. In order to price a bond—and in order for an investors to evaluate a price quote from a dealer—it is necessary to know the bond's rating. We believe that this information is so integral to the way credit products trade in the market that it is appropriate to require the public dissemination of bond ratings. We also believe that requiring the disclosure of the history of ratings transitions for rated securities would impose a degree of accountability on bond raters that does not always exist in the current environment. We are particularly encouraged that the Commission's proposal would apply not just to structured credit products bit to debt instruments generally.

We urge the Commission to reconsider the proposal's six month delay between a rating action and public disclosure of the action. We believe real-time disclosure would provide the market with much-needed transparency regarding rating actions. We recognize the Commission's concern about preserving the proprietary nature of ratings, especially for rating agencies that use a subscriber-based revenue model. However, we believe that a rating change itself is too important to warrant a six-month disclosure lag. We also are confident that rating agencies, including those that use a subscriber-based revenue model, can generate revenue from value-added services, such as commentary and analysis that would not be made publicly available, in addition to ratings themselves.

We also urge the Commission to use the opportunity provided by revisiting rating agency rules to address an issue related to how rating agencies charge market participants for the use of bond ratings. Currently, bond ratings are required by rule to be cited in certain ways by broker-dealers. For example, printed confirmations of bond trades provided to investors by dealers must include the rating of the bond that was traded. The rating agencies in some circumstances impose charges on dealers for citing ratings on confirmations even though such citations are required by rule. We urge the Commission to consider whether it is appropriate for rating agencies to charge market participants for using ratings when such use is required by statute or regulation.

Rating symbology for structured credit products

Section III. of the rule proposal release describes a proposed rule change to require rating agencies to employ a different set of ratings symbols for structured credit products than for other debt instruments or, alternatively, to require rating agencies to publish a report describing the rating methodology associated with each rating of a structured credit product. The purpose of the proposal is to help investors distinguish between ratings on structured debt securities and

other debt products and to encourage investors to rely less heavily on ratings and to do their own credit analysis of securities in which they invest.

RBDA supports this proposal. We believe that in order to comply with the proposed rule change, most rating agencies would choose to assign a different set of rating symbols to structured credit products than to publish methodology reports with each rating. That outcome would help alleviate confusion among investors as to the implied definitions of ratings for structured products and the comparability of ratings for structured products and other debt securities. We also believe that separate rating symbols for structured credit products would encourage investors to undertake a greater degree of analysis of rated securities before investing.

The historical credit performance of structured credit products is much shorter than that of traditional debt products such as municipal, corporate and sovereign bonds. Also, in the short history of products such as CDOs and subprime-backed ABS, their credit performance has proven to be much weaker than that of traditional debt products. Based on ratings originally assigned to many structured securities, there is little comparability between, say, a typical "triple-A" rated subprime-backed CDO tranche and a "triple-A" rated general obligation municipal bond. Yet, the two products were assigned identical ratings at issuance. We believe this misleads and confuses investors.

Ultimately, what matters most in the credit performance of any security is the likelihood of default and the expectation for recoveries given a default. Ratings across product groups should compare expected credit performance on that basis. Because the historical credit performance of structured credit products is too short and too volatile to be fairly compared to traditional debt securities, investors should have the ability to distinguish between ratings on products that, based on recent history, are likely to perform differently.

We again commend the Commission for its leadership in addressing difficult and complicated issues related to credit ratings and structured credit products. We support many of the Commission's proposals, and we believe many of the provisions contained in the rule proposal release would improve the use of credit ratings in traditional credit sectors as well as for structured credit products. We also urge the Commission to reconsider whether anything short of prohibiting conflicts inherent in the "issuer-pays" model can adequately address those conflicts. We appreciate the opportunity to comment on the proposal and we would be happy to provide any assistance you would find useful going forward.

Sincerely,

/s/

Michael Decker
Co-Chief Executive Officer

/s/

Mike Nicholas
Co-Chief Executive Officer