Moody's Investors Service

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March 28, 2009

By Electronic Mail

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

Re: Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-59343; File No. S7-04-09 ("Re-Proposing Release")

Dear Ms. Murphy:

I. INTRODUCTION

Thank you for the opportunity to provide comments on the re-proposed amendments ("**Re-proposed Amendments**") to existing rules ("**Existing Rules**") implementing the Credit Rating Agency Reform Act of 2006 ("**Reform Act**"). Moody's Investors Service ("**MIS**") appreciates the efforts of the Securities and Exchange Commission ("**Commission**") to address issues raised by MIS and other market participants regarding the Commission's original proposals, set out in its June 2008 Release (the "**Initial Release**"),[1] to amend paragraph (d)(3) of Rule 17g-2 and paragraphs (a)(3) and (b)(9) of Rule 17g-5. Nevertheless, we still have significant concerns about the Re-proposed Amendments.

The Commission is proposing to:

- ***compel Nationally Recognized Statistical Rating Organizations ("NRSROs") to make rating action histories for Issuer-Paid Ratings[2] available for free***

  MIS believes that the Reform Act's purpose could be better achieved by extending the Existing Rule to ratings assigned under all business models.

  This Re-proposed Amendment fails to satisfy an important regulatory and market interest – to make side-by-side comparisons of all NRSROs' rating performance

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

2 We use the term "Issuer-Paid Rating" to refer to ratings that fall within the scope of existing paragraph (d)(3) and proposed paragraph (d)(3) of Rule 17g-2, *i.e.*, any credit rating paid for by an obligor, issuer, underwriter or sponsor of the security being rated.

possible. The Re-proposed Amendments do not promote rating quality and accountability among all NRSROs.

MIS also questions the Commission's authority to adopt the Re-proposed Amendment because it is not narrowly tailored to achieve the purpose of the Reform Act and would deprive NRSROs that assign Issuer-Paid Ratings of the value of their property without just compensation.

- ***prohibiting NRSROs that are paid by issuers, arrangers and sponsors (collectively, "Issuers") from assigning or maintaining credit ratings for Defined Structured Finance Products[3] unless the Issuer makes the information provided in the rating and surveillance process available to all other NRSROs***

  This Re-proposed Amendment does not address the root causes of rating shopping and is likely to result in replacing one form of rating shopping with another. More importantly, the Re-proposed Amendment further entrenches ratings in federal securities regulation by creating the incorrect impression that ratings are a sufficient substitute for transparency in structured finance markets.

As we discuss in more detail below, MIS also believes that the Re-proposed Amendments reflect some inconsistencies. Specifically, the existing NRSRO system and the Re-proposed Amendments seek to encourage more NRSROs to assign credit ratings while simultaneously creating incentives for market participants to treat credit ratings from different NRSROs as substantively interchangeable. The ultimate objective of such an approach – encouraging more providers of substantially identical opinions – is unclear. What is clear, however, is that this approach could reinforce, rather than diminish, Issuers' ability to shop for ratings.

We believe that the Commission should promote healthy competition among all NRSROs by, among other things, providing for consistent regulatory treatment of all NRSROs and mandating better disclosure by Issuers *to the market* of information about structured finance products. This should help enhance the ability of (i) NRSROs to offer unsolicited ratings and research and (ii) investors to make meaningful assessments and comparisons of NRSROs' work.

II. RE-PROPOSED AMENDMENTS TO RULE 17G-2: XBRL RATING ACTIONS DATABASE

A. Summary of MIS's Response

As we stated in our comments on the Initial Release,[4] we agree that public disclosure of aggregate ratings performance over time and analyses of that performance are important parts of the NRSRO oversight framework. We already publish and make freely available various statistical ratings performance reports, a number of which are incorporated by reference into our Form NRSRO.[5] We believe it is unnecessary and inappropriate, however,

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[3] We use the term "Defined Structured Finance Product" to refer to the securities and instruments that fall within the scope of proposed paragraph (b)(9) of Rule 17g-5, *i.e.*, any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. We use the term "structured finance product" to refer to structured securities and instruments within the ordinary meaning of the term.

[4] See *Comment Letter Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations - Release No. 34-57967, File No. S7-13-08* (July 28, 2008), available on the Regulatory Affairs webpage at moodys.com.

[5] See, *e.g.*, *Guide to Moody's Default Research: October 2008 Update* (Document #11205).

to require an NRSRO to disclose publicly and for free a compilation of rating histories for 100% of its Issuer-Paid Ratings, even on a prospective and time-delayed basis, for the following reasons:

- The Reform Act's purpose will not be achieved unless all NRSROs are subject to the disclosure requirement, regardless of their business model.
- The Re-proposed Amendment will deprive NRSROs that determine Issuer-Paid Ratings of the value of their property without just compensation and could affect adversely their ability to diversify their revenues.
- A narrowly tailored, non-discriminatory rule is much more likely to promote rating quality while protecting the property of NRSROs, regardless of the business model they employ.

B. Detailed Analysis

1. The Reform Act's Purpose Will Not Be Achieved unless All NRSROs Are Subject to the Disclosure Requirement

In its Preamble, the Reform Act indicates that it is adopted:

"To improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."

The clearest statement of the Commission's purpose in adopting the Existing Rule and putting forward the Re-proposed Amendment seems to be set out in one of the questions that the Commission has posed. It asks whether the goals of the Re-proposed Amendment – "greater accountability of NRSROs and promotion of competition" – will be achievable if subscriber-paid ratings are not subject to the rule's requirements.[6] This suggests that the Commission might be focusing on the means, rather than the purpose of the Reform Act.

To achieve the Reform Act's purpose, it is essential that market participants be able to assess and compare all firms that are competing. We believe that authorities and market participants are interested in the quality of all NRSROs' ratings, which means being able to assess and compare the aggregate performance of all NRSROs' ratings, not just Issuer-Paid Ratings. In particular, we expect that authorities and market participants are very interested in comparing the aggregate performance of Issuer-Paid Ratings to the performance of non-issuer-paid ratings (including subscriber-paid ratings). The Existing Rule and Re-proposed Amendment, however, will not enable such comparisons to be made. Instead, only comparisons among NRSROs that assign Issuer-Paid Ratings, which already are made publicly available, will be possible. Consequently, the absence of uniformity in regulatory approach and the corresponding lack of transparency regarding the performance of non-issuer-paid ratings is likely to impede, rather than promote, the Reform Act's purpose of improving rating quality for all NRSROs.

Moreover, excluding subscriber-paid ratings from the scope of the disclosure requirements is a flawed approach because, among other things, it fails to address potential conflicts of interest that credit rating agencies ("**CRAs**") may face with respect to subscribers.

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[6] Re-proposing Release at 6489.

It is essential to acknowledge that the only parties likely to pay for credit ratings – whether Issuers, investors or governments – are parties directly interested in the outcomes. So long as CRAs compete for business, potential conflicts of interest will exist since whoever is the object of that competition (*e.g.*, an Issuer, investor or government) has reason, and from time to time may seek, to influence the entity that is competing for its business. For example:

- Issuers are motivated to obtain the highest possible rating and sustain that rating or have it upgraded.
- Investors with "short" positions in securities may be highly motivated to encourage a negative rating action, and the more negative and unexpected the action the better.
- Investors that take "long" positions are likely to prefer lower ratings before they purchase a security and, thereafter, are likely to prefer ratings that are maintained or raised, not lowered.
- Governments, which often face competing financial market and social policy objectives, may seek to have ratings "protect" nationally or systemically important Issuers including sovereign and sub-sovereign Issuers, large industrial employers, major financial institutions and entities in which the government has a direct or indirect financial interest.

Conflicts of interest arise, therefore, under any business model. NRSROs that primarily assign subscriber only-paid ratings, where the subscribers typically are long and/or short investors, are as likely to face potential conflicts of interest in the rating process as NRSROs that primarily assign Issuer-Paid Ratings. Therefore, if the Commission believes that enhanced scrutiny of the ratings performance of Issuer-Paid Ratings will be beneficial to users of credit ratings and lead to greater accountability of NRSROs that produce such ratings, it should impose similar requirements on all NRSROs, regardless of their business model.

2. Re-proposed Amendment Deprives NRSROs That Assign Issuer-Paid Ratings of the Value of Their Property without Just Compensation

We have a protected property interest in the historical data we collect and maintain on rating actions. It is time-consuming and costly to construct and maintain ratings history databases. We have invested significant resources in developing and maintaining data products and analytical tools that leverage our historical rating databases in the reasonable expectation that, among other things, we can derive revenue from our investment. Our investment has proved to be worthwhile and we have been generating increasingly greater revenues from products and services based upon our historical rating history database. In particular, we estimate that revenues from subscription products that incorporate historical rating data have been increasing steadily (at a rate of approximately 15% per year) since 2000. This has enabled us to diversify our sources of revenue.

The Commission's proposals to limit the scope of the Re-proposed Amendment to credit ratings initially determined on or after June 26, 2007 and permit NRSROs to delay disclosure of rating actions for twelve months do not adequately protect our property interest in *historical* rating data. For example, while the potential impact on revenues for ratings history products might be limited in the first few years after the Re-proposed Amendment is implemented (because the historical database will extend back only a year or two), as time

passes the amount of information contained in each data file will grow.[7] This longer, free historical record will become increasingly valuable to competitors, data vendors and other users interested in historical data and, consequently, will cause the value of our existing services and subscription products that incorporate rating histories to decrease over time. As noted above, our business for products and services that incorporate rating histories has grown steadily and significantly over the past few years. Adoption of the Re-proposed Amendment, however, will freeze our ability to derive value from our property as the years of freely available rating history data accumulate. In addition to impairing the value of existing products, the Re-proposed Amendment, if adopted, is likely to adversely affect our capacity to create new products and services that use rating history data and thereby limit our future profitability or willingness to develop new products and services that could be of significant use to market participants and authorities.

As we indicated in the preceding subsection, we believe that the Re-proposed Amendment, if adopted, will not be effective at achieving the Reform Act's purpose. Indeed, as discussed in subsection 4 below, that purpose could be better achieved by a rule that, unlike the Re-proposed Amendment, is narrowly tailored. Particularly given these additional factors, serious questions arise about whether adoption of the Re-proposed Amendment would constitute the kind of taking of private property without just compensation that is barred by the Fifth Amendment.

3. Impact on Revenue Diversification

Aside from our concerns about the constitutionality of the Re-proposed Amendment, we believe that this potential impairment of our property may lead to an unintended policy outcome: greater reliance from a financial perspective on rating fees from Issuers. The Commission has expressed concern about the potential conflict of interest that arises for NRSROs that operate primarily under an issuer-pays model. One way to mitigate this conflict is for an NRSRO to diversify its revenue sources, *e.g.*, through the sale of credit-related research and products to investors and other market participants. If the Re-proposed Amendment is adopted, however, the ability of NRSROs that provide Issuer-Paid Ratings to derive revenue from products that include rating action histories will be impaired.

4. The Reform Act's Purpose Could Be Better Achieved through a Narrowly Tailored, Non-Discriminatory Rule

The Commission's rules and regulations regarding NRSROs must be narrowly tailored to achieve the purpose of the Reform Act, which is to improve rating quality. The Commission already has adopted a rule requiring NRSROs to disclose rating action histories for random 10% samples taken from each class of Issuer-Paid Ratings for which the NRSRO has 500 or more outstanding Issuer-Paid Ratings. If the Existing Rule encourages market participants or observers to produce ratings performance studies, these studies could complement the studies already made available by NRSROs that assign Issuer-Paid Ratings and help users of credit ratings assess and compare the performance of one NRSRO's Issuer-

[7] If, for example, the Re-proposed Rule were implemented as proposed in November 2009, the free XBRL data file would include approximately 1.5 years of rating history with a one year gap (November 2008-November 2009). In 2019, the free XBRL data file would include 11.5 years of rating history with a one year gap. The data files in 2019 will be significantly more valuable than the data files in 2009 because they will contain at least 10 years of rating history for some rated issuers and obligations.

Paid Ratings with those of another NRSRO's Issuer-Paid Ratings. Importantly, however, the Commission has not allowed any time to pass to be able to judge whether the Existing Rule will operate effectively to facilitate comparisons in the aggregate performance of Issuer-Paid Ratings.[8] Consequently, at this time, a rule requiring NRSROs to publicly disclose for free the rating action histories for 100% of their Issuer-Paid Ratings cannot be considered to be narrowly tailored.

The Commission has indicated that it is concerned that a rule requiring NRSROs that assign subscriber-paid ratings to make all, or even a sample, of their rating histories publicly available for free could substantially impair their primary source of revenue, *i.e.*, subscriptions for current ratings. By extending the Existing Rule to subscriber-paid ratings, however, the Commission could address this concern, avoid discriminatory treatment of some NRSROs and facilitate comparisons of the rating performance of all NRSROs. Alternatively, the Commission could permit all NRSROs to provide rating action histories on a subscription basis. We also would not object to a requirement to provide free access to such data files upon request by the Commission for purposes such as the production and publication of independent research. This research could be produced and published by the Commission itself or by academics who commit not to use the data for any commercial purpose.

III. RE-PROPOSED AMENDMENTS TO RULE 17G-5

A. Summary of MIS's Response

The Commission has stated that the goals of the Re-proposed Amendments to Rule 17g-5 include reducing the risk that Issuers will shop among CRAs for the highest rating and providing users of credit ratings with a broader range of views on the creditworthiness of structured finance products by promoting the issuance of ratings by NRSROs that are not hired by the Issuer. The Commission has suggested that, by opening up the rating process to more NRSROs, the Re-proposed Amendments will make it easier for the hired NRSRO to resist pressure from the Issuer by increasing the likelihood that any steps taken to inappropriately favor the Issuer will be exposed to the market through ratings issued by other NRSROs.

Rating shopping, in structured finance as well as other credit markets, is a harmful practice engaged in by some Issuers and/or subscribers. The problem exists regardless of whether Issuers or subscribers pay for ratings and stems from Issuers' control of the information needed to analyze an obligation and assign a rating. It occurs in situations where those paying for credit ratings do not feel constrained by, among other things, market disciplinary forces, to seek the best quality rating. Opaque markets can facilitate rating shopping by limiting the ability of CRAs, other analysts and investors to: (1) assess independently the creditworthiness of Issuers; and/or (2) express opinions to compete with Issuer-Paid or subscriber-paid ratings.

We agree with the Commission that rating shopping should be deterred because it has the potential to have an adverse effect on rating quality. We believe, however, that the best way to achieve this goal is for the Commission to require Issuers to make all the information

[8] In our view, in assessing the effectiveness of the Existing Rule the Commission should focus on whether market participants and observers produce rating performance studies and not simply consider whether or not market participants have an interest in using the raw data.

reasonably considered relevant to an investment decision broadly available to the market and accessible to investors, other market participants and CRAs alike. This approach also would be consistent with what we believe should be the Commission's ultimate goals: improving rating quality, improving investors' ability to make well-informed investment decisions, reducing the risk of investor over-reliance on credit ratings in structured finance markets, and promoting fair and transparent markets.

We are concerned, however, that the Re-proposed Amendments will introduce incentives for Issuers, investors and CRAs to act in a manner that is inconsistent with these goals. In particular, we believe that the Re-proposed Amendments will:

- replace rating shopping with "information shopping" (where Issuers shop for the NRSRO that demands the least amount of information) or "definition shopping" (where Issuers shop for the NRSRO with the least stringent interpretation of Defined Structured Finance Product);
- jeopardize market integrity by permitting selective disclosure of opinions based on material, non-public information to the clients of subscriber-paid NRSROs and/or inadvertently facilitating insider trading and tipping;
- increase the risk of over-reliance on NRSROs and their credit ratings by substituting credit ratings for transparency in structured finance markets and further embedding NRSROs in the regulatory framework; and
- provide, at best, an incomplete solution to one of the most significant vulnerabilities identified by the recent financial turmoil: inadequate transparency in structured finance markets.

B. Detailed Analysis

1. Commoditization of NRSRO Ratings Discourages Competition Based on Quality

As we explained in our September 5, 2008 comment letter to the Commission,[9] the existing NRSRO system creates incentives for users of credit ratings to view ratings from all NRSROs as interchangeable. Ratings, therefore, will tend to become commoditized, which will detract from traditional incentives for users to differentiate among NRSROs on the basis of rating quality and credibility. This in turn can lead to Issuers shopping for the NRSRO that will assign the highest possible rating because, at least in the short term, some investors might regard the conferral of NRSRO status as a measure for evaluating the credibility of a CRA.

The Re-proposed Amendment to Rule 17g-5 seeks to address rating shopping but without dealing with its root cause – a regulatory framework that provides incentives for market participants to treat NRSROs' ratings as substantively interchangeable. Moreover, as we discuss subsection 3 below, the proposed amendment to Regulation FD exacerbates the problem because it further reinforces the inaccurate impression that all credit ratings are the same.

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[9] See *Comment Letter Re: References to Ratings of Nationally Recognized Statistical Rating Organizations – Files S7-17-08, S7-18-08 and S7-19-08* (September 5, 2008), available on the Regulatory Affairs webpage at moodys.com.

2. One Form of Shopping Likely to Be Replaced with Others

Proposed paragraphs (a)(3)(C) and (D) of Rule 17g-5 provide that an NRSRO paid by an Issuer to provide a credit rating ("**Issuer-Paid NRSRO**") for a Defined Structured Finance Product will have to obtain prescribed representations ("**Representations**") from the Issuer. Among other things, the Issuer-Paid NRSRO will have to obtain a Representation that the Issuer will post on a password-protected website ("**Issuer Portal**") all written information the Issuer provides to the Issuer-Paid NRSRO for the purpose of determining the initial credit rating, or undertaking surveillance on, the security or instrument at the same time such information is provided to the Issuer-Paid NRSRO. The NRSRO will not be permitted to issue or maintain a credit rating unless, among other things, it obtains such Representations and can reasonably rely upon them.

We believe it is likely that these provisions will create incentives for Issuers to shop for the NRSRO that will demand the least information in the initial rating process and/or the surveillance process. For example, Issuers may choose not to engage NRSROs that have a reputation for seeking (or a methodology that calls for) more information than others. Alternatively, they may engage an NRSRO but subsequently use the threat of withdrawing a Representation or indicating that the Issuer-Paid NRSRO can no longer rely upon the Representations in order to discourage the Issuer-Paid NRSRO's analysts from asking for certain information during the initial rating process. In either case, this could lead to less-informed and/or more volatile credit ratings, contrary to the Commission's underlying goal to facilitate better-informed decision-making by investors.

Moreover, because the information disclosure requirements will be triggered only if the Issuer pays an NRSRO to assign a credit rating, it is possible that some Issuers will seek ratings only from NRSROs that receive fees from investors and other subscribers, not because they believe that rating quality will be higher but to avoid having to disclose information. The result would be less transparent markets, since the Issuer's information would not be available to any other market participant and the credit ratings assigned by subscriber-paid NRSROs would be available only to subscribers.

Similarly, the broad and ambiguous scope of proposed paragraph (b)(9) of Rule 17g-5 likely will create incentives for Issuers to shop for the NRSRO that uses the least stringent interpretation of Defined Structured Finance Product. Since the Re-proposed Amendment exposes NRSROs to regulatory sanctions for non-compliance, some NRSROs may be inclined to adopt expansive and stringent interpretations of "Defined Structured Finance Product". Because the Commission has not proposed to regulate directly the conduct of Issuers, the Issuers will have an incentive to push for a narrower and less stringent interpretation and potentially to pay only those NRSROs that agree to their request.

3. Re-proposed Amendments May Jeopardize Market Integrity

The Commission adopted Regulation FD in 2000 to address the concern that Issuers were selectively disclosing material, non-public information to, among others, sell-side analysts but not the public.[10] Sell-side analysts, in turn, could have disclosed the material, non-public information they received to their subscribers. The purpose of Regulation FD was

[10] Commission, *Selective Disclosure and Insider Trading*, Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99 (August 15, 2000).

to promote market integrity and investor confidence in U.S. markets by curtailing selective disclosure. MIS is unsure, therefore, why the Commission has now proposed that, in order to promote competition in the CRA industry, a compromise on the fundamental premise underlying Regulation FD is under consideration. The Re-proposed Amendments would enable NRSROs to provide their credit ratings, informed by material, non-public information, selectively to a discrete group of investors. We believe that amending Regulation FD in such a manner will encourage market abuse and undermine the integrity of the U.S. market.

In the Re-Proposing Release, the Commission outlines several reasons why it believes that it is appropriate to amend Regulation FD to permit such selective disclosure. Of particular note is the stated reason that the proposed disclosure program under Rule 17g-5 will be triggered only when an Issuer-Paid NRSRO is "hired" to provide a credit rating and, therefore, a publicly disclosed credit rating for the Defined Structured Finance Product likely will be issued along with unsolicited credit ratings made available solely to a selected group of subscribers.

The Re-proposed Amendment appears to be based on the incorrect premise that NRSROs and their credit ratings are homogeneous and fungible, *i.e.*, that one NRSRO's credit ratings are substantively identical to every other NRSRO's credit ratings. That assumption seems to underlie the Commission's conclusion that disclosure by one NRSRO of its credit rating will be sufficient to ensure that the public has access to all of the relevant considerations pertaining to material non-public information provided to NRSROs in the rating process. This simply is not true. Different NRSROs use different methodologies, assess factors differently, come to different conclusions about credit risk and explain their reasoning in different ways. In fact, these potential differences in credit opinions seem to be something that the Commission expects and to which it attributes value elsewhere in the Re-Proposing Release. Otherwise, if credit ratings from different NRSROs were substantively identical, why would there be any value in policy initiatives intended to increase the number of credit ratings available for a given, Defined Structured Finance Product?

Since the credit ratings produced by different NRSROs are *not* substantively identical,[11] amending Regulation FD to permit the disclosure of material, non-public information to NRSROs that do not make their credit ratings public is likely to result in the selective disclosure to subscribers, either of opinions based on material, non-public information or of the material, non-public information itself. We find it paradoxical that the Re-proposed Amendment would facilitate selective access by investors to credit ratings based on material, non-public information but not require Issuers to make this information available on a non-selective basis to the market.

We expect that such a change in the regulatory framework could create incentives for NRSROs that currently make their ratings publicly available to modify their practices, since they may benefit more from providing some or all of their ratings on Defined Structured Finance Products only to subscribers. This could result in less transparent markets.

The Re-proposed Amendments also may pose serious, practical implementation problems that may inadvertently jeopardize market integrity. Specifically, MIS believes that the password-protected Issuer Portals and websites that Issuer-Paid NRSROs will be required to maintain ("**NRSRO Webpages**") will present a significantly increased risk of data leakage,

[11] The fact that rating shopping occurs is evidence that ratings are not substantively identical.

in comparison with the current practice of maintaining material, non-public information on internal networks or data storage systems. For example, we expect that the use of Issuer Portals and NRSRO Webpages will increase the risk of data leakage by potentially exposing the information to search engines and other Internet-based information stores. This will make the information more visible to hackers, who could seek to access the information. In addition, while existing corporate controls and policies can operate to prevent or materially reduce the risk of leakage in the context of internal networks, these policies and procedures are much less effective at addressing such risks in the context of externally facing networks. This is because placing information on an externally facing network such as the Internet, where the only security is password protection, necessarily involves a loss of control over access to such information.[12] It should be noted that, if the Re-proposed Amendment is adopted, a potentially unlimited number of Issuer Portals could be established and that they will be operated and maintained by entities with varying levels of internal controls and that might not be subject to robust regulatory oversight by U.S. or other authorities.

We believe that the threat to market integrity is so great that it constitutes a sufficient reason in itself for the Commission not to adopt the Re-proposed Amendment. If the Commission nevertheless decides to adopt the Re-proposed Amendment, we strongly recommend that the Commission, rather than NRSROs and Issuers, establish and maintain a password-protected website for the information the Commission seeks to have NRSROs and Issuers post. NRSROs and Issuers could submit data through encrypted systems to the Commission for posting on a password-protected Commission website accessible to NRSROs that provide the appropriate Certifications. While this website would still present some risk of data leakage (because it would be an externally facing network), the risk would be lower than if the data were posted on a potentially unlimited number of Issuer Portals subject to varying degrees of internal controls since the Commission would be in a better position to monitor and control access to its webpage.

4. Re-proposed Amendments Increase Risk of Over-Reliance on NRSROs and Credit Ratings

Financial sector regulators globally have recommended that investors develop a better understanding of the attributes and limitations of credit ratings.[13] The Commission itself has expressed concern about the potential for investors to over-rely on credit ratings and is considering whether or not to amend certain rules and forms to delete references to ratings and/or ratings-based criteria.[14] Historically, MIS consistently has supported reducing or eliminating the use of ratings in regulation. We also have taken steps to encourage investors to understand ratings better and rely on them less.

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[12] Data stored on internal networks typically is protected by many levels of security. A hacker seeking to access that information would have to bypass all of these levels of security before being in a position to use a password to access the data. By contrast, the only security feature protecting the data that would be stored on the proposed Issuer Portals and NRSRO Webpages would be a password.

[13] *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience* at 8, 37-38 (April 2008); International Organization of Securities Commissions, *Final Report: The Role of Credit Rating Agencies in Structured Finance Markets* at 2-3 (May 2008).

[14] See, *e.g.*, Commission, *References to Ratings of Nationally Recognized Statistical Rating Organizations*, Release IC-28327, File No. S7-19-08 at 40125-40126 (July 1, 2008).

Consequently, we are concerned that the Re-proposed Amendments to Rule 17g-5 may undercut efforts to curb inappropriate use of credit ratings. These concerns arise because, as discussed in more detail below, these Re-proposed Amendments are directed only at increasing the number of NRSRO credit opinions about Defined Structured Finance Products instead of ensuring, through an enhanced, mandatory disclosure regime applicable to Issuers, that investors have access to all of the material information reasonably relevant to their investment decisions. In the absence of an improved disclosure regime for structured finance Issuers, investors may be inclined to over-rely on NRSRO credit ratings or avoid investing in the structured finance market.

Moreover, these Re-proposed Amendments appear to outsource to NRSROs the role of enforcing conduct requirements for Issuers. The Commission has not proposed that Issuers be required to disclose information either to the market (ideally) or other NRSROs. Instead, the Commission proposes to prohibit Issuer-Paid NRSROs from providing or maintaining credit ratings for Defined Structured Finance Products if the Issuer fails to provide, or indicates that the Issuer-Paid NRSRO can no longer rely upon, the prescribed Representations. This outsourcing is likely to increase the importance of NRSROs in the regulatory framework and potentially deepen investors' reliance on NRSROs. This consequence flows from investors' continued lack of direct access to the relevant information and the Commission's requirement that NRSROs assume a new role as enforcers of conduct requirements for Issuers, rather than from any improvement in rating quality. We believe that the Commission should not place NRSROs in this position. Instead, as we discuss in more detail below, the Commission should impose public disclosure requirements directly upon Issuers instead of seeking to regulate their behavior indirectly through NRSROs.

IV. RE-PROPOSED AMENDMENTS DO NOT ADDRESS INADEQUATE TRANSPARENCY IN STRUCTURED FINANCE MARKETS

MIS believes that the best way to discourage Issuers from shopping for an NRSRO on the basis of factors other than rating quality and credibility is for the Commission to update the disclosure regime applicable to Issuers. This regulatory approach should not only improve investors' ability to make well-informed investment decisions but discourage over-reliance on credit ratings and help restore confidence in credit markets and credit ratings generally.

Similar to the analysis of other types of securities, analyzing and monitoring structured finance products is a data-intensive process. The information needed is granular, often relating to the individual assets in the structured pool and the legal features of the structure.[15] Importantly, detailed and high quality data are essential inputs to the analytical methodologies, qualitative judgments and quantitative models that project cash flows from the assets and allocate those projected flows to the various tranches in the structured financing. Irrespective of the rigor of the methodological approach or the model used in the analysis, if the

[15] The assets are the source of payment to the securities issued by the special purpose vehicle ("**SPV**") and it is therefore necessary to have credible and reliable information about the assets' characteristics. For example, in analyzing a mortgage-backed security, the following types of information may be useful to prospective investors for each loan in the structured pool: amount of the mortgage; location of the property; ratio of the loan amount to value of the property; ratio of the loan payment to the income of the borrower; and whether the property was the borrower's home or whether it was an investment. Examples of the type of information required on an ongoing basis to monitor a mortgage-backed security include performance measures such as loan delinquencies, foreclosures and losses.

underlying data used are of inadequate quality or stale, the resulting analysis will in turn be similarly susceptible.

However, structured finance markets generally operate under a limited information disclosure model where CRAs ask for additional information to rate securities. Simply put, Regulation AB, Rule 144A and the continuing disclosure requirements for publicly offered securities do not require public dissemination of sufficient information about the structure or underlying assets of a securitization to afford reliable analysis based on publicly available sources. Consequently, unlike the corporate market, where investors and other market participants, including opinions providers such as CRAs, sell-side analysts and academics, can develop informed opinions based on publicly available information, in the structured finance market, there is insufficient public information about structured securities.

While MIS (and other market participants) are implementing various reforms to address shortcomings in this sector, MIS believes that confidence in structured finance markets will not be restored unless the Commission enhances and updates the mandatory disclosure regime for structured finance products. In particular, MIS recommends that the Commission consider the following measures:

- **Expand Regulation AB's disclosure requirements to underlying assets**

  Regulation AB currently requires the disclosure of information about asset pools on an aggregate basis, supplemented by some additional information about significant obligors. Regulation AB could be revised to require more disclosure about obligors so that investors could assess more thoroughly information about the assets underlying the securities. Options could include: (1) broadening the definition of "significant obligor" to increase the amount of information available about the related assets; (2) requiring disclosure about the characteristics of each obligor (instead of just on an aggregate basis); or (3) requiring disclosure about the characteristics of a statistically significant sample of individual obligors.

- **Address the need for greater transparency regarding privately placed, structured finance products that trade in secondary markets**

  There has been a significant expansion in the private placement market for structured finance products. Privately placed securities can be held or resold, subject to certain restrictions, to qualified institutional buyers (*i.e.*, sophisticated investors). Resales of privately placed securities to qualified institutional buyers may be exempt from registration under the Securities Act of 1933 pursuant to Rule 144A. This rule contains only minimal disclosure requirements and is premised on the assumption that these sophisticated investors can obtain and analyze the information they need before making investment decisions and, therefore, do not need the protection of a prospectus or continuing disclosure rules.

  Rule 144A was developed with general corporate debt obligations in mind and predates the creation of a significant private placement market for structured finance products. In contrast to private offerings of general corporate debt securities, private offerings of certain types of structured finance products often are tailored to meet the needs of specific investors and originators. Consequently, structured finance products can be much more complex than general corporate debt securities, which tend to have standardized terms and often are issued by entities for which potential investors have

independent access to a substantial amount of information. Due to these factors, the quality and clarity of disclosure for privately offered structured finance products often lags behind the quality and clarity of disclosure for privately offered corporate debt securities. Furthermore, as demonstrated by recent events, the lack of current information regarding structured finance products and the underlying pools of assets can hinder the efforts of secondary market purchasers to make informed investment decisions. In these circumstances, investors might be inclined to over-rely on credit ratings or use them improperly to assess risks other than credit risk. Alternatively, potential investors might refrain acquiring privately placed structured finance products unless and until they can readily access reliable, up-to-date information about the securities.

For these reasons, we recommend that the Commission consider developing an appropriate disclosure regime for privately placed, structured finance products that trade in secondary markets (even if such trades occur only among qualified institutional buyers). The Commission has many tools at its disposal to improve the quality of disclosure available to investors in privately placed structured finance products. Action by the Commission in this area could include: (1) revising rules to specify enhanced minimum disclosures to be provided to purchasers of structured finance products sold under Rule 144A; and/or (2) Commission or staff publication of interpretive guidance regarding disclosure of the terms and asset structure for structured finance products.

Enhancing the disclosure regime for structured finance products would yield three principal benefits. First, giving investors access to more information about structured finance products allows them to conduct their own analysis and develop their own independent views about potential or existing investments. This would reduce the risk of investor over-reliance on credit ratings. Such access also would have the effect of enhancing investors' ability to meaningfully assess the work of the CRAs.

Second, embedding enhanced information requirements in offering documents intended for investors likely will improve the information quality about structures and assets. Issuer indifference to information quality is less likely to be a problem if the information is subject to securities law requirements for accuracy and completeness than if it is left to the demands of competing CRAs. This approach, which is analogous to the approach taken in corporate debt markets, aligns responsibility for information quality with the party who: (i) has the greatest control over the information in the first place; and (ii) will enjoy the greatest benefit from access to the securities markets.

Third, if sufficient information is made available to investors, then it is necessarily also available to those CRAs not selected to rate a securitization. As a result, CRAs would be in a position to offer unsolicited ratings and research, which would broaden the range of information available to investors.

In summary, reform of the disclosure regime for structured finance products would accomplish the principal objectives of the Re-proposed Amendments while facilitating the achievement of broader regulatory goals, such as increased transparency and liquidity in structured finance markets.

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Once again, we appreciate the opportunity to comment on the Re-proposed Amendments. We would be pleased to discuss our comments further with the Commission or its staff.

Sincerely,

Michel Madelain
Chief Operating Officer
Moody's Investors Service

ANNEX: RESPONSES TO SELECTED QUESTIONS

A. RE-PROPOSED AMENDMENTS TO RULE 17G-2

1. *Would there be costs in addition to those identified above, such as costs arising from systems changes and restructuring business practices to account for the new reporting requirement?*

CUSIP Licensing Costs

As we stated in our comments on the Initial Release, MIS believes that an NRSRO should not be required to include CUSIPs or ISINs in the prescribed XBRL data file unless the NRSRO is permitted to use such numbers in the file without having to pay a fee.

Like the Existing Rule, the Re-proposed Amendment contemplates a change in the way we use CUSIPs, since we would be required to "redistribute" the CUSIP Service Bureau's data to the public. In addition, the Re-proposed Amendment contemplates the redistribution of a much larger amount of data because we would be required to make rating history files for 100%, instead of just a random 10% sample, of our Issuer-Paid Ratings publicly available for free. In our experience, the usage of CUSIPs contemplated by the Re-proposed Amendment is associated with the highest level of licensing fees typically charged by the CUSIP Service Bureau. Therefore, if the Re-proposed Amendment is adopted, we will incur both transaction costs to amend our license and a potentially much higher, annual licensing fee consistent with such usage of CUSIPs.

We believe that the Commission's estimate that an NRSRO "opting to purchase a license would incur a fee of $100,000" obscures the true, initial and ongoing costs that the Existing Rule and Re-proposed Amendment will impose on us. First, the Commission's estimate is presented in such a way that it could leave the impression that this is a "typical" licensing fee and that it is a one-time expenditure.[16] In fact, the licensing fee is a recurring fee and is likely to vary based on the number of securities the NRSRO rates and the way in which it uses the CUSIPs. The wholesale redistribution of CUSIPs by NRSROs envisaged by the Re-proposed Amendment constitutes a significantly different usage than the redistribution by NRSROs of a random sample of 10% of the CUSIPs they use, as contemplated by the Existing Rule. While we have not had any discussions yet with the CUSIP Service Bureau regarding our license, we believe, based on our knowledge of the fees that we currently pay, that our annual licensing fee under the Existing Rule easily could be ten times higher than the Commission's estimate. The licensing fee to publish XBRL rating histories for all of the securities we rate, instead of just a random 10% sample, could be significantly higher.

In addition, because the Commission has mandated the use of CUSIPs in the prescribed XBRL data file and the CUSIP Service Bureau is the only provider of CUSIPs, our ability to negotiate reasonable license fees for the required use is significantly compromised. Moreover, since the CUSIP Service Bureau is operated by an affiliate of a large NRSRO, other NRSROs may be at a significant disadvantage in negotiating the costs of their licenses,

[16] While the Commission notes in the Re-proposing Release that licensees typically pay a renewable license fee and that the license cost varies with "usage", the sentence in which the Commission reiterates its estimate does not expressly indicate that the estimated cost is an "average, annual cost".

as compared with the affiliated NRSRO. We believe that to the extent any use of CUSIPs is mandated by the Commission, either under the Existing Rule or the Re-proposed Amendment, safeguards against these costs and competition concerns should be provided.

B. RE-PROPOSED AMENDMENTS TO RULE 17G-5

1. *Would the information required to be maintained on the NRSRO's Internet site be sufficient to alert other NRSROs that the rating process has commenced and where they can locate information to determine an unsolicited rating? For example, should the rule require the NRSRO to alert by e-mail all NRSROs that obtain a password to access the site when new information is posted to the site? Would such a requirement be feasible?*

We believe that the information prescribed by proposed Paragraph (a)(3)(i) of Rule 17g-5 would provide sufficient information to enable other NRSROs to determine whether and when an NRSRO has commenced the rating process for an Issuer-Paid Rating of a Defined Structured Finance Product and how to locate the relevant information to determine its own rating. We do not believe that NRSROs should be required to alert other NRSROs when new information is posted to the NRSRO Webpage. Such a requirement would increase the compliance burden for the NRSRO that is "hired" by the Issuer without significantly improving the capacity of other NRSROs to monitor updates to NRSRO Webpages. This is because NRSROs interested in determining their own ratings would still have to monitor their email for update messages from other NRSROs, then check other NRSRO Webpages to obtain the relevant information and then check the relevant Issuer Portals. By contrast, daily or even twice-daily monitoring of other NRSRO Webpages would not appear to be a time-consuming process.

Moreover, such a two-step process (*i.e.*, posting information to the NRSRO Webpage and then emailing updates to eligible NRSROs) could increase the risk of errors in the communication process. For example, an NRSRO might inadvertently fail to disseminate data about an update, make a transcription error in the email update message, send the message to an inaccurate email address or one that is no longer monitored, or send the update to an NRSRO that is not eligible to access the data. In addition, transmitting email messages about updates to NRSRO Webpages could increase the risk that the data will be accessed illegally. Unless email is encrypted, it is a less secure communication medium than a password-protected website. If, on the other hand, NRSROs were to send encrypted messages to other NRSROs, it would be more difficult for the NRSRO that sent the encrypted messages to monitor email communications for compliance purposes. There is also the possibility, with encrypted and unencrypted messages, that a recipient accidentally could forward the information to others.

2. *Should the Commission only require that final information be posted on the Internet Web site to avoid the potential that an NRSRO would use erroneous information to determine a credit rating?*

No. If the Commission decides to adopt the Re-proposed Amendments to paragraph (a)(3) of Rule 17g-5, we agree that the goal should be to make it possible for NRSROs that have not been retained by the Issuer to issue credit ratings contemporaneously with the hired NRSRO so that market participants can have the benefit of these ratings before making an

investment decision. We also agree with the Commission that including all iterations of the various components of the information used to determine the credit rating could make it easier for other NRSROs to follow the progression of changes that may occur and determine an initial credit rating more quickly when the loan pool, legal documentation and other relevant information is finalized.

3. ***Should other entities besides NRSROs be permitted to access the arrangers' Internet Web sites? For example, should credit rating agencies not registered with the Commission be permitted to access the sites? If so, how could the amendment be crafted to ensure that only entities meeting the definition of ''credit rating agency'' in Section 3(a)(61) of the Exchange Act be permitted to access the arrangers' Internet Web sites?***

As indicated earlier in this submission, MIS believes that the Re-proposed Amendments to Rule 17g-5 do not address the inadequate transparency in structured finance markets and may lead to over-reliance by investors on NRSROs and/or the inappropriate use of credit ratings, thereby exposing the markets to greater systemic risk. MIS believes that the Commission should amend existing structured finance disclosure regime to require Issuers to make a wider range of information available to investors regarding structured finance products. If the Commission nevertheless decides to adopt the Re-proposed Amendments, we believe that restricting access to this information only to NRSROs will be disadvantageous both to: (i) CRAs that do not wish to have their ratings used in securities regulation; and (ii) investors, who would benefit from access to a wider range of opinions on credit.

4. ***Should the amendment require the arranger to represent that it will not provide any information to the hired NRSRO that is material without also disclosing that information on the Internet Web site?***

No. We believe it is likely that requiring NRSROs to obtain such a Representation will have a chilling effect on oral communications by the Issuer to the NRSRO. Moreover, as indicated earlier in our response, we believe that it is inappropriate to regulate Issuers' conduct indirectly by imposing requirements on NRSROs. Among other problems, this approach outsources a regulatory function to NRSROs and further entrenches them in the regulatory system.

5. ***For the purposes of [proposed paragraph (a)(3)(iii)(C) of Rule 17g-5], should the Commission provide a standardized list of information that, at a minimum, should be disclosed [for the purpose of determining an initial credit rating]? If so, what information should the list include? Do any commenters believe that this would have the effect of impermissibly regulating the substance of credit ratings and the methodologies used to determine credit ratings?***

6. ***For the purposes of [proposed paragraph (a)(3)(iii)(D) of Rule 17g-5], should the Commission provide a standardized list of information that, at a minimum, should be disclosed [for the purpose of undertaking credit rating surveillance]? If so, what information should the list include? Do any commenters believe that this would have the effect of impermissibly regulating the substance of credit ratings and the methodologies used to determine credit ratings?***

MIS believes that such requirements will have the effect of impermissibly regulating the substance of credit ratings and the methodologies used to determine credit ratings. If the Commission believes that it is essential to specify the minimum information that Issuers should disclose, it should revisit the existing structured finance disclosure requirements applicable to Issuers. This would make the information available to everyone, as is the case in corporate markets.

7. *Are the estimates of the one-time and recurring burdens of the re-proposed additional disclosures accurate? If not, should they be higher or lower?*

We preface our answer by noting that we believe we have had insufficient time to assess fully the burdens associated with the Re-proposed Amendments and that such an evaluation is challenging because the current requirements have not been fully defined or finalized. We believe, however, that the Commission has significantly underestimated the initial and recurring burdens associated with the Re-proposed Amendments.[17]

First, developing the software and password-protected NRSRO Webpage will involve planning, analysis, requirements gathering, validation, design, development, quality assurance, user acceptance testing, sign-off by all interested parties, deployment and post-production support. A project of this magnitude will involve several different departments. We estimate that the project could require at least a thousand, and possibly several thousand, hours of work.

Second, implementation of the Re-proposed Amendment will require the development and implementation of significant, additional policies, processes and controls. For example, we expect that we will need to develop and implement policies, processes and controls (including additional internal audit and compliance processes) regarding:

- which transactions must be disclosed, when they must be disclosed and when information about a transaction needs to be updated[18] on our NRSRO Webpage;
- receipt of other NRSROs' Certifications;
- assignment of, changes to and revocation of passwords provided to other NRSROs;
- receipt of Issuers' Representations, including the receipt of updated Representations when, *e.g.*, transactions close and responsibility for appropriate Representations is transferred from one entity (*e.g.*, the underwriter) to another (*e.g.*, a trustee);[19]
- access by our employees to Issuer Portals, distribution of information downloaded from Issuer Portals and associated recordkeeping; and

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[17] The Commission estimates that it will take, on average, 300 hours for an NRSRO to develop a system, as well as policies and procedures, for the disclosures required by the Re-proposed Amendments to Rule 17g-2. In addition, the Commission estimates that it will take an NRSRO one hour per transaction to update the lists maintained on its password-protected NRSRO Webpage and that an NRSRO like MIS will be contacted to rate approximately 3,880 transactions per year.

[18] For example, the names assigned to structured finance transactions often change one or more times during the rating process. It might be necessary to update our NRSRO Webpage to reflect such name changes.

[19] Once a transaction has closed, the entity that provided information during the rating process often ceases to play such a role. In many instances, however, the entity that is expected to provide information during the surveillance period is not named until after the transaction closes. NRSROs, therefore, would be faced with a situation where they would want to obtain some kind of commitment from the Issuer during the rating process that it would compel an as yet unnamed entity to provide appropriate Representations to the NRSRO after the transaction closes.

- the deterrence and detection of potential instances of misuse by employees of material, non-public information available on other NRSRO Webpages and Issuer Portals.[20]

We estimate that it could take at least 1,000 hours to develop and implement these policies, procedures and controls.

Third, if the Re-proposed Amendment applied only to credit ratings assigned for transactions executed after the rule came into force, we would need to develop new contract terms regarding the processes envisaged by the Re-proposed Amendment. We also would need to develop appropriate procedures to ensure that these new terms were incorporated into contracts on a going forward basis. We estimate that the development of new contract terms and development of appropriate procedures would take at least 40 hours.

If, however, the Re-proposed Amendment applied to credit ratings assigned to transactions executed before the rule came into force, the initial implementation burden would be significantly greater. We would need to notify the appropriate entity (*e.g.*, the provider of surveillance data) of the new requirements and reach an agreement to amend the applicable contracts, or enter into a new agreement, to provide for the receipt by MIS of the prescribed Representations. We estimate that this notification and amendment process easily could take 10,000 hours or more.

Fourth, we also will need to develop a training program and roll it out to relevant employees (including analytical staff and their managers in our Structured Finance Rating Group, our technology staff and our compliance staff). We believe that implementation of the Re-proposed Amendment will require at least 500 hours to develop a training module and for affected staff to complete initial training.

On an ongoing basis, we believe it would take one to two hours to per transaction to update the NRSRO Webpage, depending on the frequency with which key data (such as transaction and Issuer names) change during the rating process. Using the Commission's estimate of the average number of transactions per year, we estimate that updating the NRSRO Webpage could take 3,880 to 7,760 hours per year.

In addition, we estimate that we will incur at least the following ongoing burdens as follows:

- internal audit processes (at least 200 hours per year);
- receiving Certifications and issuing passwords (at least 20 hours per year) to NRSROs;[21]

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[20] Due to the increased access to material, non-public information by analysts, technology professionals and other administrative personnel, we believe that NRSROs will need to develop processes to audit such access. Currently, the audit process is limited by the fact that employee access to material, non-public information is limited to internal systems. Under the Re-proposed Amendment, however, that access will be expanded to external systems, which raises different and increased risks.

[21] It is unclear at this time whether an NRSRO that sought to access our NRSRO Webpage would be granted a single password, or whether a batch of passwords would be assigned to individuals within the NRSRO. Our estimate that it would take 20 hours per year to receive Certifications and issue passwords assumes that a single password is issued to each NRSRO. If it were necessary to issue multiple passwords to a given NRSRO, the amount of time required to manage the issuance and revocation of passwords would increase substantially.

- compliance reviews concerning MIS's obligations regarding the posting of information on its NRSRO webpage (at least 80 hours per year);
- management of MIS's access to NRSRO Webpages and Issuer Portals, plus recordkeeping burdens associated with accessing NRSRO Webpages and Issuer Portals (if MIS decided to access NRSRO Webpages and Issuer Portals regularly for the purpose of determining unsolicited ratings, we anticipate that we would need to devote at least one to two people, full time, to these activities);
- compliance reviews regarding MIS's management of its access to passwords, use of information accessed from NRSRO Webpages and Issuer Portals and associated recordkeeping (at least 100 hours per year);
- compliance reviews to ensure that MIS is enforcing procedures reasonably designed to prevent the misuse of material, non-public information available on other NRSRO Webpages and Issuer Portals (at least 800 hours per year); and
- training for new employees and refresher courses (at least 200 hours per year for affected employees to complete such training).