Setting the global standard for investment professionals

CFA Centre for Financial Market Integrity
Member Poll on Credit Rating Agencies

April 2009

Purpose & Methodology

On 15 April 2009, the CFA Institute Centre for Financial Market Integrity will provide testimony from the investor's perspective during the U.S. SEC select roundtable investigating credit rating agency (CRA) issues. In recent months the Centre has suggested several reforms in this area, greatly strengthened by CFA Institute member input; in this next round of testimony we would like to provide the SEC with the latest perspectives of those members who use and are familiar with CRA services. As such, a short, four question survey was sent to a sample of members for their input.

The survey was delivered to 19,983 members Monday, 31 March 2009. Of those, 1,186 responded to the survey (5.9 percent).[1] The margin of error based on this number of responses is ±2.8 percent at the 95 percent confidence level. The survey closed on Friday, 3 April 2009.

Findings are presented in aggregate and by region. Regional differences were tested for significance at the 95 percent confidence level. Column letters are used to interpret statistically significant results; in the tables below, if one or more column letters appear in a cell, it indicates that the cell containing the letter has a value that is significantly larger than the cells referenced by letters. Cells with significant differences are highlighted in blue. Cells with red text indicate a sample size of less than 30.

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[1] Number of responses varies by question as not all respondents answered each question and 'not sure' responses were excluded

Summary of Results

Overall, 60 percent of members feel credit ratings from national Credit Rating Agencies are not valid and 40 percent feel they are valid.

- There are no significant differences by region

Similarly, 60 percent indicate these ratings are not useful in making investment decisions.

- Again, there are no significant differences by region.

About half (51 percent) of members disagree with the U.S. government’s steps to deemphasize reliance on credit by removing any requirement for credit ratings in order to sell corporate debt securities.

- 29 percent of members agree with the U.S. government’s steps
- A significantly higher proportion of members in Latin America are neutral on the topic (‘neither agree nor disagree’) (40 percent) compared to members in EMEA (18 percent) and North America (20 percent).

Finally, the majority of members believe more needs to be done to regulate CRAs (79 percent)

- 15 percent feel current regulation is adequate and 6 percent feel less regulation is needed
- A significantly higher proportion of members in Europe, Middle East, Africa (85 percent) feel more needs to be done compared to members in North America (77 percent).

How valid do you feel credit ratings from national CRAs are?

	Region				
	Total	Asia Pac (B)	EMEA (C)	Latin America (D)	North America (E)
Sample Size	1,182	113	200	20	849
Not valid (bottom two box)					
Count	714	70	116	13	515
Column %	60%	62%	58%	65%	61%
Valid (top two box)					
Count	468	43	84	7	334
Column %	40%	38%	42%	35%	39%

* Statistically significant result within this Column Variable at 95%

Significant Difference within Groups: BCDE. Upper case at 95%

Cells with red text indicate that Unweighted Count for regular variables and Unweighted Mentions for multi-response variables is less than 30

How useful do you find such ratings in making investment decisions?

	Region				
	Total	Asia Pac (B)	EMEA (C)	Latin America (D)	North America (E)
Sample Size	1,182	113	200	20	849
Not useful (bottom two box) Count	707	69	112	11	515
Column %	60%	61%	56%	55%	61%
Useful (top two box) Count	475	44	88	9	334
Column %	40%	39%	44%	45%	39%

* Statistically significant result within this Column Variable at 95%

Significant Difference within Groups: BCDE. Upper case at 95%

Cells with red text indicate that Unweighted Count for regular variables and Unweighted Mentions for multi-response variables is less than 30

US government's steps

To what extent do you agree or disagree with the recent US government's steps to deemphasize reliance on credit by removing any requirement for credit ratings in order to sell corporate debt securities?

	Region				
	Total	Asia Pac (B)	EMEA (C)	Latin America (D)	North America (E)
Sample Size	1,183	112	200	20	851
Disagree (bottom two box)					
Count	598	53	98	9	438
Column %	51%	47%	49%	45%	51%
Neither agree nor disagree					
Count	242	25	35	8	174
Column %	20%	22%	18%	40% CE	20%
Agree (top two box)					
Count	343	34	67	3	239
Column %	29%	30%	34%	15%	28%

* Statistically significant result within this Column Variable at 95%

Significant Difference within Groups: BCDE. Upper case at 95%

Cells with red text indicate that Unweighted Count for regular variables and Unweighted Mentions for multi-response variables is less than 30

What is your opinion on the current state of CRA regulation?

Excludes 'not sure' responses

	Region				
	Total	Asia Pac (B)	EMEA (C)	Latin America (D)	North America (E)
Sample Size	1,055	108	175	17	755
More needs to be done to regulate CRAs Count Column %	832 79%	90 83%	148 85% E	16 94%	578 77%
Current regulation is adequate Count Column %	160 15%	14 13%	19 11%	1 6%	126 17%
Less regulation is neeeded Count Column %	63 6%	4 4%	8 5%	0 0%	51 7%

* Statistically significant result within this Column Variable at 95%

Significant Difference within Groups: BCDE. Upper case at 95%

Cells with red text indicate that Unweighted Count for regular variables and Unweighted Mentions for multi-response variables is less than 30

CRA Survey Report
Credit Rating Agency Survey

Credit Rating Agency Survey - distribution on 3/31/2009

Start Date: 3/31/2009
End Date: 4/3/2009
Respondents Invited: 19265
Total Respondents Completed: 1186 (6.16%)
Partial Completes: 0(0%)

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1. How valid do you feel credit ratings from national Credit Rating Agencies (CRAs) are?

(Each Respondent could choose only **ONE** of the following options:)

Response	Total	% of Total Respondents	%
Not validat all1	135		11%
2	579		49%
3	425		36%
Veryvalid4	43		4%
Total Responses:	1182	0% 20% 40% 60% 80%	

2. How useful do you find such ratings in making investment decisions?

(Each Respondent could choose only **ONE** of the following options:)

Response	Total	% of Total Respondents	%
Not usefulat all1	162		14%
2	545		46%
3	390		33%
Veryuseful4	85		7%
Total Responses:	1182	0% 20% 40% 60% 80%	

3. To what extent do you agree or disagree with the recent U.S. government’s steps to deemphasize reliance on credit ratings by removing any requirement for credit ratings in order to sell corporate debt securities?

(Each Respondent could choose only **ONE** of the following options:)

Response	Total	% of Total Respondents	%

Strongly disagree	190		16%
Disagree	408		34%
Neither agree nor disagree	242		20%
Agree	242		20%
Strongly agree	101		9%
Total Responses:	1183	0% 20% 40% 60% 80%	

4. What is your opinion on the current state of CRA regulation?

(Each Respondent could choose only **ONE** of the following options:)

Response	Total	% of Total Respondents	%
More needs to be done to regulate CRAs	832		70%
Current regulation is adequate	160		14%
Less regulation is needed	63		5%
Not sure	128		11%
Total Responses:	1183	0% 20% 40% 60% 80%	

Setting the global standard for investment professionals

26 March 2009

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

Re: Security Ratings, File No. S7-18-08; References to Ratings of Nationally Recognized Statistical Rating Organizations, File No. S7-17-08; References to Ratings of Nationally Recognized Statistical Rating Organizations, File No. S7-19-08

Dear Ms. Murphy:

The CFA Institute Centre for Financial Market Integrity (the "CFA Institute Centre")[1] appreciates the opportunity to comment on certain aspects of the three releases referenced above that propose to revise the treatment of credit references in the Securities Act of 1933, Securities Act of 1934, Investment Company Act of 1940 and Investment Advisers Act of 1940 (collectively, Securities Acts) and related forms.

Executive Summary

Rule 2a-7 of the Investment Company Act of 1940

Minimum credit risk. We generally support the proposed elimination of references to credit ratings in determining minimal credit risk, especially given that boards can still rely on ratings issued by NRSROs in making their determination.

Portfolio liquidity. We believe heightened awareness of liquidity needs is warranted and support amendments that would prohibit a fund from holding more than 10 percent of the fund's assets in securities considered illiquid when they were purchased. We also recommend that the final rule include a clearer definition of what it believes makes a security "liquid."

[1] The CFA Institute Centre for Financial Market Integrity is a part of CFA Institute. With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong, and New York, CFA Institute is a global, not-for-profit professional association of more than 94,900 financial analysts, portfolio managers, and other investment professionals in 131 countries and territories, of whom 83,200 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

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Monitoring minimal credit risks. We recommend that the final rule provide more guidance as to what will trigger the need to reassess whether a security continues to provide minimal credit risk.

Affiliated transactions. We support the proposed reporting of when a fund's affiliate purchases a security from the fund that is no longer an "Eligible Security" as providing an additional degree of transparency.

Rule 10f-3 of the Investment Company Act of 1940

We generally support the proposed change from relying on credit ratings to using other means for measuring liquidity and credit-quality conditions, particularly given that boards would be allowed to incorporate into their approval of procedures NRSRO ratings, reports, analyses and other assessments.

Rule 10b-10 under the Securities Exchange Act of 1934

We do not support the proposed elimination of any reference to whether the security is rated. Instead, in keeping with the current rationale that whether a security is unrated by an NRSRO may prompt a dialogue between investors and their brokers, we favor the alternative proposal that would require the confirmation to disclose whether or not the security is rated, as opposed to only stating that it is not rated.

Rule 134 of the Securities Act of 1933

We support the proposed amendment that would allow references to ratings by any credit rating agency, not just NRSROs, in certain communications that are not deemed to be a prospectus, so long as the communication describes the rating agency and its rating methodologies.

Discussion

We agree that the investing public and certain market participants have suffered a false sense of security because of ratings assigned by nationally recognized statistical ratings organizations (NRSROs). We therefore generally agree with the objectives of these three proposals to eliminate, modify or substitute references to ratings assigned by an NRSRO in an effort to reduce reliance on ratings that may have inadvertently conveyed an "official seal of approval". We do, however, question the breadth of certain of the proposed changes and urge retention of the current regulation for several of the rules.

Investment Company Act of 1940—Amend References to Credit Ratings

Rule 2a-7

Minimal Credit Risk

As it currently stands, Rule 2a-7 limits portfolio investments to securities that have received credit ratings from NRSROs in one of the two highest short-term rating categories or comparable unrated securities (an "Eligible Security"). Furthermore, the rule limits money market fund investments to securities that the fund's board determines present minimum credit risks, a determination that usually relies on the advice of the fund adviser and is based, in part, on the ratings assigned by the NRSRO.

Proposed amendments to Rule 2a-7 would continue to require money market funds to invest only in securities that present minimum credit risks, but would no longer require them to limit their investments to securities that are assigned ratings in the top two categories by NRSROs. References to NRSRO ratings would be eliminated from the rule and "Eligible Securities" instead would be determined by the board.

Specifically, under the proposed amendments, the fund board would determine whether a security is an "Eligible Security" based on whether it presents minimal credit risks and whether the issuer is able to meet short-term financial obligations. In making this determination, the SEC notes that boards would "still be able to use quality determinations prepared by outside sources, including NRSRO ratings that they conclude are credible". In the release, the SEC also notes its expectation that fund boards "would understand the basis for the rating and make an independent judgment of credit risk."

We believe that eliminating explicit references to credit ratings in Rule 2a-7 is acceptable. If fund boards and the managers working on their behalf fulfill their obligations under the proposed rule, then we do not believe the elimination of reference to NRSROs will cause investors in money market funds material harm. Given that the board could still rely on ratings by NRSROs in making a determination that a security presents a minimal credit risk, this appears to signal only a moderate shift from current oversight duties. However, we do recognize that there is an accompanying expectation that boards would understand the basis for ratings that are assigned and make "independent judgments of credit risks." We believe that this responsibility is required by the current rule.

It is implicit in the existing rule that a board, either on its own or, more likely, with the assistance of the fund manager's staff, has the ability to make independent assessments of the credit quality of securities that are considered for investment. This is because the rule limits investments to securities with NRSRO-credit ratings in one of the two highest categories or in ***comparable unrated securities***. To be able to determine that an unrated security is comparable to a rated one requires, first, that the board or its agents be able to conduct their own credit analyses on the unrated security and, second that they understand the NRSRO's rating methodologies well enough to recreate the NRSRO's analyses in order to determine comparability. Considering that the boards or their agents are expected to be able to make these determinations, we believe there is no need to require an NRSRO rating.

Portfolio Liquidity

We support proposed amendments that would require a money market fund to hold securities that are liquid enough to meet reasonably foreseeable redemptions in light of the fund's commitments. However, as we have seen in the past 18 months, instruments once considered liquid can quickly become illiquid. Consequently, we urge the Commission to provide a clear definition of what it considers “liquid.”

We also support the provisions that would prevent a fund from holding more than 10 percent of its assets in securities considered illiquid (under the Commission’s definition of “liquid”) when they were purchased. Particularly in light of recent market volatility, we believe that heightened awareness of liquidity needs is warranted.

Monitoring Minimal Credit Risks

Under the current rule, a money market fund must reassess whether a security continues to present minimal credit risks and take appropriate action when a security has been downgraded by an NRSRO. Proposed language would instead impose an obligation to reassess minimal credit risk whenever the board “becomes aware of any information about a portfolio security or an issuer of a portfolio security that may suggest that the security may not” continue to present such risks and then to take appropriate action. Staff commentary notes that while advisers do not have to subscribe “to every rating service publication in order to comply with this proposal”, they are expected to exercise “reasonable diligence” in monitoring relevant information about portfolio securities.

While we appreciate the proposal’s attempt to replace current requirements under Rule 2a-7 with language that eliminates express reliance on NRSRO ratings, we recommend that the final rule provide more guidance as to what will suffice under this language. Requiring an adviser to take action whenever it becomes aware of “any” information that “may” suggest a change in a security casts an overly broad net. Instead, we suggest that the obligation pivot on whether there is “credible” information that “reasonably suggests” a change in portfolio quality. Even with such modifications, however, we believe that the adviser needs additional guidance as to its monitoring obligations. Moreover, we question whether the adviser’s obligation to stay “abreast of new information” about a portfolio security that is reported in the national financial press *or* publications subscribed to by the adviser provides adequate investor protections.

Notice of Affiliated Transactions

We support aspects of the proposal that would require a fund to notify the SEC when an affiliate (or its promoter or principal underwriter) purchases a security from the fund that is no longer an “Eligible Security” under Rule 17a-9 of the Investment Company Act of 1940. We believe that this adds an added degree of transparency and is warranted in light of recent events in the market that tended to disguise actual risk.

Rule 10f-3

Currently, Rule 10f-3 defines certain conditions under which funds that are affiliated with members of an underwriting syndicate may purchase securities from the syndicate. Municipal securities that may be purchased in reliance upon the rule must be rated investment grade by at least one NRSRO or, for less-seasoned securities, in one of the three highest ratings by an NRSRO. Fund directors are charged with the responsibility for approving procedures for purchases made under the rule and determining that purchases comply with those procedures.

As proposed, reliance on credit ratings would be replaced with a requirement that eligible municipal securities be those that are "sufficiently liquid that they can be sold at or near their carrying value within a reasonably short period of time." The securities would also have to be either "subject to no greater than moderate credit risk" or, if seasoned securities, "subject to a minimal or low amount of credit risk." In keeping with its duties under the current rule, the board would be required to approve procedures to ensure that municipal securities would meet the proposed liquidity and credit-quality conditions. The release notes that the board could incorporate into their approval of procedures NRSRO ratings, reports, analyses and other assessments.

In general, we support the proposed changes to Rule 10f-3. While the duty to make credit determinations (in this case, approve the procedures for purchases and determine compliance) may appear to require expertise beyond typical board experience, boards would be allowed to rely on information and assessments provided by other sources.

Securities Exchange Act of 1934—Remove References to NRSROs

Rule 10b-10

As noted in the release, paragraph (a)(8) of Rule 10b-10 requires that transaction confirmations for most debt securities must inform investors whether a security is unrated by an NRSRO as a means for prompting a dialogue between investor and broker about the security. We believe this rationale remains valid.

In proposing elimination of paragraph (a) (8), staff reaffirms that an issuer's creditworthiness is a relevant topic for discussion and encourages investors to understand all credit-related risks before investing. The release also allows broker-dealers to volunteer in their confirmations the information that is proposed to be deleted.

We believe that the logic for deleting the reference to credit ratings in this case is questionable on two levels. First, noting that a security is unrated does not in and of itself unduly convey a judgment on that security. It simply allows the investors to raise relevant questions with their brokers. Second, without a prompt, the typical retail investor may not know to query the broker about the credit status of an issuer, thereby losing the ability to gain all the information he deserves in order to make informed investment decisions.

Accordingly, we support the alternative raised in the release whereby the confirmation would disclose whether or not the security is rated, as opposed to only stating when it is not rated. We believe that this approach serves the underlying purpose to put the investor on notice of any issues he may consequently want to raise with his broker.

Securities Act of 1933—Replace Requirements that Rely on Security Ratings with Alternative Requirements

Rule 134

Currently, Rule 134(a) (17) allows security ratings by NRSROs to be disclosed in certain communications that are not a prospectus or free writing prospectus. A proposed amendment would expand this disclosure to include ratings by any credit-rating agency, not just NRSROs. We support this amendment, provided that the communication includes a description of the credit-rating agency and its rating methodologies.

Conclusion

The CFA Institute Centre appreciates the opportunity to comment on these three releases relating to various references to credit ratings in the securities acts. In most part, we agree with, or do not object to, the proposed changes to and deletions of such references. However, as noted above, we believe that several proposed amendments exceed what is good for the market and the investing public and should not be implemented.

Should you have any questions about our positions, please do not hesitate to contact Kurt N. Schacht, CFA at kurt.schacht@cfainstitute.org or 212.756.7728; or Linda Rittenhouse at linda.rittenhouse@cfainstitute.org or 343.951.5333.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht
Managing Director
CFA Institute Centre for
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/s/ Linda L. Rittenhouse

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Senior Policy Analyst
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CFA INSTITUTE
Centre for Financial Market Integrity

25 July 2008

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

Re: Proposed Rules for Nationally Recognized Statistical Rating Organizations—File No. S7-13-08

Dear Ms. Morris:

The CFA Institute Centre for Financial Market Integrity[1] is pleased to comment on the SEC's release that proposes changes to the current framework within which NRSROs operate. While we do not believe that NRSROs/credit rating agencies (CRAs) are solely responsible for the dramatic effects on the market stemming from the subprime mortgage crises, we appreciate that the current crises have highlighted shortcomings within the ratings process and CRA operations.

We support disclosure of information to the public that provides investors and regulators alike with the "reasoning" behind ratings that are assigned by CRAs. This includes the methodologies used and assumptions relied upon, which invites stringent review of ratings that do not correlate with the models used. We also appreciate the efforts through these proposals to address and manage some of the more obvious conflicts of interest between those providing and those receiving ratings. As recognized in this release, more than disclosure is required to shore up the credit ratings process and restore investor confidence in the system.

The results of a recent opinion poll conducted by CFA Institute only underscore this need for reform. In a survey that generated nearly 2,000 responses from its members worldwide, 11 percent of respondents reported witnessing a CRA changing its rating in response to pressure from an investor, issuer, or underwriter.[2] In other results, a plurality - 47% - supported the idea of a different rating system for structured products; and 55% indicated support for CRAs grouping themselves into an international standard-setting and monitoring self-regulatory body with enforcement powers. While as a general rule we favor self-regulation of markets,

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[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries of whom more than 82,600 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 56 countries and territories.

[2] See results of survey at www.cfainstitute.org/memresources/monthlyquestion/2008/june.html

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whenever possible, we also recognize the current authority of the Commission to regulate aspects of NRSRO activities.

General Comments

As a procedural matter, we question the setting of a 30-day public comment. A 45- or 90- day comment period would have been more appropriate and allowed the analysis that certain aspects of this proposal demand.

As the first 25 pages attest, this issue is complex and requires a thorough understanding of the inter workings of many factions. It follows that this proposal is similarly detailed. While we appreciate the SEC's efforts to address this area quickly, we also believe that complex new policy that is rushed though is often detrimental to the markets in the long run. Given the severity and depth of problems stemming from matters related to these proposals, we urge the SEC to reopen the comment period for all or certain parts of this proposal to enable further public consideration of the issues raised in this release.

We recognize that much of the current problem may have roots in the loan origination process. However, we also believe that CRAs could have done a better job of informing investors about the purpose and use of ratings so that investors did not continue to unduly rely on them or assign them inappropriate significance. We welcome these proposals as an effort to require CRAs to further educate the investing public about the analysis underlying their ratings, as well as to manage conflicts inherent in the appearance of a "pay for ratings" system.

This is an area in which we have been involved for some time and have already taken positions/recommended changes, particularly with respect to structured finance products. This involvement has extended not only to reform efforts within the current US system, but also to reviewing proposals being considered outside of the United States.[3]

As early as 2006, CFA Institute called for more accountability by rating agencies, noting that "Investors need to be confident that the credit-rating information they use to evaluate companies is accurate, unbiased, and reliable." [4]

Since then, the CFA Institute Centre has called for a number of reforms in this area, including

- Using a rating nomenclature/categorization that distinguishes structured products from both corporate and commercial paper ratings to help investors recognize the differences;

[3] See, e.g., April 2008 letter from Charles Cronin, Head, CFA Institute Centre Europe, Middle East and Africa, to Kim Allen, IOSCO General Secretariat–Letter of "public Comment responding to "IOSCO Technical Committee Consultation Report on Credit Rating Agencies"; see also March 2008 comment letter from Charles Cronin to Carlo Comporti, the Committee of European Securities Regulators–Response to CESR consultation paper "The role of credit rating agencies in structured finance."
[4] See 2008 statement to Congress by CFA Institute CEO Jeff Diermeier: www.cfainstitute.org/centre/pdf/jeff_diermeier_testimony_credit_rating_agencies.pdf

- Encouraging a global best practice of prohibiting the practice of "notching", where a credit rating agency unilaterally issues a rating on an entity or structure that was not sought by the issuer, and for the primary purpose of "punishing" the entity or structure for not engaging that CRA; [5]

- Creating an executive-level compliance officer position at credit rating agencies to ensure implementation and enforcement of the IOSCO code;

- Requiring complete adoption of the IOSCO code to claim compliance; and

- Calling on credit rating agencies to refrain from rating new structured products until the statistical data are sufficiently robust to produce a defensible rating.[6]

We also have publicly called for a refinement or even elimination of the concept of "investment grade" in ratings wherever possible to reduce misconceptions about the purpose of assigned ratings. We will address this in our response to the Commission's second set of proposals to amend rules and forms that reference ratings issued by rating agencies.

We provide specific comments on certain aspects of the proposals below.

Specific Comments

A. Disclosing and Managing Conflicts of Interest--Amendments to Rule 17g-5

(a) Enhanced Disclosure of Information Used in the Rating Process for Structured Finance Products

We appreciate the objectives expressed in the proposal to provide the public with information relating to information the NRSRO has received and uses to determine a rating as a condition to rating a structured finance product. We also recognize disclosure of such information as a way to (1) manage conflicts of interest relating to being paid for providing a rating, (2) increase the transparency of the process, (3) foster competition among market participants, including other NRSROs, and (4) expose inaccurate ratings.

In general, we support additional disclosure by the CRAs that help to manage the conflicts of interests presented in certain credit rating arrangements. In order to achieve the goals stated in the proposal, however, the information must be focused. We feel strongly that providing a large amount of raw data or other

[5] This position comports with provisions in section 15E (i) (1) (A), (B), and (C) of the Credit Rating Agency Reform Act of 2006, which prohibits conduct by NRSROs that is unfair, coercive, or abusive, including practices related to conditioning the issuance of ratings on the purchase of other services or products; refusing to rate, or lowering/threatening to lower ratings on securities/instruments issued by a pool or part of a transaction unless the NRSRO also rated a portion of the assets within the pool or part of such transaction; and modifying/threatening to modify ratings based on an agreement to purchase the rating or other services or products of the NRSRO.

[6] See 5 February 2008 press release:
http://www.cfainstitute.org/aboutus/press/release/08releases/20080205_02.html.
Also see comments to Committee of European Securities Regulators —
http://www.cfainstitute.org/centre/topics/comment/2008/pdf/cesr_cra_response.pdf;
and to the International Organization of Securities Commissioners —
http://www.cfainstitute.org/centre/topics/comment/2008/pdf/iosco_consultation_cras_response.pdf.

information that is not closely related to the determination of a debt rating generally is not helpful to investors and will not achieve the desired objectives of this proposal.

Thus, we question the proposed requirement to disclosure “all information” provided to and used by the NRSRO in determining the initial credit rating and undertaking credit rating surveillance. By requiring disclosure of “all information”, we fear that this requirement may result in a “data dump” that will be of limited use to investors and regulators. While some of this data may be useful to regulators, we encourage a more focused approach to providing investors with a summary of the underlying information about the process used to assign the rating, including the underlying assumptions relied upon and methodologies used by the NRSRO. If the SEC needs additional information for regulatory examinations or otherwise, it may want to require records of such information to be made readily and publicly available by the CRA for prescribed time periods.

For both the initial credit rating and subsequent credit rating surveillance, the release does not dictate the information that must be disclosed but does note what information the SEC “anticipates” will be disclosed. We suggest that the adopting release explicitly require at least what information is to be provided in order to satisfy the disclosure requirements.

We also support an objective of this proposed amendment which is to foster competition among market participants, including NRSROs, through the broad dissemination of information provided to and relied upon by the rating NRSRO. We understand that this information will not only serve as a check on the accuracy of the rating but also will allow rating agencies to issue unsolicited ratings.

While we support this objective generally, we do, however, caution against the unethical use of unsolicited ratings to “punish” or otherwise manipulate market participants into engaging a particular NRSRO, a practice commonly known as “notching.” As recognized in the Credit Rating Reform Act of 2006, threatening or lowering ratings based on reciprocity by the issuer/obligor or otherwise conditioning a credit rating based on whether the obligor will purchase a rating is prohibited conduct. We encourage the Commission in any final rulemaking to emphasize the illegality of any such conduct in connection with the practice of unsolicited ratings.

We also recommend that the SEC require disclosure about any steps that were taken by the NRSRO, issuer, underwriter, sponsor, depositor, or trustee to verify information about the assets underlying or referenced by the security or money market instrument. Similarly, we recommend that the Commission require disclosure of results of any steps undertaken by these parties to verify information about the assets underlying or referenced by a structured finance product. If no such steps were taken, we believe this also should be noted.

Finally, a number of CRA websites require registration before allowing access to technical information on methodologies and assumptions. We urge the Commission to adopt a requirement that CRAs eliminate this registration requirement as a prerequisite for obtaining such information. To the extent methods or assumptions change, CRAs should be required to maintain archival materials of the methods and assumptions in effect at the time of any earlier rating.

(b) Prohibiting Conflicts of Interest Between NRSROs and Those Receiving Ratings

We appreciate the objective of this proposal to deter those providing the ratings from benefitting from essentially telling the issuer or obligor how to receive a particular rating, thus rating their own work. However, as the Commission recognizes in the release, communication between the NRSRO and other parties about NRSRO procedures and methodologies serves a useful purpose. We encourage striking a balance where useful communication is not deterred but manipulation or self-serving practices are not encouraged.

To that end, we strongly support rules that would prohibit discussions that recommend the creation or design of a securitized finance product, but that would allow discussions of the assumptions and rationales underlying the rating decisions. Such rules would recognize the reality that drawing the line between making recommendations and providing feedback is a challenging process.

Given the difficulty in separating meaningful discussions from proactive involvement in the structuring of instruments to obtain certain ratings, we also recommend that NRSROs be required to create an executive-level compliance position charged with monitoring these discussions and the overall rating process. To further enhance its value, this position should be free of any influence from both the compensation practices and reporting authority of any affiliate consulting or advisory division of the CRA. Vesting oversight in a compliance officer one step removed from initial ratings process would, when combined with appropriate disclosure, help to manage these communications and the potential conflicts of interest they may create, and will further work to ensure that investor interests are being protected.

Additional Recommendations

We recommend that different analyst groups be assigned responsibility for determining initial ratings from those engaged in ongoing monitoring and subsequent actions. Doing so reduces the risk that pressure placed on the analyst providing the initial credit assignment by the issuer or underwriter will be passed on to the analyst responsible for subsequent reviews and adjustments in ratings. We also suggest that analysts responsible for ongoing monitoring be rotated after prescribed time periods so as to discourage the formation of personal relationships that may impair objectivity.

(c) Prohibiting Conflicts of Interest Related to Fee Discussions

We support the proposed amendment to Rule 17g-5 that would separate the NRSRO personnel involved in fee discussions from those actual conducting the credit rating analysis.

The Commission asks whether small NRSROs should be exempt from rules that would separate personnel involved in fee discussions from those conducting credit rating analysis. The Commission further asks whether disclosure of such conflicts would provide sufficient information to investors to permit such an exemption.

While we recognize such requirements may create a hardship for small CRAs, the CFA Institute Centre does not support such an exemption. In its Research Objectivity Standards ("ROS"), the CFA Institute Centre calls for reporting structures that "ensure that research analysts do not report to, and are not supervised or controlled by… another department of the firm that could compromise the independence of the analyst." It also calls on firms to implement procedures that prevent other functions within the firm "from reviewing, modifying, approving, or rejecting research or recommendations on their own authority."[7]

(d) Prohibiting Conflicts of Interest Related to Receiving Gifts

We support restrictions on the monetary value of gifts or other perquisites a credit analyst can receive from the party being rated or those related to the securities being rated in order to curtail the "buying" of ratings through gifts. Monitoring these activities could easily be part of the duties expected of the compliance officer. And while we believe the $25 limit on gifts does not meet the test of a material gift that might impair the objectivity of an analyst, we also believe that a limit of twice that amount would also be unlikely to meet the material test.

B. Recordkeeping—Amendments to Rule 17g-2

(a) Public Record of Rating Actions

We have long supported efforts to develop XBRL for the financial reporting area for public companies and generally support the development of a format that allows investors the ability to receive and compare information efficiently. However, we have a number of concerns about the proposed amendments that would require NRSROs to make records of rating actions publicly available through the NRSRO's Web site in an XBRL Interactive Data File.

First, the proposed time lag for making information publicly available from the NRSRO would not meet the stated goal of the proposal to make "it easier for persons to analyze the actual performance of the credit ratings the NRSROs issue in terms of accuracy in assessing creditworthiness." In order to do this, current and prospective investors in companies or in specific rated issues need information on current ratings in a timely fashion. As proposed, the NRSRO would be allowed up to six months after the date of the rating action to make its record publicly available. In any event, any such public filing that is made by the NRSROs should clearly be marked "historical" so that inexperienced users of the NRSRO's web site do not mistake it for current data.

We also have additional concerns surrounding the proposal that this information be filed in an XBRL format. Specifically, we encourage a longer review be considered for this aspect of the proposal so as to develop greater clarification of the Commission's short- and longer-term expectations in this area. Usually, XBRL documents contain information as of a point in time and are not constantly updated. However, given the number of different classes of securities (e.g., preferred, senior debt, sub-debt, etc.) to which NRSROs assign ratings for a number of issuers, NRSROs need guidance on how to meet their obligation under this proposal. For example,

- Is the NRSRO required to file a single document with all ratings for all companies and related history? Or
- Should the NRSRO instead file a separate instance document for each action for the company (e.g., similar to a XBRL tagged press release?)

[7] This language is found in Standard 4.0. While it relates specifically to research in an investment banking environment, the principles are equally applicable in this instance.

Should the SEC decide to require the reporting of information through XBRL, an approved taxonomy related to the required fields will need to be developed. This taxonomy will need to incorporate tags for descriptions of the company, facts about the rating and descriptions of issues associated with the rating. The more complete that the information is regarding the issuance of a rating, the greater level of transparency that will be derived. In order to provide investors with the greatest benefit, the format of all required information should be consistent, so that users do not need multiple applications to access and analyze the data.

In order to ensure comparability, we suggest that the SEC or its assigned taxonomy standard setter (possibly XBRL US) work with NRSROs and users of the information to determine these tags. In addition, an ongoing maintenance plan will need to be developed. Given the uncertainty of the scope of the historical data that will be required, we question the use of XBRL and suggest exploration of other formats that may be more suitable for accessing and sorting the number of lines that may exist.

We believe more information is required before there can be an accurate assessment of the potential costs of using XBRL in this area. The scope of the instance document—one for all or one for each activity—will greatly impact the amount of time to issue the first document and to provide updates. Given the historical nature of most of the information, we recommend that the Commission develop a central storage database for assessing accuracy and compliance.

(b) Record of Material Deviation from Model Output

We strongly support the proposed requirement that the NRSRO issuing a rating make a record for the reasons for material differences between a credit rating implied by a quantitative model and the actual rating issued. As explained in the release, this would only occur where "a quantitative model is a substantial component of the credit ratings process for the type of obligor or security being rated and the output of the model would result in a materially different conclusion if the NRSRO relied on it without making an out-of-model adjustment." The NRSRO would bear the responsibility for determining what is a "substantial component" and what is a "material" difference. We agree that this is an important means of providing SEC examiners and internal NRSRO auditors with the means to reconstruct the process used by the NRSRO in determining the rating.

(c) Record of Complaints Against Third-Party Analysts

Similarly, we support the proposed amendment that would require the NRSRO to retain records of complaints against credit analysts related to the assignment of ratings as a way to better reveal the pressures that arrangers or others wield when dissatisfied with a rating. The release also notes that the mere existence of this rule may in and of itself deter NRSROs from succumbing to such pressures.

(d) Record of Communications Relating to Monitoring

Requiring NRSROs to maintain a record of internal and external communications related to "monitoring" seems entirely appropriate, especially given that the monitoring of credit ratings appears to have been more problematic than the initial assigning of one. Extending the record-keeping requirements to the monitoring phase should help address this. With respect to the question raised in the release, we recommend replacing the word "maintaining" with "monitoring" as an appropriate clarification to the rule.

C. Amendments to the Instructions for Form NRSRO

(a) Disclosure of Enhanced Ratings Performance Measurement Statistics

The SEC is proposing to require NRSROs to publicly disclose raw data that the marketplace would need to apply credit ratings performance metrics.

In particular, a proposed amendment would require NRSROs to disclose “separate sets of default and transition statistics for each asset class of credit rating” for which an NRSRO is seeking registration, or is already registered, “and any other broad class of credit ratings issued by the NRSRO.” It would also require NRSROs registered in a certain class of credit ratings, “when generating the performance statistics for that class to include credit ratings of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage -backed securities transaction.”

A second amendment would require that the class-by-class disclosures of performance statistics and ratings be broken out into periods of one, three and ten years.

A third amendment would focus on what ratings actions are required to be included in performance measurement statistics by replacing the term of “downgrades and default rates” with “ratings transition and default rates.” This change is intended to signal that upgrades, as well as downgrades are to be included in the statistics

Finally, a proposed amendment would require an NRSRO to disclose “defaults relative to the initial rating and incorporate defaults that occur after a credit rating is withdrawn.” The intent of this amendment is “to prevent an NRSRO from manipulating the performance statistics by not including defaults when generating statistics for a category of credit ratings (e.g., AA) because the defaults occur after the rating is downgraded to a lower category (e.g., CC) or withdrawn.”

In general, the CFA Institute Centre supports all of these amendments and believes they may be useful to investors’ decisions.

D. Differentiation in Credit Ratings for Structured Finance Products—New Rule 17g-7

We strongly support Commission efforts to require rating agencies to differentiate ratings for structured finance products from both corporate and commercial paper ratings. Investors need to be alerted to the fact that structured finance products carry a number of underlying risks that are different or not associated with corporate debt and money market instruments.

As we have stated previously, we strongly believe that many investors in fixed income instruments need the additional information that alerts them to differences in the structure, cash flow, and volatility.[8] Accordingly, different analysis is required to provide investors with the information they need in order to make informed investment decisions. This required differentiation and associated clarification/education is a major step forward for the investing public.

[8] See June 12, 2008 Press Release by CFA Institute Centre, “Investors Will Benefit From SEC’s Rating Agency Reform.

In the past, we have suggested use of a rating nomenclature/categorization to help investors recognize the differences. In light of the proposed new rule's intent to address this goal, we believe this clarification should come both through the use of different symbols for structured products, and the availability of an accompanying report. The purpose of the different symbol is to ensure that investors are aware that these instruments mature differently from more traditional corporate or sovereign debts. By making an accompanying report available, the NRSROs would help investors make such inquiries.

Conclusion

As reflected in our comments above, we strongly support aspects of the Commission's proposals to address NRSRO activities. We believe that this call to increase NRSROs' accountability—through enhanced disclosure and rules to manage their conflicts of interest—will serve the important step of starting to restore investor confidence in the system.

We appreciate the opportunity to comment on these proposals. If you have questions about any of the positions taken in this letter or would like additional information, please do not hesitate to contact Kurt Schacht at 212.756.7728 (kurt.schacht@cfainstitute.org) or Linda Rittenhouse at 434.951.5333 (linda.rittenhouse@cfainstitute.org).

Sincerely,

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