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U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549
Attn: Jonathan G. Katz, Secretary

June 9, 2005

Re: Definition of Nationally Recognized Statistical Rating Organization; File No. S7-04-05

Ladies and Gentlemen:

The Bond Market Association (the "BMA")[1] and the Securities Industry Association (the "SIA"[2] and, together with the BMA, the "Associations") welcome the opportunity to comment on the proposed new rule published by the Securities and Exchange Commission (the "Commission" or the "SEC") under the Securities Exchange Act of 1934, which would define the term "nationally recognized statistical rating organization" ("NRSRO").

The Associations have been and continue to be active participants in the debate concerning credit ratings agencies. The BMA has written a number of comment letters

[1] The Bond Market Association is an international trade association representing approximately 200 securities firms and banks that underwrite, distribute and trade in fixed income securities in the U.S. and internationally. More information about the BMA and its members and activities is available on its website www.bondmarkets.com.

[2] The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA members, including investment banks, broker-dealers and mutual fund companies, are active in U.S. and foreign markets and in all phases of corporate and public finance. More information about the SIA and its members and activities is available on its website www.sia.com.

on the U.S. and European proposals regarding credit rating agencies.[3] The Associations applaud the Commission for its thoughtful approach to bringing more clarity and transparency with regard to the NRSRO concept. This letter will give our views on some of the issues raised by the Commission in the proposing release (the "Release"), specifically:

1. **Public Availability**. The Commission has asked how it should be determined whether an NRSRO is making its credit ratings readily available on a widespread basis. We do not believe the commission should limit the means by which rating agencies disseminate their ratings, since there are undoubtedly many ways in which such disseminations could be effected. Nevertheless, we believe it would be appropriate for the Commission to state that internet posting alone would be sufficient, since the vast majority of investors in rated securities have access to the internet.

The Release also mentions the issue of whether a credit rating agency should be required to disclose ratings to the public when the rating agency has prescribed conditions for not publishing the issuer's ratings (e.g. in the case of "private" ratings provided only to the issuer). The Release contains an interpretation that "publicly available" means that ratings used for regulatory purposes must be disseminated on a widespread basis. We support this interpretation, as it applies to the use of ratings for SEC regulatory purposes. However, we understand that investors often request private ratings of unrated securities or obtain a credit enhancement for a rated security and then obtain a private higher rating. If another regulator (e.g. the NAIC) is willing to allow an investor (e.g. an insurance company) to use such a rating for regulatory (e.g. permitted investment) purposes, even if the rating is not made public, we do not believe the rule should make the issuer of such a private rating ineligible for NRSRO status merely because it provides a private rating.[4]

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[3] See, e.g. Comment letter, dated January 28, 2005, from the BMA to the Committee of European Securities Regulators ("CESR") on CESR's technical advice to the European Commission on possible measures concerning credit rating agencies (Consultation Paper of November 2004), available at http://www.bondmarkets.com/assets/files/CESR%20CP%2030%20Nov%2004%20-%20Final.pdf; Letter, dated November 6, 2004, from the BMA on the Report of the Chairmen's Task Force of the Technical Committee of the International Organisation of Securities Commissions regarding a Code of Conduct Fundamentals for Credit Rating Agencies, available at http://www.bondmarkets.com/assets/files/Response%20to%20IOSCO%20Final%20-%20Clean.doc; Letter, dated August 5, 2004, from the BMA to the Committee of European Securities Regulators, responding to CESR's call for evidence on Possible Measures Concerning Credit Rating Agencies, available at http://www.bondmarkets.com/assets/files/CESR%20Call%20-%20BMA%20comment%20letter.pdf ; Letter dated July 28, 2003 from John M. Ramsey to Jonathan G. Katz on Credit Rating Agency Concept Release (see Release footnote 48).

[4] See, for example, Technical Committee of the International Organization of Securities Commissions, Code of Conduct Fundamentals for Credit Rating Agencies (December 2004)(hereinafter "IOSCO Code Fundamentals", Section 3.4 which states "Except for 'private ratings' provided only to the issuer, the CRA should disclose to the public, on a non-selective basis and free of charge, any rating regarding publicly issued securities . . . if the rating action is based in whole or in part on material non-public information."

2. **Requirement to rate specific securities**. We agree with the requirement that an NRSRO rate specific securities and not provide solely entity ratings. Many bond issuers have several different classes or issues of outstanding debt obligations with varying maturities and structures. Those issues often have different rights, depending on the terms under which they were issued, including different call features, covenant packages, seniority or subordination in the corporate capital structure, collateral, guaranties and other economic attributes. Consequently, publication of a single issuer rating could be misleading. It should be made clear that an NRSRO may also issue company specific assessments, such as "default predictors."

3. **Current Assessment Requirement**. The proposed definition requires a rating to be a "current" assessment." This, in turn, would require the rating agency to have and follow procedures designed to ensure that its ratings are reviewed and, if necessary, updated on the occurrence of material events. We agree that this requirement is desirable. We also agree, however, that the Commission should not prescribe a specific time period within which an NRSRO's ratings would need to be updated, since the appropriate time will vary from security to security. We believe that some NRSROs have begun to publish lists of securities ratings, along with the date of the most recent rating/rating report. We believe this should be encouraged. We also believe the Commission should address the update requirement with respect to private ratings. We understand that at least one rating agencies does not update private ratings, and that some ratings are designed for a particular purpose and would not need updating.[5]

4. **Nationally recognized**. In determining whether to issue a no action letter, the Staff has considered the single most important factor to be whether the credit rating agency is "nationally recognized" in the United States by the predominant users of securities ratings as an issuer of credible and reliable ratings. The Proposed Rule's standard is whether a credit rating agency is "generally accepted in the financial markets as an issuer of credible and reliable ratings by the predominant users of securities ratings." The staff believes that this "recognition" or "acceptance" is a proxy for whether ratings are credible and reliable and can reasonably be relied upon in the marketplace.

The Release proposes two ways that a rating agency could meet this component of the NRSRO definition: (1) statistical data that demonstrates market reliance on the credit agency's ratings such as, market movements in response to ratings changes, and (2) attestations by authorized officers of users representing a "substantial percentage of the relevant market" that the credit rating agency's ratings are credible and actually relied upon by them. It also asks whether other types of information would be appropriate, such as the fact that a rating agency has many subscribers, or the views of issues.

We believe it is very difficult to measure "reliance" on ratings. Many ratings do not involve upgrades and downgrades and therefore may not produce market movements.

[5] See IOSCO Code Fundamentals, Section 1.9, which states "Except for ratings that clearly indicate they do not entail ongoing surveillance, once a rating is published the CRA should monitor on an ongoing basis and update the rating . . . ." (emphasis supplied).

Moreover, market movements in response to ratings changes may be difficult to attribute solely to a particular rating change, if the change is made in response to issuer developments and is made at the same time as the public announcement or the same time other rating agencies are taking similar action. Either attestations by authorized officers of users or the number of subscribers willing to pay for the rating agency's research reports would be a much more objective measure.

We believe the requirement of attestations from users representing a "substantial percentage of the relevant market" needs further clarification. For example, clarification is required with regard to how to determine what is the relevant market for a particular security, e.g., whether that market is defined geographically or by common characteristics of investors or dealers. Additional clarification is needed with regard to what percentage is considered substantial, e.g. 10%? 20%?, and what metric should be used to calculate that percentage, e.g., the number of users or the amount of assets they own or manage.

Finally, we believe that, if the purpose of this test is as a proxy for whether ratings are credible and reliable and whether they can reasonably be relied upon in the marketplace, then the views of issuers may not be meaningful and may be subject to conflicts of interest.

5. **Limited Sector/Geography Recognition**. We applaud the Commission's decision to recognize that the definition of NRSRO should include credit rating agencies that confine their activities to limited product or geographic sectors. We believe that there are valid arguments that, once an agency is recognized for issuing credible and reliable ratings within a limited sector or geographic area, it should meet the NRSRO definition without product or geographic limitation ("broad recognition"). There are also valid arguments on the other side ("narrow recognition"). However, we believe the balance favors broad recognition. First, this will enable relatively new entrants to build out their businesses, and will help to lower what has been a barrier to new entrants into the market. Second, once a firm has demonstrated the ability to publish credible, reliable ratings in one area, it has proved its expertise in credit risk assessment, and, thus, its ability to produce credible ratings in other areas. Third, using broad recognition avoid the problem of distinguishing ratings that are considered to be issued by an NRSRO from those that are not, particular when the Commission prohibits NRSROs from disclosing that they are NRSROs. Finally, it levels the playing field with existing NRSROs, which do not have to obtain Commission permission before beginning to rate new types of securities. The argument for narrow recognition, of course, is that the Commission's test for "nationally recognized" is that the rating agency is generally accepted in the financial markets as an issuer of credible and reliable ratings by the predominant users of securities ratings. General recognition for a particular expertise does not necessarily equate to acceptance in other areas. On balance, however, we believe this should be a matter for determination when the NRSRO's designation is being reviewed.

6. **Analyst Experience and Training**. The ability to identify, understand and analyze data from and about issuers is clearly crucial to credit rating agencies. The Proposal contains a number of recommendations with respect to workload and training of "analysts" and other staff, but does not define the term "analyst." Consequently, it is not clear whether the proposal is limited to persons who are responsible for recommending ratings, or would apply to all rating agency staff who perform any kind of financial or credit analysis. We believe a definition of "analysts" would be helpful, and that the definition of Research Analyst in Regulation AC, which depends on the definition of a Research Report and focuses on those primarily responsible for the preparation of reports could be used as a model. Such a definition would recognize that the ratings process is a team and committee process. Consequently, every person on the team may not have the same level of competence. What is important is that the rating agency has procedures for ensuring that the persons actually responsible for the report have the required experience and competence and are responsible for delegated work.[6] We also believe that an NRSRO should have policies and procedures in place to ensure compliance with requirements for the qualifications, experience, workload and performance of its ratings staff.

7. **Number of Ratings Per Analyst**. We do not support a Commission-imposed limitation on the number of ratings per analyst. The right number of ratings will depend on the nature of the securities being rating, the complexity of the issuers, and the resources available to the analysts, among other things. We believe, however, that disclosure by an NRSRO of the number of credit analysts they employ and the average number of issues rated or otherwise followed would be salutary.

8. **Ratings Relying Primarily on Quantitative Models**. We do not believe that a rating agency that uses solely quantitative models and does not request that an issuer's senior management participate in the rating process free of charge should be designated an NRSRO. There is substantial volatility in these ratings and they often give false positive results regarding credit rating problems. However, ratings based solely on quantitative information may have their place and be useful for investors and others. For example, Moody's KMV RiskCalc Model is based solely on quantitative factors. It does not actually assign a rating, but rather an expected default frequency, which can then be easily correlated to a certain rating level. Nevertheless, we believe there is a substantial difference between ratings that rely primarily on quantitative models and those that include extensive contacts with the issuer's management, and that the former should not be the only ratings relied upon for regulatory purposes. If the Commission determines not to exclude firms relying primarily on quantitative models from NRSRO designation, we believe a rating agency that relies primarily on such models should provide clear disclosure that its ratings are based solely on quantitative factors.

[6] Compare IOSCO, Code Fundamentals, Section 1.4 ("the CRA should use people who, individually or collectively have appropriate knowledge and experience in developing a rating opinion for the type of credit being applied.")

9. **Conflicts of Interest**. The Release states that the examination of NRSROs or comment letters on the Commission's 2003 concept release on rating agencies (the "Concept Release")[7] revealed a concern with potential conflicts of interest, including (1) potential conflicts created when issuers pay for their ratings; (2) conflicts due to the marketing by NRSROs of ancillary services to issuers, such as pre-rating assessments and corporate consulting; (3) giving subscribers preferential access to rating analysts; and, (4) unsolicited ratings.

We agree that ratings should not be unduly influenced by a person with a vested interest in the level of the rating. For that reason, we believe rating agencies should have policies and procedures to prohibit the rating agency and analysts who rate particular companies from owning securities in those companies.[8] However, we believe it is important to determine whether potential conflicts are likely to have an adverse effect on the independent judgment of analysts. Moreover, we do not agree that all the listed potential conflicts are actual conflicts that should be eliminated rather than managed. We also believe it is salutary for rating agencies to have a policy that analyst compensation will be unrelated to the amount of revenue the rating agency derives from issuers that the analyst rates.[9] Similarly, we believe rating agencies should prohibit an employee from participating in the rating process for an issuer if the employee has had recent employment or another significant business relationship with the rated entity or has an immediate relation (e.g. a spouse, partner, parent, child or sibling) who currently works for the rated entity. We understand that the Commission believes that its authority to regulate the practices of NRSROs is limited. However, the topic of analyst conflicts seems no less important than the ratio of companies covered.

We agree that unsolicited ratings raise sufficient concerns that credit rating agencies should have procedures designed to avoid employing improper practices with respect to unsolicited ratings and to verify compliance with those procedures. We do not believe, however, that unsolicited ratings are per se manipulative or that they should be banned.

We do not believe that the fact that issuers often pay for ratings creates a per se conflict of interest. Rating agencies must please a number of different constituencies, including not only issuers, but also investors and investment bankers. In addition, we believe rating agencies value their reputations for accuracy and trenchant analysis. Consequently, we believe the disclosure of the source of any payments for the rating is sufficient to put users on notice of any potential conflict.

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[8] See, e.g. IOSCO Code Fundamentals, Section 2.9 (The CRA and its employees should not engage in any securities or derivatives trading presenting conflicts of interest with the CRA's rating activities).

[9] See IOSCO Code Fundamentals, Section 2.11, which proposes that the CRA's code of conduct should state that a CRA analyst will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from issuers that the analyst rates or with which the analyst regularly interacts.

The question of ancillary services is one that should be closely evaluated. Credit rating agencies do not currently provide the same level of ancillary services that were provided by accountants before such services were limited by law and regulation. In addition, we believe that many services that might be considered "ancillary" to the "ratings" business are actually either an integral part of the ratings business or should be seen as complementary and not conflicting. Consequently, we believe that any risk that performance of such services will have an adverse effect on the independence of the judgment of the ratings analyst may be managed with policies and procedures adopted by the rating agencies. Requiring the complete separation of "rating services" from so-called ancillary services may have a substantial negative effect on the cost of implementing Rule 3b-10. In this regard, we note that the IOSCO Code Fundamentals only require that a rating agency separate its credit rating business and analysts from other businesses of the rating agency *that may present a conflict of interest*.[10]

For example, we believe that rating assessments or evaluation services ("RAS/RES") are not ancillary services or consulting services, but are core rating products. They involve communicating to issuers that a proposed structure of a hypothetical security would receive a designated rating. Nothing about provision of the rating assessment should affect the judgment of the analyst in recommending an actual rating. Consequently, any requirement to separate the staff advising issuers as to a proposed rating from the rating analysts who actually rate such products would needlessly produce increased cost for both issuers and rating analysts. Potential conflicts of interest can be adequately controlled if rating analysts are not allowed to market the rating agency's services and are not informed whether a prospective rating customer was solicited for other types of business.

Similarly, Moody's KMV RiskCalc model is probably not a rating product within the meaning of the Release, since it is not security-specific and does not produce ratings within a specific number of ratings categories, although the expected default frequencies produced by the model can easily be correlated to a certain rating level. Yet we see no reason why the provision of such expected default frequencies should be viewed as inconsistent with the rating business. It is based on the same underlying information and is a complementary service.

Another example of a complementary service is the provision of insurance company payment ratings. They are different from credit ratings, but sufficiently similar that they pose no risk to the judgment of a single rating staff.

Along the same lines, if a credit rating agency were to establish a business to perform continuous due diligence on issuers of debt securities in order to aid underwriters in performing due diligence in connection with underwritings, we believe it would be counterproductive if the Commission's rules required that such business be performed only by employees separated by information walls from the rating analysts. The

[10] See IOSCO Code Fundamentals Section 2.5.

information required by the rating agency to perform these functions would be the same. The expertise required of the rating agency staff would be the same. The engagements would be complementary. As in the case of RAS/RES services, we believe rating analysts should not market such services, but we see no problem with their performing them.

10. **Financial Resources**. We agree that an NRSRO should have the financial resources necessary to ensure that it can comply with its rating procedures and to monitor continuously the financial condition of the issuers of the securities it rates. In our opinion, an NRSRO should make its audited financial statements available to users of its ratings so that they can assess whether the NRSRO meets this requirement. We do not think an NRSRO should be required to provide users of ratings with information relating to the percentage of revenue it receives from all issuers or subscribers, but we would support a requirement for disclosure of issuers or subscribers from whom NRSRO's receive more than a specified proportion of their revenues, e.g. 5%, so that such users can assure themselves that the NRSRO is finally independent of its large subscribers and issuers. We would not favor limiting the percentage of revenues an NRSRO receives from a single issuer or subscriber. We believe that the existence of such concentrations should be considered by the SEC in determining whether to approve or re-approve designation as an NRSRO. However, the effect of such concentrations may vary by market and it will be important for the Commission to apply its own judgment in determining whether such concentrations are likely to affect the NRSRO's independent credit judgment.

11. **Other issues**. Although the Release cites, in footnote 55, the IOSCO Code Fundamentals, it does not state the extent to which other issues addressed in the IOSCO Code Fundamentals, or rating agency codes of conduct that comply with the IOSCO Code Fundamentals, will be treated in determining compliance with the Commission's 3-pronged test for NRSRO designation. For example, the IOSCO Code Fundamentals require (1) that a credit rating agency use rating methodologies that are rigorous, systematic and, where possible, result in ratings that can be subjected to some form of objective validation based on historical experience; (2) that analysts should use methodologies established by the rating agency and should apply a given methodology in a consistent manner; (3) that credit ratings should be assigned by the agency and not by any individual analyst; and (4) that rating agencies have a policy that they not forbear or refrain from taking a rating action based on the potential effect (economic, political or otherwise) of the action on the rating agency, an issuer, an investor, or other market participants. These are all factors that the Commission should consider in determining whether to grant or renew NRSRO status.

12. **The Interpretations**. We believe it would be useful for the final Rule 3b-10 to include the interpretations of the components of the definition discussed in the Release. Although the release is relatively short, it contains much information other than the interpretations, and, over time, the interpretations will be more difficult to find. Given the concerns about barriers to entry into the credit rating agency business, we believe that

the Commission should help potential new entrants by maintaining the relevant interpretations in a readily accessible place, such as in or accompanying the rule.

13. **More Substantive Regulation of Credit Rating Agencies**. The IOSCO Code Fundamentals have only recently been put into place. The major credit rating agencies have adopted Codes of Conduct to meet the IOSCO requirements. We believe the Commission should allow more time to determine whether those Codes of Conduct are working before seeking extensive new regulatory powers over credit rating agencies. As the Release points out, many commenters on the Concept Release supported the concept of regulatory oversight of NRSROs solely to allow the Commission to determine whether a credit rating agency continued to meet the NRSRO criteria on an ongoing basis. We believe the Commission either has or should have the authority to determine whether a rating agency meets or continues to meet the requirements for designation as an NRSRO. We do not, however, believe that more extensive regulation of rating agencies is warranted. We urge the Commission to allow the market to police the rating agencies and not to attempt to impose new regulatory burdens that will attempt to substitute the Commission's judgments for those of the market.

The Associations thank the Commission for this opportunity to comment on the proposed rule and Release. If you have any questions on these comments, please feel free to contact Marjorie Gross of The Bond Market Association at 646.637.9204 or mgross@bondmarkets.com or Frank Fernandez from the Securities Industry Association at 212-618-0517 or ffernandez@sia.com.

Very truly yours,

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