

**STANDARD  
& POOR'S**

June 9, 2005

Jonathan G. Katz, Secretary  
United States Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: Proposed Rule To Define Nationally Recognized Statistical Rating  
Organizations (File No.: S7-04-05)

Dear Mr. Katz:

This letter and accompanying Annex are submitted by Standard & Poor's Ratings Services ("Ratings Services"), a part of Standard & Poor's, a division of The McGraw-Hill Companies, Inc., in response to the Securities and Exchange Commission's ("Commission") proposed rule ("Proposed Rule") to define Nationally Recognized Statistical Rating Organizations ("NRSROs"). The Proposed Rule would define an NRSRO as:

an entity (i) that issues publicly available credit ratings that are current assessments of the creditworthiness of obligors with respect to specific securities or money market instruments; (ii) is generally accepted in the financial markets as an issuer of credible and reliable ratings, including ratings for a particular industry or geographic segment, by the predominant users of securities ratings; and (iii) uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of nonpublic information, and has sufficient financial resources to ensure compliance with those procedures.

Over the last century credit ratings have provided an effective, independent and objective tool in the market's evaluation and assessment of credit risk and, by virtually all accounts, have served the U.S. securities markets extremely well. As Ratings Services observed in its response to the Commission's June 4, 2003 Concept Release, *Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws*, ("Concept Release"), the availability of independent, objective and credible credit ratings is a principal factor in the U.S. debt markets' depth, breadth, efficiency and cost effectiveness. In response to the Concept Release, Ratings Services urged the Commission to maintain use of the NRSRO

regulatory concept in light of its widespread acceptance by market participants and successful adoption into numerous federal and state regulations and statutes. Ratings Services, as well, encouraged the Commission to improve upon the success of the NRSRO concept by increasing the transparency of the NRSRO designation process and reducing regulatory barriers to entry while, at the same time, ensuring that the capital markets remain the ultimate arbiter of the credibility of the ratings process. We believe that the Proposed Rule is a step toward accomplishing these important goals.

While Ratings Services believes that each component of the proposed NRSRO definition will help to provide assurances to the market that NRSROs' credit ratings are independent, objective and credible, we continue to believe that the second proposed component of the definition — that an NRSRO is “generally accepted in the financial markets as an issuer of credible and reliable ratings” — is the single most important and indispensable component. As we indicated in response to the Concept Release and as many others have repeatedly observed, the continuation of a regulatory concept that recognizes the market as the best judge of the independence, objectivity and credibility of a credit rating agency's rating opinions is the key to preserving the valuable role of credit rating agencies in the U.S. capital markets.

The next critical step for the Commission will be implementing appropriate designation criteria in a manner that accomplishes its goals while avoiding mandates that could compromise the constitutionally protected independence of rating agencies and the editorial control they maintain over the rating opinions and commentary they publish. As we have previously explained, there is no single correct methodology for the evaluation of the creditworthiness of an issue or issuer and there is no absolutely correct rating opinion. Instead, a rating opinion is an analytic judgment based on a wide range of factors. To ensure that the market receives rating agencies' best judgments of an issuer's or issue's creditworthiness, analysts and rating committees must be free to issue rating opinions without being restrained by the imposition of government-drafted analytical norms that could erode the individual quality and independence of their analysis, stifle innovation and ultimately limit the availability of valuable credit analysis and information in the marketplace.

Ratings Services is encouraged that the Proposed Rule reflects an understanding of the need to avoid intrusive regulation that will compromise these vital principles of independence and editorial control. On its face, the Proposed Rule does not seem to contemplate rigid standards to be imposed by the Commission, but rather looks to whether a rating agency is generally accepted in the financial markets as an issuer of credible ratings and requires rating agencies to use their own “systematic procedures” to manage perceived conflicts of interest, prevent misuse of nonpublic information and maintain sufficient resources. That approach is consistent with actions taken in Europe by the Committee of European Securities Regulators (“CESR”), which recently approved oversight of rating agencies based on self regulation and market forces, and the International Organization of Securities Commissions (“IOSCO”), which issued its Code of Conduct Fundamentals for Credit Rating Agencies in December 2004 to be implemented by credit rating agencies globally.

We are also generally encouraged by the accompanying commentary to the Commission’s Proposed Rule which observes, for example, that the Commission is not proposing “to prescribe a specific time period within which an NRSRO’s ratings would need to be updated” (Proposed Rule at 27); to “require that a credit rating agency satisfy specified minimum experience and training requirements to meet the proposed definition of the term “NRSRO” (*id.* at 34); to “explicitly limit the definition of the term ‘NRSRO’ to entities that systematically contact an issuer’s senior management” (*id.* at 40); or to “standardize the use of rating symbols by NRSROs.” *Id.* at 49.

Some portions of the Proposed Rule commentary, however, raise significant concerns. The commentary includes questions that suggest the potential for regulation that would effectively substitute the Commission’s judgment (in the form of minimum standards and requirements) for the judgment of particular NRSROs. By way of example, the commentary poses questions regarding: the “minimum standards for a credit rating agency’s analysts to continuously monitor and assess relevant developments” (*id.* at 38); the “manner and methods that must be used to distribute ratings” (*id.* at 25); the “criteria that a credit rating agency should use in assessing the experience and training of an analyst” (*id.* 35-36); and “what type of workload is reasonable for the analytical quality of a credit rating agency’s ratings to remain high.” *Id.* at 37-38.

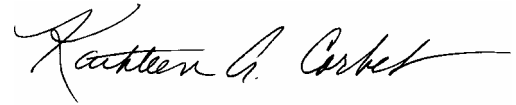
Such regulation would not only be impractical — the type of research and analysis necessary to produce a credible credit rating varies considerably depending on a myriad of factors affecting each individual rating — but would also strike at the heart of the constitutionally protected independence of Ratings Services and other rating agencies. State and federal courts have consistently recognized that rating opinions deserve a high level of First Amendment protection in a wide array of circumstances. This is based on the reality that, at their core, rating agencies perform First Amendment functions by gathering information on matters of public concern, analyzing it and disseminating opinions about it to the general public. These First Amendment protections exist to foster robust debate and to avoid the chilling effect that would inevitably accompany governmental standardization of the formation and dissemination of opinions about matters of public interest — including the assessment by rating agencies of the likelihood that debt will be repaid. These protections would, of necessity, be of central importance to any court passing upon the constitutionality of new regulations.

The Commission’s questions also suggest the potential for regulation that would not only encroach on NRSROs’ constitutionally protected independence, but could also confuse and mislead the market. For example, the Commission has asked whether it should “require credit rating agencies to disclose the number of credit analysts they employ and the average number of issues rated or otherwise followed by those analysts.” *Id.* at 38. Although the Commission states that it is not currently proposing this requirement, a future requirement of such disclosures could suggest to the market that the average number of issues or issuers covered by an analyst is a proxy for high quality analysis when, in fact, the appropriate level of coverage for a particular issue or issuer depends on a broad spectrum of variables.

In its final rulemaking, we urge the Commission to clarify that any new rules and regulations will not be meant to establish Commission control over the manner and method in which NRSROs gather information about issues and issuers; analyze that information; form opinions about that information; and disseminate those opinions to the market.

Attached hereto as Annex A are Ratings Services' responses to specific questions that accompanied the Commission's Proposed Rule and commentary. Ratings Services appreciates the opportunity to address these issues and looks forward to working with the Commission as it considers the appropriate actions to take.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Kathleen A. Corbet". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Kathleen A. Corbet  
President  
Standard & Poor's

cc: The Honorable William H. Donaldson, Chairman  
The Honorable Paul S. Atkins, Commissioner  
The Honorable Roel C. Campos, Commissioner  
The Honorable Cynthia A. Glassman, Commissioner  
The Honorable Harvey J. Goldschmid, Commissioner

## ANNEX A

### *Publicly Available Credit Ratings*

**SEC Questions:** How should it be determined whether an NRSRO is making its credit ratings readily available on a widespread basis? Should our rule specify the manner and methods that must be used to distribute ratings? Should Internet posting itself be sufficient? (Proposed Rule at 25).

**Ratings Services' Response:** Ratings Services agrees with the Commission that the credit ratings of NRSROs should be publicly available at no cost and widely disseminated if used for U.S. regulatory purposes. (Proposed Rule at 23). As some commenters indicated to the Commission in response to the Concept Release, broad dissemination of credit ratings improves transparency and efficiency in the market, helps to prevent potential selective disclosure of material nonpublic information and enables ratings comparability. Indeed, Ratings Services itself broadly disseminates all of its public credit ratings (which account for 99% of its U.S. ratings) and related commentary through real time posts on its Web site, a wire feed to the news media, subscription services such as Ratings Direct and Credit Wire as well as through more traditional print publications.

While Ratings Services believes that broad dissemination of credit ratings is key to a transparent and efficient market, Ratings Services does not support the promulgation of a specific definition of what constitutes satisfactory publication. Given the numerous forms of media through which credit ratings may be disseminated, including the Internet, wire services and hard-copy formats, specifically defining one, or even several, "adequate" methods of dissemination with any particularity would be unwise in that it might hinder rather than promote wide dissemination of ratings. For example, if the Commission delineated Internet posting as a "sufficient" means of dissemination to satisfy this first proposed NRSRO criterion, new NRSROs might be encouraged to limit their dissemination of credit ratings to that minimum requirement and nothing else. Official demarcation of what constitutes "adequate" publication could thus have the unintended negative consequence of limiting, rather than expanding, the currently broad and robust dissemination of credit ratings to the market. In addition, any government mandate specifying the specific manner and method of acceptable publication by NRSROs would raise significant First Amendment concerns.

### *Current Credit Options*

**SEC Questions:** Should the Commission provide additional interpretation regarding what it means for a credit rating agency's credit ratings to be "current assessments"? Should the Commission specify the time period? Will the proposed rule's provisions provide sufficient assurance to the markets that ratings are current? (Proposed Rule at 27).

***Ratings Services' Response:*** Rating Services agrees with the Commission that credit ratings used for U.S. regulatory purposes should be “current assessments” and believes that the Proposed Rule’s provisions will provide sufficient assurances to the market in this regard. Ratings Services believes that additional interpretation is unnecessary and, in any event, would likely be unworkable given the subjective nature of ratings assessments, which are typically formulated and disseminated after deliberation of whatever duration is required to assess the particular issue or issuer being considered. By allowing NRSROs to define the phrase “current assessment” on a case-by-case basis based on their experience, judgment and the particular facts involved in each rating opinion, the Proposed Rule provides appropriate assurances to the market without attempting to impose uniform standards on rating opinions related to disparate issues, issuers and methods of analysis.

For the same reasons, Ratings Services agrees with the Commission that it should not promulgate rules that would “prescribe a specific time period within which an NRSRO’s ratings would need to be updated.” *Id.* at 27. As the Commission recognizes, “the appropriate time period for responding to a material event may vary considerably based on, for example, the complexity of an issuer or the specific security being rated.” *Id.* Any rule attempting to impose a specific, fixed period during which ratings must be updated would by its nature be arbitrary, burdensome and ultimately ineffective. Such regulation would also involve the Commission in the manner and method of issuing credit ratings, thus raising serious First Amendment concerns.

Ratings Services believes that to determine whether an NRSRO’s credit ratings are current assessments, the Commission can review an NRSRO’s definitions and relevant disclaimers or qualifications.

### ***General Acceptance in the Financial Markets***

***SEC Questions:*** How else could the Commission define the term “NRSRO” in order for users of a credit rating agency’s ratings to determine whether such ratings are credible and are reasonably relied upon by the marketplace? Are the approaches discussed above useful for determining whether a credit rating agency meets the second component of the proposed definition? Are there other types of information that would be appropriate? For example, should the fact that a credit rating agency has many subscribers support a finding that the credit rating agency satisfies the second component? What types of statistical data could be relied on to determine if a credit rating agency’s credit ratings are relied on by the marketplace? What standards should be considered to assess such statistical data? Should the views of issuers be a relevant consideration in determining whether a credit rating agency meets the second component of the NRSRO definition? (Proposed Rule at 29-30).

***Ratings Services' Response:*** Ratings Services has frequently expressed to the Commission its strong belief that the single most important criterion for NRSRO designation should continue to be that a rating agency is generally accepted in the financial markets as a provider of credible rating opinions. Ratings Services supports the Commission’s determination that credit rating agencies that confine their activities to limited sectors of the

debt market or to limited geographic areas may qualify for NRSRO designation. Criteria other than financial market acceptance run the risk of creating or appearing to create a substantive role for the Commission in the day-to-day operations of NRSROs or in the substance of their ratings.

Ratings Services agrees with the Commission that the Commission may seek information from rating agencies and the markets related to an entity's claim of general acceptance of its ratings without imposing or appearing to impose such operational criteria on NRSROs. Such information may, as the Commission has suggested, include statistical data (including default and transition studies) as a measure of market usage of an entity's ratings.

Another important measure of a rating agency's acceptance in the financial markets can be, as the Commission has suggested, the prevailing and sustained views of market participants that utilize credit ratings.

In addition, Ratings Services believes that market acceptance can be evaluated by considering the nature and number of a rating agency's subscribers, the number of ratings assigned annually by the rating agency and the number of issuers or others who request ratings. The Commission might also consider the number of citations to the rating agency's ratings in trade publications and other financial press.

### ***Limited Coverage NRSROs***

***SEC Questions:*** Should a credit rating agency that is recognized by the financial marketplace for issuing credible and reliable ratings within a limited sector or geographic area meet the NRSRO definition only for its ratings within such sector or geographic area, or more broadly? If a credit rating agency meets the NRSRO definition only with respect to its ratings within a particular sector or geographic area, would the NRSRO classification interfere with the credit rating agency's ability to expand its business? How should ratings from such an NRSRO be identified so that broker-dealers and other users of NRSRO ratings for regulatory purposes can determine which credit ratings from the NRSRO may be used for regulatory purposes? We noted above that commenters mentioned that it would be difficult for limited coverage NRSROs to provide a full and accurate assessment of credit risks without a broader expertise in credit risk assessment. We request further comment on this view given our proposal to permit limited coverage NRSROs. (Proposed Rule at 31).

***Ratings Services' Response:*** As noted in prior submissions, Ratings Services supports elimination of barriers to entry among NRSROs and thus favors the extension of NRSRO status to limited coverage firms that cover particular sectors of the capital markets or particular geographic regions. These limited coverage firms should meet the fundamental criterion for designation, *i.e.*, widespread market recognition and acceptance as an issuer of credible and reliable ratings for the limited sector or limited geographic area by the predominant users of securities ratings, as well as any other criteria promulgated by the Commission.

## ***Analyst Experience and Training***

***SEC Questions:*** The Commission recognizes that the evaluation of an analyst's experience would involve a degree of subjectivity. The Commission requests comment on the appropriate subjective criteria that a credit rating agency should use in assessing the experience and training of an analyst to meet the proposed NRSRO definition. In addition, what objective criteria are relevant? What level of importance should be given to the subjective and objective criteria? How can a credit rating agency in seeking to meet the proposed NRSRO definition demonstrate that it has adequate procedures designed to ensure that its analysts are competent? What factors should a credit rating agency consider in evaluating the background of its analysts and other members of its staff? (Proposed Rule at 35-36).

***Ratings Services' Response:*** Ratings Services agrees with the Commission that rating agencies with systematic procedures "designed to ensure that [their] analysts are able to identify, understand, and analyze information relevant to the issuers whose securities they rate" are more likely to produce thorough, competent credit analysis. In assessing the competence of analysts, Ratings Services considers their level of education; experience within sectors, industries and geographic regions; experience with particular transactions and asset classes and other specialty areas; analytical ability; decision making; professionalism; time management ability; leadership; teamwork; and their written and verbal communication skills. Ratings Services has adopted and continues to enhance policies and procedures designed to ensure that its analysts receive sufficient training and support to facilitate the generation of independent, objective and credible rating opinions.

While Ratings Services is confident that its standards and procedures for analyst background and training would meet any minimum requirements imposed by the Commission, Ratings Services does not support the promulgation of NRSRO designation criteria that are conditioned on specific attributes of a rating agency's staff. Objective criteria such as a minimum number of years experience in the industry, or educational background, may not be applicable from issue to issue. Similarly, mandated subjective criteria would naturally be susceptible to wide interpretations and, like objective criteria, would not take into account the varying demands of different analytics, rating criteria and methodologies, or the needs of a particular rating agency. Government mandates for analyst training, background, experience, or other characteristics could also prove to be a significant barrier to entry to NRSRO designation. Standardized staffing and training requirements would also intrude upon the editorial control that is vital to the independence and creativity of Ratings Services and other NRSROs and would inevitably trigger significant First Amendment issues.

Ratings Services agrees with those commenters who have indicated that rating agencies have strong incentives to monitor the quality of their analysts without government mandate due to constant scrutiny from issuers and investors. At most, the Commission should require as a prerequisite to NRSRO designation that an NRSRO have in place and publicly disclose policies and procedures that, based on the judgment and experience of the NRSRO,



will ensure independent, objective and credible ratings. The effectiveness of those policies and procedures should be measured by the market's acceptance of the NRSRO's ratings, as well as statistics such as default and transition studies. Such an approach would avoid not only inflexible and ineffective mandates, but also inappropriate involvement of the Commission in NRSROs' substantive operations.

### ***Number of Ratings per Analyst***

***SEC Questions:*** Is the concern that a credit rating agency's ratings may become less reliable as the number of issues rated per analyst increase valid? If so, what type of workload is reasonable for the analytical quality of a credit rating agency's ratings to remain high? (Proposed Rule 37-38).

***Ratings Services' Response:*** Credit ratings disseminated by Ratings Services are the result of a rigorous analytical process that requires intense and time consuming scrutiny by Ratings Services' analysts. To produce credible ratings, an analyst must have the time and resources to fully participate in these extensive procedures. Ratings Services does not believe, however, that there is a definable "reasonable workload" to ensure a sufficiently high level of analytical rigor. The number of issues or issuers that can be effectively covered by a particular analyst varies widely depending on a broad spectrum of variables, including the size and complexity of the particular issue or issuer, the experience and expertise of the analyst as well as industry concentrations and trends. Additionally, a regulation mandating specific workloads for analysts would jeopardize NRSROs independence and would likely not survive First Amendment scrutiny.

Ratings Services believes that its excellent track record — proven by studies on ratings trends which have shown a clear correlation between initial ratings assigned by Ratings Services and the likelihood of issuer default — demonstrates that it has effectively maintained reasonable workloads for its analysts without government mandate. Ratings Services notes also that, as described in the Commission's request for comments, commenters indicated that other rating agencies as well have powerful incentives to maintain reasonable analyst workloads to ensure that the quality of their analysis remains high.

***SEC Questions:*** Should the Commission specify minimum standards for a credit rating agency's analysts to continuously monitor and assess relevant developments relating to their ratings so that users of the credit rating agency's ratings can determine whether the credit rating agency meets the NRSRO definition? (Proposed Rule at 38).

***Ratings Services' Response:*** Just as it does not support the promulgation of any standards related to the number of issues that may be covered by a particular analyst, Ratings Services does not support minimum standards governing how NRSROs "monitor and assess relevant developments" related to the issues and issuers they rate. The promulgation of any such rules would strike at the heart of the constitutionally protected independence of Ratings Services and other rating agencies. As set forth above and in Ratings Services' repeated submissions to the Commission, there is no single correct methodology for the

evaluation of the creditworthiness of an issue or issuer and there is no absolutely correct rating opinion. Because each rating opinion represents an analytic judgment based on a wide range of factors, market participants will sometimes disagree with Ratings Services' opinions (and rating agencies will frequently disagree with one another) regarding a particular issue or issuer. These differing opinions are inherent in the delicate and often contentious task of analyzing creditworthiness and, indeed, benefit the market by providing alternative opinions and methodologies for consideration. To ensure that the market receives a rating agency's best judgments as to creditworthiness, analysts and rating committees must be free to issue rating opinions without being restrained by the imposition of government-drafted analytical norms or concern about being second-guessed by regulators.

A regulatory regime that requires common procedures or approaches for issuing a rating opinion for all rating agencies would also raise significant First Amendment concerns. As set forth in Ratings Services' Response to the Concept Release, Ratings Services' credit ratings are entitled to the same First Amendment protections as any other widely disseminated opinions. These protections exist precisely to foster robust debate and to avoid the chilling effect that would accompany governmental standardization of the formation and dissemination of opinions about matters of public interest — including the assessment by rating agencies of the likelihood that debt will be repaid.

For these reasons, the Commission should avoid the promulgation of rules and regulations that attempt to substitute the Commission's judgment for the judgment of a particular NRSRO, including rules and regulations that would govern how NRSROs "monitor and assess" relevant developments.

***SEC Questions:*** If a credit rating agency relies primarily on quantitative models to develop credit ratings, how can such a firm's ratings reflect a thorough analysis of the specific credit characteristics of a particular security? (Proposed Rule at 38).

***Ratings Services' Response:*** Ratings Services believes, based on extensive experience, that credit ratings based on both quantitative measures and qualitative analytical judgments serve the financial markets better than measures derived solely from quantitative measures. While credit scores, for instance, have some usefulness, they are subject to the disadvantages inherent in all statistically derived data, and the models upon which such data are derived. Some models may focus on fluctuations of equity value or volatility of asset value more than others, and different models may assess correlated credit risks and risks by sectors differently. Because statistical scoring models of various types exist with different methodologies and varying results, multiple models would need to be developed and identified in order to provide coverage across the spectrum of rated securities and issues that currently exists. Further, statistical models tend to yield volatile results with considerable false signals, reflecting market sentiment.

Nevertheless, if in the future a credit rating agency that uses only computerized statistical models could meet the criteria for NRSRO designation (including, most importantly, that it has achieved general acceptance in the financial markets as an issuer of

credible ratings), Ratings Services believes that it would be appropriate for the Commission to designate the agency an NRSRO. Ultimately, it is this market acceptance, not Commission review, that should determine whether such rating agencies effectively serve the capital markets.

**SEC Questions:** Should the Commission require credit rating agencies to disclose the number of credit analysts they employ and the average number of issues rated or otherwise followed by those analysts, as suggested by commenters?" (Proposed Rule at 38).

**Ratings Services' Response:** Ratings Services believes that the Commission could appropriately consider the number of analysts employed by a credit rating agency in the NRSRO designation process. However, mandating disclosure by rating agencies of the average number of issues rated by those analysts would serve little practical purpose and might in fact mislead the market. Mandating such disclosure would suggest that a lower average number of issues rated is a proxy for high quality analysis. The appropriate level of coverage for an issue or issuer depends, however, on a broad spectrum of variables. If, for instance, a rating agency predominantly covers issues or segments of the market that are unusually complex, the rating agency might want to limit the number of issues and issuers covered by each analyst. By contrast, a rating agency that covers issues and issuers that present fewer analytical challenges could, in theory, produce high quality credit ratings while assigning a greater number of issues or issuers per analyst.

#### ***Information Sources Used in the Ratings Process***

**SEC Questions:** Should a credit rating agency be required to test in some way the integrity of information provided directly by issuers (both public and nonpublic) and through third party vendors? Are there other appropriate objective methods for determining whether a credit rating agency has reasonably tested the integrity of the information on which it bases its ratings? (Proposed Rule at 39).

**Ratings Services' Response:** As suggested in the Concept Release, a large portion of the economic, financial and other information utilized by credit rating agency analysts during the rating and editorial process is gathered directly from issuers and from public filings. Ratings Services' analysts press issuers to respond to comprehensive questions that help the analysts develop a full picture of the issuer's true credit quality. However, Rating Services' analysts are not auditors. They do not (and cannot) perform an audit of information provided by a rated company. Indeed, the Commission has explicitly recognized that NRSROs should not be required to "audit or otherwise ensure the accuracy of an issuer's financial condition." *Id.* at 39 n.80.

While Rating Services does not support the promulgation of rules that would attempt to make it the responsibility of NRSROs to ensure that issuers disseminate truthful information, Rating Services strongly supports actions taken by Congress, the Commission and other regulators, which have strengthened, and will continue to strengthen, the process by

which financial information is audited and provided by issuers and auditors to the market, including Ratings Services.

### ***Contacts with Management***

***SEC Questions:*** In designing and implementing systematic procedures to ensure credible and reliable ratings, should a credit rating agency seeking to meet the definition of NRSRO address how and the extent to which it involves an issuer's senior management in the rating process? To meet the proposed NRSRO definition, should a credit rating agency's procedures require that the credit rating agency request an issuer's senior management to participate in the credit rating agency's rating process without incurring a fee? (Proposed Rule at 40).

***Ratings Services' Response:*** While Ratings Services frequently has significant contact with the senior management of issuers that it rates, it believes that it is possible to perform a high quality credit analysis relying solely on publicly available information related to an issuer, where, for example, the issuers are reporting companies registered with the Commission or are subject to extensive regulatory public information requirements. Ratings Services believes that investors and the marketplace benefit greatly from ratings issued in this manner with respect to debt issues of significance, whether or not management chooses to participate in the rating process. Ratings Services also believes that any such regulation would involve the Commission too deeply in the manner and method of issuing credit ratings and would face serious First Amendment scrutiny. Thus, Ratings Services does not support the promulgation of regulations that would require rating agencies to meet with an issuer's senior management before promulgating ratings.

### ***Organizational Structure***

***SEC Questions:*** Would information on a credit rating agency's organizational structure be useful to users of ratings? If so, what information would be useful? (Proposed Rule at 42).

***Ratings Services' Response:*** Ratings Services believes that the Commission could appropriately consider the internal structure of rating agencies seeking NRSRO status. The Commission's consideration should be mindful not to impose operating or organizational criteria or to interfere with the substantive rating process or the operations of a credit rating agency's business through, for example, specification of approaches to address any perceived conflicts of interest.

### ***Conflicts of Interest***

***SEC Questions:*** What specific conflicts of interest should be addressed in a credit rating agency's procedures and how should they be addressed? Should a credit rating agency that engages in activities that present potential or actual conflicts of interest be

excluded from the definition of NRSRO? Alternatively, is it sufficient for a credit rating agency to impose and implement safeguards to prevent potential conflicts of interest from affecting the quality and independence of its credit ratings? Are there other practices that raise concerns similar to those raised by conflicts of interest, for example, those referred to in footnote 93 regarding unsolicited ratings, that should be addressed in a credit rating agency's procedures? (Proposed Rule at 44).

***Ratings Services' Response:*** As noted in prior submissions, Ratings Services is committed to having in place, and adhering to, policies and procedures to minimize the effects of any perceived conflicts of interest. Ratings Services believes that the independence, credibility, and integrity of its operations are adequately protected by these policies and procedures. Ratings Services believes that the maintenance of such policies and procedures is important to the credibility of its credit rating business and the value of its franchise and that it is appropriate for the Commission to consider the existence of such policies and procedures when making determinations related to NRSRO status.

Specifically, Ratings Services believes it is appropriate for the Commission to consider whether NRSROs adopt policies and procedures to identify and eliminate, or manage and disclose, as appropriate, actual or potential conflicts of interest that may influence the opinions and analyses or the judgment of their analysts. The Commission may appropriately consider, similar to the provisions of IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies, whether such policies and procedures are reasonably designed to address potential conflicts arising from issuer and subscriber influence; unsolicited ratings; the offering of consulting or advisory services to rated issuers; analyst/subscriber communications; the securities ownership and trading activities of employees; and the participation of credit rating analysts in negotiations with issuers regarding fees. The Commission may appropriately consider whether such policies are designed to prevent ratings from being influenced by the potential effect (economic, political, or otherwise) of a rating action on the NRSRO, its employees, affiliates, subscribers, or any other person, including the issuer whose financial obligation the NRSRO is rating.

While Ratings Services does not object to continuing efforts by the Commission to consider the internal policies and procedures of NRSROs, the Commission's consideration should not be used to impose operating criteria or to interfere with the substantive rating process or the operations of a credit rating agency's business.<sup>1</sup>

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<sup>1</sup> Ratings Services notes that the term "unsolicited rating," which is discussed in footnote 93 of the Proposed Rule, is susceptible to varying definitions. Indeed, in its "Technical Advice to the European Commission," the Committee of European Securities Regulators ("CESR") noted "the difficulties expressed by market participants to come up with a definition of unsolicited ratings that can encompass all the relevant aspects that need to be consider[ed] in the relationship between issuers and CRAs." CESR chose not to provide the European Commission with a definition of the term, observing that "respondents . . . generally felt that transparency rather than prohibition or other kinds of regulation would best achieve the aim of enhancing confidence in unsolicited ratings." Ratings Services agrees that given the difficulty of defining the term (as well as the practical and constitutional

## ***Misuse of Information***

***SEC Questions:*** As discussed above, to meet the third component of the NRSRO definition, should a credit rating agency demonstrate that it has systematic procedures designed to prevent the misuse of material nonpublic information? What types of procedures are reasonable for a credit rating agency to protect material nonpublic information? Should a credit rating agency have personnel dedicated specifically to verifying employees' compliance with such procedures? Should persons performing this function provide ongoing training of employees and act as a resource to answer questions as they arise? Should the procedures provide for a system by which employees can report violations of the controls in place to protect nonpublic information or other inappropriate activities? The Commission encourages commenters to provide information on appropriate procedures for receiving and adequately securing material nonpublic information. (Proposed Rule at 46-47).

***Ratings Services' Response:*** Ratings Services believes it is appropriate for the Commission to consider whether NRSROs "have policies and procedures that are designed to effectively protect nonpublic information provided by issuers." *Id.* at 46. It is also appropriate for the Commission to consider whether such policies and procedures include a process for employees to report violations of the controls in place to protect nonpublic information. While the Commission may appropriately consider the existence of such policies and procedures in the NRSRO designation process, it should not mandate such policies and procedures.

Ratings Services' Code of Practices and Procedures protects against the misuse of nonpublic information by requiring, among other things, that employees and members of their immediate families may not own any security of any obligor or issuer if the employee regularly interacts with the obligor or issuer in the course of his or her employment with Ratings Services. Employees who do not participate in the rating of a security, obligor or issuer, are similarly prohibited (along with their immediate families) from purchasing or selling a security if they are in possession of confidential, non-public information regarding the security, the obligor of such security, or an issuer. Additionally, the Code of Practices and Procedures provides that confidential information provided by issuers shall be used only for the purposes for which it is given to Ratings Services and shall not be directly disclosed to any third party without the prior written consent of the issuer. All confidential information received in hard copy form must be stored in secure areas that are not readily accessible to third parties or employees of a non-ratings business related to Ratings Services. Where confidential information is received in electronic form, it must similarly be stored by Ratings Services in a manner so that it is not accessible to third parties or employees of a non-ratings business.

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concerns associated with regulation of the manner and method of issuing credit ratings), the Commission should refrain from enacting rules broadly designed to regulate "unsolicited ratings." The Commission may appropriately consider whether NRSROs disclose their policies and procedures related to issuer involvement in ratings.

## ***Financial Resources***

***SEC Questions:*** Should a credit rating agency make its audited financial statements readily available to users of securities ratings in order for such users to assess whether a credit rating agency has sufficient financial resources to satisfy the third component? What other types of financial information could a credit rating agency make available to users of securities ratings for purposes of the third component? Should a credit rating agency provide users of securities ratings with information relating to the percentage of revenue it receives from particular issuers or subscribers as compared to the credit rating agency's total revenues? Should a credit rating agency establish procedures to limit the percentage of revenues it receives from a single issuer or subscriber? How else can it be determined that a credit rating agency is financially independent of both subscribers and rated issuers? (Proposed Rule at 48).

***Ratings Services' Response:*** NRSROs should disclose financial information sufficient to demonstrate their financial resources, including publicly available audited financial statements if an NRSRO is a public company or a division, unit or subsidiary of a public company.

Ratings Services agrees with the Commission that it should not attempt to mandate an objective standard that would attempt to assure the market of a credit rating agency's independence based on financial resources. *Id.* at 47-48. As noted in Ratings Services' Response to the Concept Release and suggested in the Proposed Rule, the interests of the market and investors would likely not be served by the promulgation of rules and regulations that would condition NRSRO status on certain financial criteria. Such standards would likely serve as a barrier to entry in the industry and, in any event, the financial resources required to issue credible credit ratings would likely vary considerably based on the size and scope of each NRSRO's business.

Ratings Services rates such a large number of issuers that no one issuer is responsible for more than a *de minimis* portion of Ratings Services' revenue. Ratings Services believes that regulations limiting the percentage of revenues that an NRSRO could receive from single issuers or subscribers would present a significant barrier to entry and would be an unwise mandate. Related disclosure would burden NRSROs while providing marginal benefit to the market.

## ***Standardized Ratings Symbols***

***SEC Questions:*** Should the Commission continue to rely on existing market-based standards for rating symbols and rating categories, or should specific standards be incorporated into the definition of the term "NRSRO"? If the latter, what standards are appropriate? (Proposed Rule at 50).

***Ratings Services' Response:*** As noted in prior submissions, Ratings Services believes that the mandated use of uniform rating symbols is not only unnecessary but, more

importantly, might not be in investors' best interests. Ratings Services publishes on its Web site and in a broad array of publications, a full explanation of its rating symbols and a definition of what each means. Investors have easy access to these clear explanations. Mandating uniformity of rating symbols could mislead investors into assuming that all NRSRO credit ratings are fungible and involve the same analytical judgments, criteria and methodologies, thus obscuring the fact that a credit rating is a particularized opinion of an individual rating agency, based on such rating agency's independent assessments and methodologies. Government required uniform rating symbols would also raise serious First Amendment concerns.

### ***Statistical Models***

***SEC Questions:*** Should a credit rating agency that relies solely or primarily on statistical models be able to meet the proposed NRSRO definition? If so, under what circumstances? The Commission also requests comment on guidelines for assessing the relevance and reliability of statistical models used in the ratings process. (Proposed Rule at 51).

***Ratings Services' Response:*** As noted above, although Ratings Services believes that credit ratings based on both quantitative measures and qualitative analytical judgments serve the financial markets better than credit measures derived solely from quantitative or statistical information, a credit rating agency that uses only computerized statistical models should be entitled to NRSRO status if it meets the criteria for designation (including, most importantly, that it is generally accepted in the financial markets as a provider of credible rating opinions).

### ***Provisional NRSRO Status***

***SEC Question:*** Does the Commission's proposed NRSRO definition and approach for promoting competition address the competitive concerns raised by commenters' supporting provisional NRSROs? (Proposed Rule at 54).

***Ratings Services' Response:*** Ratings Services believes that the Commission's proposed NRSRO definition and its approach for promoting competition adequately address the competitive concerns raised during the Concept Release comment period. As noted in its response to the Concept Release, Ratings Services believes it to be critical to the effectiveness and integrity of the NRSRO concept that the market be the judge of the credibility (based on the performance of the credit rating opinions) of a rating agency's rating opinions and that the single most important and critical criterion for NRSRO designation should be that a rating agency is generally accepted in the financial markets as a provider of credible rating opinions. As further noted in prior submissions, Ratings Services generally supports the promulgation of rules and regulations that would extend NRSRO status to "limited coverage" rating agencies that meet this and any other criteria for NRSRO designation.



*Costs* (Proposed Rule at 63-66).

The commentary accompanying the Proposed Rule includes a section related to potential costs of rulemaking that refers, among other things, to the costs attendant to NRSRO “renewal” of no-action letters. To the extent the Proposed Rule contemplates a renewal process applicable to existing NRSROs, Ratings Services believes the plan for an oversight framework currently being negotiated between those NRSROs and the Commission would (and should) obviate the need for such renewals. Since November 2004 the Commission and existing NRSROs, including Ratings Services, have had numerous productive, good-faith discussions related to a potential framework for NRSRO oversight (“Framework”). This Framework is aimed at providing the market with assurances that NRSROs have in place, disclose and follow appropriate policies and procedures designed to result in ratings uncompromised in their independence, objectivity and credibility. The Framework is carefully crafted to best preserve the constitutionally protected independence of NRSROs and to avoid regulatory second-guessing of particular credit ratings decisions.

Because the Framework would require NRSROs to submit detailed compliance reports to the Commission on an ongoing basis, it would accomplish the same goal as any renewal requirement and thus make it unnecessary for the additional costs recognized by the Commission to be borne by NRSROs.