

Egan-Jones Ratings Company

Tel. 1-610-642-2411 segan@Egan-Jones.com

*Providing timely, accurate credit
ratings to Institutional Investors*

Sept. 5, 2008

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

Re: Proposed Amendments to References to Ratings of Nationally Recognized Statistical Rating Organizations (Release Nos. IC-28327; IA-2751) File No. S7-19-08

Dear Ms. Harmon:

The SEC's request for possible changes in the usage of ratings for money market funds is yet another manifestation of the broader issue regarding the underlying causes of and solutions to the credit crisis. The IMF has estimated the losses of the current crisis at over \$1 trillion. In the money market area, although no fund has recently "broken the buck" some quasi-money market funds such as the Florida fund has been unable to redeem investors at face value. Furthermore, several money market funds, including ones managed by Bank of America, Janus, Legg Mason and Northern Trust¹, have needed support in excess of several hundred million dollars or the purchase of depressed securities in order to redeem withdrawals at par.

The numerous revelations over the past year have made clear that the rating firms which are paid by issuers have conducted their business with an emphasis on promoting revenue rather than protecting investors. The massive cuts from "AAA" to "D" in the case of various SIVs (Structured Investment Vehicles)², the emails stating an issuer could be "structured by a cow" and still be rated (see the e-mail excerpts released in the SEC's July 2008 Investigation of Select Credit Rating Agencies)³, and the one year delay in taking action on inflated model-driven ratings provide indisputable evidence that issuer-paid rating firms have not acted on the investors' behalf⁴. In fact, it is both unfair and unrealistic to expect issuer-supported rating firms to serve investors' interests since such action jeopardizes their revenue base. Moody's addressed this very issue in describing its experience when it tightened standards in the commercial mortgage-backed securities area; its market share plunged as it tightened standards⁵. Simply put, a conservative rating firm is likely to be an under-employed rating firm. Unfortunately, for fiduciaries, the corollary is that conflicted ratings must remain suspect.

The 2006 Act codified the SEC's stance on not reviewing rating decisions, per se, which is appropriate given the high level of expertise and judgment required for rendering ratings. However, the underlying premise of this proposed rule takes the laissez faire approach too far by its overreliance on the market simply punishing those who do not conduct sufficient due diligence on their own. This ignores two realities of the marketplace. First, most investors in the international debt markets do not have the "in house" capability to replicate the work product of a rating agency which is properly performing its function. Second, the "issuer-pay" business model - which is the basis on which most rating firms are hired - inexorably leads to "rating shopping" where whoever provides the highest rating is normally the firm which receives the rating business. Additionally, it is not only institutional investor

moneys and their beneficiaries who are exposed, in many cases it is taxpayers. Directly or indirectly, taxpayer support was needed in connection with Bear Stearns, Countrywide, IndyMac, Fannie Mae, and Freddie Mac. Non-inflated (i.e., non issuer-paid) ratings would have forced many of these companies to address their problems much earlier when they were manageable, rather than waiting until capital was unavailable or prohibitively expensive.

Returning to the usage of ratings by money market funds, a number of investors have provided support for the continued usage of ratings in order to provide some base level on which funds can compete. Without ratings, the concern is that some funds will take excessive risk, “break the buck,” and jeopardize the industry’s future (unlike bank deposits under \$100,000, most money fund investments are not FDIC insured). We view this as a reasonable stance, but perhaps a more valid point is that the usage of conflicted ratings has already lead to unwise investments as evidenced by the current financial landscape.

A middle ground to addressing the various concerns in this area is the requirement of a non-conflicted rating when possible and a requirement for a closer review by the fund if there is a substantial spread between the ratings from issuer-support and investor-supported firms. Fiduciaries should also be required to disclose whether the ratings used in their debt investment portfolio have been paid for by the issuer of those securities.

Sean J. Egan, President
Egan-Jones Ratings Company

References

1. “Legg Mason Support for Money Fund to Cut Earnings” by Sree Vidya Bhaktavatsalam of Bloomberg News, June 30, 2008
2. Rhinebridge PLC was cut from “AAA” on Oct. 16, 2007 to “D” on Oct. 19, 2007 while Axon, Cheyne, and Ottimo were cut from “AAA” to “D” within 90 days
3. SEC’s “Investigation of Select Credit Rating Agencies” dated July 2008, page 14
4. “Moody’s to Investigate Staff over Ratings Bug” by Sam Jones and Gillian Tett of The Financial Times, July 2, 2008
5. “Moody’s Excluded from Rating 70% of New Commercial Mortgage” by Mark Pittman of Bloomberg News, July 18, 2007