Marjorie E. Gross
400 West End Avenue
New York, NY 10024

917.848.8387
mgross@nysbar.com

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Attention: Ms. Nancy M. Morris, Secretary

March 8, 2007

Re: S7-04-07

Ladies and Gentlemen:

I appreciate the opportunity to comment on the proposed rules and registration form published by the Securities and Exchange Commission (the "Commission") under the Securities Exchange Act, as amended by the Credit Rating Agency Reform Act of 2006 (the "CRA Reform Act"), which would provide for the registration and supervision of credit rating agencies as nationally recognized statistical rating organizations ("NRSROs"). The proposed regulatory scheme does a good job of balancing the Congressional intent to increase competition among rating agencies and the need to ensure the impartiality and integrity of ratings, while being mindful of the Congressional direction that the Commission's rules and regulations be narrowly tailored to meet the requirements of the CRA Reform Act and not purport to regulate the substance of credit ratings or the procedures and methodologies by which NRSROs determine credit ratings. The following comments will address some of the question posed in the proposing release (the "Release") and point out other technical issues raised by the proposed rules and form.

1. **For free or for a reasonable fee**.

Congress defined the credit rating agencies that are eligible to apply to be NRSROs as those in the business of issuing credit ratings for free or for a reasonable fee. There is no indication that, by the use of the term "reasonable fee," Congress intended the Commission to institute detailed regulation of the pricing of NRSRO rating services. Moreover, the reference to fees was clearly intended by the drafters to indicate the permissibility of NRSROs charging for credit ratings. Compare the SEC's 2005 Definition of NRSRO (An NRSRO must issue credit ratings that are "publicly available," meaning "disseminated on a widespread basis at no cost," SEC Release 33-8570 (April 19, 2005) and IOSCO, Code Fundamentals of a Code of Conduct for Credit Rating

Agencies, (PD 180, December 2004)(hereinafter "IOSCO Code Fundamentals") Section 3.4 (same, except for private ratings).

Nevertheless, since the drafters used the term "reasonable fees," it is logical to conclude that they believed that the designation gave a registered NRSRO a responsibility to charge market-based fees. In my opinion, the best way to determine if a credit rating agency charges such fees is to invite its customers to comment on its pricing.

The Release states that the Commission believes that the fees contemplated by the statute are those charged by a credit rating agency for a "customer" to access or receive the agency's credit ratings, and that this would include fees charged to issuers, obligors or underwriters to determine or maintain a credit rating, but would NOT include other fees because "regulatory users of credit ratings would not need access to these other services to comply with statute and regulations using the term NRSRO." I agree that Congress was concerned with the fees charged by a credit rating agency to "customers" to receive a credit rating. There is no indication in the statute, however, that Congress intended the reasonableness of the fees charged by NRSROs to be limited to users that use ratings for regulatory purposes. Indeed, the Congressional findings relate more broadly to investor protection. See CRA Reform Act, Section 2.

Many individual bond investors rely on ratings that are provided to them by their broker-dealers on confirmations and account statements. Thus, they have a strong interest in making sure that the licensing fees charged by NRSROs to financial intermediaries for publishing ratings on confirmations and account statements are reasonable, so that their broker-dealers will continue to supply such information. Consequently, when the Commission looks at the reasonableness of fees, it should include all fees charged to investors and their intermediaries to access credit ratings, as well as fees to issuers, obligors and underwriters to determine or maintain a credit rating.

Finally, the Proposing Release states that the information elicited in item 6 and (after registration) item 7 would assist the Commission in monitoring the cost to regulatory users of accessing or obtaining credit ratings. No such information seems to be elicited in items 6 and 7.

2. **Performance Measurement Statistics**.

In the Release, the Commission asks whether the performance measurement statistics required by Exhibit 1 to Form NRSRO (e.g. historical down-grade and default rates within each credit rating category) should use standardized inputs, time horizons and metrics to allow for greater comparability. I believe that such standardized inputs would be a great benefit to users of ratings in comparing the reliability of ratings of different NRSROs, thus promoting competition. Standardized inputs would also make it easier for the General Accounting Office to fulfill its responsibilities under Section 7 of the CRA Reform Act to conduct a study to determine the impact of the Act on the quality of credit ratings, by establishing a comparable methodology for back-testing the quality of ratings. Some rating agencies already publish statistics on ratings migration/transition and ratings

volatility. Having standardized measures of such performance would help investors to measure the predictive ability of credit ratings. Even if ratings of different rating agencies measure different things (e.g. the risk of default vs. loss given default), standardized time horizons and metrics would make it easier to compare how well each does at measuring the factor the rating is designed to measure.

3. **Appeals Process**.

Exhibit 2 to Form NRSRO requires the applicant/registrant to disclose their procedures and methodologies for determining credit ratings, including "the notification of rated obligors or issuers of rated securities about credit rating decisions and for appeals of final or pending credit rating decision." It does state whether such an appeal process is required, although this may be the implication of the requirement. Compare IOSCO Code Fundamentals 3.7 (rating agency should afford the issuer an opportunity to clarify any factual misperceptions). I believe the Commission should clarify this point.

4. **Compliance with IOSCO Code Fundamentals**.

The Release asks whether Exhibit 5 to the Form NRSRO should require a credit rating agency to disclose whether it complies with international "principles and codes of conduct" related to credit rating agencies, such as the IOSCO Code Fundamentals. As the Commission notes in the Release, the IOSCO Code Fundamentals are generally consistent with the CRA Reform Act and the proposed rules. Nevertheless, the IOSCO Code Fundamentals contain a number of requirements that are more detailed than those required by Form NRSRO and the proposed rules. See, for example, IOSCO Code Fundamentals Section 1.9, requiring that the credit rating agency regularly review the issuer's creditworthiness, and Section 3.7, regarding the opportunity to clarify factual misperceptions). Consequently, it would be useful to users of ratings if Exhibit 5 required an applicant or NRSRO to state whether it complies with the IOSCO Code Fundamental, and, where it does not, to explain why. See, e.g. IOSCO, Review of Implementation of the IOSCO Fundamentals of a Code of Conduct for Credit Rating Agencies (PD 233, February 2007)(summarizing a sampling of codes of conduct for compliance with the IOSCO Code Fundamentals).

5. **Disclosure of Conflicts**.

Exhibit 6 to the Form NRSRO must contain information regarding conflicts of interest relating to the issuance of credit ratings. There are a number of inconsistencies in the descriptions of the conflicts in the Instructions to Form NRSRO and in the Release. For example, the Release states that it is a conflict of interest if the rating agency "relies" on fees from issuers, obligors and underwriters to determine credit ratings or the rating agency operates under a subscriber fee based business model. The Instructions to Form NRSRO do not elicit the rating agency's compensation model. I believe ratings users would benefit from knowing the NRSRO's compensation model because it is useful to put conflicts of interest into context. For example, a rating agency may charge fees to issuers, underwriters and subscribers (including licensees). However, users will be hard

pressed to determine the significance of these potential conflicts without further disclosure of the relative importance of revenues from these sources to the rating agency.

Rule 17g-5 makes it unlawful for an NRSRO to have certain conflicts of interest unless it discloses the type of conflict on its Form NRSRO. One of the prohibited conflicts is owning securities or money market instruments of a subscriber that uses the credit ratings of the rating organization for regulatory purposes. The Commission should provide further advice on whether an NRSRO may state that some of its subscriber customers may use its ratings for regulatory purposes or whether the Commission expects rating agencies to ask subscriber customers if they plan to use ratings for which they subscribe for regulatory purposes. Compare Form NRSRO Item 6 (it is not enough for a certifying QIB to subscribe to the rating agency's ratings; it must state that it has seriously considered them).

6. **Other persons who assist the designated compliance officer**.

Exhibit 9 requires information about the credit rating agency's designated compliance officer and "any other persons that assist the designated compliance officer in carrying out the responsibilities set forth in Section 15E(j) of the Exchange Act." The Commission should clarify whether the persons for whom information must be provided is limited to compliance officers or also includes systems people who prepare reports used by the compliance staff and secretaries or others who assist the compliance staff.

7. **Definition of "Net Revenue**."

The CRA Reform Act requires an NRSRO to provide to the Commission on a confidential basis "a list of the 20 largest issuers and subscribers that use the credit rating services of the applicant by amount of net revenues received therefrom in the fiscal year immediately preceding the date of submission of the application." See Section 15E(a). Although the CRA Reform Act does not define "net revenue," Exhibit 10 would define it as all fees, sales proceeds, commissions and other revenue received by the applicant and its affiliates for any type of service, and net of any fees, sales proceeds, rebates, commissions and other monies paid to the customer by the credit rating agency and its affiliates.

As the Commission notes, the purpose of the "largest issuers and subscribers" requirement is to identify large customers that could potentially have undue influence on an NRSRO given the amount of revenue the customer provides the NRSRO. Consequently, while it makes sense to subtract rebates with respect to fees charged to issuers or subscribers in determining net revenues, it seems counter-intuitive to subtract all other monies paid to the customer by the credit rating agency, when such monies are unrelated to the customer's status as an issuer or subscriber, e.g. monies paid by the credit rating agency to an issuer for products or services provided by the issuer.

8. **Specific Revenue Items**.

Exhibit 12 would require an applicant to provide information as to the amount of revenue generated from various credit rating services, compared to revenue from other sources. The specific revenue items would be (1) revenues from determining and maintaining credit ratings, (2) revenues from subscribers, (3) revenues from granting licenses or publishing rights, (4) revenues from private ratings, and (5) revenue from all other services and products. The Proposal refers sometimes to subscribers for ratings and sometimes to subscribers for the analysis behind the rating. The Commission should make clear whether it believes that revenues from subscriptions to analysis are included in category (2) or (5).

9. **Recordkeeping**.

Proposed Rule 17g-2 would require an NRSRO to maintain certain records for three years after the NRSRO's business relationship with the customer ended. The records that would be so retained include (1) each person that solicits a rating to be determined and the credit rating so determined, and (2) each person that subscribes to the credit ratings or credit analysis of the rating agency and the compensation received from that subscriber. Given the length of time that an NRSRO may be in existence, this record retention requirement may be the equivalent of a requirement to maintain the records in perpetuity. The Commission has not articulated a rationale for such a long-term maintenance requirement and why a shorter period, e.g. 6 years, would be inconsistent with investor protection.

10. **Form NRSRO**

Item 6 requires an applicant to state, for each class of credit ratings for which it is applying to be registered, the "consecutive years issued." The CRA Reform Act requires that an NRSRO have been in business as a credit rating agency for at least three consecutive years immediately preceding the date of its application, but it does not require that the agency have issued a particular type of ratings for three consecutive years before it is registered as an NRSRO with respect to that type of rating. The Commission should make clear that the information as to each type of rating is for the benefit of rating users and not a condition to registration.

Item 7 requires the same information. In order to avoid the need to update this information each year, it would be logical for the form to require the approximate date such ratings were first issued.

For both items 6 and 7, it is unclear whether the Commission wants different information for different securities within a rating classification. For example, a rating agency will not necessarily have begun issuing ratings at the same time for financial institutions and brokers or dealers; or for issuers of government securities, municipal securities and foreign government securities.

If you have any questions on these comments, please feel free to contact me.

Very truly yours,

Marjorie E. Gross

Marjorie E. Gross