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March 12, 2007

Filed Electronically

Ms. Nancy Morris, Secretary
U.S. Securities and Exchange Commission
100 F St., N.E.
Washington, D.C. 20549

Re: *Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, File No. S7-04-07*

Dear Ms. Morris:

DBRS appreciates this opportunity to comment on the above-referenced proposal to establish a regulatory regime implementing provisions of the Credit Rating Agency Reform Act of 2006 (the "CRA Act").[1] DBRS is a Toronto-based credit rating agency established in 1976 and still privately owned by its founders. With affiliates located in New York, Chicago, London, Paris and Frankfurt, DBRS analyzes and rates a wide variety of issuers and instruments, including financial institutions, insurance companies, corporate issuers, issuers of government and municipal securities and various structured transactions. Designated by the SEC staff as a nationally recognized statistical rating organization ("NRSRO") in 2003,[2] DBRS currently maintains ratings on more than 28,000 securities of more than 2000 issuers in approximately 20 countries around the globe.

In drafting these proposed rules, the Commission has been called on to balance the need to ensure the quality, independence and objectivity of credit ratings used for regulatory purposes with the goal of fostering competition in the credit rating industry,[3] as well as the CRA Act's mandate that the rules be "narrowly tailored" to meet the statute's requirements.[4] DBRS commends the Commission's efforts to strike this delicate balance,

[1] "Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations," SEC Rel. No. 34-55231 (Feb. 2, 2007), 72 Fed. Reg. 6378 (February 9, 2007) (the "Proposing Release").

[2] *See* Letter from Annette L. Nazareth, Director, Division of Market Regulation, Securities and Exchange Commission, to Mari-Anne Pisarri, Pickard and Djinis LLP (February 24, 2003).

[3] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850*, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

[4] Securities Exchange Act of 1934 ("Exchange Act") § 15E(c)(2).

especially given the extraordinarily tight time constraints the statute has imposed. DBRS also applauds the Commission's efforts to create a regulatory regime that is largely consistent with international standards such as the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (the "IOSCO Code"),[5] with which DBRS already complies.

Nevertheless, as discussed in more detail below, DBRS believes that in some respects the proposed rules do not fully account for the way in which credit rating agencies are organized and operate; are inconsistent with the approach the Commission has taken in other regulatory contexts; require disclosure of a level of detail that would overwhelm more than it would inform; potentially require public disclosure of trade secrets; do not accomplish the objectives of the CRA Act; are unduly burdensome; and/or are unclear. We draw the Commission's attention in particular to our discussion of the need to accommodate global rating enterprises in Section A.1, the need to avoid discriminatory accounting standards in Section C, and the need to prohibit notching in Section F.

For purposes of clarity, we have organized our comments according to the specific rules the Commission has proposed. In view of the length of these comments, we have appended a table of contents at the end of this letter.

A. PROPOSED RULE 17g-1 - REGISTRATION REQUIREMENTS

A credit rating agency that elects to be treated as an NRSRO must apply to the Commission for registration as such. The CRA Act, as codified in additions to Section 3 and a new Section 15E of the Exchange Act, spells out the minimum information a credit rating agency must supply in its NRSRO application and gives the Commission the discretion to require any additional information that is necessary or appropriate in the public interest or for the protection of investors. The Commission has proposed new Exchange Act Rule 17g-1 and new Form NRSRO to implement these registration provisions. Form NRSRO is designed, among other things, to elicit the information the Commission needs to determine whether an NRSRO has adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies. The same Form is to be used for initial registrations, amendments and the annual certifications required by Exchange Act Section 15E(b)(2).

While DBRS generally supports the structure and content of Form NRSRO, and the proposal to use the same Form for registrations, annual certifications and interim amendments, we believe that the following modifications to and clarifications of the Form are necessary to achieve the purposes of the CRA Act. We also note other aspects of Rule 17g-1 that we believe merit further attention.

1. Identification of the NRSRO

[5] IOSCO Technical Committee (December 2004).

Credit rating agencies come in many shapes and sizes, and have a range of different business models. Global rating agencies like DBRS typically operate through an international network of affiliated entities. Although the primary rating organization establishes uniform ratings policies, procedures and methodologies and enforces a uniform code of ethics, it often is necessary for tax efficiency reasons to incorporate or otherwise organize the rating agency's foreign offices as separate entities under local law. Even where this is done, however, the credit ratings of the enterprise are issued in a seamless fashion and the primary rating organization stands behind all ratings issued in its name.

For example, DBRS operates in the United States through an affiliate known as DBRS, Inc. and in Europe through an affiliate known as DBRS (Europe) Limited. All ratings, however, are "DBRS" ratings and are formulated in accordance with a uniform set of processes and procedures. Moreover, all DBRS analysts, wherever they are located, are subject to the Code of Conduct DBRS has adopted in accordance with the IOSCO Code, as well as DBRS's various other internal policies and procedures.[6] DBRS understands that other designated NRSROs operate in a similar fashion.

Because, notwithstanding their multifaceted corporate structures, global rating agencies speak with one voice, DBRS submits that they should be subject to a unified NRSRO registration. Including in a single Form NRSRO pertinent information about the ratings activities of all affiliates who function as part of a unified enterprise would provide the users of credit ratings with a clear and accurate picture of that enterprise's operations. Conversely, atomizing such an enterprise for registration purposes would present a distorted view of its ratings business and would be administratively unwieldy.

To address this issue, DBRS suggests that proposed Form NRSRO be revised to permit a credit rating agency to include in its registration application any affiliated entity that functions with the registered entity as part of a unified credit rating enterprise, if the affiliated entity is organized under the laws of a country different from the applicant/NRSRO's country of organization. In order to avail itself of this option, the registrant should be required to supply identifying information about its rating affiliates and supply certain undertakings designed to ensure that all entities covered by a single NRSRO registration operate pursuant to the same credit rating polices, procedures and methodologies, the same insider trading and conflict of interest policies and procedures and, if applicable, the same code of ethics. To the extent possible, the definitions used in Form NRSRO for this purpose should be consistent with the definitions used in existing SEC rules and regulations.

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[6] The only exception to this general rule is where the laws of a foreign country restrict aspects of a policy, such as where non-U.S. privacy laws limit an employer's ability to collect personal information about an employee or his family. If such a case arises, DBRS enforces its personal conduct policies and procedures to the extent permitted by the law in question.

Given the inordinately tight time constraints in effect here,[7] DBRS submits for the Commission's consideration the specific changes to proposed Form NRSRO set forth in Appendix 2 to this letter.

2. Form NRSRO, Item 1 - Contact Information and Other Identification

DBRS suggests that a telephone number, facsimile number and e-mail address be added to the NRSRO contact person information required in Item 1.E. This type of information is typically required for contact persons of other SEC-registered entities.

We also note that the Instructions to Form NRSRO indicate that the name of the credit rating agency and date of application should be provided on each page. We suggest a header be added to the Form for this purpose.

3. Form NRSRO, Item 3 - Undertaking by Non-Resident NRSRO

Item 3 of proposed Form NRSRO would require a non-resident[8] applicant for NRSRO registration to attach to its initial application a copy of the recordkeeping undertaking proposed to be required by Rule 17g-2(f). The proposed undertaking is designed to enable the Commission to obtain a non-resident's records subject to SEC examination authority without having to travel outside the United States. As proposed, the NRSRO would be obligated to produce requested records "in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period."

DBRS (itself a non-resident NRSRO) agrees that an undertaking of this nature will allow the Commission to efficiently oversee foreign registrants. Nevertheless, DBRS believes that the proposed language should be altered in two respects. First, while requiring a non-resident NRSRO's records to be available to SEC examiners in English is a sensible idea, further requiring those documents to be delivered "in a form acceptable to the Commission and its representatives" would hold non-resident NRSROs to standards higher than those that apply to domestic registrants.

Proposed Rule 17g-2(d) would allow registered NRSROs to preserve required records in any manner that makes the record "easily accessible to the rating organization's principal office and to any other office that conducted activities causing the record to be made or received." Proposed Rule 17g-2(g) generally requires that rating agencies furnish the

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[7] The current NRSRO designations will become void on June 26, 2007 ***at the latest***, unless the designated rating agencies have already furnished applications for registration under the Act by that time. Exchange Act, § 15E(l)(2); Proposing Release at 10, 72 Fed. Reg. at 6380.

[8] A non-resident rating organization is one that is incorporated, otherwise organized or has its principal office in a location outside the U.S., its territories or possessions.

Commission and its staff with "legible, complete, and current copies" of requested documents. In explaining these proposed recordkeeping requirements, the Commission confirmed that it "does not intend that . . . proposed Rule 17g-2 require a specific form of record. An NRSRO would have the flexibility to implement a recordkeeping system that captured the [required] information in a manner that conformed to the NRSRO's internal processes."[9] DBRS heartily endorses this sensible approach, and submits that it should apply equally to non-resident rating agencies. Having to transform records into any format SEC examiners might request would be unfair and burdensome for foreign registrants.

Likewise, DBRS submits that giving non-residents only fourteen days to supply requested documents (unless the Commission expressly consents to a longer period) could impose an undue burden on such registrants. An NRSRO's ability to gather and ship records depends on facts and circumstances, including the quantity of records involved and whether translation is needed. Rather than specify a time period in the rule, DBRS suggests that Form NRSRO, Item 3 and Rule 17g-2(f) be amended to provide that a non-resident rating organization must "promptly" produce copies of the requested book(s) or record(s). This will permit the NRSRO and the SEC staff to negotiate an acceptable production schedule, and will be consistent with the approach the Commission proposes to take with regard to domestic registrants.[10]

4. Form NRSRO, Item 6 - Categories of Credit Ratings for which Registration is Sought and QIB Certifications

The CRA Act, by adding definitions to Section 3 of the Exchange Act, sets threshold eligibility standards for credit rating agencies that wish to register as NRSROs.[11] Among these is a requirement that the entity has been in the business of issuing credit ratings for at least three years immediately preceding the date of its registration application. The statute further provides that NRSRO registration may be sought regarding up to five categories of issuers,[12] and requires the rating agency to supply written certifications by Qualified Institutional Buyers ("QIBs") for each category as to which registration is requested.[13]

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[9] Proposing Release at 65-66, 72 Fed. Reg. at 6394.

[10] Proposed Rule 17g-2(g) provides that a rating organization must "promptly" furnish the Commission and its representatives with copies of requested records. As explained in Section A.13 of these comments, DBRS submits that the meaning of the term "promptly" depends on facts and circumstances.

[11] *See* Exchange Act §§ 3(a)(60), (61) and (62).

[12] These five categories are (i) financial institutions, brokers or dealers, (ii) insurance companies, (iii) corporate issuers, (iv) issuers of asset-backed securities and (v) domestic or foreign governments or municipalities. Exchange Act § 3(a)(62)(B).

[13] Exchange Act §§ 15E(a)(1)(B)(ix) and 15E(a)(1)(C). Under Exchange Act § 15E(a)(1)(D), a credit

The Commission proposes to implement these statutory requirements by eliciting in Item 6 of Form NRSRO information about the categories of credit ratings for which an applicant is applying for registration, along with the QIB certifications. As a general matter, DBRS believes that proposed Item 6 and the QIB certification language effectively implement the NRSRO eligibility standards established by Congress.

In response to the Commission's request for comment,[14] DBRS agrees that NRSROs should be required to notify the Commission if a QIB withdraws its certification. QIB certifications are a way for the Commission to use the marketplace as a proxy for determining the quality of an entity's credit ratings. Withdrawal of a certification could indicate that an NRSRO no longer possesses the financial and managerial resources it needs to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies. Therefore, we suggest that the Commission add a notification of withdrawal requirement to the final rules.

We further suggest that when it adopts the final rules, the Commission provide guidance regarding the requirement that a rating agency be in business for at least three consecutive years preceding the date of its NRSRO application. In particular, we think it would be helpful for the Commission to confirm that the applicant/NRSRO itself (including its rating affiliates)[15] must have engaged in the subject rating activity. In other words, a rating agency would not meet the three-year test simply by hiring analysts with the requisite experience. We also ask for confirmation that, in evaluating whether an applicant has the requisite managerial resources to qualify for registration as an NRSRO, the Commission will take into account the breadth of the applicant's experience in each of the classes of credit ratings for which registration is sought.

5. Form NRSRO, Exhibit 1 - Credit Ratings Performance Measurement Statistics

Exchange Act Section 15E(a)(1)(B)(i) requires that an application for NRSRO registration include credit ratings performance measurement statistics over short-term, mid-term, and long-term periods, as applicable. These statistics must be updated on a yearly basis as part of the NRSRO's annual certification.[16] Proposed NRSRO Exhibit 1 would require rating organizations to publicly disclose the required credit ratings performance

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rating agency that was designated as an NRSRO before August 2, 2006 does not have to submit QIB certifications.

[14] Proposing Release at 35, 72 Fed. Reg. at 6386.

[15] *See* Section A.1 of these comments.

[16] Exchange Act §15E(b)(1)(A).

measurement statistics, including, as applicable, historical down-grade and default rates within each of the organization's rating categories. The Commission also proposes to require NRSROs to define their credit rating categories (that is, to explain each grade or notch they use) and to explain their performance statistics, including the "metrics used to determine" those statistics.

Publishing information about the historic default and downgrade rates of a rating organization's rating categories promotes transparency and enables the users of credit ratings to best judge the performance of those ratings over time. For this reason, the IOSCO Code calls for the dissemination of such performance statistics.[17]

DBRS generally supports Exhibit 1 and the accompanying Instructions as they are proposed, although we request the Commission to provide further guidance on the meaning of "metrics used to determine the statistics." We do not believe that any additional or alternative performance measurement statistics are necessary; nor do we believe that the calculation of historical default and downgrade rates should use standardized inputs, time horizons or metrics. So long as a rating organization clearly and accurately discloses the way in which it calculates its performance statistics, the organization should have the flexibility to derive those statistics as it sees fit. Standardizing performance measurements may lead rating agencies to standardize their rating methodologies, which would deprive the marketplace of a healthy diversity of ratings opinions. We further note that although rating agency performance calculations are not standardized today, there is no evidence that the users of credit ratings are unable to assess rating agencies' performance.

6. Form NRSRO, Exhibit 2 - Procedures and Methodologies Used in Determining Credit Ratings

Exchange Act Section 15E(a)(1)(B)(ii) requires an NRSRO application to include information regarding the procedures and methodologies the credit rating agency uses to determine its credit ratings. The statute does not define what a "procedure" or "methodology" is; nor does it specify which procedures and methodologies must be disclosed or what level of detail about those procedures and methodologies is required. The Commission proposes to implement this provision by requiring rating organizations to disclose, in Exhibit 2, the following, as applicable:

a. policies for determining whether to initiate a credit rating;

b. a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors;

[17] IOSCO Code, § 3.8.

c. a description of quantitative and qualitative models and metrics used to determine credit ratings;

d. procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments;

e. the structure and voting process of committees that review or approve credit ratings;

f. procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions, and for appeals of final or pending credit rating decisions;

g. procedures for monitoring, reviewing and updating credit ratings; and

h. procedures to withdraw or suspend the maintenance of a credit rating.

The foregoing information must be disclosed for all the rating agency's credit ratings, including unsolicited ratings. The Commission proposes to define the term "unsolicited credit rating" as a credit rating that the rating agency determines without being asked to do so by the issuer or underwriter of the rated securities or money market instruments or the rated obligor.

As the Commission has observed, credit rating agencies generally maintain extensive procedures and methodologies for determining credit ratings.[18] These procedures and methodologies cover a range of topics and are quite voluminous. While many of these procedures and methodologies can be publicly disclosed, others cannot, because they involve the rating agency's trade secrets or other forms of intellectual property. Like the other designated NRSROs, DBRS currently publishes extensive information about its ratings policies, procedures and methodologies, but these disclosures are by no means exhaustive.[19]

While DBRS believes that the topics identified in proposed Exhibit 2 and its Instructions would enable the Commission to evaluate whether a rating agency is able to consistently produce credit ratings with integrity and would provide relevant information to the users of credit ratings,[20] we are concerned that the lack of clarity as to the level of detail required to

[18] Proposing Release at 42, 72 Fed. Reg. at 6388.

[19] DBRS's rating policies, procedures and methodologies are published on www.dbrs.com.

[20] DBRS commends the Commission for including topics that relate to credit rating agencies employing different business models (*e.g.,* those who determine credit ratings through quantitative models and those who conduct qualitative analyses, as well as those who use an issuer-pay model and those who use a

be publicly disclosed could harm both the rating organizations and the users of credit ratings.

From the NRSROs' perspective, requiring the publication of all rating procedures and methodologies would be costly and burdensome and could force the disclosure of trade secrets or other proprietary information. From the public's perspective, the level of detail suggested by the current proposal would be so overwhelming that it would hinder rather than facilitate a meaningful evaluation of the credit rating agencies, and would provide no useful basis for comparing NRSROs. Consequently, proposed Exhibit 2 is not "narrowly tailored" to meet the requirements of the CRA Act.[21]

In order to address these problems, DBRS suggests that the Instructions to Form NRSRO, Exhibit 2 be amended to require a rating organization to disclose *information* about the itemized credit rating policies, procedures and methodologies, but not necessarily the policies, procedures and methodologies themselves. This instruction would conform more closely to the language of the statute, which requires an NRSRO registration application to "contain information regarding . . . the procedures and methodologies that the applicant uses in determining credit ratings."[22]

We also suggest that the Commission incorporate into the Instructions for Exhibit 2 a disclosure standard derived from the IOSCO Code. In this regard, we propose the following language:

> *The credit rating agency should publish sufficient information about its credit rating policies, procedures and methodologies so that outside parties can understand how the rating agency determines credit ratings, including unsolicited credit ratings.*[23]

We believe this flexible standard will achieve the purposes of the CRA Act without either imposing undue burdens on NRSROs or inundating the public with excessive information.

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subscriber-pay model).

[21] *See* Proposing Release at 25, 72 Fed. Reg. at 6383 ("The Commission construes the Act's requirement that implementing rules be 'narrowly tailored' to also apply to proposed Form NRSRO").

[22] Exchange Act § 15E(a)(1)(B)(ii).

[23] *See* IOSCO Code, §§ 3.5 and 3.10. The latter section provides: "Because users of credit ratings rely on an existing awareness of [the rating agency's] methodologies, practices, procedures and processes, [the rating agency] should fully and publicly disclose any material modification to its methodologies and significant practices, procedures and processes." The Commission's proposal to require a prompt amendment of Exhibit 2 in the event any disclosed information becomes materially inaccurate comports with this provision of the IOSCO Code.

7. Form NRSRO, Exhibit 5 - Code of Ethics

Exchange Act Section 15E(a)(1)(B)(v) requires an NRSRO application to disclose whether the rating organization has a code of ethics in effect, and if not, why not. The Commission proposes to implement this provision by requiring an applicant/NRSRO to attach its code of ethics as Exhibit 5 to Form NRSRO or to explain in that Exhibit why it does not have a code of ethics. The Commission does not propose to specify the contents of an NRSRO's code of ethics, instead giving the rating agencies the flexibility to establish codes that are appropriate for their business models and organizational structures.

DBRS, which currently maintains a Code of Conduct in conformance with the IOSCO Code and also satisfies the code of ethics requirement under the Investment Advisers Act of 1940 ("Advisers Act"),[24] applauds the Commission's flexible approach in this area. The public availability of NRSRO codes of ethics will allow the users of credit ratings to evaluate which rating agencies have sufficient controls to ensure the independence and integrity of their credit opinions. There is no need for the Commission to establish specific standards in this regard.

In view of the global nature of the credit rating industry, DBRS does believe, however, that the Commission should require NRSROs to disclose whether they comply with international principles and codes of conduct related to credit rating agencies. We note in particular that users of credit ratings should have access to information about an NRSRO's compliance with the IOSCO Code, which is a "best practice" that helps to ensure quality, independence and transparency in the credit rating industry.

8. Form NRSRO, Exhibit 6 - Identification of Conflicts of Interest[25]

Section 15E(a)(1)(B)(vi) of the Exchange Act requires an NRSRO application to contain information regarding any conflicts of interest relating to the rating organization's issuance of credit ratings. The Commission proposes to implement this provision by requiring an applicant/NRSRO to include in Form NRSRO, Exhibit 6 a general description of the types of conflicts of interest that arise from its credit rating business.

Although the statute does not specify the nature of the conflicts that should be disclosed, the Commission proposes to do so in the Instructions to Exhibit 6. In this regard, the Instructions would identify a range of disclosable conflicts that might arise from a rating agency's dealings with rated obligors, issuers or underwriters of rated securities or money market instruments, or the users of credit ratings. DBRS endorses the Commission's

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[24] *See* Advisers Act Rule 204A-1. DBRS is currently registered as an investment adviser under this statute.

[25] These comments should be read in conjunction with our comments on proposed Rule 17g-5, which appear in Section E. of this letter.

recognition of the fact that conflicts of interest may arise in all rating agency business models. However, DBRS submits that in certain respects, the proposed list of conflicts is too broad, and in other respects, it is too narrow.

Among the types of conflicts whose disclosure is proposed to be required are:

> • whether the credit rating agency receives compensation from entities that use its credit ratings for regulatory purposes and for other services (identify the services);
>
> • whether the credit rating agency or an affiliate owns securities of, or has any other form of ownership interest in, an entity that uses credit ratings for regulatory purposes;
>
> • whether a credit rating agency's employees are permitted to own securities of an entity that uses credit ratings for regulatory purposes; and
>
> • whether the credit rating agency, its affiliates, or its employees have any other business relationship or affiliation with a rated obligor, issuer of rated securities or money market instruments, underwriter of rated securities or money market instruments, or entity that uses credit ratings for regulatory purposes.

DBRS respectfully submits that the foregoing language is too broad insofar as it assumes the existence of a conflict of interest whenever a rating agency, its affiliates or its employees deal in any respect with a user of its credit ratings. Rating agencies who operate under an issuer-pay model typically distribute their credit ratings for free and may not even know who is using their credit ratings. In this regard, DBRS ratings (except for private ratings and ratings for certain private placement transactions) are distributed publicly, at no cost, through the company's website at www.dbrs.com.[26] It is not possible under these circumstances for DBRS to track everyone who uses its credit ratings or to know what they are using the ratings for. Moreover, it is hard to see how a rating agency's (or its affiliate's or employee's) dealings with someone who accesses the agency's credit ratings for free over the Internet could compromise the integrity of those credit ratings.

In addition to identifying too many people as potential sources of conflicts of interest, the proposed language also seems in some respects to cover too many kinds of business dealings. For example, the "any other business relationship or affiliation" category quoted above could capture situations -- such as a rating agency employee's maintaining a checking account at a rated bank -- that do not pose a real threat to the integrity or independence of credit ratings.

[26] Ratings and rationales are also publicly distributed through Bloomberg, Reuters, First Call, ABSNet and other electronic and print services.

On the other hand, DBRS submits that the foregoing conflict descriptions are too narrow insofar as they focus exclusively on entities that use credit ratings for regulatory purposes. For example, a portfolio manager who subscribes to an NRSRO's credit ratings in order to make investment decisions with regard to separately managed accounts might still be in a position to influence the rating agency to maintain a favorable rating on his portfolio securities. Were the rating agency to succumb to that influence, the integrity of the NRSRO's ratings -- which other parties use for regulatory purposes -- could be compromised.

In order to address these concerns, DBRS suggests that the first category set forth above be amended to read:

> • *whether the credit rating agency receives compensation from entities that subscribe to its credit ratings, analyses or reports, or that obtain other services from the credit rating agency (identify the other services).*

DBRS further suggests that the phrase "an entity that uses credit ratings for regulatory purposes" in the second and third categories cited above be changed to *"a subscriber to the rating agency's credit ratings, analyses or reports."*

Finally, DBRS suggests that the last category described above be changed to read as follows:

> • *whether the credit rating organization or a person associated therewith has any other material business relationship or affiliation with a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber to the rating organization's credit ratings, analyses or reports. A "material" business relationship or affiliation is one that reasonably could be deemed to compromise the integrity of the rating organization's credit ratings.*

We believe that with these suggested changes, Exhibit 6 will focus more clearly on situations that could threaten the integrity and independence of credit ratings and that in so doing, it will be more narrowly tailored to the requirements of the CRA Act.

9. Form NRSRO, Exhibit 8 - Information About Credit Analysts and Their Supervisors

Exhibit 8 of proposed Form NRSRO would require rating agencies to provide a range of biographical and professional information regarding each credit analyst employed by the firm, as well as each officer and employee of the NRSRO responsible for supervising such credit analysts. DBRS respectfully submits that this proposal would be costly and

burdensome for NRSROs, would provide a marginal-at-best benefit to the users of credit ratings and could impede fair competition in the credit rating industry.[27]

We note that the proposed analyst/supervisor disclosure requirements are similar in many ways to the Commission's 2000 proposal to require investment advisers to make extensive biographical and professional history disclosures on Form ADV about the advisers' supervised persons who provide investment advice to clients.[28] Public commenters strongly opposed this proposal,[29] which has yet to be adopted.[30] Many of the objections raised to the Advisers Act proposal apply with equal force to proposed Exhibit 8. For example, commenters on the 2000 proposal cited the enormous cost and administrative burden advisers would face in monitoring and disclosing the biographies of all current advisory representatives. Proposed Exhibit 8 would impose a similarly heavy burden on NRSROs, particularly if the personal histories of analysts employed by an NRSRO's global rating affiliates were to be included. Moreover, annually certifying that all the biographical information included in Form NRSRO is current, accurate and complete would be an overwhelming task.

In response to the earlier Advisers Act proposal, commenters also explained that because advisory clients hire an investment adviser *firm*, not the individuals employed by the firm, investors are much less interested in details about the lives of individual employees than they are in information about the adviser itself. DBRS submits that the users of credit ratings likewise select a rating agency based on its overall performance and the quality of its credit ratings, analyses and reports rather than on the employment history and post-secondary education of any particular credit analyst or her supervisor. The publication of information about an NRSRO's rating policies, procedures, methodologies and performance history should give the public the information it needs in this regard to assess the NRSRO's credit ratings.

Moreover, given the number of biographies that would need to be supplied for large NRSROs, proposed Exhibit 8 would do more to overwhelm than inform the users of credit ratings, with the predictable result that they will not read any disclosure at all.[31] In fact, the

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[27] We note further that certain non-U.S. laws may prohibit a credit rating agency from publishing such personal information about its employees.

[28] *See* SEC Release No. IA-1862 (April 5, 2000).

[29] *See* Summary of Comments on Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV under the Investment Advisers Act of 1940 (July 27, 2000) ("Summary of Comments").

[30] *See* SEC Release No. IA-1897 (Sept. 12, 2000).

[31] Commenters on the 2000 Form ADV proposal voiced similar concerns that the proposal "would require advisers to deluge clients with paper." *Summary of Comments*, text accompanying note 225. A lesson can be learned from the mutual fund world as well, where too much required disclosure has effectively led to no disclosure at all. *See, e.g.*, Christopher Cox, Chairman, and Andrew J. Donohue,

only people who can be relied upon to read the level of detail Exhibit 8 proposes to require are other NRSROs, who might use such information to raid a competitor's staff. Because smaller NRSROs could be particularly vulnerable in this regard, the proposal could actually impede rather than foster competition in the credit rating industry.

Notwithstanding the problems with proposed Exhibit 8, DBRS agrees that the Commission needs a certain level of information about a rating agency's staff in order to evaluate whether that agency has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies. DBRS believes that this can be accomplished by revising proposed Exhibit 8 to require only the following information:

- *For each category of credit ratings as to which the rating organization is applying to be or is currently registered as an NRSRO (as reported in Items 6 or 7, as applicable), the number of credits for which an analyst is responsible.*

- *A general description of the rating organization's supervisory structure as it relates specifically to credit analysts.*

- *A description of any general standards of education or business experience that the rating organization requires of its credit analysts*[32] *and training that the rating organization provides to its analysts.*

DBRS further submits that an NRSRO should be required to update Exhibit 8 only as part of an annual certification, as is the case with Item 7 of the proposed Form. We note that information relating to an NRSRO's level of staffing is relevant only in relation to the scope of its rating activity. DBRS believes that modifying Exhibit 8 as suggested herein will allow the Exhibit to be "narrowly tailored" to the requirements of the CRA Act.

10. Form NRSRO, Exhibit 9 - Information About the NRSRO's Compliance Personnel

Section 15E(j) requires each NRSRO to designate an individual responsible for administering the organization's policies and procedures to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities

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Director, Division of Investment Management, Remarks at the SEC Interactive Data Roundtable (June 12, 2006)(official transcript available at http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf).

[32] This information is similar to that required for persons involved in determining or rendering investment advice on behalf of registered investment advisers. *See* Form ADV, Part II, Item 5.

laws and rules. This requirement is similar to the ones already imposed on NRSROs under the Advisers Act and the IOSCO Code.[33]

The Commission proposes to require a rating organization to disclose, in Form NRSRO, Exhibit 9, information about the education and employment history of both the firm's designated compliance officer and other persons who assist the compliance officer in carrying out his responsibilities. DBRS generally agrees that information about a compliance officer's employment history and post-secondary education may assist the Commission in evaluating whether a rating agency has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[34]

On the other hand, DBRS does not agree that it is necessary or practical to provide biographical information on "*any other persons that assist*" the compliance officer. First, it may be difficult, if not impossible, to determine who all those people are. In a rating organization with a true "culture of compliance," every employee assists the compliance officer in some respect or other. Second, it does not appear that the benefit to be gained by including on proposed Exhibit 9 each person who provides compliance assistance would outweigh the administrative burden of monitoring and disclosing the biographies of these people, who may come from the credit analysis, human resources, IT, marketing or other areas of the firm.

In order to narrowly tailor this Exhibit to the requirements of the CRA Act, DBRS submits that Exhibit 9 should be revised to require information only as to a rating organization's designated compliance officer. Furthermore, because the compliance officer's title and responsibilities are established by law, it is not necessary to require disclosure of this information in Exhibit 9. Thus, the second bullet point in the Instructions for this Exhibit should be eliminated.

11. Form NRSRO, Exhibit 11 - Audited Financial Statements[35]

Proposed Exhibit 11 would require an applicant for NRSRO registration to furnish audited financial statements for the three fiscal or calendar years immediately preceding the date of

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[33] *See* Advisers Act Rule 206(4)-7 and § 1.15 of the IOSCO Code.

[34] We do not believe, however, that this information will be of particular interest to the users of credit ratings, who, as noted above, select rating agencies based on the quality of the firm's ratings and analyses.

[35] These comments should be read in conjunction with our comments on proposed Rule 17g-3, which appear in Section C. of this letter.

the application. These financial statements must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in owners' equity. The Instructions to Exhibit 11 provide that a credit rating agency that is a division, unit or subsidiary of a parent company can provide the parent company's audited consolidated and consolidating financial statements. The Instructions also permit an applicant who does not have audited statements for the second or third years preceding its application to submit certified unaudited financial statements instead, although audited statements would still be required for the year immediately preceding the application. DBRS endorses this flexible approach.

Unlike Exhibits 1 - 9, an NRSRO would not need to update Exhibit 11 after registration. However, updated financial statements and other financial information would have to be furnished to the Commission in accordance with proposed Rule 17g-3, which is discussed below. We note that while Rule 17g-3 would require these annual financial statements to be prepared in accordance with generally accepted accounting principles ("GAAP") and in compliance with applicable provisions of SEC Regulation S-X,[36] the Instructions to Exhibit 11 do not contain a similar requirement.

We ask the Commission to confirm in the final Instructions to Exhibit 11 that the financial statements required to be submitted as part of an initial NRSRO application need not have been prepared in accordance with U.S. GAAP and need not comply with Regulation S-X.

12. Public Availability of Form NRSRO

In order to promote transparency in the credit rating industry, Section 15E(a)(3) provides, with some exceptions, that the Commission, by rule, shall require a registered NRSRO to make information on its application form available to the public on its website or through another comparable means. Paragraph (d) of proposed Rule 17g-1 would implement this provision by requiring that information be made publicly available within five business days of an NRSRO's being registered or furnishing an amendment or annual certification on Form NRSRO.[37] The Commission opines that this brief period should give the NRSRO sufficient time to make its registration information public while ensuring that the users of credit ratings have timely access to that information.[38]

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[36] 17 CFR §§ 210.1-01 - 210.12-29.

[37] Information about an NRSRO's 20 largest issuer and subscriber customers, QIB certifications, financial statements and other data required by Form NRSRO Exhibits 10 - 13 would not need to be made public. In addition, an NRSRO could seek confidential treatment for its registration information pursuant to applicable laws and rules.

[38] Proposing Release at 20, 72 Fed. Reg. at 6382.

DBRS does not believe this timeframe is adequate. Given the volume of information that must be posted on an NRSRO's website or otherwise made publicly available, it could take much longer than five days to accomplish this task without imposing undue burdens on the rating agency. Moreover, while DBRS agrees that transparency generally benefits the users of credit ratings, we think it is highly unlikely that these parties will monitor NRSRO filings so closely that they would be materially affected by the timing of a rating agency's public disclosure. For these reasons, DBRS respectfully requests that "5 business days" be changed to "20 business days" in proposed Rule 17g-1(d).

DBRS has an additional concern about the Commission's views regarding the publication of NRSRO applications. In the Proposing Release, the Commission states that while a credit rating agency would not be obligated to make its Form NRSRO application publicly available until after registration, "this information typically would be made available by the Commission to members of the public before the application is acted on by the Commission."[39] DBRS does not understand this statement. Applications for investment adviser registration on Form ADV, for example, are not typically made public until after the Commission acts on them.[40]

Although, as the Commission notes, an applicant for NRSRO registration could seek confidential treatment of information contained in its application in accordance with existing laws and rules,[41] requiring rating agencies to take this additional step (whose success is by no means guaranteed) serves no purpose. Because the public cannot use a rating organization's credit ratings for regulatory purposes until after the organization is registered as an NRSRO, the public has no need to access an NRSRO application upon its filing.

DBRS therefore asks the Commission to confirm, when it adopts Form NRSRO, that it will not make NRSRO registration applications publicly available until a final decision on them has been made.

13. Updating Form NRSRO After Registration

Section 15E(b)(1) of the Exchange Act requires a registered NRSRO to amend its registration application promptly in the event that any part of the application becomes materially inaccurate. Although neither the CRA Act nor proposed Rule 17g-1(f) explicitly defines the term "promptly," the Commission has opined in the Proposing Release that

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[39] *Id.* at 21, 72 Fed. Reg. at 6382-83.

[40] In this regard, we note that federally registered investment advisers file their registration applications through a password-protected electronic system, the Investment Adviser Registration Depository. After such registrations are effective, the public may access the applications through the Investment Adviser Public Database.

[41] Proposing Release, text accompanying notes 76 and 78, 72 Fed. Reg. at 6382, 6383.

"promptly" means two days after the NRSRO determines that the information has become materially inaccurate.[42]

DBRS does not believe it is appropriate to define "promptly" in this way, because it often will take more than forty-eight hours for an NRSRO to gather all the details of a material change, process that information and generate an accurate report for inclusion in an amendment to Form NRSRO. What constitutes a "prompt" response may vary considerably depending on the facts and circumstances of each individual situation. The Commission recognized this fact when it dealt with registration form updating requirements applicable to broker-dealers and investment advisers. In the broker-dealer context, the Commission stated:

> [We have] not defined what constitutes 'prompt' filing for purposes of Rule 15b3-1 because whether a filing is deemed 'promptly filed' needs to be determined on a facts-and-circumstances basis.[43]

DBRS urges the Commission to take a consistent approach in the NRSRO context and to leave the term "promptly" undefined.

14. Withdrawal of Investment Adviser Registration

As noted above, DBRS is currently registered with the Commission as an investment adviser pursuant to the Advisers Act. In order to avoid duplicative regulation, Congress, as part of the CRA Act, expressly excepted registered NRSROs who do not otherwise engage in advisory activities from the definition of "investment adviser" under the Advisers Act.[44]

Like the regulatory regime the Commission proposes under the CRA Act, the rules promulgated under the Advisers Act require the filing of interim amendments and annual updates to registration forms and the operation of comprehensive compliance programs. Under these rules, DBRS will be required to make certain filings and comply with other regulatory obligations prior to the time it files its NRSRO registration application.[45]

The Proposing Release does not address issues relating to credit rating agencies' transition from the Advisers Act regulatory regime to the new one adopted under the CRA

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[42] *Id.* at 23, 72 Fed. Reg. at 6383.

[43] SEC Rel. No. 34-41594 (July 2, 1999) at note 42. DBRS further notes that forty-eight hours is closer to an "immediate" deadline than it is to a "prompt" one.

[44] CRA Act, § 4(b)(3)(B), amending § 202(a)(11) of the Advisers Act.

[45] For example, in the next few months, DBRS will be required to file an annual update to its Form ADV and conduct an annual review of its compliance program in accordance with Advisers Act Rule 206(4)-7.

Act. Because of the extremely tight deadline Congress imposed on this transition,[46] DBRS respectfully asks the Commission to relieve the current NRSROs from the burden of complying with their obligations under the Advisers Act while they prepare to register as NRSROs under the rules now being developed.

B. PROPOSED RULE 17g-2 - RECORDKEEPING

After registration, an NRSRO would be subject to several substantive rules, one of which would impose recordkeeping obligations on the rating organization. The required records, as well as other records maintained by NRSROs, would be subject to examination by the Commission's staff.[47] In discussing the importance of the proposed recordkeeping rule to the Commission's ability to monitor a rating agency's compliance with Section 15E of the Exchange Act, the Commission indicated that examiners would use an NRSRO's records to monitor whether the rating organization was, among other things, "following its disclosed procedures and methodologies for determining credit ratings."[48] While this statement may be true as a general proposition, DBRS is concerned that, taken out of context, it could invite examiners to "double check" or second-guess the credit rating opinions developed by an NRSRO. Such an exercise would be contrary to the CRA Act, which expressly forbids the Commission from regulating the substance of credit ratings or the procedures and methodologies by which a NRSRO determines those credit ratings.[49] DBRS respectfully asks the Commission to clarify this point in the final rule release.

Proposed Rule 17g-2 covers two types of records: those an NRSRO would be required to make and retain and those an NRSRO would be required to retain if they are already made. The rule also would prescribe the time periods and manner in which all these records must be kept. With regard to this last issue, as noted above, the Commission does not propose to prescribe the format in which an NRSRO must preserve the required records. Instead, the Commission proposes to afford NRSROs the flexibility to implement recordkeeping systems that conform to their internal processes.[50] DBRS strongly supports this sensible approach.

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[46] *See* note 7, *supra.*

[47] *See* Exchange Act § 17(b)(1) and § 5 of the CRA Act, the latter of which added NRSROs to the list of entities required to maintain records and disseminate reports pursuant to § 17(a)(1) of the Exchange Act. *See also* proposed Rule 17g-2(g).

[48] Proposing Release at 65, 72 Fed. Reg. at 6393.

[49] Exchange Act § 15E(c)(2) ("Notwithstanding any other provision of law, neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any nationally recognized statistical rating organization determines credit ratings").

[50] Proposing Release at 65-66, 72 Fed. Reg. at 6394.

1. Rule 17g-2(a) - Records Required to be Made and Retained

This provision would require an NRSRO to make and retain in complete and current form certain financial records, records regarding the NRSRO's current credit ratings, records regarding persons who solicit the NRSRO to determine or maintain a credit rating, records regarding subscribers to the NRSRO's credit ratings and/or credit analyses, and records describing the types of products and services the NRSRO offers. DBRS generally supports this part of the proposal, but seeks clarification concerning certain records relating to current credit ratings.

Proposed Rule 17g-2(a)(2) would require an NRSRO to keep six kinds of information about each of its current credit ratings.[51] These include the procedures and methodologies used to determine the rating, the method by which the rating was made readily accessible and whether the rating was solicited or unsolicited. While DBRS agrees that this kind of information would help SEC examiners evaluate whether a rating agency is complying with its disclosed policies, procedures and methodologies, DBRS believes that the same goal can be attained in a less burdensome manner.

Depending on the NRSRO's operations and business model, the necessary information can be effectively maintained through the use of exception records rather than the creation of affirmative records for each rating. For example, instead of making a record that each of its credit ratings was determined in accordance with its established procedures and methodologies, the NRSRO could record instances in which the established procedures and methodologies were not followed and describe how those excepted credit ratings were determined. Likewise, instead of making a record that each credit rating was disseminated in the manner disclosed in Form NRSRO, Item 6.B or 7.B, as applicable, the rating agency could identify which of its credit ratings (such as private ratings or ratings for certain private placement transactions) were disseminated in some other way.

Finally, a rating agency that typically issues credit ratings at the request of an obligor, issuer or underwriter could create a record stating that fact and on an ongoing basis simply record which of its credit ratings were unsolicited. On the other hand, an NRSRO operating on a subscriber-pay model could keep a record to that effect and note any deviations from its standard practice.

DBRS submits that this approach to documenting an NRSRO's rating activities would more narrowly tailor the proposed recordkeeping rule to the requirements of the CRA Act. Thus, we ask the Commission, in adopting the final rules, to clarify that a rating agency can meet its obligations under Rule 17g-2(a) through the creation and retention of relevant exception records instead of creating affirmative records for each credit rating.

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[51] We note that a record of the rating itself is not included in this list, although such a record may be implied by the introduction to the subsection.

2. Rule 17g-2(b) - Records Required to be Retained if Made

The second part of proposed Rule 17g-2 deals with other types of records an NRSRO might make or receive in the course of its business. Although an NRSRO would not be obligated to create most of these records,[52] if such records are created or received, they must be preserved in order to facilitate the Commission's oversight of the rating agency. With two exceptions discussed below, DBRS has no objection to the general categories set forth in proposed Rule 17g-2. However, we are concerned that the scope of what an NRSRO would need to preserve under these categories is too broad.

Turning first to the objectionable categories, we note that proposed Rule 17g-2(b)(4) would require an NRSRO to retain "[a]ll compliance reports and compliance exception reports that relate to its business as a credit rating agency." In explaining the rationale for this part of the proposal, the Commission said that the retention of such documents "would identify activities of the NRSRO that its designated compliance officer had determined raised, or did not raise, compliance and control issues," and would permit SEC examiners to conduct more focused examinations.[53] DBRS respectfully submits that a requirement like this would actually interfere with an NRSRO's compliance program.

In order for a compliance program to function effectively, there must be open and honest communication between the compliance officer and the rest of the company's employees. Making every document that goes into or out of a compliance office a record that must be preserved and turned over to the regulators would stanch the necessary flow of communication and isolate the compliance officer. The Commission already recognized this fact when it addressed the recordkeeping requirements applicable to investment advisers in connection with the Code of Ethics Rule under the Advisers Act.[54] In this context, the Commission said

> As amended, [the Advisers Act recordkeeping rule] requires advisers to keep copies of their code of ethics, records of violations of the code and actions taken as a result of the violations . . . . [W]e are not requiring advisers to keep records of . . . whistleblower reports. Commenters have persuaded us that requiring these records could have a chilling effect on employees' willingness to report violations, particularly in smaller organizations.[55]

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[52] Two types of documents are required, however: the record that must be made under proposed Rule 17g-6(b) concerning a decision to decline to determine or withdraw a credit rating on a structured product and Form NRSRO as required under Rule 17g-1. *See* proposed Rule 17g-2(b)(8) and (9).

[53] Proposing Release at 71, 72 Fed. Reg. at 6395.

[54] *See* Advisers Act Rules 204-2(a)(12) and 204A-1.

[55] SEC Rel. Nos. IA-2256 and IC-26492 (July 2, 2004), § II.H. (footnote omitted).

DBRS further submits that it is inappropriate to require NRSROs to keep records documenting a compliance officer's determination that a particular activity did not raise compliance and control issues. Such a requirement would discourage compliance officers from examining potentially questionable activities and would invite SEC examiners to second-guess a compliance officer's determination that an activity was permissible.

In order to avoid these problems, we suggest that proposed Rule 17g-2(b) be reworded to read as follows:

> *(4) Records of failures to comply with its policies or procedures to prevent the misuse of material, nonpublic information; its code of ethics, if any; its policies and procedures to address and manage conflicts of interest; or its procedures and methodologies used to determine credit ratings, and actions taken as a result of such compliance failures.*

DBRS has a similar objection to proposed Rule 17g-2(b)(5), which would oblige NRSROs to retain copies of all internal audit plans, audit reports and records relating thereto. As it stands today, nonpublic companies are not required to conduct internal audits. Requiring NRSROs to retain an internal audit "road map" for the SEC examiners would discourage private companies from engaging in the kind of honest self-assessment about compliance and control risks that an internal audit entails. Moreover, although the Commission takes the position that its examiners have the authority to look at all records maintained by registered entities such as broker-dealers and investment advisers,[56] to our knowledge, SEC examiners do not typically require such registrants to turn over internal audit records as part of routine compliance inspections. DBRS therefore submits that subsection (b)(5) of proposed Rule 17g-2 should be eliminated entirely.

With regard to the scope of the records to be retained under the remaining provisions of the proposed rule, we note that the requirement in proposed Rule 17g-2(b)(2) that an NRSRO retain "[i]nternal records, including non-public information and work papers, used to determine a credit rating," and the requirement in subsection (b)(3) that an NRSRO retain "[c]redit analysis reports, credit assessment reports, and private rating reports and internal records, including non-public information and work papers, used to form the basis for the opinions expressed in these reports," could arguably oblige rating agencies to save every scrap of paper generated in connection with their credit ratings and ratings reports. We suggest that these provisions be amended to require the retention of only such documentation as is necessary to establish the basis of the credit rating or the opinions expressed in the credit reports. We also suggest that the Commission provide guidance

[56] *See* Exchange Act § 17(b)(1) and Advisers Act § 204.

on the meaning of the term "marketing materials" used in subsection (b)(6) of proposed Rule 17g-2.

Finally, DBRS objects to the scope of subsection (b)(7) of the proposed recordkeeping rule, which would require an NRSRO to retain "[a]ll external and internal communications, including electronic communications, received and sent by the rating organization and its employees relating to initiating, determining, maintaining, changing, or withdrawing a credit rating." DBRS submits that this language would impose an undue burden on registered rating agencies and is not "narrowly tailored" to the requirements of the CRA Act. To address this issue, DBRS suggests that the language be amended to eliminate the words "and internal." In our view, the retention of documented external communications (*i.e.* those between an NRSRO and an obligor, issuer, underwriter or user of credit ratings) is sufficient to permit the effective oversight of the NRSRO's credit rating activities.

3. Rule 17g-2(c) - Record Retention Periods

DBRS does not object to this subsection insofar as it would require an NRSRO to keep the records described in subsections (a)(1), (a)(2) and (a)(5)[57] for three years after the date the record is replaced by an updated record. Nor does DBRS object to the proposal to require retention of the documents described in Rule 17g-2(b) for a period of three years after the date the record is made or received by the NRSRO.

However, DBRS does see a problem with the proposal to require that records identifying persons who solicit the NRSRO to determine or maintain a credit rating and the credit ratings determined therefor, as well as records identifying subscribers to the NRSRO's credit ratings and/or credit reports (including the compensation received therefrom), be maintained for three years after the person identified in the record last receives a product or service from the NRSRO. Read literally, this language could oblige a registered rating agency to keep stale contact information, as well as certain credit ratings and compensation information, for decades. If the purpose of this provision is to ensure that SEC examiners have access to the contact information for every person who has asked an NRSRO to determine or maintain a credit rating and every person who has subscribed to a credit rating or a credit report for the past three years, this can be accomplished by amending proposed Rule 17g-2(c) to read as follows:

> *(2) Records indicating the identity and last-known principal business address of the persons identified in paragraphs (a)(3) and (a)(4) of this section must be retained for three years after the date of the last receipt by the person in the record of a service or product of the rating organization. Records containing the other information required to be retained*

[57] *I.e.,* entries into its accounting system and ledger balances, as well as the records relating to its credit ratings and other products and services.

pursuant to paragraphs (a)(3) and (a)(4) must be retained for three years after the date the information is replaced with updated information.

4. Rule 17g-2 - Other Provisions

DBRS supports the remaining provisions of the proposed recordkeeping rule, with the exception of the non-resident undertaking, as discussed in Section A.3 above.

C. PROPOSED RULE 17g-3 - AUDITED FINANCIAL STATEMENTS

Subsection (a) of this rule would require a registered NRSRO to furnish the Commission, on a confidential basis, with certain audited financial statements and schedules within 90 days after the end of the NRSRO's fiscal year.[58] These financial statements would have to be prepared in accordance with generally accepted accounting principles and would have to comply with applicable provisions of SEC Regulation S-X.[59] While DBRS agrees that annually receiving independently audited financial statements from NRSROs will assist the Commission in its oversight functions, DBRS is concerned that Rule 17g-3, as it is broadly written, could impose an undue burden on non-U.S. and private rating agencies. As such, it is not narrowly tailored to the requirements of the CRA Act and will impede rather than foster competition in the credit rating industry.

In this regard, we are concerned that the reference to "generally accepted accounting principles" in proposed Rule 17g-3 could be construed to mean U.S. GAAP. Financial statements prepared in accordance with credible local country standards such as Canadian GAAP or international financial reporting standards ("IFRS") should provide the Commission with the information it needs to monitor an NRSRO's financial resources to ensure that the rating organization can consistently produce credit ratings with integrity.[60] That being the case, requiring non-U.S. NRSROs to reconcile their financial statements to U.S. GAAP would impose a burden on these rating agencies that is neither necessary to protect investors nor meaningful for the Commission's oversight purposes. We therefore ask the Commission to confirm that the reference to "generally accepted accounting principles" in proposed Rule 17g-3 is not limited to U.S. GAAP.

Likewise, DBRS submits that the proposal to require an NRSRO's annual financial statements to comply with applicable provisions of Regulation S-X would impose an enormous and unwarranted expense on rating agencies like DBRS that are private companies. Regulation S-X prescribes the requirements for financial statements that

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[58] *See* Exchange Act § 15E(k) authorizing the Commission to promulgate rules in this area.

[59] *See* note 36, *supra*.

[60] *See* Exchange Act § 15E(d).

companies must file in connection with registration statements, reports, proxy statements and other filings under the Securities Act of 1933 ("Securities Act"), the Exchange Act, the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940. Because this regulation is designed with public companies in mind, it cannot be applied to private businesses without great start-up and ongoing costs.

For example, Rule 4-01(a)(2) of Regulation S-X allows foreign private issuers[61] to prepare their financial statements according to any comprehensive body of accounting principles, but only if a reconciliation to U.S. GAAP is also filed as part of the financial statements. In order to support local tax filings, an NRSRO must prepare its financial statements in accordance with the accounting principles generally accepted in its locality.[62] Because, as noted above, the Commission should be able to evaluate the sufficiency of an NRSRO's financial resources by examining financial statements prepared according to any credible generally accepted standards, there is no regulatory justification for requiring foreign private NRSROs to incur the expense of reconciling their financial statements to U.S. GAAP.

Regulation S-X also contains numerous references to public company governance structures, such as audit committees. Since audit committees function within a corporate setting and typically are staffed by independent directors, they are often not found in unincorporated entities or privately-owned enterprises.[63] Likewise, Regulation S-X refers to interim and pro-forma financial statements,[64] neither of which are normally required of private companies.

In addition to these problems, we submit that proposed Rule 17g-3 would create costly confusion for non-public rating agencies, because it would force them to decide which parts of Regulation S-X are "applicable" to them.[65] Making this determination would be an expensive exercise involving accountants, lawyers, and repeated requests for guidance from the Commission's staff. Inconsistent application of Regulation S-X among NRSROs is likely to ensue.[66]

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[61] A "foreign private issuer" means a foreign issuer (other than a foreign government) that does not exceed certain minimum contacts with the United States. *See* Securities Act Rule 405 and Exchange Act Rule 3b-4. The use of the term "private" here does not connote private ownership of the entity's securities, but rather that the entity is non-governmental in nature.

[62] For example, financial statements for DBRS and its U.S. and U.K. rating affiliates are prepared in accordance with Canadian GAAP, U.S. GAAP and IFRS-UK, respectively.

[63] *See* 17 CFR § 210.2-01(f)(17) and Exchange Act § 3(a)(58).

[64] *See* Regulation S-X, Articles 10 and 11, respectively.

[65] Proposed Rule 17g-3 requires NRSROs to comply "with applicable provisions of Regulation S-X."

[66] For example, while DBRS assumes that the Sarbanes-Oxley-related attestation requirements of Rule

For all these reasons, DBRS respectfully submits that the phrase "must comply with applicable provisions of Regulation S-X (§210.1-01 - §210.12-29, of this chapter)," should be eliminated from proposed Rule 17g-3(a).

On another matter, proposed Rule 17g-3(c) requires that an NRSRO's audited financial statements be "certified" by a qualified and independent accountant. DBRS notes that financial statements are usually audited or certified, but that an accountant does not typically certify audited statements. Therefore, DBRS suggests that the rule be changed to require that financials be "audited" by a qualified and independent accountant.

DBRS does not object to defining an accountant's qualification in accordance with Rule 2-01(a) of Regulation S-X.[67] However, DBRS believes that the Commission's proposal to define an accountant's independence in accordance with Regulation S-X could raise some of the same issues addressed above. Among other things, we note that generally accepted auditing standards outside the United States may entail their own independence requirements; we also note that Regulation S-X defines independence in part by whether the issuer's audit committee administers the engagement of the accountant.[68] DBRS requests that the Commission refine this part of the proposal to ensure that it is narrowly tailored to the requirements of the CRA Act and that it does not hinder competition by discriminating against non-U.S. or privately held NRSROs.

Finally, the Commission proposes to require that an NRSRO's annual audited financial statements include three supporting schedules, which would update the information proposed to be required in Exhibits 10, 12 and 13 of Form NRSRO.[69] While DBRS agrees that the Commission needs to receive updated information in this area in order to effectively oversee the NRSROs it registers, DBRS does not believe that it is either necessary or practicable for these schedules to be audited. First, we note that while Form NRSRO proposes to require an applicant for registration to furnish the Commission with audited financial statements in Exhibit 11, the information contained in Exhibits 10, 12 and 13 would not have to be audited for purposes of the application. If the Commission can effectively evaluate a rating agency's initial qualification for NRSRO registration by

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2-02(f) (17 CFR § 210.2-02(f)) would not apply to the audited financials required of a private entity under proposed Rule 17g-3, another NRSRO might reach a different conclusion.

[67] 17 CFR § 210.2-01(a). This provision requires that a certified public accountant be duly registered and in good standing as such under the laws of the place of his residence or principal office, and that a public accountant be in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

[68] 17 CFR § 210.2-01(c)(7).

[69] Proposed Rule 17g-3(b). This information would include the list of the NRSRO's largest customers, a breakdown of revenues and information about total aggregate and median credit analyst compensation.

examining unaudited information about the agency's largest customers, revenues derived from specific sources and analyst compensation, there is no reason why the Commission cannot evaluate the rating agency's continued qualification by looking at the same type of information.

Moreover, requiring that the schedules to an NRSRO's financial statements be audited would substantially increase the cost of the rating agency's annual audits. This could be particularly burdensome on smaller rating agencies, thus hindering competition in the credit rating industry. DBRS therefore submits that the Commission should not require the schedules described in proposed Rule 17g-3(b) to be audited.[70]

D. PROPOSED RULE 17g-4 - PREVENTING THE MISUSE OF INSIDE INFORMATION

This proposed rule would implement Section 15E(g)(1) of the Exchange Act, which requires NRSROs to establish, maintain and enforce written policies and procedures to prevent the misuse of material, nonpublic information. The Commission proposes three general requirements in this regard, although it otherwise leaves it to the rating agencies to tailor specific procedures to best fit their operations.

In particular, the proposed rule would require the adoption and enforcement of procedures to prevent (a) the misuse of material nonpublic information obtained in connection with the performance of credit rating services;[71] (b) an associated person of an NRSRO or a member of that person's household from trading or otherwise benefiting from a transaction in securities or money market instruments when the person possesses or has access to inside information obtained for the purpose of developing a credit rating; and (c) the inappropriate dissemination of a credit rating action prior to making the action readily accessible.

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[70] DBRS also suggests that the "Note to paragraph (b)(3)" in this proposed rule be reworded to track more closely the Instructions to Form NRSRO, Exhibit 10.

[71] The Proposing Release notes a concern that subscribers to a rating agency's more detailed credit reports and analyses may inappropriately learn material nonpublic information in the possession of a credit analyst. Proposing Release, note 233 and accompanying text. For purposes of completeness, DBRS would like to point out that the witnesses at the Commission's 2002 credit rating agency hearings saw absolutely no evidence that rating agencies selectively disclose nonpublic information to their subscribers. *See* Testimony of Malcolm S. Macdonald, Vice President - Finance and Treasurer, Ford Motor Company, Transcript of Hearings on the Current Role and Function of the Credit Rating Agencies in the Operation of the Securities Markets, November 15, 2002 at 46 ("I have to say up front that the agencies with whom we deal have been absolutely superb in their handling of confidential information. In the 20 or so years that I've had personal experience, we have never come across a situation where confidences have been abused"); testimony of Frank A. Fernandez, Senior Vice President, Chief Economist and Director of Research, The Securities Industry Association, *Id.* at 69 ("I hear and see nothing either on an anecdotal or a secondhand nature that there has been any abuse of [the Regulation FD exemption] at all").

Proposed Rule 17g-4 is generally consistent with existing requirements under the IOSCO Code and the Advisers Act.[72] DBRS believes this proposal will help ensure that material nonpublic information obtained in connection with credit rating activities continues to be protected. However, we respectfully suggest that the Commission provide guidance on the interplay between proposed Rule 17g-4(b) and Exchange Act Rules 10b5-1 and 10b5-2, which address, respectively, when a person is presumed to have traded on the basis of inside information and insider trading in the context of a family relationship.

E. PROPOSED RULE 17g-5 - CONFLICTS OF INTEREST

Section 15E(h) of the Exchange Act requires each registered NRSRO to establish, maintain and enforce policies and procedures reasonably designed to address conflicts of interest that may arise in connection with the rating agency's business. The statute also directs the Commission to adopt rules relating to conflicts arising from, among other things: (i) the manner in which an NRSRO is compensated; (ii) an NRSRO's provision of ancillary services to obligors and their affiliates; (iii) the personal or financial relationships between an NRSRO and its associated persons on the one hand, and obligors and their affiliates on the other; and (iv) any affiliations between an NRSRO or its associated persons and underwriters of rated securities.

The Commission proposes to implement these statutory provisions by adopting new Rule 17g-5. This rule would address NRSRO conflicts of interest in two ways: by requiring that certain kinds of conflicts be disclosed and managed, and by prohibiting other kinds of conflicts altogether. In structuring the proposed rule this way, the Commission has acknowledged that an outright ban on all conflicts of interest could adversely affect an organization's ability to operate as a credit rating agency.[73]

With regard to the first category, proposed Rule 17g-5 identifies seven types of conflicts that an NRSRO would have to manage by adopting policies and procedures, and would have to publicly disclose on Form NRSRO, Exhibit 6. These conflicts include those arising under an issuer-pay model (*i.e.,* an NRSRO's receipt of compensation from a person that is subject to a pending or issued credit rating), as well as those that arise under a subscriber-pay model (*i.e.,* an NRSRO's receipt of compensation from a subscriber who uses the credit ratings for regulatory purposes). They also include owning securities or money market instruments of either a party rated by the NRSRO or a subscriber who uses the NRSRO's credit ratings for regulatory purposes; having any other business, personal or ownership relationship or affiliation with a rated party, an underwriter of rated securities or money market instruments or a subscriber; being an officer or director of a rated party, the underwriter of rated securities or money market instruments or a subscriber; or anything

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[72] IOSCO Code §§ 3.11 - 3.18; Advisers Act § 204A.

[73] Proposing Release at 87, 72 Fed. Reg. at 6399.

else that the NRSRO identifies as posing a conflict of interest in connection with its credit rating business.[74]

As indicated in our comments to Form NRSRO, Exhibit 6,[75] we applaud the Commission for recognizing that conflicts of interest can arise under any NRSRO business model, and we generally support the Commission's identification of those conflicts. However, as was the case with the Instructions to Exhibit 6, we believe that the articulation of conflicts in Rule 17g-5(b) needs to be modified in some respects. First, we suggest that all references to subscribers who use credit ratings for regulatory purposes should be changed to subscribers to a rating agency's credit ratings, analyses or reports. An NRSRO may not know how its subscribers are using its credit ratings; moreover, the conflict derives from the rating agency's receipt of compensation from or relationship with subscribers, not the use to which a subscribed-for credit rating is put.

Second, as was the case with the Instructions to Exhibit 6, the "any other relationship or affiliation" language in proposed Rule 17g-5(b)(5) should include a materiality standard, so that it picks up only those relationships and affiliations that could reasonably be deemed to compromise the integrity of the NRSRO's credit ratings. Finally, for purposes of clarity, we suggest that the phrasing of Rule 17g-5(b) and the Instructions to Exhibit 6 be conformed so that the Form's required disclosures track the rule more closely.

In addition to the seven types of conflicts that would need to be managed and disclosed, proposed Rule 17g-5 also identifies four other types of conflicts that are prohibited outright. In this regard, the proposed rule would forbid a registered NRSRO from:

1. issuing or maintaining a credit rating solicited by a person who was the source of 10% or more of the total net revenue[76] of the NRSRO and its affiliates during the most recently ended fiscal year;

2. issuing or maintaining a credit rating if the NRSRO, a credit analyst who participated in determining the credit rating or a person responsible for approving the credit rating owns the securities of, has any other ownership interest in, or is a borrower or lender with respect to the rated person;

3. issuing or maintaining a credit rating with respect to a person associated with the NRSRO;[77] and

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[74] Rule 17g-5(a) and (b).

[75] *See* Section A.8 of this letter.

[76] "Net revenue" under this rule would be defined the same way as is proposed under Rule 17g-3.

[77] A "person associated with an NRSRO" means a partner, officer, director or employee of the NRSRO, or any other person who directly or indirectly controls, is controlled by or is under common control with the

> 4. issuing or maintaining a credit rating where a credit analyst who participated in determining the credit rating or a person responsible for approving the credit rating is also an officer or director of the rated person.[78]

DBRS has no objection to the first, third and fourth of these proposed prohibitions.[79] However, we do believe that the second prohibition merits further attention. In explaining this part of the proposal, the Commission opined that while it may be appropriate for an NRSRO to allow employees who are not involved in determining or approving a particular credit rating to own the rated party's securities, it is not appropriate for parties involved in the rating process to have a direct financial interest in the rated issuer or obligor.[80] The Commission does not believe that a person having such a financial interest could issue an impartial credit rating.

DBRS agrees, as a general proposition, that an NRSRO should not have a financial interest in the parties it rates. We also agree that special concerns arise when employees who determine or approve credit ratings have such a financial interest, although we do not believe the conflict posed by this situation is as unmanageable as the Commission suggests. For example, we believe that indirect ownership of rated securities through diversified collective investment schemes, such as mutual funds and exchange-traded funds, would not jeopardize an individual's ability to determine or approve a credit rating for those securities in an objective manner. The same conclusion pertains to ownership of direct or guaranteed obligations of national, state or provincial governments, particularly where those obligations have received an investment-grade rating by at least two NRSROs.

An incentive to skew a credit rating also would be lacking where the person determining or approving the credit rating is unaware of his or her financial stake in the rated party and has no ability to influence or control that stake. This would occur, for example, where the employee's disqualifying investments are held in a blind trust or similar vehicle.

It further appears that proposed Rule 17g-5(c)(2) goes too far in prohibiting credit analysts who determine credit ratings and NRSRO employees who approve those ratings from being a "borrower or lender" with respect to the rated person. Read literally, this could interfere with routine, arm's-length financial transactions such as obtaining mortgages or

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NRSRO. Exchange Act, § 3(a)(63).

[78] Proposed Rule 17g-5(c).

[79] We note, however, that calculating aggregate net revenues for an NRSRO and all of its affiliates might be a difficult task for a rating agency that is part of a complex corporate structure.

[80] Proposing Release at 89, 93, 72 Fed. Reg. at 6399, 6400.

home loans from, or maintaining checking or savings accounts with, a rated financial institution. DBRS submits that these routine transactions do not pose such a threat to the integrity of an NRSRO's credit ratings that they need to be banned altogether. Instead, they should be subject to the "manage and disclose" requirements of proposed Rule 17g-5(a) and (b).

Questions also arise regarding the application of proposed Rule 17g-5 to financial interests held by the spouses or other immediate family members of persons who determine or approve credit ratings. In this regard, DBRS asks the Commission to provide assurance that the prohibitions contained in Rule 17g-5(c)(2) do not apply to securities owned by a spouse or other immediate family member of an associated person of an NRSRO, so long as that associated person has no ownership interest in, or influence or control over, the spouse's or other family member's ownership of the subject securities. As with routine financial transactions, the potential conflicts posed by such family situations are best handled under a "manage and disclose" regime.[81]

Finally, DBRS sees the need for some transition relief. Current regulatory regimes applicable to NRSROs afford rating agencies a certain degree of flexibility in crafting their conflict of interest policies and procedures.[82] Even if the Commission were to adopt the changes suggested above, requiring applicants for NRSRO registration to fully comply with the prohibitions set forth in Rule 17g-5(c)(2) at the time their applications are submitted could cause financial hardship to the rating agencies' associated persons by requiring a "fire sale" of their personal investments.[83] Consequently, DBRS submits that a reasonable compliance grace period for NRSRO applicants should be provided.

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[81] We further seek assurance that a spouse's or other immediate family member's participation in an employer-sponsored automatic investment plan would be governed by Rule 17g-5(a) and (b) and not by 17g-5(c). "Automatic investment plan" means a program in which regular periodic purchases or withdrawals are made automatically in or from investment accounts in accordance with a predetermined schedule and allocation. *See, e.g.*, Advisers Act Rule 204A-1(e)(2).

[82] For example, Rule 204A-1 under the Advisers Act does not dictate the personal trading restrictions an adviser imposes on its supervised persons. Furthermore, the IOSCO Code is implemented on a "comply or explain" basis, which means that a rating agency's code of conduct may deviate from the IOSCO provisions so long as the rating agency explains the deviation and how its code nonetheless achieves the objectives contained in the IOSCO provisions.

[83] In this regard, although DBRS generally forbids its staff to invest in the securities of any issuer that DBRS rates (which is broader than the prohibition in proposed Rule 17g-5(c)), it does permit an employee to continue to own securities that become restricted after the employee buys them or that the employee already owns at the time he or she joins DBRS. The ownership and disposition of such "grandfathered securities" are subject to special conflict procedures.

A grace period is also in order for registered NRSROs whose associated persons already own the securities of an entity at the time that entity becomes a rated party,[84] or who acquire an unsolicited financial interest in a party subject to a pending or issued credit rating of the rating organization.

In order to address all these issues, DBRS respectfully suggests that the following new sections (d) and (e) be added to Rule 17g-5:

> *(d) Exceptions. The prohibitions contained in paragraph (c) of this rule shall not apply to the following:*
>
> > *(i) the ownership by a person associated with the rating organization of securities or money market instruments through a diversified investment scheme, such as a mutual fund or exchange-traded fund;*
> >
> > *(ii) the ownership by a person associated with the rating organization of direct or guaranteed obligations of a national, state or provincial government, provided that such obligations are rated in one of the four highest categories by at least two nationally recognized statistical rating organizations;*
> >
> > *(iii) the ownership by a person associated with the rating organization of securities or money market instruments held in a blind trust or similar vehicle designed to eliminate the associated person's influence and control over, and knowledge of, his investments;*
> >
> > *(iv) the ownership of securities or money market instruments by a spouse or other immediate family member of a person associated with a rating organization, provided that the associated person has no ownership interest in, or influence or control over, the spouse's or immediate family member's ownership of those securities or money market instruments; and*
> >
> > *(v) opening, obtaining, or maintaining a deposit account, checking account, mortgage, home equity loan, consumer loan or similar account or loan, in an arm's-length transaction between the person associated with the rating organization and the rated party.*
>
> *In order to qualify for this exception, the rating organization must disclose and implement policies and procedures to address and manage the conflicts of interest identified in this paragraph (d).*

[84] This could occur, for example, where an issuer or obligor solicits a new rating from the NRSRO, or where an entity becomes a rated party by virtue of an acquisition or merger.

> *(e) Grace Period. A rating organization shall not be deemed to have violated paragraph (c)(2) of this rule where a person associated with the rating organization owns the securities of or has another financial interest in an entity at the time that entity becomes a rated person, or where the associated person acquires an unsolicited financial interest in a rated person, such as through an unsolicited gift or inheritance, provided in each case that the financial interest is disposed of as soon as practicable, but no later than 60 days after the associated person has knowledge of and the right to dispose of the financial interest, and provided further that during such grace period, the rating organization shall maintain policies and procedures to address and manage this conflict of interest.*

DBRS further suggests that the Commission provide for a reasonable transition period within which persons associated with applicants for NRSRO registration can become compliant with Rule 17g-2(c). Such relief should be conditioned on the rating organization's maintaining policies and procedures to manage all conflicts of interest during the transition period.

We believe that the modifications we have suggested will more narrowly tailor Rule 17g-5 to the requirements of the CRA Act.

F. PROPOSED RULE 17g-6 - PROHIBITED ACTS AND PRACTICES

Section 15E(i) of the Exchange Act directs the Commission to promulgate rules to prohibit any act or practice relating to the issuance of credit ratings by NRSROs that the Commission finds to be unfair, coercive or abusive. The statute identifies three possible candidates for rulemaking in this area: (1) conditioning or threatening to condition the issuance of a credit rating on the purchase by the obligor or its affiliate of other products or services (including pre-credit rating assessments) offered by the NRSRO or a person associated therewith; (2) notching (which is defined in more detail below); and (3) modifying or threatening to modify a credit rating, or otherwise departing from the NRSRO's standard rating procedures and methodologies, based on whether the obligor or its affiliate agrees to purchase the credit rating or any other product or service offered by the NRSRO or a person associated therewith. Proposed Rule 17g-6 addresses each of these topics and outlaws a fourth practice that the Commission also finds to be unfair, coercive or abusive.

Subsections (a)(1), (a)(2) and (a)(3) of the proposed rule would outlaw various practices in which an NRSRO ties, or offers or threatens to tie, the issuance or modification of a credit rating to the purchase by an issuer, obligor or affiliate thereof of other products or services offered by the NRSRO or its affiliates. The conduct proposed to be outlawed by these provisions is already forbidden under the IOSCO Code,[85] and DBRS supports these provisions as proposed.

[85] *See* IOSCO Code §§ 2.1, 2.3, 2.4 and 2.5.

Subsection (a)(4) of the proposed rule is intended to deal with the question of "notching," which Exchange Act Section 15E(i)(1)(B) defines as

> lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the nationally recognized statistical rating organization[.]

Having preliminarily determined that notching is an unfair, coercive or abusive business practice, the Commission proposes to forbid an NRSRO to refuse to rate, or to discount or withdraw the rating for, a structured product (*i.e.,* an asset pool or a mortgage-backed or asset-backed securities transaction) because the NRSRO has not rated all of the underlying assets. However, the Commission does not propose to make this prohibition absolute; rather, Rule 17g-6(a)(4) would allow an NRSRO to refuse to rate or to withdraw a rating on a structured product where that rating agency has rated less than 85% of the market value of the assets underlying that product.[86] According to the Commission, this exception is designed to address the concern that an NRSRO would be forced to rate a structured product even if a portion of the underlying assets were not rated at all, or if those assets were rated by a rating agency that used different methodologies to assess the creditworthiness of the assets and may have determined credit ratings different from those that the NRSRO would have determined.[87] The Commission apparently derived the 85% threshold from the current practice of certain NRSROs.[88]

DBRS agrees that notching should be prohibited under Rule 17g-6, but does not agree with the proposed exception. As the Commission noted in the Proposing Release, forcing issuers of structured products to obtain credit ratings from the same agencies that rated the underlying assets inhibits competition in the structured finance market and solidifies the dominance of the largest rating agencies.[89] The notching issue is not limited to the highly visible Collateralized Debt Obligations ("CDOs") and money market funds, but also affects a broad range of other products such as Collateralized Loan Obligations, debt issued by Structured Investment Vehicles and by Derivative Products Companies, and many monoline financial guarantee situations.

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[86] The Commission also proposes in Rule 17g-6(b) to require a rating organization that refuses to issue or withdraws a credit rating on a structured product to document the reason for the refusal or withdrawal. DBRS supports this part of the proposal.

[87] Proposing Release at 103, 72 Fed. Reg. at 6403.

[88] *Id.,* note 278.

[89] *Id.* at 102, 72 Fed. Reg. at 6402.

And the anti-competitive effects of notching are by no means limited to structured finance. Because so many debt instruments eventually find their way into structured products, notching has a ripple effect back to the wider corporate bond universe. In other words, allowing large NRSROs to notch structured products also gives these NRSROs a competitive edge in the corporate rating universe, as these securities make up the assets held by the structured products. In view of the fact that CDOs are the single largest investor group in the United States today, notching could have a profound and harmful effect on efforts to increase competition among NRSROs. Notching may also affect the purchase decisions for a structured entity, because buying securities or money market instruments not rated by one of the largest NRSROs may prevent the obligor later on from hiring one of the dominant NRSROs to rate the structured product.

Unfortunately, it is unlikely that the Commission's proposal with regard to notching will significantly improve the status quo. The 85%-threshold exception the Commission proposes is derived from the very industry practice that Congress set out to change. There is no empirical evidence to suggest that this figure is necessary or appropriate to protect the quality of credit ratings used for regulatory purposes. Given the robust standards now being established under the CRA Act and the fact that each NRSRO's ratings methodologies and performance statistics will be published on their website, an NRSRO rating a structured product should, if necessary, be able to rely on the quality of the ratings other NRSROs have issued on the underlying assets.

In order to foster competition in the credit rating business while protecting the integrity of credit ratings used for regulatory purposes, DBRS respectfully suggests that the last sentence of proposed Rule 17g-6(a)(4) be amended to read as follows:

> *The prohibitions on refusing to issue a credit rating or withdrawing a credit rating shall not apply unless the assets underlying the asset pool or the asset-backed or mortgage-backed securities have been rated by at least one nationally recognized statistical rating organization.*

An exception of this nature would permit an NRSRO to refuse to rate or withdraw a rating on a structured product only if the underlying assets either were unrated or were rated by a non-NRSRO. In all other cases, DBRS submits that the NRSRO rating a structured product should - if it does not have its own ratings - rely on the ratings other NRSROs have issued on the underlying assets. In so doing, the NRSRO rating the structured product would have the freedom to decide how to deal with such underlying assets. For example, it could select the rating of an NRSRO whose rating methodologies and performance are close to its own; it could use an average or some other form of blended rating; or it could opt for a more conservative approach and select the lowest NRSRO rating outstanding. So long as the rater of the structured product publicly discloses the methodology it uses in this regard, and the rater has not notched, the marketplace can judge the quality of the ratings. Should the reaction to ratings determined in this manner be unfavorable, the

NRSROs and the collateralized debt obligors can adjust their behavior accordingly. In this way, the competitive landscape for structured finance ratings would be dictated by free-market forces and not by the government or the dominant rating agencies.

The final subsection of proposed Rule 17g-6 would prohibit an NRSRO from issuing an unsolicited credit rating[90] and thereafter communicating with the rated party to induce or attempt to induce that party to pay for the credit rating or any other product or service offered by the NRSRO or its affiliates. Although this practice is not identified in the CRA Act, the Commission has nonetheless determined that it is unfair, coercive or abusive. DBRS requests that the Commission clarify the scope of this prohibition.

As the Commission has observed, NRSROs operating under an issuer-pay model may occasionally issue unsolicited credit ratings in order to maintain active ratings for major issuers in a given industry.[91] DBRS agrees that it is never appropriate for an NRSRO to attempt to extract payment from a rated party in an abusive or coercive fashion. However, read literally, proposed Rule 17g-6(a)(5) would forbid the NRSRO from ever communicating with the subject of an unsolicited rating to offer credit ratings or other services for compensation. In effect, this provision would establish a permanent "Do Not Call" list for issuers, obligors and underwriters. Such a list would prevent NRSROs who might issue unsolicited ratings to build market recognition from ever expanding their market share, even if they were, over time, able to convince the issuer that their analyses and ratings were a value-add proposition. In this way, proposed Rule 17g-6(a)(5) would impede, rather than foster, competition among rating organizations.

In order to avoid this insalubrious consequence, DBRS asks the Commission to confirm that the prohibition set forth in proposed Rule 17g-6(a)(5) does not forbid an NRSRO from attempting to sell future credit ratings or other services to a party that has been the subject of a past unsolicited rating. Any such future marketing attempts, of course, would have to be free from abuse or coercion, which DBRS agrees have no place in the credit rating industry.

CONCLUSION

We would be happy to supply the Commission or the staff with additional information regarding any of the matters discussed herein. Please direct any questions about these comments to the undersigned or to our outside counsel, Mari-Anne Pisarri of Pickard and Djinis LLP. She can be reached at 202-223-4418.

Very truly yours,

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[90] As noted above, an “unsolicited” credit rating is one not initiated at the request of the issuer, obligor or underwriter.

[91] Proposing Release at 104, 72 Fed. Reg. at 6403.

/s/

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APPENDIX 1
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APPENDIX 2
PROPOSED CHANGES TO FORM NRSRO
USE OF RATING AFFILIATES

In order to implement the comments set forth in Section A.1. of this letter, DBRS first suggests that a new Item 4 be added to the Form to elicit information as to whether the applicant/NRSRO uses rating affiliates in the conduct of its business, *viz*.:

4. Check the applicable box.

☐ The credit rating agency does not use any rating affiliates (SEE INSTRUCTIONS) in the conduct of its credit rating business.

☐ The credit rating agency uses one or more rating affiliates in the conduct of its credit rating business. If this box is checked, supply in an INITIAL APPLICATION or an AMENDMENT to this Item the information regarding the rating affiliates required by Exhibit 4.

In addition, the following new language should be added at the end of the Instructions to Form NRSRO, Exhibit 4:

A credit rating agency that uses one or more rating affiliates in the conduct of its credit rating business must supply the following information for each such rating affiliate:

1. Name

2. Address

3. Legal status (i.e., corporation, limited liability company, partnership, other (specify))

4. Place and date of formation (i.e., state or country where incorporated, where the partnership agreement was filed, or where the entity was formed)

5. Undertakings in substantially the following form shall be given with regard to each rating affiliate insofar as the rating affiliate's credit ratings are used for U.S. regulatory purposes:

a. The ratings activities of [the rating organization] and its rating affiliate are conducted in a seamless, integrated fashion. This means, among other things, that all credit ratings are issued as ratings of [the rating organization] and that [the rating organization] stands behind all of the credit ratings issued in its name.

b. The rating affiliate employs the same policies, procedures and methodologies that [the rating organization] uses to determine credit ratings.

c. The rating affiliate is subject to the policies and procedures [the rating organization] has established, maintains and enforces to prevent the misuse of material, nonpublic information.

d. The rating affiliate is subject to [the rating organization's] written code of ethics, if any, unless otherwise expressly disclosed.

e. The rating affiliate is subject to [the rating organization's] written policies and procedures to address and manage conflicts of interest.

f. Upon a request by the Commission and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at the Commission's principal office in Washington D.C., an accurate copy of any book(s) or record(s) of the type required by Rule 17g-2(a)(2), (b)(2) or (b)(3) relating to credit ratings or credit analysis reports, credit assessment reports and private rating reports produced by the rating affiliate. Where necessary, such documents will be translated into English.

g. The rating affiliate shall comply with administrative subpoenas, demands or other requests for information issued by the Commission, insofar as those subpoenas, demands or information requests pertain to credit ratings issued or distributed to U.S. persons.

DBRS further suggests that the following new definitions be added to the **EXPLANATION OF TERMS** found in Section F of the Form NRSRO Instructions:

> *RATING AFFILIATE is a CREDIT RATING AGENCY that: (i) directly or indirectly CONTROLS, is CONTROLLED by or is under common CONTROL with the rating organization; and (ii) was organized or formed under the laws of a country other than the country under whose laws the rating organization was organized or formed.*
>
> *CONTROL means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract or otherwise.*
>
> - *A PERSON is presumed to control a corporation if the PERSON: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.*
>
> - *A PERSON is presumed to control a partnership if the PERSON has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.*
>
> - *A PERSON is presumed to control a limited liability company if the PERSON: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests in the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC.*
>
> - *A PERSON is presumed to control a trust if the PERSON is a trustee or managing agent of the trust.*