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NORTHWESTERN
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Ms. Nancy M. Morris
Secretary - Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Re: SEC Proposed Rules Implementing Provisions of the Credit Rating Agency Reform Act of 2006 (File No.: S7-04-07)

Dear Ms. Morris:

I support the efforts of Congress to encourage competition in the rating industry by reducing the barriers to entry while at the same time allowing the market to decide which ratings methodologies and firms provide the most valuable guidance through their rating systems. The strength of our capital markets have been built on their ability to innovate and for market participants to decide which methods and financial structures are more useful – allowing others to wither and die.

As some of my comments have already been made more eloquently by others (e.g. the comments by Professor Helwege, Professor Duffie, and Professor Calomiris et al) I will not repeat them here, but will instead emphasis a few additional points. In the interest of full disclosure, I sit on the Moody's Academic Advisory and Research Committee. The views expressed in this letter are my own and are based on my readings of the proposed ruling as well as my reading of the academic research including my own work on the role of bond ratings in public capital markets.

To understand the effect of Proposed Rule 17g-6(a)(4) and whether is useful to use regulation to reduce the variation in ratings across agencies, it is useful to consider why such variations arises to begin with and what advantages or disadvantages this variation may create. Variation in ratings may arise to difference in the data available to the agencies. Part of the role they play in capital markets is to collect information on credit quality that is not easily or publicly available. Difference in ratings also arise due to differences in methodology used by the agencies. Each of them will argue that part of their competitive advantage is the model they have developed to evaluate credit risk. This is both the analytic models which the rating agencies have built up over time as well as differences in experience and perspective of the individuals who make the final judgement call.

This variation contains information which may be useful to the market and which should be available to the market. The rules should expose these differences to the market and allow them to use this information. The variation in ratings can be due to systematic or non-systematic reasons.

Variation in ratings for systematic reasons:

Rating agencies may differ in their expertise or ability to rate debt securities – and the more complicated the security, the more important this expertise may be. If difference in expertise or differences in method lead to systematic differences in ratings (e.g. some firm's ratings are more conservative) and firms or underwriters know this, this provides an opportunity and incentive for firms or underwriters to shop for a rating. I can search for the rating agency which will most likely give me the highest rating. If regulations then require other rating agencies to accept the initial rating at face value (without adjustment or notching), it creates an incentive to find the most favorable ratings first. Equally important, it becomes difficult for the market to determine whether the agreement in ratings is a product of two independent analysis or one. As a market participant, I would like to see the difference of opinion between agencies and have the opportunity to use this information – and my experience with the rating agencies historical ratings – to make my own investment decision.

Variation in ratings for non-systematic reasons:

Although the rating agencies have made enormous progress in developing data bases, analytic systems, and professional judgement which have improved the quality of ratings – credit rating is not a science. There is not one method or approach upon which all market participants agree. There are legitimate differences in opinion on the appropriate rating for a given debt security – even if no specific rating agency is systematically more or less conservative.

This is similar to Professor Helwege's analogy to the SAT. Firms or underwriters who are searching for a rating are like a student taking the SAT. They have some idea of what the correct score is. If I take the SAT and score much better than expected (I get lucky), I will not take the SAT a second time. If I take the SAT and score much worse than expected (I get unlucky), I will take the SAT a second time. The decision to take the exam a second time is not random, and contains information about what I think my innate ability is.

The same may be true with ratings. Issuers have an incentive to get the highest rating they can. If I ask for a rating, and receive a rating much better than expected, I will be less likely to pursue a second rating, than if the first one is much worse than expected. The market understanding this incentive, can incorporate the fact that I obtained a single rating in their investment decision. However, if other rating agencies are required to use the initial rating (if they have not rated a sufficient percent of the underlying securities), without adjustment or notching we will cloud the information available to the market. Do we see two identical ratings because there are two independent draws and the rating agencies agreed or because the second rating is a regulatory required copy of the first?

In my opinion, the diversity of opinion is a valuable component of a well functioning financial market. This is the intent of this regulation. By making entry into the credit rating agency industry easier, the objective is to expand the diversity of opinions and thus get closer to the truth. We just want to be careful that each step along the way encourages that diversity. It is not clear to me that Proposed Rule 17g-6(a)(4) will do that. Thank you for taking the time to consider my thoughts.

Very truly yours,

Mitchell A. Petersen