January 31, 2020

Securities and Exchange Commission
Fixed Income Market Structure Advisory Committee
100 F Street, NE
Washington, DC 20549-1090
Attn.: Michael Heaney, Committee Chairman

Re: Comments on File Number 265-30, Comments to the Committee Meeting to be held on February 10, 2020

Dear Mr. Heaney,

Egan-Jones Ratings Company appreciates the opportunity to provide our comments to the Credit Ratings Subcommittee of the Fixed Income Market Structure Advisory Committee (the "Committee") on its deliberations about the current model for credit rating issuance and the regulatory regime for Nationally Recognized Statistical Rating Organizations ("NRSROs"). Egan-Jones is currently one of nine NRSROs registered with the Commission and, as an NRSRO, provides credit ratings in respect of financial institutions, brokers, dealers, insurance companies and corporate issuers. We welcome the Committee's debate on the appropriate model for credit ratings.

As the Committee is aware, many market observers attribute faulty and conflicted credit ratings as a primary impetus behind the last financial crisis. Indeed, a staff report of the U.S. Senate found that "inaccurate … credit ratings introduced risk into the U.S. financial system and constituted a key cause of the financial crisis."[1] As a direct result of such concerns and as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commission enacted various rules and created its Office of Credit Ratings to oversee activities of the NRSROs. These actions were designed to mitigate conflicts of interest and better ensure transparency of ratings.

While those efforts were important steps to improving the market integrity of credit ratings, it has increasingly become apparent that such steps are insufficient to reduce the fundamental conflict of interest which permeates the credit ratings business: because security issuers pay for the overwhelming proportion of credit ratings, NRSROs are incentivized to compete for issuers' business by providing higher ratings. We believe that no amount of disclosure or internal separation of ratings and marketing staff is sufficient to overcome the taint created by such conflicts.

[1] Wall Street and the Financial Crisis: Anatomy of a Financial Collapse, Majority and Minority Staff Report, Permanent Subcommittee on Investigations, U.S. Senate, April 13, 2011, p. 6.

Nor are we alone. Market observers increasingly highlight the perverse effects of this fundamental conflict of interest. For instance, note the following articles:

- "Inflated Bond Ratings Helped Spur the Financial Crisis. They're Back: Credit grading firms are giving out increasingly optimistic appraisals as they fight for market share in booming debt-securities market", citing what the article terms a "systemic flaw" notes that "[b]ehind the ratings inflation is a long-acknowledged flaw Washington didn't fix: Entities that issue bonds – state and local governments, hotel and mall financiers, companies – also pay for their ratings" and quoting a former analyst as stating "The incentives are wrong. They stayed wrong."[2]
- "SEC Fix for Conflicts of Interest at Credit-Ratings Firms Has Failed" noting that "the government didn't eliminate the conflict" and that the solution allowing for unsolicited ratings "was a failure."[3]
- "SEC Urged to End Ratings Firms' Conflicted Business Model: An advisory panel is considering whether to recommend a new dynamic" reporting on the last public meeting of the Committee and noting widespread opposition to the issuer-pay business model.[4]

We believe that there is a ready solution to this issue: the Commission should more fully embrace investor-paid business models. For example, in order best to eliminate conflicts of interest, Egan-Jones's subscription ratings are principally investor-paid and the ratings (not the full reports) are publicly-available at no cost on major financial information outlets, providing transparency to market participants.

We also believe that broker-dealers, index providers and fiduciaries should disclose whether they are relying on ratings paid by investors or issuers and periodically perform due diligence on the effectiveness of such ratings in order to protect their beneficiaries. Lastly, we believe the current credit ratings oligopoly, especially in respect of structured finance security ratings[5], exacerbates this dynamic by reinforcing the status quo across the industry. The Commission should encourage greater competition—especially in the area of ratings of asset-backed securities—and be vigilant not to erect barriers to entry which prevent more meaningful competition. Presented with more alternatives as to credit ratings business models, we believe that market participants will over time gravitate to those NRSROs which best eliminate conflicts of interest. As has been seen in other market sectors, when presented with meaningful choices, investors—those most affected by ratings—are best placed to choose for themselves which ratings they trust. Accordingly, the

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[2] Wall Street Journal, August 7, 2019.
[3] Wall Street Journal, October 29, 2019.
[4] Wall Street Journal, November 4, 2019.
[5] See, e.g., SEC, "Annual Report on Nationally Recognized Statistical Rating Organizations", January 2020, while noting some slight decreased concentration in certain specific areas, nonetheless indicating that the three largest credit ratings firms account for nearly 80% of all ratings in asset-backed securities (Chart 2).

Commission should not unnecessarily restrict investors' access to different credit ratings business models. We believe that allowing asset-backed securities market participants to choose a firm with an investor-paid business model would serve as a significant check on the ratings-shopping problem.

Finally, as expressed by capital markets participants in the articles cited above, we are doubtful that enhanced regulatory scrutiny will be effective but instead will raise the costs and burdens for the industry—particularly for the smaller NRSRO firms—reinforcing barriers to entry. A sounder approach is one that has already proven successful in connection with the last crisis: allow investors to choose an investor-paid model.[6] Doing so directly and clearly provides a solution to the conflict of interest concern of market professionals.

Again, we appreciate the opportunity to provide comments to the Committee. Should you have any questions or would like any additional information, please contact the undersigned.

Sincerely,

/s/ Sean Egan

Sean Egan
Chief Executive Officer

[6] Fortune, August 6, 2008, "8 who saw the crisis coming…"