

**S&P Global Ratings**  
55 Water Street  
New York, NY 10041

February 3, 2020

*Submitted Electronically*

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

**Re: Comments on File Number 265-30**

Dear Mr. Heaney,

I write in response to the invitation to submit written statements to the Fixed Income Market Structure Advisory Committee ("FIMSAC") ahead of the committee's next public meeting on February 10, 2020. According to the agenda, the meeting will include panel discussions and potential recommendations from the Credit Ratings Subcommittee, which has been considering proposals for an alternative compensation model for nationally recognized statistical rating organizations ("NRSROs"). We look forward to seeing the subcommittee's presentation/proposal and expect to have more detailed comments after reviewing it carefully.

I understand that the discussion of alternative compensation models at recent FIMSAC meetings stems from concerns that have been raised about conflicts of interest in the issuer-pays compensation model currently used by most NRSROs, and whether sufficient action has been taken to date to mitigate these conflicts. As I noted in my November 26, 2019 letter to FIMSAC, the debate over conflicts of interests and NRSRO compensation models is not new and was a primary focus of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). In considering any recommendation, it is important that FIMSAC give due consideration to the numerous requirements Dodd-Frank now imposes on NRSROs and other market participants to mitigate the very same conflicts of interest that FIMSAC is now also seeking to address, as well as the substantial changes that many NRSROs have implemented over the last ten years. There is nothing to indicate that these important changes have failed to serve their intended purpose. I invite FIMSAC to view our default and transition studies (<https://www.spglobal.com/ratings/en/research-insights/default-transition-and-recovery/default-transition-and-recovery-sector>), which show that performance of our credit ratings is strong, as well as our publications on current credit issues including CLO, leveraged lending (<https://www.spglobal.com/ratings/en/research-insights/topics/leveraged-finance-clos-uncovered>), and BBB (<https://www.spglobal.com/en/perspectives/bbb>) markets.

Imposing an alternative compensation model, particularly one that would constitute a significant wholesale change to the credit rating industry, would likely have a substantial and disruptive impact on the global financial markets. It is, therefore, crucial that the committee invite and consider the views of all affected market participants, including users of credit ratings—both issuers and investors globally—as well as NRSROs, to ensure that the committee fully understands the potential consequences of any recommended alternative compensation model. To minimize any unintended consequences or market disruptions, any proposal that could potentially and fundamentally impact the financial markets should be carefully tailored to address a clearly identified issue.

### **NRSRO Compensation Model**

Every business model presents potential conflicts of interest or other adverse consequences. Recommending or mandating any particular business model would neither eliminate potential conflicts of interest, nor would it solve the wider concerns around the current state of credit markets, which seem to be fueling the renewed discussion around NRSROs. Indeed, as recognized by government agencies here and abroad, including the studies previously conducted by the Securities and Exchange Commission (“SEC”) and the Government Accountability Office (“GAO”), no business model is entirely free of conflicts of interest. In our view, the key to addressing conflicts of interest is to identify, disclose and manage potential conflicts and to provide transparency regarding ratings, rating methodologies, and rating performance. This allows investors to decide which ratings to consider in making informed investment decisions.

S&P Global Ratings believes in market choice and that market participants should remain free to choose the NRSRO they consider to be the most qualified and experienced for a particular rating. We believe each NRSRO should choose the securities and securities issuers on which it believes it can, and would like to, form a credit opinion. And we believe each NRSRO should employ the business model it believes will allow it to provide meaningful and thorough credit risk analysis to the market, subject to effective regulatory oversight and the effective identification, disclosure and management of potential conflicts of interest.

In our view, the advantages of the “issuer-pays” model far outweigh those of other business models. The model ensures all of our ratings and ratings criteria are made available to the entire investment community free of charge in real-time, which has two primary advantages: (1) it increases access to credit ratings to everyone, including retail investors, small community banks, towns and municipalities; and (2) it subjects our ratings to scrutiny every day from investors, regulators, academia, the media, and other NRSROs. The model also provides NRSROs with both access to high-quality information that enhances the quality of analysis and the resources necessary to invest and deliver the quality and scope of ratings, analysis and surveillance that today’s markets demand.

Business models that shift the expense of credit ratings to investors will still face potential conflicts of interest. For example, rating agencies can face pressures by investors both to assign lower ratings (to obtain higher yields) and to avoid downgrades (to avoid losses). Governments, and their representatives, also have their own interests or biases which they may seek to serve in administering any government-run model. For example, governments may seek higher ratings of their own debt (to avoid paying higher yields).

Business models that randomly assign NRSROs effectively treat ratings as a commodity and incorrectly presume all ratings are of equal quality and utility. Business models that remove an issuer's or investor's choice to select the most qualified, experienced NRSRO to rate a particular issuance ultimately reduce the amount of useful information available to investors and other market participants. Such models also unfairly and inaccurately assume that investors do not have views on these issues and cannot form their own opinions about the strengths and weaknesses of different NRSROs. Business models that require a board or other administrative process to assign NRSROs may cause delays or other inefficiencies in the debt issuance process, delaying issuer's access to capital. Business models that assign NRSROs on a random basis reduce the incentives for NRSROs to innovate, enhance and strengthen their models, criteria and methodologies, or otherwise take steps to compete on analytical excellence. Business models implemented by government agencies, including those that assign the NRSRO most "qualified" to rate a particular issuance, may be seen as an endorsement of the credit rating by the government, encouraging over-reliance on credit ratings by investors.

Moreover, the SEC has already spent significant time and effort studying a potential assignment system for the rating of structured finance securities and identified multiple, significant concerns. Among the previously-identified issues, the SEC cautioned that an assignment system "may be costly to implement and administer," may present an "operational complexity" that may impact "the quality of credit ratings and the functioning of the structured finance markets," "could create new conflicts of interest" as individuals on any assigning board may have their own interests they may seek to serve in administering assignments and, to the extent it is viewed by investors as a government-endorsement of credit ratings, "may conflict" with Congress' overarching "goal in the Dodd-Frank Act of reducing reliance on credit ratings."<sup>1</sup>

The key to addressing the conflicts of interest inherent in all business models is not to ban or endorse a particular model — but to identify, disclose and manage those conflicts and increase transparency regarding business models, rating methodologies, and rating performance so that it is ultimately the investor who decides which ratings to consider in making investment decisions. Dodd-Frank, and the associated rules subsequently adopted by the SEC, have in fact resulted in the increased identification, disclosure and management of potential conflicts, as well as an increase in transparency around rating agency business models, rating methodologies, and rating performance. Rather than recommending a particular compensation model, FIMSAC could instead consider whether there are ways to enhance current rules to increase transparency about conflicts of interest and/or to reduce the risks of investors' over-reliance on ratings.

### **Changes and Enhancements made at S&P Global Ratings Since the Financial Crisis**

S&P Global Ratings is committed to providing transparency to the market through high-quality independent opinions on creditworthiness. Safeguarding the quality, independence and integrity of our ratings, including by identifying and managing potential conflicts of interests, is embedded in our culture and at the core of everything we do. Since the Financial Crisis, we have invested heavily to further the quality, transparency and integrity of our ratings and we emerged as a stronger

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<sup>1</sup> See SEC Report to Congress on Assigned Credit Ratings as Required by Section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (December 2012), at p. 74-77.

organization.

#### Ratings Quality and Transparency.

- We enhanced our criteria and model development processes. Our criteria must undergo an independent review and validation before they are approved for use by our U.S. board of directors. Our validation team also periodically reviews and back-tests existing criteria and models.
- We publish all our criteria on our website free of charge. We have a formal process to receive and consider investor and other market participant comments on our proposed and in-use criteria.
- We require mandatory analytical training and certifications.
- We created cross-functional credit conditions committees, composed of economists and senior analytical staff around the world. The committees review evolving market and macroeconomic developments and publish commentaries on their credit impacts.
- Our ratings must undergo a formal review by analysts at least annually. Ratings may also be reviewed by our independent Ratings Risk Review function for quality control.
- Our annually published default and transition studies show the performance of our ratings over time. We also increased the information we publish in connection with each rating.

#### Managing Potential Conflicts of Interest.

- We fully separated commercial and analytical activities. Analysts cannot engage in sales or marketing activities, commercial staff cannot engage in credit rating activities, and communications between commercial and analytical staff are restricted and, in many cases, monitored by our Compliance department. For example, an analyst may not learn of the commercial aspects of a transaction.
- Analysts' compensation does not depend on the volume of ratings they produce or on the rating assigned.
- For each rating decision taken by a rating committee, analysts must disclose any conflict. We also restrict analysts from holding securities in the sectors they rate, and monitor their holdings.
- We periodically rotate the analysts assigned to a particular issuer, and conduct 'look-back' reviews of the work performed if an analyst leaves us to take employment with an issuer.

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#### Compliance and Internal Controls.

- In addition to enhancing our various policies and procedures, we built out a Compliance department with approximately 80 staff globally. We embedded Compliance officers in our rating practices to anticipate, identify and address potential issues. Among other activities, Compliance provides training, monitors compliance with regulations and our policies, and reports on significant issues to our regulators.
- We strengthened our approach to identifying, preventing and managing risks. Our Ratings Risk Review and Internal Audit functions provide independent oversight.
- We established an internal control structure with dedicated personnel to strengthen governance and accountability. We file an annual management assessment report to the SEC on the effectiveness of our internal control structure regarding compliance with our policies, procedures and methodologies for determining ratings.

#### Regulatory Oversight.

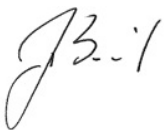
- We are subject to comprehensive regulatory oversight in over 20 countries and the European Union. Each regulator oversees our compliance with their respective credit rating agency regulations. Common regulatory themes include the mitigation, management and disclosure of conflicts of interest.
- In the U.S., Congress directed the SEC to create an Office of Credit Ratings. OCR conducts on-site examinations at least annually and monitors the activities of the NRSROs throughout the year. The examination includes how we manage conflicts of interest and whether we follow our policies, procedures and methodologies. The SEC summarizes the results of the examination in an annual public report, and submits an annual public report on CRAs to Congress.

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S&P Global Ratings is committed to a better public understanding of our ratings processes and the steps we have taken to further ratings quality and manage conflicts of interest. We welcome the everyday scrutiny of our published ratings and underlying methodologies from academia, the media, and every corner of the capital markets.

S&P Global Ratings welcomes the opportunity to continue to be part of the ongoing dialogue on these important issues and to provide FIMSAC with additional comments on any proposed recommendation it may make.

Sincerely,



John Berisford  
President

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