April 20, 2020

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

Re: Securities and Exchange Commission Fixed Income Market Structure Advisory Committee (File No. 265-30)

Dear Mr. Heaney:

The undersigned trade associations appreciate the opportunity to provide feedback on the discussion by the Fixed Income Market Structure Advisory Committee (FIMSAC) around examining issues concerning credit rating agencies (CRAs), specifically assessing potential alternatives to the CRA business model. In response to the discussion document circulated in advance of FIMSAC's February 10th meeting, we would like to provide our views on potential ramifications of some of the alternative models under discussion, particularly around the assignment model.[1] While we think there are potential ideas worth exploring for FIMSAC to improve the fixed income markets, particularly for the investor community, we are concerned that proposals aimed to mitigate potential conflicts of interest surrounding the "issuer-pays" model by introducing a new alternative compensation model could potentially yield lower quality credit ratings and reduce information available to investors--creating new conflicts that do not currently exist.

The U.S. capital markets are the largest and most robust in the world, and credit ratings help provide efficiency in the debt markets for our member companies seeking to raise capital for their business operations as well as investors that are seeking comparability and transparency in information on products when making their investment decisions. Our associations represent member companies that are on both issuers and investors. A healthy and functioning credit ratings market allows for market efficiency for the deployment of capital for companies as well as insight and predictability for investors and other market participants. Any proposal that

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[1] https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-021020-crs-working-document-alternate-model-and-potential-initiatives.pdf

fundamentally alters the current market and process for issuance of credit ratings should be heavily scrutinized to shield from unintended negative consequences resulting in potential disruptions to global financial markets.

Before delving into FIMSAC's work on CRA regulation, it is important to highlight the robust regulatory regime established by the Credit Rating Agency Reform Act of 2006 ("2006 Act") and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). In the 2006 Act, Congress first authorized the SEC to create a voluntary registration and oversight program for CRAs. The Dodd-Frank Act, among other reforms, introduced improvements to mitigate conflicts of interest, increase disclosures relating to methodologies and ratings performance, and created the Office of Credit Ratings (OCR) within the SEC, which annually examines and continuously monitors SEC registered CRAs. OCR Director, Jessica Kane, recently noted that the SEC's oversight is "leading to meaningful changes in conduct by the entities and individuals OCR oversees, and has resulted in structural improvements by [CRAs] in internal controls, governance, and policies and procedures that bolster regulatory compliance."[2]

Much of the current debate has focused on the conflict of interest present in the "issuer-pays" model as well as reports on ratings shopping in the current market. Indeed, alternative models such as the assignment model, as well as others that have been contemplated previously as directed under section 939F of the Dodd-Frank Act, all carry their own unique conflicts of interest.[3] In its study, the SEC found there could be numerous negative consequences to the implementation of alternative business models, including many that are included in the FIMSAC Discussion Document.[4] We encourage FIMSAC to closely examine those conclusions and to clearly articulate the problem its recommendation is intended to resolve. .

The current "issuer-pays" model allows for ratings and ratings criteria to be made public for the benefit of all investors, including smaller entities who can use ratings as one input into their own credit analysis, and also opens up increased scrutiny of ratings and methodology from a wider audience. CRAs do not employ standardized or identical methodologies, nor would doing so benefit the market, and

[2] https://www.sec.gov/news/speech/speech-jessica-kane-2020-02-24
[3] https://www.sec.gov/files/assigned-credit-ratings-study.pdf
[4] https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-021020-crs-working-document-alternate-model-and-potential-initiatives.pdf

indeed the SEC is prohibited by law from regulating credit rating methodologies, which allows for CRAs to innovate and compete in the development and quality of their ratings that ultimately provides value to investors. Alternatively, an assignment model would instead treat ratings as a commodity that would deprive the market of competitive forces and could potentially result in a reduction of useful information available to investors and other market participants. All CRAs and their respective ratings criteria would be deemed equal as part of the assignment model, which could then introduce lower quality credit ratings into the market and undermine investor protection. Further incentives to compete and improve credit ratings quality would be reduced as the basis for differentiation and scrutiny as tools of market discipline would be removed resulting in potential further deterioration of quality in credit ratings.

Additionally, the process used to ultimately assign CRAs could result in market delays and other inefficiencies in the issuance process. Placing an intermediary third-party between an issuer and a CRA will significantly impact time to market and diminish the efficient distribution of debt capital. As the SEC noted in its study as part of 939F, such a system would likely raise costs to issuers which could then be passed on to investors, as issuers would have to bear the time and resource costs of onboarding new CRAs.

To the extent that a third-party or assigning board is utilized, the assignment process could result in the creation of new conflicts of interest, as those involved in assignment may have their own interests. Also, the presence of an assignment entity could be viewed by investors as an implicit government endorsement of credit ratings, which moves away from Congressional intent in Dodd-Frank for reducing reliance on credit ratings.

Additionally, linking rating assignments to past performance can, as the SEC found, undermine quality by, for example, leading CRAs to be overly conservative in order to avoid a downgrade that could negatively impact their performance statistics[5]. It would discourage innovation and encourage homogeneity of credit ratings to satisfy the selected performance metric. Moreover, comparing performance across CRAs is challenging because CRAs rate to different outcomes. Some CRAs have ratings that are more stable, while others are more sensitive to market changes; some CRAs rate

[5] https://www.sec.gov/files/assigned-credit-ratings-study.pdf. See pages 75-76.

to expected loss, while others rate to default probability. A metric that measures performance would favor one approach over another, which would violate the Exchange Act by interfering with the substance of credit ratings.

For these reasons, we believe that the current "issuer-pays" compensation model for credit ratings agencies provides considerable value as compared to other alternative models. We applaud FIMSAC for discussing and considering ways to ensure that the market for credit ratings results in the highest quality to the benefit of both issuers and investors, and we believe that there could be potential other improvements to the system that would achieve FIMSAC's goals. However, we do not believe that a fundamental change to the compensation model would result in these sought after policy objectives and instead would ultimately result in decreased information for investors, reduced credit quality, and the introduction of new conflicts of interest.

We look forward to continued engagement with the FIMSAC and the SEC on this and other important issues.

Sincerely,

U.S. Chamber of Commerce
Securities Industry and Financial Markets Association
Loan Syndications and Trading Association

cc: The Honorable Jay Clayton
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee