CreditSights

April 10, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549

Re: File No 4-579

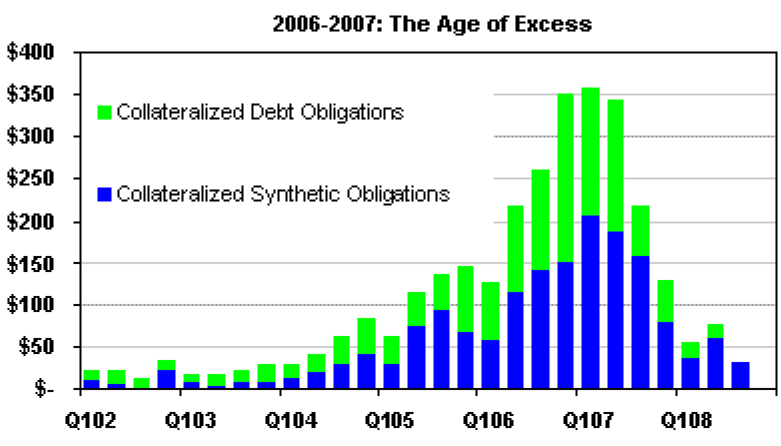
Dear Ms. Murphy:

CreditSights appreciates the opportunity to provide comments to the SEC as the Commission moves on to the next evolutionary stage in the ongoing and much-needed reform of the credit rating agency industry. In our comments, we would like to focus somewhat more on the issue of disclosure and documentation and how limitations in this area are a major threat to meaningful change in the rating agency industry. We reiterate what we stated in our July 29, 2008 comments to the Commission on such areas as CLOs and how artificial constraints on document availability to independent, investor-pay ratings firms is a major factor impairing new entry and limiting competition in the structured finance space. We see little that has changed in this area and believe more has to be done. We stand by those earlier recommendations and incorporate them by reference into this commentary.

We are well aware of the efforts made within the SEC to consider enhanced disclosure for the array of structured products that saw such a massive origination boom in recent years and specifically in 2006 and 2007 when analysis and due diligence seemed to be totally abandoned in the structured finance wave. We found the recent comments by Commissioner Kathleen L. Casey in her February 6, 2009 speech on a more level playing field for structured finance disclosure heartening and very much consistent with promoting competition from new NRSROs and more high quality research firms. We also applaud the efforts of Erik Sirri in this area. We would highlight that much more focus on asset disclosure rules is needed beyond the current "Re-proposed Rule" (File. No. S7-04-09) if the coming wave of defaults and asset charge-offs is to be properly framed and assessed in a market that will see no shortage of ongoing stress. That is particularly the case if the Commission wants input from more parties than those that essentially *created* and exacerbated the crisis in the first place. In other words, the analytical input has to come from more than just the entrenched incumbents (arguably a duopoly and a half) and the Wall Street firms that have ongoing on-balance-sheet, contingent balance sheet, and market-making exposures to the assets they will be analyzing. Of course the market needs their focused efforts as well to deliver detailed, information-intensive analysis, but it needs more than that.

The scope of the crisis calls for more research input, an enlarged role of less "axed" players, and a more open debate on underlying assumptions. As highlighted in recent comments on the recent Re-proposed Rule, this may require decisive action by the Commission in tandem with some changes in the securities laws around disclosure across some asset classes. The daunting task of trying to appeal to a Congress that is looking more for villains (who are plentiful, come with scowling, unflattering headshots, and make for good hearings fodder) than substantive change may just make this task a bit too much for optimism. The proponents within the Commission of real meaningful change in the structure of this industry as opposed to just behavioral curbs hopefully will find the support they need. It is clear from hearings and even from our discussions with staff members of the Commission that the scope of the problem is understood. What is less clear is whether the rules that will end up being put into place will reflect the reality that the crisis in structured finance cannot just be dealt with by conflicts-of-interest paperwork and a de facto "administrative tax."

If there is to be more investment in people and systems to create viable competitors, the perception of a level information playing field is critical, and it absolutely has to be addressed. It will help promote more competition across NRSROs and also allow more investors (who unduly relied solely on ratings) to roll up their sleeves and deal with their current problems. The analytical challenges will remain daunting for a wide array of assets from CLO's to CMBS. Each has its own distinct set of data requirements, and the NRSROs and Wall Street constituencies will aggressively resist any attempt to "cut in on their action." We do not need to point out that the problem has migrated to a *global scale*, so this fits into the regulatory debate in Europe as well. The magnitude of the global exposure will also create more revenue streams for research and ratings providers. That will in turn attract established research and ratings providers, more asset class experts (loans, commercial real estate, securitized products) and more experienced personnel (notably from "the street" and perhaps from the incumbent rating agencies themselves) to potentially new NRSROs. Capital will follow the opportunity and fund the future growth.



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The incumbents would naturally like to be the ones to create and sell all the better mousetraps for dealing with the structured finance meltdown. That is more than a little brazen given that they created the infestation of mice in the first place. In essence they helped create the problem and want information restrictions to remain in place so they can also charge for the solution and the monitoring of the securities' health. The major rating agencies currently can translate a closed information loop into pricing power, high profit margins, and even more market power. They can at least bear the strain of some more aggressive competition from institutional level firms. The Commission has to at least consider more mandatory disclosure on outstanding deals. In many cases the data is there literally at the push of a button from established vendors and data systems (e.g. private bank loan documents, CLO deal docs, and private financial statements). While it varies by structured finance asset class, there are minimal (even negligible) costs to producing complete and ongoing disclosure in many types of structured deals despite the protests of some of the usual suspects. Furthermore, the information is widely distributed across loan investors and dealers. The independent NRSROs or independent research firms simply are not allowed *official* access to what is for all intents and purposes in the public domain. Improved information disclosure can attract focus from the many professionals who have been involved in the asset class as well as new business models with a subscriber-pay revenue base that will have an inherent interest in providing a quality product.

If the Commission wants more quality professionals to compete in the credit ratings and research space, they need to be able to get the information to compete. The current situation in structured finance is akin to asking new NRSROs to rate corporate issuers without the financial statements or without Reg FD requirements to provide them with a level information playing field. That would of course be absurd. So is the current situation in asset classes such as CLOs and CDOs. We also would remind the Commission that many of the players who consistently opposed Reg FD are the same ones who seek to torpedo meaningful rating agency reform. Disclosure is the friend of better analysis, more useful ratings, and higher quality research. It is also the enemy of the expense line and new legal fees, so it will be roundly opposed by the usual parties.

The NRSRO Regulatory Framework: Missing Some Critical Elements
We have found that the debates around the direction of the NRSRO regulatory framework tend to be dominated by a few characteristics:

- **Excessive focus on "behavioral" checks and balances.** Monitoring the risks of rating agency conflicts of interest at both the individual and institutional levels are obviously critical, and we fully support those initiatives. The policy debates around "conflicts of interest" in fact tend to dominate the reform process and squeeze out consideration of other overriding problems that go to the core of the competition issue and market-based solutions. In the end, the incumbents are well aware that such behavioral policies do little if anything to threaten their entrenched position in credit ratings, and they are quite happy to keep that debate going as long as possible. The agencies will be more than happy for everyone to concentrate on this aspect of the reform process since it does absolutely nothing to lower barriers to entry. The fact that such "conflicts" reform is necessary speaks worlds of how the incumbents have conducted themselves and it thus begs more decisive action in other areas as well where the industry structure can be changed in the right direction. It is easier to say to the agencies "promise not to do bad things anymore, and make people sign forms saying so" than it is to tackle the painful process of disclosure reform or even broach the topic of additional legislation with a Congress that was so less than impressive in the TARP hearings.

- **Backward looking views of what "ratings" products and services mean.** The guidelines issued tend to fixate on ratings explicitly and less on the information intensity that can be wrapped around ratings products or come as part of incremental service from rating providers—particularly in subscriber-paid business models. At the end of the day, the ability to predict default has been the core of a credit rating over the years. In recent years, the next generation of value-added products and services has been rolling out, and there is much more to come in the future. Adding a few more letters and numbers offered up by a relative handful of boutiques (Baa1, AAA, or even "AA-SF" etc.) is not the main event and should not be the key part of the debate. There are "good ratings" that are "good" in the narrow context of predicting default, and then there is "good information" in helping raise the awareness of the qualitative factors, the range of potential assumptions, the inherent weakness of models in predicting some variables, and highlighting the relative risks across various asset classes. These risks run the gamut from structural (e.g. covenants) to legal (e.g. domicile risk and local laws) to risks of omission (e.g. counterparty risk). It is not solely about predicting the risk of default. The fact that some of the incumbents looked to capture all these risks in a few letters and numbers has led many expert witnesses from the markets and academia to highlight over the years that "there is little information content in a rating."

  The focus on one single metric—as in the alphanumeric rating—is understandable but it ignores the growing complexity of the market and the fact that many new tools and new ratings products and services will be coming out now and over the intermediate term. The agencies know that is the case, and have been rolling those out under their quasi-protected regulatory mandate. Yet it is striking that they keep the debate focused on the single metric and managed to lobby in a 3-year holding period on new NRSROs in structured finance while working vigorously to slow reform that would allow many firms to get the information to start the three-year clock. It is quite a racket. The incumbents are pushing into default risk model and data and analytics businesses, offering covenant research products, expanding default and recovery research, and—in the ultimate irony—offering valuation services for highly illiquid structured finance products that their models helped render illiquid.

- **Narrower goals of agency transparency rather than information availability**. We applaud the goals of improving rating agency transparency and have long been advocates of such requirements. That said, such reform has no impact on the bigger challenge of structural change in the ratings industry. The most glaring weakness in the ratings reform process that we have seen in the past 7+ years (dating from the initial Sarbanes-Oxley legislation and the March 2002 Senate Enron hearings on the rating agencies) was the failure to tackle in force the disclosure issues that have given the incumbent rating agencies such an insurmountable advantage in some areas of finance—most notably in private bank loans, CMBS, RMBS, and across myriad ABS/ABCP structures. It is perhaps not a surprise that those very areas are the most tortured in the current markets and are at the core of the current systemic crisis. Company disclosure is something the SEC has always pushed successfully and thoroughly, but the segments of the fixed income markets where the current crisis has been centered is an area where that is not the case. The underwriters and bulge bracket banks, the incumbent rating agencies, and their daisy chain of legal beneficiaries will do their best to derail any such initiatives.

Information: the Linchpin to Competition, Quality, and Adding Value

To gather the necessary ingredients for sound research and ratings in the structured finance space, more resources must be brought to bear by the SEC on the issue of disclosure. Otherwise, the perception of competition will be more cosmetic than real. The regulators need to readdress the role of how documents are made available (or more to the point, how access is impeded). Potential new NRSROs have less access now than the incumbent agencies, the underwriters, and asset managers, and are often precluded from even *buying* disclosure by entrenched vendors whose economic fate is aligned with the status quo. That reality will impair any new entrant's ability to score and rate various sub-sectors of the structured finance market. That is, unless the new entrant is content to rate such products badly, with less analytical foundation, and is more fixated on the concept of just being an NRSRO rather than being a good one. The SEC needs to take a harder look at this aspect of the business since the underwriters, incumbent ratings agencies, the private equity firms, and leveraged finance issuers themselves will most decidedly undermine such initiatives without a stronger regulatory hand.

For example, the idea of making equivalent disclosure a requirement only for *prospective* deals is suboptimal since that opens up the playing field for the analysis of only a trickle of *future* deals in a market that has been devastated by the *past* deals. The focus over the next 5 years will not be on the new deals. Rather, it will be on the wave of deals printed in the peak of the credit crisis—the ones that are currently "ticking." These are after all the asset pools that are the heart of the current problem, they are the deals that, for example, will plague the monolines or which are being carried at values on the books of major financial institutions at marks that are subject to much debate. These are also the asset pools that will bear the brunt of a record default wave and plunging recovery rates in the coming years. They are the source of much debate around how to treat certain liability management actions (e.g. debt buybacks and exchanges). For example, the ratings criteria for structured products such as CLOs are seeing some very heated debate behind the scenes that are now spilling onto the trading floors. Investors in that case once again will be held hostage to the policies of the incumbent oligopoly.

Competition, Barriers to Entry, and Regulatory Evolution

As we have testified in numerous forums from the post-Sarbanes-Oxley Enron hearings on the rating agencies in March 2002 to the original November 2002 SEC roundtable on the rating agencies to various House and Senate hearings on rating agency reform in 2005 and 2006, CreditSights supports the concept of the NRSRO designation. Our view on the regulatory needs has been consistent through discussions with staff members from the SEC and Treasury over the years. We supported and still support maintaining such a designation on the basis that the overriding policy initiative is to provide some logical checks and balances on an industry that is an almost-overriding force in the capital markets and an integral part of the underwriting process. The rating agencies have tried to run the charade for years that they are just a bunch of journalists living large off the benefits of the First Amendment as opposed to a market segment that has much more in common with the securities industry and the investment advisory business. The incumbents' backstop strategy if the regulation trend line grows too onerous for unfettered ability to maneuver at will is to push for scrapping the NRSRO concept themselves. That way they can exploit the well-documented natural barriers that they have so successfully stacked to the sky using the unnatural natural barriers created by the exploitation of past SEC rules.

The rating agencies also have benefitted from a system where they can leverage their entrenched and protected position in ratings to rapidly buy into new business lines. These run the gamut from new content platforms to analytics to data. No one begrudges them their right to compete aggressively in the marketplace or enter new businesses, but their documented attempts to keep operators in those other business out of their ratings businesses certainly raises a fairness flag if not free market alarms. Another risk is that the ratings incumbents can then turn around and less-than-subtly leverage their clout with financial institutions to cross-sell products. It is a compelling sales process indeed when you are discussing ratings, claims-paying ability, or mutual fund ratings on one end of the hall and selling new high margin products at the other end of the hall. Little has been done to tackle this conflict issue despite the fact it was also frequently encountered in the audit profession. In the case of the audit profession, the concept of audit integrity existing side-by-side with cross-selling high margin services such as consulting was seen as inconsistent. Given the performance of the rating agencies in the recent debacle, it is certainly not safe to assume the best.

While we do not expect action to be taken in this area, it just underscores the sweet deal that the agencies have in the marketplace and at the regulatory table. It is worth considering additional lowering of the barriers to encourage more competition from large-cap and well established data and analytics providers to allow more competition in the credit ratings space. That might entail scrapping the three-year rule or perhaps narrowing the NRSRO designation to an all-encompassing category that scraps the distinct asset class breakdown lobbied into the Credit Ratings Reform Act by the incumbents. For example, companies with expertise in single name credit would be natural candidates to expand in CLOs. The incumbents cite track record as a key factor in fighting for the three-year rule, but track record is something they should not benefit from given their abysmal failure in structured finance. Their measured damage control process should be met with intensive competition sooner rather than later, and the abundant availability of experienced personnel from institutional investors, the banks, and the rating agencies themselves provide the components for viable competition now. That is especially the case if information barriers are lowered.

The new market entrants will need access to more information even as the bar will be raised for new firms to enter the space given tight budgets. The Commission has a unique opportunity to be a catalyst for market entry for a number of reasons given the market backdrop today. First, the dislocation of personnel with strong structured finance backgrounds provides a ready base of intellectual capital to draw upon. Some of these people may be perceived as part of the past problem, but they can now be part of the solution. They have a tremendous familiarity with what went right and what went wrong. The same is true from hedge funds and the fairly defunct structured investment vehicle business. With more disclosure and open channels of information flow, much can be achieved. The incumbent rating agencies should hardly be allowed to dictate the pace of new information or the reassessment of assumptions. Differentiation across pools of assets—the good, the bad, and the ugly of structured finance—is best handled with more input rather than less, and with more independent voices to raise the level of debate. Right now the brush painting structured finance tends to be a roller. With more granularity there will more exacting views of valuation and will probably also help liquidity over time in select structures. Those independent voices need to be adequately armed with disclosure, however, and should not be undermined by the players that will be all-too-frequently looking to protect their market power, their entrenched position, and their ancestral institutional ties to underwriters.

Equivalent Disclosure

The area we have focused in on in this comment to the SEC—just as we did in the last round of comments this past summer— is equivalent disclosure. We believe that non-NRSRO independent research firms that do not engage in underwriting or asset management should also have access to such information, as should all investors for that matter. We would highlight again that the main strategic thrust of the recent structured finance wave has been to take high risk assets (leveraged corporate loans, leveraged commercial real estate transactions, subprime and high LTV or low quality residential mortgages etc.) and repackage them in a manner that allowed them to be resold globally to investors with a high quality focus. These investors usually required high credit ratings as a matter of mandatory portfolio parameters or regulatory risk guidelines.

The underlying principle that eased disclosure requirements in the past had been tied to the concept of very sophisticated investors operating in high risk markets would let the market govern the required disclosure and those investors were up to the task. The trend toward repackaging those assets to resell to high quality investors changes the rules of the game and undermines those assumptions. It in effect made the rating agencies and the underwriters the governors of what would be disclosed, how the assumptions would be applied, and how much detail would be made available for third parties (i.e. those who are shut out of the ratings process). Potential competitors cannot support the ongoing risk assessment of such assets for investors without full access to the underlying asset pools and related documentation—whether original documents or ongoing amendments as required. Many of the "quality-oriented investors" that ended up holding the product (and the bag) may lack the resources to follow the underlying and that is where new investor-pay ratings firms could play a role as well.

The motives by various parties to resist any increase in available disclosure to any new market entrants who are outside the "closed loop" will be obvious enough. For the major agencies and underwriters, the resistance is about money, and it is about protecting an entrenched franchise. That is understandable, but does it present an optimal regulatory solution? The resistance to more disclosure is also about avoiding the risk of third parties raising issues that have not yet been raised by the incumbents or the underwriters—who for their part may also have substantial direct asset risk to the structures under question. The market-makers may also not want to raise questions that would raise alarms and prompt too many bid lists. The desire to keep out unwanted third-party independent views is a natural side-effect of looking to control information flows and more profitably manage less efficient markets for maximum P&L (or minimal losses). That is how it still works under the status quo approach, but that approach is what got the credit markets to where is today.

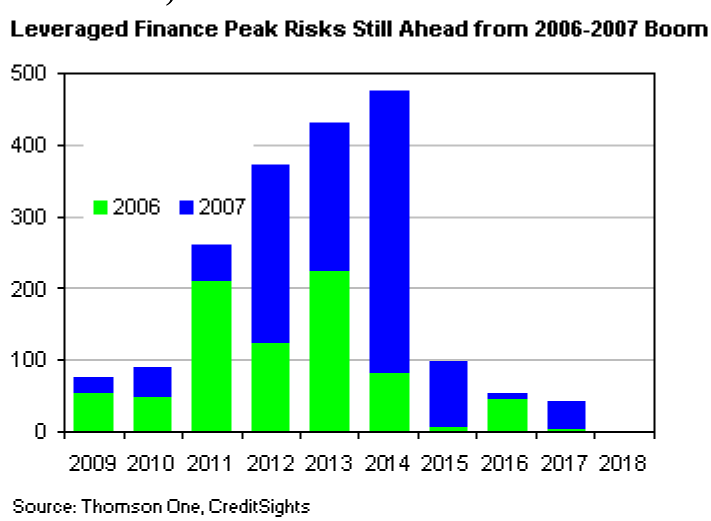
Incumbent rating agencies and underwriters often defend the current system by asserting that independent research firms that did not rate the original structured finance deal lack the full range of information to make an informed assessment. Then the incumbents and underwriters turn around and resist attempts to allow such access. They will certainly resist full disclosure of pool data and related documents for the past deals and most notably the low quality transactions printed in 2006-2007. It is an understandable reaction by parties that had run a very lucrative underwriting business outright (in the case of the banks) or had run a closet underwriting business (in the case of the large incumbent rating agencies). In the most recent structured finance binge, aggressive and well informed third-party research and/or ratings could have potentially slowed the flow of product or raised some additional and necessary questions. That would have in part undermined the ability to feed the underwriting machine for the banks and dealers, would have curbed the issuer-paid revenue stream for the rating agencies, and would have eaten into the law firms' fee-fest. It is not surprising those are the parties that most frequently resist the rating agency reform process.

It was that very concern over more market entry that led the major CRA incumbents to so vigorously oppose the various versions of the Credit Rating Reform Act as it morphed from the House version to the Senate version back in 2005-2006. By pushing to break up the categories of NRSRO across asset classes, the major rating agencies were in essence lobbying to have the structured finance rating process somewhat ring-fenced from the competition to keep the high margin party going as long as possible. As we all now know, that party had already overstayed its welcome and contributed to the worst financial systemic meltdown since the Great Depression. There are some strange moments to remember from the legislative process. During the debate on the House version of the rating agency bill when it came to a vote, one House opponent of the bill vehemently stated that allowing new ratings agencies into the NRSRO space could create the risk of the worst financial crises since the S&L crisis. The irony of that statement does not need a lot of highlighting given what transpired with the status quo.

One notable example of this disclosure shortfall (and there are many from CLOs to CMBS to RMBS) lies in the corporate bank loan market. While some public companies are required to file bank loans documents (subject to a materiality "test"), many private companies do not. Some parties access disclosure systems that are made available to select institutional investors, asset managers, and intermediaries. The next level of critical data—the financial statements of nonpublic leveraged finance companies, are also highly restricted with respect to availability. The easy tactic is to use the rules around "confidentiality agreements" to keep out non-investors. That is a useful and defensible tactic. That barrier could be circumvented by an appropriately crafted loophole that the SEC could assist in devising by the way it categorizes the next group of NSROS that did not get paid to rate those structures. After all, the companies that rate these structures have access. Why wouldn't the less conflicted investor-pay competitors also have access given the consistency with policy goals?

The rating agencies that rated the CLOs and/or single name loans have ongoing access across the board. The agencies also had detailed and frequent portfolio reports on the SIV ABCP in 2007. These are the same portfolios and ABCP structures that had so spectacularly melted down in the summer of 2007 even as the NRSROs barely highlighted the problems (asset-liability mismatches, subprime exposure etc.) until they were already very much in evidence. The losses generated in a range of high quality funds including state pension funds have been devastating.

In our view, among the next great percolating crises is in the area of structured corporate product. That is very much the case in CLOs where the 2006-2007 leveraged finance (and refinance) wave has left the market with a massive maturity hump of covenant-lite loans from 2011 through 2014. The incumbent NRSROs will be there to downgrade the deals in waves on their own managed time frame and at their own discretion. Unfortunately, additional work cannot effectively be done by third parties or new NRSROs without a more active role in mandating additional disclosure. That may not stop some firms from rating them, but it is not the ideal way to rate. The Commission is in a position do something about this, and to also make new recommendations to Congress.



The incumbents and underwriters and the various trade groups that have seen their members profit handsomely from the origination cycle—and who will be looking to dominate the next up-cycle in securitization—will have many eloquent reasons why enhanced disclosure will create undue burdens (as in push the button and upload), unfair encroachment of intellectual property rights (as in more public disclosure of deals that have crippled the financial system), and will create great confusion in the market merely by allowing a relative handful of firms access to information that is already in the hands of the incumbent rating agencies, the underwriters, and many holders of the instruments. There is of course the always-ready warning that new disclosure will have a "chilling effect" on new deals in the future. Perhaps a little chill in 2006 and 2007 might have been a good thing? Given the lack of a track record of Wall Street firms walking away from hefty fees (as in they *do not*) or the incumbent rating agencies suddenly abandoning what has been their highest margin business, we see many of these opposition points as hollow.

Despite some warning to the contrary on hesitance to use the securitization markets if too much information sharing is required, it is safe to say that financial service companies will still look to maximize their balance sheet turnover to drive ROE. The need for such deals will be unrelated to some additional disclosure in an asset pool. In addition, the all-in cost of transacting structured finance deals is not going to be affected in any meaningful way by enhanced disclosure. It may, however, be influenced by the painful experiences of many investors in this cycle. If such deal flow is constrained the next time around, it is more likely to be a function of how poorly this cycle was handled under the status quo system that seems to be the favored course for the most self-interested among the reform opposition. Providing more information and on a regular basis is a market-based solution. The market might welcome more analytical input using information that is broadly disseminated to both investors and new NRSROs alike. Perhaps the whole regulatory overhaul could be funded by a tax on lawyers using the words "chilling effect?"

About CreditSights: CreditSights is an independent research firm based out of New York with a European subsidiary (CreditSights Ltd.) based in London and an Asian subsidiary (CreditSights Asia Research) based in New Delhi. CreditSights is a Registered Investment Advisor regulated by the SEC and is regulated by the FSA in the UK. The company has never applied to be an NRSRO. The company was incorporated in 2000 with 8 employees and today has 120 employees serving a client base of approximately 6,000 subscribers across 900 institutions. CreditSights does not manage assets and is not involved in any underwriting activities. We are purely a subscriber-paid research firm offering a range of fundamental, quantitative and ratings products to debt and equity investors and corporate risk managers.

Sincerely,

/s/ Glenn Reynolds

Glenn Reynolds
CEO
CreditSights, Inc.