COLORADO PERA®

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VIA ELECTRONIC MAIL

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

RE*: Roundtable on Oversight of Credit Rating Agencies (File No 4-579)*

On behalf of the Colorado Public Employees' Retirement Association (Colorado PERA), and as a member of the Council of Institutional Investors (Council), I greatly appreciate the opportunity to participate in the Securities and Exchange Commission's (SEC) Roundtable on Oversight of Credit Rating Agencies. Colorado PERA is a pension fund with more than $31 billion in assets and a duty to protect the retirement security of 430,000 plan participants and beneficiaries located around the United States. The Council, a leading voice for good corporate governance and shareowner rights, is a nonprofit association of more than 140 public, union and corporate pension funds with combined assets that exceed $3 trillion.

Credit ratings are an important, and sometimes mandated, tool for numerous categories of market participants, including pension funds like Colorado PERA. Today references to ratings are incorporated in investment guidelines, swap documentation, loan agreements, collateral triggers, and other important documents and provisions. In the case of most institutional investors, credit ratings are part of the mosaic of information considered as part of the investment process, they are generally not a sole source for making decisions. However, credit ratings are so prevalent in laws, regulatory provisions and contractual investment policies that they ultimately serve as a first cut to identify instruments eligible for further consideration and analysis. Without such a tool investors are faced with literally hundreds of thousands of new instruments to consider each year.

According to the SEC's July 2008 *Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies*, some Nationally Recognized Statistical Rating Organizations (NRSROs) have failed to manage adequately conflicts of interest or even maintain the level of resources needed to ensure their ratings accurately reflect credit risk. In light of this conclusion and given the significance of credit ratings to all participants in the

marketplace and the critical gatekeeper role played by the credit rating agencies, the Council commissioned a white paper to analyze, from the investor perspective, the pros and cons of various additional reforms to credit rating agencies. The report identified two key areas for immediate further action: oversight and accountability.

Vast improvements in both areas can be achieved by strengthening regulatory powers, ensuring they are the responsibility of a dedicated well resourced entity and eliminating rating agencies' exemption from liability. These approaches will help restore the creditability of these financial gatekeepers.

Oversight

To immediately address rating agency failures, regulatory authority over credit rating agencies must be statutorily mandated and expressly consolidated in a dedicated entity. Oversight must be substantively strengthened, and the oversight entity must have the resources, expertise and independence necessary to manage the complexities of the ratings industry. Several approaches to the oversight entity would accomplish these objectives.

Oversight could continue to rest with the SEC. To strengthen SEC oversight, this responsibility could be housed in a new SEC division staffed by individuals with appropriate expertise. Congress must ensure that this new division has the resources necessary to effectively monitor and police the agencies. The Commission must ensure that the new division is a robust enforcer.

One alternative to a new SEC rating agency division would be the establishment of a freestanding Credit Rating Agency Oversight Board (CRAOB) with a structure and mission similar to that of the Public Company Accounting Oversight Board (PCAOB). A second option would be the expansion of the PCAOB's jurisdiction to cover rating agencies, since the Board's purpose, to protect investors and the public interest by promoting informative, fair and independent audit reports, would somewhat parallel that of the CRAOB.

Regardless of where the regulatory authority lies, it must be strengthened by statutory modifications. Both the regulator and Congress must work together to establish and affirm the extension of authority in a variety of areas, including:

- **Disclosure of Credit Rating Actions.** The regulator must have the power to require each NRSRO to publicly disclose complete historical records for all outstanding credit ratings, regardless of whether, or from whom, the NRSRO received compensation. Without complete disclosure, investors and the market at large lack the data necessary to assess and compare ratings and rating agencies.

- **Conflicts of Interest.** At minimum, the regulator must have the ability to (1) mandate disclosure of potential conflicts of interest; (2) police conflicts of interest; (3) freely investigate NRSRO business relationships; and (4) determine what further regulations, if any, are needed to ensure the independence of NRSROs and to promote high quality ratings. For example, similar to the provisions governing auditors, rating agencies should be required to disclose business relationships and should be prohibited from engaging in business activities other than issuing ratings. Disclosure rules and prohibitions on ancillary business activities should apply to all NRSROs.

- **Fees.** The regulator must have the power to regulate how NRSROs are compensated for determining ratings. A full range of payment options—including amortizing fees over the life of the instrument, tying total compensation to the accuracy of the rating and instituting a "fee-for-service" system—should be investigated and feedback from all market participants should be considered by the regulator. In addition to regulating payment methods, the regulator must have the power to require NRSROs to publicly disclose fee schedules and the amount of compensation received for individual ratings. This level of disclosure would enhance investors' understanding of rating agencies' business relationships and possible conflicts of interests thereby allowing for more robust assessment of the reliability of a particular rating by the investor.

- **Methodologies.** At a minimum, the regulator must require NRSROs to disclose to investors greater detail regarding their rating methodologies. With key information, such as the underlying assumptions used to determine a specific security's rating, investors would have the opportunity to evaluate closely the NRSROs' processes and quality of ratings. The regulatory authority should have substantive oversight of rating agency methodologies, a power specifically denied to the SEC in the Credit Rating Agency Oversight Act of 2006. With this authority and after a complete and balanced investigation into the potential costs and benefits of such proposals, the regulator could:

    - Prohibit NRSROs from issuing ratings on new types of securities for which there is little historical data;
    - Mandate NRSROs' use of third-party due diligence services to ensure the accuracy of data used to establish ratings on complex securities; or
    - Require each NRSRO to rate different classes of securities using the NRSRO's "universal scale" (i.e. rating municipal bonds on the same scale as corporate bonds).

Accountability

Financial gatekeepers are less likely to engage in negligent, reckless or fraudulent behavior if they are subject to a risk of liability for these behaviors. Rating agencies, however, are currently immune from such checks. In order to make NRSROs properly accountable, Congress must:

- Remove NRSROs' exemption from misstatements in registration statements in Section 11 of the Securities Act of 1933 and their exemption from liability as experts under Securities Act Rule 436; and
- Adopt legislation indicating that NRSROs are subject to private rights of action under specified statutory criteria.

Over the longer term, regulators and investors must also take action to enhance NRSRO accountability by broadening and deepening their reliance on alternative measures of credit risk and expanding their analysis of liquidity risk. But because institutional investors vary in the amount of time and money they can afford to spend on the analysis of credit and liquidity risks, and because alternatives to credit ratings are being refined, regulators and market participants should work closely to develop a process and timeline for the removal of references to credit ratings from regulations.

In the short run an immediate removal of regulatory references to credit ratings would leave a gap for certain investment processes, would harm investors by removing a minimal floor for some investment decisions and would disrupt the credit markets. However in the long run, institutional investors at large are likely to grow more comfortable with a regulatory move away from credit ratings. And as institutional investors continue to encourage the formation and development of alternative information markets, market pressures from the demand side should motivate the NRSROs to improve their performance and accountability.

Ultimately if credit rating agencies do not accept accountability for the manner in which they conduct their function within established industry standards and if the transparency of their function is not dramatically improved so as to allow investors to judge the appropriateness and reliability of the ratings, fiduciaries like Colorado PERA will no longer attribute value to the ratings and they will cease to contribute to our investment process. We respectfully suggest that the thoughtful reforms outlined above are appropriate and worthy steps necessary to reform the credit rating industry and protect the investor.

Again thank you for the opportunity to provide an investor's perspective of the challenges facing us in the area of credit rating regulation and I look forward to sharing thoughts and ideas at the Roundtable on April 15, 2009.

Respectfully submitted,
/s/
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General Counsel