INVESTMENT COMPANY INSTITUTE

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September 13, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Solicitation of Comment to Assist in Study on Assigned Credit Ratings (File No. 4-629)

Dear Ms. Murphy:

The Investment Company Institute[1] is pleased to respond to the Securities and Exchange Commission ("Commission") request for comment to assist with its study relating to the process for assigning credit ratings to structured finance products ("SFPs").[2] The study is required to address the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign a nationally recognized statistical rating organization ("NRSRO") to determine credit ratings for SFPs (hereinafter, "SFP Assignment System" or "System").[3] The study also is required to examine alternative models for improving the quality of SFP ratings, including reviewing the current process for rating such securities.

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.9 trillion and serve over 90 million shareholders.

[2] The study is being conducted pursuant to Section 939 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act"). *See* Solicitation of Comment to Assist in Study on Assigned Credit Ratings, SEC Release No. 34-64456 (May 10, 2011).

[3] The SFP Assignment System specifically refers to the proposed system to assign ratings to SFPs under Section 15E(w) of the Securities Exchange Act of 1934 as set forth in the Dodd-Frank Act. Following the study, the Commission must implement a rule, as it determines necessary or appropriate, to establish a system for the assignment of NRSROs to determine initial ratings for SFPs. The Act requires that the Commission implement the SFP Assignment System unless it determines that another system would better serve the public interest and the protection of investors.

As investors in the securities markets, ICI member funds use credit ratings in a variety of ways as part of their investment process. Consequently, they have a significant interest in the soundness of the credit rating system for all rated securities, including SFPs. For this reason, ICI has long supported NRSRO reforms, including many of those contained in the Dodd-Frank Act to enhance disclosure, transparency, management of conflicts of interest, and accountability in the ratings process.[4] Such measures are designed to address concerns about the credibility and reliability of credit ratings and seek to improve the quality of credit rating procedures.

We are concerned that instead of serving the public interest and the protection of investors, the SFP Assignment System may, as discussed below, confuse investors, hinder competition among NRSROs, and harm the SFP market. A more effective and appropriate manner to improve the quality of SFP ratings would neither single out a segment of the rated market nor impede competition among NRSROs and new entrants to the ratings industry. Instead, it would include a combination of steps designed to address the credit-rating process and the related regulatory controls for *all* rated securities. These measures would include: (1) implementing the other NRSRO provisions of the Dodd-Frank Act, including the legal accountability sections and its recently proposed changes to the regulatory framework for NRSROs; (2) enhancing the Rule 17g-5 Program for unsolicited ratings; and (3) improving issuer disclosures for SFPs. In conducting its study, we recommend that the Commission consider this multi-faceted solution as a superior alternative to the SFP Assignment System.

I. Proposed SFP Assignment System

Contrary to the goals of the Dodd-Frank Act, the SFP Assignment System would harm rather than improve the ratings process for SFPs. The System would establish a Credit Rating Agency Board ("Board") to assign one "qualified NRSRO" – as determined by the Board – to provide an initial rating for an SFP. Assigning a single NRSRO to a SFP in this way would stifle competition by precluding the possibility of multiple initial ratings on a security and perhaps a range of opinions and insights for investors to consider. Investors should be encouraged to pick and choose investment transactions using, to the extent they desire, the ratings from the various NRSROs, not a single NRSRO. The fact that the SFP Assignment System would permit an issuer to seek additional ratings from other NRSROs does not help because an issuer could not seek an additional rating until after obtaining an initial credit rating through the assignment process. Thus, at the time of the initial rating, only one NRSRO rating would be available.

The uncertainty created by the Board review process could also hamper competition. The Board would identify "qualified NRSROs" (*i.e.,* those eligible for assignment of SFP initial ratings) based on various criteria, including technical and institutional capacity, past performance and feedback

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[4] *See, e.g.,* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, dated August 8, 2011 ("ICI August 8, 2011 Letter").

from investors. Much of this information already is required as part of the NRSRO registration process. It is foreseeable that the additional regulatory burden and uncertainty associated with becoming a "qualified NRSRO," over and above becoming an NRSRO, would discourage NRSROs from entering the SFP ratings markets.

In addition, it is unclear how the pool of "qualified NRSROs" would grow within the SFP Assignment System if increases or decreases in ratings assignments are based on past performance. How would NRSROs develop the experience to receive initial ratings assignments for SFPs? Would they be tasked with developing a history of unsolicited ratings? This scenario seems unlikely to encourage new NRSRO entrants to the SFP ratings space.

Similarly, instead of insulating participating NRSROs from industry pressure to loosen rating standards, the SFP Assignment System has the potential to allow the quality of SFP ratings to deteriorate due to lack of competition. A limited number of NRSROs currently rate SFPs, and this number may remain static or even shrink. Further, if there are a limited number of "qualified NRSROs," it may be difficult to remove one from the pool without diminishing the credibility of the SFP Assignment System. This creates a "catch-22" situation which again calls into question the quality of the ratings produced under such circumstances.

The SFP Assignment System also creates the appearance of a "seal of approval" for the assigned rating by placing a government imprimatur on the rating, regardless of any disclaimer to the contrary. This effect is directly contrary to the directive to regulators in the Dodd-Frank Act to reduce reliance on ratings in the rules under their authority and is likely to create investor confusion.[5]

In addition, by singling out SFPs and highlighting their complexity, the System suggests to investors that they (1) should be especially wary of the SFP market and (2) are not qualified to assess such securities on their own. A separate assignment system for ratings of SFPs may act as a disincentive for some market participants to invest in these products, by tainting all SFPs as more risky without adequately differentiating between the risks each issuance may entail.

Importantly, the proposed SFP Assignment System would face its own conflicts of interest. A Board designating a rating agency allows for politicizing the rating process whereby the Board could be biased on how it chooses the "preferred" rating agency.[6] Conflicts could arise because Board

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[5] The Dodd-Frank Act requires regulators to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness" as the Commission determines to be appropriate. *See* Section 939A of the Dodd-Frank Act. Even if investors question the accuracy or value of a rating, in many cases, they are unlikely to disregard the rating altogether because it may be the most complete source of information on a particular security or issuer.

[6] Depending on how it was designed even a lottery or rotation system could allow for biases, particularly if the system permitted exceptions to be made to the assignment process.

members may have a strong interest in ensuring favorable ratings for a particular issuer or security. Consequently, we do not perceive an advantage to the proposed System over the existing NRSRO models, all of which possess various beneficial and detrimental characteristics.

With respect to operations, surveillance, fees and costs, the SFP Assignment System would seem to raise as many questions as it would seek to resolve. For example, what would be the criteria used for determining the "best performer" for purposes of assigning a rating agency to a new issue? Would an "A1" rating be deemed more accurate than an "A" rating? How would the Board define success or failure? Performance of debt securities in the municipal market, for example, has as much to do with structure and maturity of the security as with its credit. Drawing a line in the SFP market would be even more difficult because of the complexity, diversity, and novelty of this market. Further, who would be responsible for surveillance under this model – the Board, the Commission, the NRSROs? How would the fees and costs of the System be allocated in a way to minimize conflicts of interest but ensure quality ratings? Retail investors may rely on ratings produced by the SFP Assignment System but more institutional market participants may discount the quality and reliability of the ratings if the process of assigning ratings is not transparent or deemed flowed in some respect.

In the end, despite being included in the Dodd-Frank Act, the SFP Assignment System will not promote the goals of the Act such as increasing NRSRO competition and independence and mitigating conflicts of interest. As discussed, aside from concerns about costs and operational issues, the System has the potential to create numerous negative consequences for the SFP market, investors and the debt rating process as a whole. Creating a separate assignment system for SFPs would not benefit users of SFP ratings because such a system would not add to the quality, integrity or clarity of a SFP rating.

II. Recommendations for Improving the Credit Rating System

Taking into consideration the various costs and benefits of the numerous models for rating securities, including SFPs, ICI believes that the best solution to improve the credit rating system for SFPs while serving the public interest and the protection of investors involves multiple parts. First, the Commission should implement the rules necessary to effectuate the NRSRO reform provisions of the Dodd-Frank Act, with the exception of the SFP Assignment System. Particular attention should be given to the provisions on legal accountability and the provisions designed to provide investors with a better understanding of individual ratings, their reliability and their limitations. Second, the Commission should enhance the existing regulatory regime for unsolicited ratings ("Rule 17g-5 Program"). Third, the Commission should improve issuer disclosure for SFPs. Together, these steps should enhance the process for rating all debt securities, not just SFPs, without hindering NRSRO competition or harming the SFP market.

A. Implement Dodd-Frank Act Provisions – Accountability and Oversight Framework

ICI has consistently called for requiring NRSROs to have greater legal accountability for the quality of their ratings given the role of ratings in the investment process and the use of ratings by investors.[7] We were therefore pleased to see Congress take several measures to heighten potential liability for NRSROs in the Dodd-Frank Act by, for example, creating a private right of action for investors when NRSROs do not follow their own disclosed ratings policies and procedures. It is only fitting that a rating agency obtaining an NRSRO designation should be held accountable to the Commission and investors if it fails to follow that process. The Commission should actively pursue actions against NRSROs for failures to comply with their stated policies and procedures to provide "teeth" to the liability provisions in the Act.[8]

Likewise, we were pleased to see provisions in the Dodd-Frank Act that would address the unique exemptive status NRSROs have enjoyed from treatment as experts subject to liability under Section 11 of the Securities Act of 1933 for statements in registration documents.[9] The Dodd-Frank Act rescinded Rule 436(g) under the Securities Act of 1933 which provided that ratings included in a prospectus are not deemed part of a registration statement for purposes of Section 11. In response, rating agencies refused to allow issuers of SFPs to include their ratings in registration documents – a requirement for certain types of registration – effectively halting the SFP market.

The Commission provided issuers with temporary no-action relief to publish documents without ratings until such time as the Commission resolves the matter. The Commission has since proposed to eliminate the need for ratings in certain types of SFP offerings to address this situation.[10] We urge the Commission to move forward with efforts to address this problem. We further urge the Commission to fully implement the Dodd-Frank Act provisions related to NRSRO liability. Such measures should encourage NRSROs to improve the quality of their ratings and analysis. Quite simply, similar to other experts, NRSROs should be held legally accountable for their actions and should stand behind their product.

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[7] *See, e.g.,* Statement of Paul Schott Stevens, President and CEO, Investment Company Institute, SEC Roundtable on Oversight of Credit Ratings Agencies, dated April 15, 2009.

[8] Investigations and examinations presumably would be undertaken by the Commission's new Office of Credit Ratings, as established by Section 932 of the Dodd-Frank Act.

[9] *See, e.g.,* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, dated December 14, 2009.

[10] *See* Security Ratings, SEC Release Nos. 33-9245 and 34-64975 (July 27, 2011).

In addition, the Commission should move forward with its recently proposed, comprehensive set of rules to resolve weaknesses in the ratings process and NRSRO structures that contributed to the ratings inaccuracies leading into the 2008 financial crisis.[11] We recommend that the Commission allow such rules to take effect and operate for a meaningful amount of time (*e.g.,* at least a year) before again considering whether to impose the SFP Assignment System or a similar system on the SFPs market. In the end, credit ratings are informed opinions which play a significant role in the investment process. Accordingly, the Institute has repeatedly stated that improving disclosure and transparency about ratings and the ratings process may be the most important reform for improving the quality and reliability of ratings. Public disclosure of this information allows investors and market participants – the consumers of ratings – to more effectively evaluate a rating agency's independence, objectivity, capability, and operations.[12] It also allows them, and competing NRSROs, to evaluate in greater detail the analysis and assumptions of the rating agency, and to perform a more thorough analysis of their own. In addition, such disclosure serves as an additional mechanism for ensuring the integrity and quality of the credit ratings themselves.

B. Enhance Rule 17g-5 Program

The Rule 17g-5 Program creates a mechanism for unsolicited initial ratings for SFPs. Specifically, an NRSRO that is not hired to determine a rating may obtain the same information at the same time a hired NRSRO receives it from the issuer/sponsor via a password-protected Internet website. Similar to the SFP Assignment System, this program is designed to prevent the arranger of a SFP from selecting the NRSRO(s) that exclusively can determine the initial credit rating for the SFP. It does not, however, raise the many issues or create the unintended consequences associated with the System as discussed above. For example, by permitting simultaneous access to information needed to formulate a rating, the Rule 17g-5 Program applies necessary pressure to a hired NRSRO(s) to maintain quality ratings.

Nevertheless, ICI does recommend several enhancements to the Rule 17g-5 Program to encourage its use. First, the Commission should increase the percent of "free peeks" for unsolicited NRSROs, to account for the scope of the SFP market and the numerous variables associated with rating an SFP (*e.g.,* from 10 percent of the issued securities for which it accessed information to 25 percent). Under one prong of the Rule 17g-5 Program, unsolicited NRSROs are permitted to access the websites of ten issuers/sponsors arrangers to review potential SFPs before they must issue a rating. It may be that a new entrant to the SFPs' ratings space determines it is not qualified to rate the first twelve SFPs it reviews, which, our members inform us, would not be surprising. The 10 percent limitation would prevent that NRSRO from producing an unsolicited rating for the remainder of the year.

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[11] Proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC Release No. 34-64514 (May 18, 2011).

[12] We do not think the proposed System adds greater clarity or transparency to the ratings of SFPs than provided by the existing ratings process, as proposed to be enhanced by the Commission's recently proposed rules.

Second, the Commission should evaluate the confidentiality considerations and limitations that have arisen around the Rule 17g-5 Program and prohibit terms of use on an Internet website by an unsolicited NRSRO that are more stringent than terms agreed to by any NRSRO hired to produce a SFP rating. It is our understanding that some arrangers are holding unsolicited NRSROs to different and higher standards regarding the confidentiality terms and conditions of use of information than hired NRSROs. As a result, some NRSROs are unable to issue unsolicited ratings or include certain information in their ratings rationale regarding how the rating was derived. Further, some issuers allegedly are being advised by arrangers or counsel not to answer questions from NRSROs under the pretense of confidentiality concerns. Although we do not know the extent or prevalence of such incidents, the mere occurrence is counter to the transparency that is critical to improving the quality of ratings and the ratings process. We urge the Commission quickly to explore this matter and rectify any developing conduct that inappropriately stands in the way of enhancing competition or the accuracy of ratings and ratings procedures.

C. Improve Issuer Disclosure

More rigorous disclosure requirements are needed for offerings of SFPs to ensure that investors are able to formulate their own informed investment decisions at the time of initial purchases and on an ongoing basis. To this end, we repeatedly have recommended and supported the expansion of disclosure of information to investors by rating agencies.[13] We also have recommended that the Commission require issuers to provide investors with increased information about SFPs.[14] Recently, the Commission has opted to do just that in the case of asset-backed securities. We commend the Commission for those efforts and encourage additional similar efforts with respect to other types of SFPs.[15]

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[13] *See, e.g.,* ICI August 8, 2011 Letter, *supra* note 4. We also have called for the Commission to require that information made available to NRSROs also be made available to investors to assist with their investment decisions. *See, e.g.,* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, dated March 26, 2009.

[14] *See, e.g.,* Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, dated February 2, 2010 and August 2, 2010.

[15] *See* Suspension of the Duty to File Reports for Classes of Asset-Backed Securities under Section 15(d) of the Securities Exchange Act of 1934, SEC Release No. 34-65148 (August 17, 2011) and Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, SEC Release Nos. 33-9175 and 34-63741 (January 20, 2011). *See also*, Letters from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, dated February 1, 2011 and November 15, 2010, (commenting on the Commission proposals).

If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, Heather Traeger at (202) 326-5920 or Frances Stadler at (202) 326-5822.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
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