INVESTMENT COMPANY INSTITUTE

Paul Schott Stevens, PRESIDENT & CEO

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May 13, 2010

The Honorable Harry Reid
Senate Majority Leader
S-221, The Capitol
Washington, DC 20510

The Honorable Mitch McConnell
Senate Minority Leader
S-230, The Capitol
Washington, DC 20510

The Honorable Christopher J. Dodd
Chairman
Senate Banking Committee
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard C. Shelby
Ranking Minority Member
Senate Banking Committee
304 Russell Senate Office Building
Washington, DC 20510

Re: Senate Amendment #3991, Credit Ratings

Dear Senators:

I am writing on behalf of the Investment Company Institute,[1] the national association of U.S. investment companies, to express our concerns with elements of Senate Amendment 3991 to S. 3217 of the Restoring American Financial Stability Act of 2010 (RAFSA). The Institute is highly supportive of the majority of rating agency reforms contained in the RAFSA, which focus primarily on disclosure and transparency of ratings and the ratings process. As long as ratings continue to play an important role in the investment process, they should provide investors and other market participants with high-quality, reliable assessments of the credit risks of a particular issuer or financial instrument.[2] We are concerned,

[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 $11.94 trillion and serve almost 90 million shareholders.

[2] Since well-before the discussions leading to the adoption of the Credit Rating Agency Reform Act of 2006, the Institute has repeatedly recommended and supported measures to improve the quality, accuracy, and integrity of ratings and the rating process. *See, e.g.,* Statements of Paul Schott Stevens, President, Investment Company Institute, on the "Credit Rating Agency Duopoly Relief Act of 2005," before the Committee on Financial Services, U.S. House of Representatives (November 29, 2005) and on "Assessing the Current Oversight and Operation of Credit Rating Agencies," before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (March 7, 2006). *See also,* Statement of Paul Schott Stevens, President and CEO, Investment Company Institute, at the SEC Roundtable on Oversight of Credit Rating Agencies, April 15, 2009.

however, that Amendment 3991, which would create a Credit Rating Agency Board to regulate structured finance product ratings, may conflict with the RAFSA, create confusion for investors, and hinder competition in the rating agency space. Presented at the last minute, the changes contemplated by the Amendment would significantly alter the current regulatory regime for rating structured finance products and could, ultimately, affect the rating process for other debt securities.

First, to properly address concerns about conflicts of interest, poor disclosure, and lack of accountability, the Institute believes the reform of the regulatory structure for rating agencies must be applied in a uniform and consistent manner and should apply equally to all types of rated securities. This uniformity and consistency is not only critical to improving ratings quality and allowing investors to identify and assess potential conflicts of interest, but also to increasing competition among rating agencies. By focusing solely on structured finance securities, the Amendment would create a different set of rules for different segments of the rated marketplace which, among other issues discussed below, could create confusion among investors.[3]

Second, establishing an additional and distinct oversight system for ratings of structured finance securities, as outlined in the Amendment, does not improve investor access to information about these securities.[4] The Institute believes that issuers, in addition to credit rating agencies, have a role to play in the effort to increase transparency and disclosure about structured finance products, as well as for other debt instruments. To this end, we have recommended that the Commission expand the disclosure of information to investors by rating agencies.[5] We also have recommended that the Commission take additional steps to provide investors with increased information by requiring increased disclosure directly by issuers to investors, and requiring the disclosure be in a standardized format where appropriate. In its recent proposal to revise the asset-backed securities regulatory regime, for example, the Commission has proposed to do just that – expand and standardize issuer disclosure in public and private offerings of asset-backed securities – and we commend the Commission for its efforts.

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[3] By creating multiple sets of rules for the assignment of ratings to different classes of securities, the Amendment moves away from other parts of the RAFSA which seek to improve transparency by harmonizing rating agency treatment of debt securities.

[4] Improvements to transparency and disclosure can be, and are being, achieved under the existing regulatory structure through rulemaking by the U.S. Securities and Exchange Commission without the confusion associated with another layer of regulation. *See, e.g., Amendments to rules for Nationally Recognized Statistical Rating Organizations,* SEC Release No. 34-61050 (November 23, 2009), 74 FR 63866 (December 4, 2009). We believe that existing Commission proposals in combination with the majority of provisions in the RAFSA should improve access to information for investors.

[5] *See* Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated September 5, 2008.

Third, we are concerned that having a Board assign a rating agency to a structured finance product stifles competition by denying the market of two or more ratings on a security and perhaps differing opinions and insights. Investors should be encouraged to pick and choose investment transactions using, to the extent they desire, the ratings they receive from the various rating agencies, not a single agency. Further, this approach creates the appearance of a "seal of approval" for the assigned rating by placing a government imprimatur on the rating, regardless of the proposed disclaimer contemplated by the Amendment. The fact that the Amendment would permit unsolicited ratings of an assigned security becomes meaningless under the proposed framework; as in the status quo, it will rarely, if ever, be done.

Fourth, a Board designating a rating agency allows for politicizing the rating process, even if it is by a lottery or rotation, whereby the Board could be biased on how it chooses the "preferred" rating agency. Conflicts can arise because Board 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 Board-model over the existing rating agency models, all of which possess various beneficial and detrimental characteristics.

Fifth, what will be the criteria used for determining the "best performer" for purposes of assigning a rating agency to a new issue? Is an 'A1' rating more correct 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 structured finance market would be even more difficult because of the complexity, diversity, and novelty of this market.[6] Further, who would be responsible for surveillance under this model – the Board, the Commission, the rating agencies?

We believe that education regarding the characteristics and limitations of a rating would be of more value to investors than the operational and policy concerns raised by the Amendment. In the end, credit ratings are informed opinions which play a significant role in the investment process.[7] 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

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[6] Moreover, it is often too late to determine if a rating is "wrong." For example, during the 2008 financial crisis, the rating agencies assigned AAA ratings to bonds that were near or at default status. By this time, it is often too late to help bondholders.

[7] We believe that the opinion cannot, however, be issued in contravention of a rating agency's own disclosed procedures and standards. Otherwise, investors are not able to evaluate the quality of the rating. Likewise, the Institute believes that is it critical for ratings agencies to conduct due diligence on the information they review to issue ratings to provide investors with confidence regarding the accuracy and quality of the rating.

more effectively evaluate a rating agency's independence, objectivity, capability, and operations. Such disclosure also serves as an additional mechanism for ensuring the integrity and quality of the credit ratings themselves.

We appreciate the substantial progress made in the RAFSA to improve the ratings process and we look forward to continuing to work with the Senate for the benefit of investors in this area.

Sincerely,

Paul Schott Stevens
President and Chief Executive Officer
Investment Company Institute

CC: Members of the United States Senate