United States Senate
WASHINGTON, DC 20510

January 8, 2014

The Honorable Mary Jo White
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman White,

We write to urge the Securities and Exchange Commission ("the Commission") to promptly address the ongoing conflicts of interest in the credit rating industry. In the years leading up to the 2008 financial collapse, the credit rating agencies enjoyed substantial profits by providing credit ratings for new types of complex structured financial products. But the credit rating industry's business model, where banks directly pay credit rating agencies to provide ratings of their financial products, was and continues to be plagued by conflicts of interest.

Credit raters know that if they do not provide the rating that an issuer wants, that issuer can just go to a competing credit rating agency and seek a higher rating, a problem known as "ratings shopping." Unsurprisingly, ratings shopping led to junk products, such as subprime mortgage-backed securities, receiving AAA ratings. These inflated ratings built up our financial sector like a house of cards. That house of cards collapsed in 2008 and helped bring our entire economy down with it.

To address the conflicts of interest in the credit ratings industry, Congress instructed the Commission to study this problem and issue a report. After submitting the report, the Commission is authorized to establish a system "for the assignment of nationally recognized statistical rating organizations to determine the initial credit ratings of structured finance products" to prevent conflicts of interest with a product's issuer, sponsor, or underwriter.[1]

Moreover, the amendment states that "by rule, as the Commission determines is necessary or appropriate in the public interest or for the protection of investors" the Commission "shall implement the system" as passed by the Senate "unless the Commission determines that an alternative system would better serve the public interest and the protection of investors."[2] After completing its report on credit ratings in December 2012, the Commission has not moved forward with these much-needed reforms.

There is ample evidence to suggest that the public interest conflicts present in the credit ratings agency business model that played a key role in the financial collapse five years ago persist. Numerous news reports, such as the attached *New York Times* articles, indicate that these

[1] Public Law 111-203 § 939F(d)(1)
[2] *Id.*

conflicts continue to leave retirees, investors, and our entire economy vulnerable. Therefore, we urge the Commission to prioritize credit ratings reforms that address conflicts of interest, increase transparency, and promote competition in the credit ratings industry.

In light of these ongoing problems, we request a response to the following questions:

(1) What actions is the Commission taking to ensure that the interests of public investors, particularly those investors representing large public investments such as pension and retirement accounts, are taken into account moving forward in its review of conflict of interest reforms? What is the timeline for those actions?

(2) The Commission's December 2012 staff report notes the conflicts of interests that continue to exist, stating that the current model "presents an inherent conflict of interest because the arranger has an economic interest in obtaining credit ratings that are demanded by investors and that lower the issuer's financing costs and the NRSRO has an economic interest in having the arranger hire it in the future;"[3] and cites a study indicating that for a credit rating agency "the more revenue a product brings in, the lower the ratings standards are for that product."[4] Does this finding reinforce the need for fundamental reforms to protect the public interest in the credit rating system? If not, why not?

(3) During a roundtable on May 14, 2013, the Commission discussed assigning nationally recognized statistical rating organizations to determine the initial credit ratings of structured finance products in order to prevent conflicts of interest with a product's issuer, sponsor, or underwriter, as well as other alternative credit rating agency reform proposals as part of its efforts to consider approaches and appropriate responses to the study's findings. What analysis has the Commission undertaken as a result of the roundtable?

   a. What further analysis does the Commission anticipate completing in order to make its determination of whether reforms are "necessary or appropriate in the public interest or for the protection of investors"[5]?

   b. What is the timeline for completing such analysis?

Thank you for your attention to this important matter. Please provide a response by February 8, 2014. If you have any questions, please contact Amanda Perez in Senator Franken's office at (202) 224-5641 and Chris Lucas in Ranking Member Grassley's office at (202) 224-6962.

Sincerely,

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[3] U.S. Securities and Exchange Commission, "Report to Congress on Assigned Credit Ratings," December 24, 2012, p. 12, http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf

[4] *Id.*

[5] Public Law 111-203 § 939F(d)(1)

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