



Via Facsimile

October 26, 2009

The Honorable Barney Frank  
Chairman, House Committee on Financial  
Services  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

The Honorable Spencer Bachus  
Ranking Member, House Committee on  
Financial Services  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

The Honorable Paul E. Kanjorski  
Chairman, Subcommittee on Capital  
Markets, Insurance, and Government  
Sponsored Enterprises  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

The Honorable Scott Garrett  
Ranking Member, Subcommittee on  
Capital Markets, Insurance, and  
Government Sponsored Enterprises  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

Dear Chairman Frank, Subcommittee Chairman Kanjorski, Ranking Member Bachus and Subcommittee Ranking Member Garrett:

I am writing on behalf of the Council of Institutional Investors (“Council”), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.

As a leading voice for long-term, patient capital, the Council welcomes the Committee on Financial Services’ (“Committee”) pending mark-up of the “Accountability and Transparency in Rating Agencies Act” (“Act”). As indicated in our letter of October 22, 2009, “we are pleased to provide our general support for the discussion draft given its adherence to our basic principles.”<sup>1</sup>

Our basic principles with respect to the regulation of credit rating agencies include:

- Securities and Exchange Commission oversight should be enhanced;
- Internal controls and governance should be strengthened;
- Transparency and disclosures should be expanded;
- Standards of accountability should be raised; and
- Reliance on ratings should be reduced.<sup>2</sup>

<sup>1</sup> Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Barney Frank, Chairman, Committee on Financial Services, United States House of Representatives et al. 1 (Oct. 22, 2009), available at

[http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/CII%20Letter%20on%20Credit%20Rating%20Agency%20Reform%2010-22-09%20\(FINAL\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/CII%20Letter%20on%20Credit%20Rating%20Agency%20Reform%2010-22-09%20(FINAL).pdf).

<sup>2</sup> *Id.*



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We note that our principles are generally consistent with the specific recommendations of the Investors' Working Group ("IWG") in its July 2009 report – *U.S. Financial Regulatory Reform: The Investors' Perspective* ("IWG Report").<sup>3</sup> The IWG, is an independent blue ribbon panel of industry and market experts created by the CFA Institute Centre for Financial Market Integrity and the Council to study and report on financial regulatory reform from the viewpoint of investors. The Council membership endorsed the findings and recommendations of the IWG Report at its meeting earlier this month.

It is our understanding that Representative Mary Jo Kilroy plans to offer the following two amendments at tomorrow's Committee mark-up of the Act:

**SEC. 2. ENHANCED REGULATION OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.**

Strike section 2 (h) (1) (B) and insert the following:

(B) INDEPENDENT DIRECTORS.—At least 2/3 of such board shall be independent directors. For purposes of this subsection, an independent director is a person whose directorship constitutes his or her only connection to the nationally recognized statistical rating organization or any affiliated company thereof.

**SEC. 9. EFFECT OF RULE 436(G).**

Rule 436(g), promulgated by the Securities and Exchange Commission under the Securities Act of 1933, shall have no force or effect.

The purpose of this letter is to express our support for both of the above proposed amendments.

Independent Directors Amendment

It is generally accepted that inaccurate and unreasonable credit ratings issued by Nationally Recognized Statistical Rating Organizations ("NRSROs") played a central role in the current financial crisis. We believe the NRSROs' board of directors share some responsibility for this failure.

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<sup>3</sup> Investors' Working Group, U.S. Financial Reform: The Investors' Perspective 21 (July 2009), [http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20\(July%202009\).pdf](http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf).



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The Council has long maintained that independence is critical to properly functioning boards.<sup>4</sup> Thus, as indicated in our letter of October 22, 2009, we support the existing provisions of the discussion draft that provide for independent directors for NRSROs.<sup>5</sup>

We, however, believe that Representative Kilroy's proposed amendment to replace existing Sec. 2(h)(1)(B) with a new provision provides two important improvements that strengthen the discussion draft.<sup>6</sup> First, the proposed amendment requires that "[a]t least 2/3" of the board be independent, rather than the existing "[a]t least 1/3."

Second, Representative Kilroy's proposed amendment narrows the definition of and independent director contained in existing Sec. 2(h)(1)(B). Both proposed changes are consistent with long-standing Council policy and, in our view, reflect current best practices in corporate governance.<sup>7</sup>

#### Rule 436(G) Amendment

The Council agrees with the IWG that NRSROs have generally escaped accountability for their shoddy performance and poorly managed conflicts of interest, at least in part, because of their statutory exemption from liability.<sup>8</sup> As also indicated in our letter of October 22, 2009, the Council supports the existing provisions of the discussion draft that firmly subject NRSROs to high standards of accountability for their actions and inactions by holding the agencies legally liable through private rights of action.<sup>9</sup> We, however, also support Representative Kilroy's proposed Rule 436(g) amendment as an important supplement to those provisions.

Given the prominent role that NRSROs played in the financial crisis, there is simply no valid reason that we are aware of that continues to justify providing those organizations with an effective exemption from liability under Section 11 of the Securities Act of 1933.<sup>10</sup> Representative Kilroy offers a simple, straightforward proposed amendment that eliminates that exemption. We note that the proposed amendment is consistent with the recommendations of the IWG,<sup>11</sup> and, in our view, is clearly in the best interests of investors.

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<sup>4</sup> Letter from Jeff Mahoney, *supra* note 1, at 3.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* & nn.9-10.

<sup>8</sup> Investors Working Group, *supra* note 3, at 20.

<sup>9</sup> Letter from Jeff Mahoney, *supra* note 1, at 3.

<sup>10</sup> See Investors Working Group, *supra* note 3, at 20.

<sup>11</sup> *Id.* at 21 ("Congress should eliminate the effective exemption from liability provided to credit rating agencies under Section 11 of the Securities Act of 1933 for ratings paid for by the issuer to offering participants.").



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We again very much appreciate your leadership in pursuing this legislation and offer our general support for its prompt passage. If you have any questions, please feel free to contact me at (202) 261-7081 or [jeff@cii.org](mailto:jeff@cii.org), or Council senior analyst Laurel Leitner at (202) 261-7086 or [laurel@cii.org](mailto:laurel@cii.org).

Sincerely,

A handwritten signature in black ink that reads "Jeff Mahoney".

Jeff Mahoney  
General Counsel

CC: The Honorable Mary Jo Kilroy