



Via Facsimile

June 14, 2010

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

The Honorable Spencer Bachus
Ranking Member
House Committee on Financial Services
B371a Rayburn House Office Building
Washington, DC 20515

The Honorable Christopher Dodd
Chairman
Senate Committee on Banking, Housing, and
Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member
Senate Committee on Banking, Housing, and
Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Frank, Chairman Dodd, Ranking Member Bachus and Ranking Member Shelby:

As you confer on the composition of financial regulatory reform legislation, I am writing on behalf of the Council of Institutional Investors (Council) to reiterate our strong support for provisions designed to enhance the oversight and accountability of credit rating agencies registered as Nationally Recognized Statistical Rating Organizations (NRSROs).

A nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion, the Council represents major, long-term investors with a duty to protect the retirement savings of millions of American workers across the country. Deeply affected by the financial crisis, our member funds have a profound interest in meaningful financial regulatory reform. Given the “central role that rating agencies played in the financial crisis,” Council members have a strong interest in ensuring that NRSROs face robust oversight and genuine accountability.¹

Based on our policy statement on financial gatekeepers² and the recommendations of the blue-ribbon Investors’ Working Group (IWG),³ the Council believes that any legislation reforming the credit ratings industry must advance the following basic goals:

- Expand the Securities and Exchange Commission’s (SEC) authority to oversee credit rating agencies;
- Enhance transparency and disclosures;
- Strengthen internal controls and governance;
- Raise standards of accountability; and
- Reduce reliance on ratings.

¹ Investors Working Group. “U.S. Financial Regulatory Reform: The Investors’ Perspective” (July 2009), at 20, www.cii.org/UserFiles/file/IWGreport.pdf. For more information, please visit www.cii.org/iwginfo.

² Council of Institutional Investors, Statement on Financial Gatekeepers (adopted May 16, 2008), www.cii.org/UserFiles/file/Statement%20on%20Financial%20Gatekeepers.pdf.

³ Investors Working Group, *supra* note 1, at 21.

Both the House and Senate versions of financial reform legislation closely align with these principles. Nevertheless, as Congress works to resolve differences between the versions, the Council believes there are a few key areas in need of particular attention by the conference committee.

Internal Controls and Governance

Executive Level Compliance Officer

Under current regulations, an NRSRO is required to designate a compliance officer responsible for administering the requisite policies and procedures and for ensuring compliance with the securities laws and rules and regulations. As evidence presented to Congress during hearings last fall demonstrates, lax internal controls and minimal accountability have allowed conflicts of interest to flourish unfettered. There is an immediate need to bolster the authority and responsibilities of the compliance officer. Consistent with the recommendations of the IWG, the Council strongly supports sec. 6002 of the House's *Wall Street Reform and Consumer Protection Act of 2009* (H.R. 4173) which elevates the compliance officer to an executive level position reporting to the NRSRO's board of directors.⁴ This provision should be incorporated into final regulatory reform legislation.

Board Independence

The Council has long maintained that independence is critical to properly functioning boards. In that respect, the Council's corporate governance policies hold that all public corporations should have a board consisting of at least two-thirds independent directors.⁵ We therefore strongly encourage the conference committee to consider further strengthening NRSRO board independence. At a minimum, the conference committee should raise board independence of NRSROs to a majority standard by retaining sec. 932 of the Senate's *Restoring American Financial Stability Act of 2010* (S. 3217).

Accountability

Although their tainted ratings played a central role in the recent financial crisis, 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. While the Council applauds the many provisions of both the House and Senate bills that would bolster the SEC's oversight authority, expand disclosure requirements and enhance internal controls, we believe that these will not alone create an adequate system of checks and balances. Effective legislation must eliminate NRSROs' unparalleled exemption from liability under Section 11 of the Securities Act of 1933. Therefore, the Council strongly supports the inclusion of sec. 6012 of H.R. 4173 in the final regulatory reform legislation as proposed today by Chairman Frank. This provision would nullify Rule 436(g) under the Securities Act and once again subject NRSROs to liability for making false or misleading statements when their ratings are included in registration statements.

⁴ *Id.* at 21.

⁵ Council of Institutional Investors, Corporate Governance Policies, § 2.3 (updated April 13, 2010), www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%204-13-10.pdf.

We note that rescinding the Section 11 exemption from liability would not expose NRSROs to litigation when their ratings turn out to be “wrong,” as some suggest. Rather, it would hold these gatekeepers to the same liability standards other experts, including accountants and non-NRSRO credit rating agencies, must meet when their opinions are used in registration statements. This provision will cause NRSROs to be more diligent about their ratings processes and management of conflicts of interest. It would also instill a sense of accountability within the ratings industry. Allowing the protective barrier to remain would impede the significant progress Congress has made in reforming the industry.

Fair Disclosure

A select few rating agencies, namely those registered as NRSROs, have long enjoyed an exemption from Regulation Full Disclosure (Regulation FD) which permits them to receive inside information from issuers that is not shared with the public or other rating agencies. We believe this exemption is no longer warranted.⁶ The Council, therefore, strongly supports Chairman Frank’s proposal to include sec. 6007 of H.R. 4173 in the base text.

Granting NRSROs unfettered access to material non-public information generates the perception that NRSRO ratings are more reliable than other sources of information, thus perpetuating lawmakers, regulators and market participants’ undue reliance on NRSRO ratings. Moreover, NRSROs’ exemption further cements the competitive advantage of those few organizations that have continued to dominate the industry. Greater competition within the industry would provide investors with a wider range of views on the risk profiles of securities.

Thank you for considering the views of the Council. We look forward to continuing to work with you and the SEC to strengthen further the oversight and accountability of credit rating agencies designated as NRSROs. If you have any questions, please do not hesitate to contact me at (202) 261-7081 or jeff@cii.org, or Council Senior Analyst Laurel Leitner at laurel@cii.org or (202) 261-0786.

Sincerely,



Jeff Mahoney
General Counsel
Council of Institutional Investors

CC: House and Senate Conferees (Via E-Mail)

⁶ 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. 27, 2009), available at <http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/10-27-09%20Council%20letter%20to%20Rep%20%20Speier%20amendment.pdf>.