

January 13, 2023

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0609

**Re: Petition for Policy Clarification on Credit Rating Agencies**

Dear Ms. Countryman,

We are a diverse group of researchers and policy advisors who care about the role of credit rating agencies in securities markets.<sup>1</sup> We represent a wide range of views, and we do not agree about every detail regarding the regulation of credit rating agencies.

However, we share the objectives of promoting the accuracy and reliability of credit ratings, and the transparency and accountability of credit rating agencies. Congress shared these objectives when it included credit rating agency reforms in the Dodd-Frank Act. Today, we ask the Commission to join us, and Congress, and demonstrate that it shares these objectives as well.

We applaud the Commission for implementing many Dodd-Frank reforms related to credit rating agencies. Yet notwithstanding these efforts, both credit ratings and credit rating agencies continue to play a central, and often troubling, role in our financial system.

In this petition, we ask the Commission to finish this aspect of the important work that Dodd-Frank mandated. Specifically, we seek clarification of important Commission policies that are contrary to Dodd-Frank, where credit rating agency reform remains unfinished and Congressional objectives remain unfulfilled. We request that the Commission reassess its approach to the oversight and accountability of credit rating agencies to ensure that credit ratings provide accurate and reliable information about issuers' credit risk to investors and that credit rating agencies do not engage in misconduct that puts our financial system at risk.

Specifically, we propose that the Commission:

- Clarify that Office of Credit Ratings annual reports will **include NRSRO<sup>2</sup> names.**
- Clarify that NRSROs are **subject to liability under Section 11.**
- Clarify **how Regulation FD applies to NRSROs.**

We begin below with some background on the reasons for our petition. Then we discuss these three straightforward policy clarifications. We believe the Commission could implement

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<sup>1</sup> This petition was drafted by staff of the International Institute of Law and Finance, a non-profit, non-partisan corporation. *See* iilawfin.org. No signatories here received compensation for the petition.

<sup>2</sup> The term "NRSRO" refers to "Nationally Recognized Statistical Ratings Organizations."

these clarifications immediately based on its current statutory authority, without the need to propose new rules. These clarifications are important. Indeed, our view is that **these clarifications are necessary in order to comply with the statutory mandate of Dodd-Frank Act**,<sup>3</sup> as we describe below.

These clarifications are particularly important now, given the challenges facing the U.S. economy and financial markets. Recent research has documented the increasing risks associated with the continued lack of oversight of credit rating agencies and particularly the risks associated with the recent growth of securitization markets.<sup>4</sup> Now is the time for the Commission to respond.

## **I. Background**

We believe there is a strong need to put academic research in front of the Commission. Nowhere is this need stronger than with respect to credit ratings and credit rating agencies. One of our primary goals in this petition is to provide the Commission with the relevant academic research to help ensure that its approach is consistent with the statutory mandate of Dodd-Frank.<sup>5</sup>

Academics have long recognized the unique and important role of credit rating agencies in financial markets.<sup>6</sup> Historically, credit rating agencies provided valuable information about the risk associated with particular debt issues. Specifically, credit ratings were designed to help market participants assess probability of default and likely recovery in the event of default. During the 1980s and 1990s, the scholarly consensus about credit rating agencies centered on the “reputational capital” view, a theory, based on information economics,<sup>7</sup> that credit rating

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<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 780). For a discussion of the Dodd-Frank reforms related to credit rating agencies, see Aline Darbellay & Frank Partnoy, *Credit Rating Agencies under the Dodd-Frank Act*, 30 BANKING & FINANCIAL SERVICES POLICY REPORT 1, 2 (2011); Aline Darbellay & Frank Partnoy, *Credit Rating Agencies and Regulatory Reform*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATION LAW (Claire A. Hill & Brett McDonnell, eds. 2012).

<sup>4</sup> See Americans for Financial Reform Education Fund, *A Giant in the Shadows: Subprime Corporate Debt*, Jan. 2023, <https://ourfinancialsecurity.org/wp-content/uploads/2023/01/1.6.23-Subprime-Corporate-Debt-A-Giant-in-the-Shadows.pdf>.

<sup>5</sup> This petition is based on, and quotes extensively from, Frank Partnoy, *What's (Still) Wrong with Credit Rating Agencies*, 92 WASH. L. REV. 1407 (2017).

<sup>6</sup> Credit rating agencies have been a topic of academic interest since well before the recent financial crisis. See GILBERT HAROLD, BOND RATINGS AS AN INVESTMENT GUIDE: AN APPRAISAL OF THEIR EFFECTIVENESS 6 (1938) (discussing the history of credit ratings and the increased reliance on ratings in the aftermath of the 1929 market crash); W. BRADDOCK HICKMAN, CORPORATE BOND QUALITY AND INVESTOR EXPERIENCE (1958) (analyzing default rates based on different ratings categories); Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619, 628-36 (1999) (discussing the early academic literature on credit rating agencies).

<sup>7</sup> Information economics dominated the thinking of legal scholars throughout the 1980s and 1990s. See John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA L. REV. 717, 751 (1984); Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984); Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient*

agencies survived and prospered based on their ability to generate and aggregate credible information about debt issues.<sup>8</sup> The essence of the reputational capital view is that credit rating agencies fill an important need arising from the information asymmetry between issuers and investors: credit rating agencies were seen as reputational intermediaries that bridged the information gap, not unlike restaurant or movie reviewers, except that they used letters (such as AAA) instead of stars or tomatoes.<sup>9</sup>

Beginning in 1999, a more critical alternative view of credit rating agencies emerged, known as the “regulatory license” view, based in large part on the empirical observation that regulators and market participants increasingly relied on credit ratings in substantive legal rules, and that this regulatory reliance distorted the market for credit ratings.<sup>10</sup> The essence of the regulatory license view is that credit rating agencies might be important, but it is not because

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*Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985); Marcel Kahan, *Securities Law and the Social Costs of “Inaccurate” Stock Prices*, 41 DUKE L.J. 977 (1992); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995); Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance*, 85 CAL. L. REV. 1 (1997).

<sup>8</sup> For example, Ronald Gilson and Reinier Kraakman described credit rating agencies as one of several reputational intermediaries (including underwriters and auditors) that pledged reputational capital as a commitment to support their role collecting and disseminating information in financial markets. See Ronald J. Gilson and Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 604 (1984) (describing “information intermediaries” and noting that “in the financial markets, the most obvious example is the role played by rating agencies such as Standard & Poor’s and Moody’s”). Similarly, Stephen Choi and Jonathan Macey described credit rating agencies as reputational intermediaries that played a private certification role without regulatory support. See Stephen Choi, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916, 934 (1998) (citing Standard & Poor’s and Moody’s as examples of how “intermediaries play a certification role without any regulatory intervention”); Jonathan R. Macey, *Wall Street Versus Main Street: How Ignorance, Hyperbole, and Fear Lead to Regulation*, 65 U. CHI. L. REV. 1487, 1500 (1998) (praising credit rating agencies and concluding: “Indeed, the only reason that rating agencies are able to charge fees at all is because the public has enough confidence in the integrity of these ratings to find them of value in evaluating the riskiness of investments.”); see also George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1110 (1995) (“Information intermediaries, such as securities analysts or credit rating agencies, facilitate such conventions by decoding ambiguous signals.”).

<sup>9</sup> Early on, financial economists have viewed credit ratings as screening mechanisms for information that is unavailable publicly and as attempts to distinguish among issuers of inferior quality and thereby avoid “average quality pricing.” See Joseph E. Stiglitz, *The Theory of “Screening”, Education, and the Distribution of Income*, 65 AM. ECON. REV. 283, 283 (1975); George A. Akerlof, *The Market for “Lemons”: Qualitative Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488, 488 (1970).

<sup>10</sup> See Partnoy, *Siskel and Ebert*, at 683-706 (describing the “regulatory license” view); see also Daniel Cash, *Credit Rating Agency Regulation Since the Financial Crisis: The Evolution of the “Regulatory License” Concept*, in REGULATION AND THE GLOBAL FINANCIAL CRISIS, D. Cash & R. Goddard, eds. (2020). Other scholars subsequently have noted that the “reputational capital” and “regulatory license” views are the two standard theories about the role of credit rating agencies. See Robert J. Rhee, *Why Credit Rating Agencies Exist*, 44 ECON. NOTES 161, 168 (2015); Robert J. Rhee, *On Duopoly and Compensation Games in the Credit Rating Industry*, 108 NW. L. REV. 86 (2014); see also Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34-72936, 109 SEC Docket 3429 (Oct. 14, 2014) (describing the increase in regulatory reliance on ratings).

they provide valuable information. Instead, credit ratings are valuable primarily because regulatory reliance on credit ratings, and the associated sticky norms that have arisen,<sup>11</sup> effectively convert ratings into a kind of financial “license” that unlocks access to the markets, even if the ratings themselves have little or no informational value, specifically with regard to their ability to accurately and reliably assess the likelihood of a default of an issuer and the potential financial loss suffered in the event of a default.

Before the introduction of regulation that depended on ratings, the credit rating business was small and relatively unprofitable.<sup>12</sup> But regulatory reliance on credit rating agencies increased starting during the mid-1970s from references in statutes and rules to NRSROs, particularly including the two most prominent rating agencies, Moody’s Investors Service, Inc. and S&P Global Ratings Inc., and – to a lesser extent – Fitch, Inc.; as regulatory licenses proliferated, NRSROs became both more profitable and less informative.<sup>13</sup>

During the 2000s, scholarly debate about the above two theoretical frameworks was mixed.<sup>14</sup> On one hand was the argument that, notwithstanding some prominent miscues (such as Enron’s investment grade credit ratings shortly before its bankruptcy in 2001), credit ratings overall were correlated with fixed income default experience and arguably reflected at least some information about issuers’ creditworthiness. On the other hand was the argument that regulatory reliance on credit rating agencies continued to increase throughout this time, even while sophisticated market participants viewed credit ratings more skeptically.<sup>15</sup>

Likewise, before 2007, regulators’ views of credit rating agencies were mixed. Some regulators were sympathetic to the important role of credit ratings in financial markets; others were critical of potential problems related to that role, including perceptions of agency costs and conflicts of interest.<sup>16</sup> In 2006, Congress adopted modest reforms to address perceived problems associated with credit rating agencies, even as regulators in a wide variety of areas continued to rely substantively on credit ratings.<sup>17</sup>

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<sup>11</sup> See Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L. Q. 43, 44 (2004); see also Claire A. Hill, *Limits of Dodd-Frank’s Rating Agency Reform*, 15 CHAP. L. REV. 133 (2011).

<sup>12</sup> See Partnoy, *Siskel and Ebert*, at 636-48.

<sup>13</sup> See *id.* at 692-94.

<sup>14</sup> See Jeffrey Manns, *Rating Risk After the Subprime Mortgage Crisis: A User Fee Approach for Rating Agency Accountability*, 87 N.C. L. REV. 1011 (2009) (giving an overview of credit ratings agencies and the problems with their ratings of subprime-backed assets before the crisis).

<sup>15</sup> See JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* 34, 283-298 (2006) (criticizing credit rating agencies and discussing the regulatory reliance on ratings). Leading institutional investors employed far more sophisticated methodologies than the ones used by the leading credit rating agencies. See Jane Tripp Howe, *Credit Analysis for Corporate Bonds*, in *BOND CREDIT ANALYSIS: FRAMEWORK & CASE STUDIES* (Frank J. Fabozzi ed. 2001); *Kamakura Credit Risk*, KAMAKURA CORP., <http://www.kamakuraco.com/Solutions/KamakuraRiskManager/CreditRisk.aspx>.

<sup>16</sup> See Jeffrey Manns, *Downgrading Rating Agency Reform*, 81 GEO. WASH. L. REV. 749, 750 (2013) (describing the bases for various credit rating agency reform approaches).

<sup>17</sup> The Credit Rating Agency Reform Act of 2006 provided authority to the Commission to implement registration, recordkeeping, financial reporting, and oversight rules. See Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 137 (2006); Oversight of Credit Rating Agencies Registered

Throughout this time, the regulatory license view gained plausibility as a theory to explain the ongoing paradox in fixed income markets: that credit ratings were enormously important, yet possessed little informational value.<sup>18</sup> Regulators and policy makers were warned about the potentially toxic role of credit rating agencies in the use of credit default swaps and the creation of collateralized debt obligations, or CDOs.<sup>19</sup> In particular, criticism focused on the reliance on crude mathematical models that did not adequately account for the correlation of CDO assets.<sup>20</sup> This was all during the early- and mid-2000s.<sup>21</sup>

Then came the global financial crisis of 2007-08. The crisis occurred when it became apparent that major financial institutions had used complex and opaque transactions to take on substantial undisclosed exposure to subprime mortgage markets.<sup>22</sup> The credit rating agencies facilitated these transactions by giving very high credit ratings to a range of risky financial instruments related to subprime mortgages; when the subprime mortgage market collapsed, so did these transactions – and crisis ensued.

Numerous scholars chronicled the revelation of bad news about the highly-rated fixed income securities at the center of the financial crisis.<sup>23</sup> After the bankruptcy declaration of

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as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857, 90 SEC Docket 2032 (Jun. 5, 2007); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342, 95 SEC Docket 321 (Feb. 2, 2009); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050, 95 SEC Docket 321 (Feb. 2, 2009).

<sup>18</sup> See Frank Partnoy, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, in FINANCIAL GATEKEEPERS: CAN THEY PROTECT INVESTORS? 59, 61 (Brookings Institution Press 2006, Yasuyuki Fuchita and Robert E. Litan, eds.).

<sup>19</sup> See *id.* at 73-80; see also FRANK PARTNOY, INFECTIOUS GREED: HOW RISK AND DECEIT CORRUPTED THE FINANCIAL MARKETS 374-92 (2003) (warning about abuses in credit default swaps and CDOs and concluding that CDOs “posed even greater dangers to the global economy”); see also Comments of Frank Partnoy, Proposed Rule, Definition of Nationally Recognized Statistical Rating Organization, Release Nos. 34-51572, IC-26834, File No. S7-04-05, Jun. 9, 2005; Testimony of Frank Partnoy, Hearings before the United States House of Representatives Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, “Legislative Solutions for the Rating Agency Duopoly,” Jun. 29, 2005.

<sup>20</sup> See Partnoy, *How and Why*, at 78 (concluding that the “credit rating agencies are providing the markets with an opportunity to arbitrage the credit rating agencies’ mistakes” and that “[t]he problems with how CDO pricing models incorporate various measures of correlation among assets are even more troubling.”).

<sup>21</sup> See Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019 (2007).

<sup>22</sup> For a detailed description of the role of the credit rating agencies in the financial crisis, see Frank Partnoy, *Overdependence on Credit Ratings Was a Primary Cause of the Crisis*, in THE PANIC OF 2008: CAUSES, CONSEQUENCES, AND IMPLICATIONS FOR REFORM (Lawrence Mitchell and Arthur Wilmarth, eds. 2010).

<sup>23</sup> See Anna Gelpern, *Financial Crisis Containment*, 41 CONN. L. REV. 1051 (2009); Adam Levitin, *The Crisis Without a Face: Emerging Narratives of the Financial Crisis*, 63 U. MIAMI L. REV. 998, 999-1010 (2009); DAVID A. WESTBROOK, OUT OF CRISIS: RETHINKING OUR FINANCIAL MARKETS (2009); DAVID

Lehman Brothers on September 15, 2008, the previously mixed assessment of the role of credit rating agencies with respect to such securities became far more critical.<sup>24</sup>

Government investigations ultimately found that the credit rating agencies, particularly Moody's and S&P, were central villains in the crisis and that the crisis could not have happened without their misconduct. The Financial Crisis Inquiry Commission called the ratings agencies "key enablers of the financial meltdown."<sup>25</sup> The U.S. Senate Permanent Subcommittee on Investigations concluded: "Inaccurate AAA credit ratings introduced risk into the U.S. financial system and constituted a key cause of the financial crisis."<sup>26</sup> The Securities and Exchange Commission and the President's Working Group on Financial Markets reached similar conclusions.<sup>27</sup>

In 2010, Congress passed Dodd-Frank, which required federal agencies to replace regulatory references to credit ratings with "appropriate" substitutes.<sup>28</sup> Dodd-Frank amended the securities laws to enhance the accountability and transparency of credit rating agencies and to create a new Office of Credit Ratings within the SEC to oversee them.<sup>29</sup> In addition, federal and

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A. SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* (2011); Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963 (2009); KATHLEEN C. ENGEL AND PATRICIA A. MCCOY, *THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS* (2011); ERIK GERDING, *LAW, BUBBLES, AND FINANCIAL REGULATION* (2013); ANAT ADMATI AND MARTIN HELLWIG, *THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT* (2013).

<sup>24</sup> In the aftermath of the financial crisis, numerous scholars wrote critically about the role of credit rating agencies and potential reform, reaching a wide range of conclusions. See John C. Coffee, Jr., *Ratings Reform: The Good, The Bad, and The Ugly*, 1 HARV. BUS. L. REV. 231 (2011); Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583 (2010); Arthur R. Pinto, *Control and Responsibility of Credit Rating Agencies in the United States*, 54 AM. J. COMP. L. 341 (2006); Lynn Bai, *On Regulating Conflict of Interests in the Credit Rating Industry*, 13 N.Y.U. J. LEGIS. & PUB. POL'Y 253 (2010); John P. Hunt, *One Cheer for Credit Rating Agencies: How the Mark-to-Market Accounting Debate Highlights the Case for Rating-Dependent Regulation*, 60 S.C. L. REV. 749 (2009); Timothy E. Lynch, *Deeply Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment*, 59 CAS. W. RES. L. REV. 227 (2009).

<sup>25</sup> FIN. CRISIS INQUIRY COMM'N, *FINANCIAL CRISIS INQUIRY REPORT* xxv (2011) ("We conclude the failures of credit rating agencies were essential cogs in the wheel of financial destruction. The three credit rating agencies were key enablers of the financial meltdown. The mortgage-related securities at the heart of the crisis could not have been marketed and sold without their seal of approval. Investors relied on them, often blindly. In some cases, they were obligated to use them, or regulatory capital standards were hinged on them. This crisis could not have happened without the rating agencies. Their ratings helped the market soar and their downgrades through 2007 and 2008 wreaked havoc across markets and firms.").

<sup>26</sup> PERMANENT SUBCOMM. ON INVESTIGATIONS, *WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE* 6 (2011).

<sup>27</sup> See U.S. SEC. & EXCH. COMM'N, *SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF'S EXAMINATIONS OF SELECT CREDIT RATING AGENCIES* 12 n.8 (2008); THE PRESIDENT'S WORKING GROUP ON FIN. MKTS., *POLICY STATEMENT ON FINANCIAL MARKET DEVELOPMENTS* 1 (Mar. 2008).

<sup>28</sup> Dodd-Frank Act § 939A(a)(1)-(2), (b).

<sup>29</sup> See Dodd-Frank Act § 932.

state prosecutors settled cases against S&P and Moody's,<sup>30</sup> and there were a handful of private investor lawsuits.<sup>31</sup>

Unfortunately, these regulatory changes have had little or no impact on the central problems associated with credit ratings, and the same credit rating-related dangers, market distortions, and inefficient allocations of capital that led to the 2007-08 global financial crisis potentially remain today.<sup>32</sup> More than a decade after that crisis, the major credit rating agencies remain among the most powerful and profitable institutions in the world.<sup>33</sup> The market for credit ratings continues to be a large and impenetrable oligopoly dominated by two firms: Moody's and S&P.<sup>34</sup> And yet credit ratings are still as uninformative as they were before the financial crisis.<sup>35</sup> Simply put, credit ratings remain enormously important but have little informational value.<sup>36</sup>

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<sup>30</sup> See Press Release, Statement of Attorney General Eric Holder, Department of Justice, *Justice Department and State Partners Secure \$1.375 Billion Settlement with S&P for Defrauding Investors in the Lead Up to the Financial Crisis* (Feb. 3, 2015); Moody's Corporation Form 8-K, Jan. 13, 2017, Exhibit 99.1.

<sup>31</sup> See Moody's Corp., Annual Report (Form 10-K) 105-106 (Feb. 25, 2016) (describing private lawsuits). See also Carrie Guo, *Credit Rating Agency Reform: A Review of Dodd-Frank Section 933(B)'s Effect (Or Lack Thereof) Since Enactment*, 2016 COLUM. BUS. L. REV. 184, 187 n.6 (2016) (reviewing federal dockets on PACER and finding only a handful of complaints filed against credit rating agencies since 2010).

<sup>32</sup> See, e.g., Frank Partnoy, *The Looming Bank Collapse*, THE ATLANTIC, Jul./Aug. 2020 (describing risks associated with Collateralized Loan Obligations and other highly-rated instruments). Government interventions during the pandemic prevented widespread defaults on high-yield loans, and it remains unclear as of mid-2022 whether correlated defaults will increase significantly in the absence of that support. Commentators also have pointed to recent weaknesses associated with credit rating agencies' assessment of risks related to climate and ESG concerns. See Tyler Gellasch & Lee Reiners, *From Laggard to Leader: Updating the Securities Regulatory Framework to Better Meet the Needs of Investors and Society*, Global Financial Markets Center at Duke Law 39-40 (2021).

<sup>33</sup> The aggregate market capitalization of the holding companies of the two major credit rating agencies, Moody's and S&P, was over \$110 billion as of this writing, and profitability measures at both Moody's and S&P have consistently been among the highest among any public companies.

<sup>34</sup> See Lawrence J. White, *The Credit Rating Agencies: An Analysis through the Lenses of Industrial Organization, Finance, and Regulation* 21 PAC. ECON. REV. 202, 202 (2016) (documenting the credit rating agency oligopoly).

<sup>35</sup> See Valentin Dimitrov, Darius Palia & Leo Tang, *Impact of the Dodd-Frank Act on Credit Ratings*, 115 J. FIN. ECON. 505, 506 (2015) (finding that after the Dodd-Frank Act credit rating agencies issued lower ratings, gave more false warnings, and issued downgrades that were less informative); see also Rhee, *Why Credit Rating Agencies*, at 171 (arguing that credit rating agencies produce little new information, but simply play a sorting function).

<sup>36</sup> See Partnoy, *The Looming Bank Collapse*, THE ATLANTIC; see also Frank Partnoy, *The Paradox of Credit Ratings*, in THE ROLE OF CREDIT REPORTING SYSTEMS IN THE INTERNATIONAL ECONOMY (Richard M. Levitch, Giovanni Majnoni, & Carmen Reinhart, eds. 2002). Credit rating agencies have responded that credit ratings are correlated with actual default experience. See STANDARD AND POOR'S RATINGS SERVICES, 2014 ANNUAL GLOBAL CORPORATE DEFAULT STUDY AND RATING TRANSITIONS 35 (2015) (showing that lower ratings are associated with greater default vulnerability). However, it would be surprising if they were not: anyone with a Bloomberg subscription and a basic knowledge of financial statements can publish credit ratings that are correlated with defaults, simply by following market prices, reading the news, and then adjusting ratings. Scholarly efforts are more skeptical about whether credit

Likewise, the academic literature on its own has not yet persuaded the Commission to implement the full slate of Dodd-Frank reforms, and scholars continued to try to understand why problems associated with credit rating agencies persist. Several financial economists responded to the Dodd-Frank reforms by assessing the frictions associated with credit ratings as a response to information scale economies, and highlighted the differences between credit rating agencies and other gatekeepers.<sup>37</sup> Others have suggested that merely increasing legal and regulatory costs for credit rating agencies can lead to less informative ratings.<sup>38</sup> One helpful study analyzed evidence of the impact of alternative approaches to ratings in the context of insurance regulation, examining the replacement of credit ratings with third-party estimates of credit losses in the context of capital regulations for mortgage-backed securities.<sup>39</sup> Some scholars have taken a comparative approach, examining efforts to reform the regulation of credit rating agencies outside the U.S.<sup>40</sup> Moreover, the academic literature continues to confront challenges, including data availability<sup>41</sup> and questions about regulatory changes.<sup>42</sup>

Meanwhile, the Commission has undertaken significant efforts to remove NRSRO references from its rules. Although many of us have supported these efforts, we also note that many institutions continue to rely on credit ratings, and there continue to be high levels of

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ratings have any informational utility. *See* Dimitrov, Palia & Tang, at 429; *see also* Mark J. Flannery, Joel F. Houston, & Frank Partnoy, *Credit Default Swap Spreads as Viable Substitutes for Credit Ratings*, 158 U. PA. L. REV. 2085, 2087 (2010) (documenting that credit default swap spreads incorporated information significantly more quickly than credit ratings).

<sup>37</sup> *See, e.g.*, Francesco Sangiorgi & Chester S. Spatt, *The Economics of Credit Rating Agencies*, 12 FOUNDATIONS & TRENDS IN FIN. 1 (2017) (developing a formal reputation model of credit rating agencies to explore distinctive aspects of credit ratings); Christian C. Opp, Marcus M. Opp & Milton Harris, *Rating Agencies in the Face of Regulation*, 108 J. FIN. ECON. 64 (2013) (developing a theoretical framework to show how rating-contingent regulation can lead to inflated ratings).

<sup>38</sup> *See* Valentin Dimitrov, Darius Palia & Leo Tang, *Impact of the Dodd-Frank Act on Credit Ratings*, 115 J. FIN. ECON. 505 (2015).

<sup>39</sup> *See* Kathleen Weiss Hanley & Stanislava Nikolova, *Rethinking the Use of Credit Ratings in Capital Regulations: Evidence from the Insurance Industry*, 10 REV. CORP. FIN. STUD. 347 (2021) (analyzing potential costs and benefits of the alternative methodology); *see also* Merritt B. Fox, *Due Diligence with Residential Mortgage Backed Securities*, Columbia Law & Econ. Working Paper No. 462 (2013) (examining due diligence and credit ratings in the context of residential mortgage backed securities offering documents).

<sup>40</sup> *See* Chris Brummer & Rachel Loko, *The New Politics of Transatlantic Credit Rating Agency Regulation*, in THE FATE OF TRANSNATIONAL FINANCIAL REGULATION, Tony Porter, ed. (2013); Daniel Cash, *A New Era for Chinese Credit Rating Provision*, 6 J. BUS. L. 417 (2020).

<sup>41</sup> *See* Marc Joffe & Frank Partnoy, *Making Credit Ratings Data Publicly Available*, San Diego Legal Studies Paper No. 18-320 (2018).

<sup>42</sup> For example, one recent study assumes that the Dodd-Frank Act increased the legal liability of credit rating agencies, even though as described below this legislative change was not implemented by the Commission. *See* Petrus Ferreira, Wayne R. Landsman, Tim Liu & Jianxin Zhao, *The Effect of Changes in Legal Liability on Credit Rating Agencies' Reliance on Financial Statement Information and Rating Quality*, Working paper (June 2002), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4146006](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4146006).



market concentration among credit rating agencies, even absent regulatory references to ratings. Institutional “stickiness” is one explanation for the continued reliance on credit ratings.<sup>43</sup>

Our petition is focused on three aspects of Commission policy that we believe create ongoing and significant risks and dangers for investors. We believe the Commission could immediately clarify its approach in these areas in ways that would significantly benefit investors, and minimize the risks and dangers. As noted above, we also believe these steps are necessary to comply with the statutory mandate of Dodd-Frank.

## **II. Name the Names of NRSROs**

Dodd-Frank amended Section 15E of the Securities Exchange Act of 1934 to enhance the regulation, oversight, and transparency of NRSROs.<sup>44</sup> The most significant oversight change was a new office within the Commission: the Office of Credit Ratings. The OCR assists the Commission in its major goals – protecting investors; promoting capital formation; and maintaining fair, orderly, and efficient markets – by overseeing NRSROs.<sup>45</sup> Section 932 of Dodd-Frank imposed new reporting, disclosure, and examination requirements on NRSROs and mandated that the OCR would implement them.<sup>46</sup>

Since its creation in June 2012, the OCR has had broad responsibility for administering SEC rules, monitoring NRSRO practices, conducting compliance examinations, protecting users of credit ratings, promoting accuracy of credit ratings, monitoring conflicts of interest, and helping to ensure greater disclosure related to ratings.<sup>47</sup> Although nine credit rating agencies are registered as NRSROs as of this writing,<sup>48</sup> Moody’s and S&P continue to dominate the market, with Fitch as a significant tertiary player; the other credit rating agencies are significantly smaller.

The OCR is required to examine each NRSRO at least annually under Section 15E of the Exchange Act. Although the specific results are not publicly available, the OCR is required to produce an annual report summarizing its essential findings, along with summaries of any NRSRO responses to material regulatory deficiencies and whether the NRSROs have appropriately addressed the OCR’s recommendations. The OCR has documented serious deficiencies over time with respect to conflicts of interest, adherence to policies and procedures, and other serious errors.

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<sup>43</sup> See, e.g., Claire A. Hill, Comment Letter on Release No. 34-64456, File No. 4-629, Request for Comments on Study Required Under Section 939(F) of Dodd-Frank (Sep. 13, 2011), <https://www.sec.gov/comments/4-629/4629-26.pdf> (describing such “stickiness” among market participants).

<sup>44</sup> See Dodd-Frank Act § 932.

<sup>45</sup> Some smaller credit rating firms are not NRSROs, but they are not significant from an economic or regulatory perspective.

<sup>46</sup> See Dodd-Frank Act § 932.

<sup>47</sup> See *Office of Credit Ratings*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/ocr>.

<sup>48</sup> See <http://www.sec.gov/ocr> (orders granting registration to NRSROs).

However, contrary to the transparency mandate of Dodd-Frank, the OCR does not identify which NRSRO was involved in each reported transgression. Instead, each violation is described only in general, often cryptic, terms, which do not permit the reader to identify which rating agency is involved.

Accordingly, we propose that the Commission require that the OCR describe violations more precisely, consistent with the requirement in Section 932(a) of Dodd-Frank that the OCR make its findings available to the public in “an easily understandable format . . . summarizing [its] essential findings,”<sup>49</sup> Congress provided that the OCR investigations should be transparent. Yet the OCR effectively hides the identity of the credit rating agencies it investigates. That should not continue.

The Commission’s and OCR’s ongoing transparency failures conflict with Dodd-Frank’s mandate that various information about credit ratings be published and made freely available on an easily accessible portion of each NRSRO’s website.<sup>50</sup> They also are contrary to the Commission’s own 2014 release implementing its new NRSRO rules, where it repeatedly emphasized the importance of making information about each agency easily accessible.<sup>51</sup> Indeed, the Commission used the term “easily accessible” repeatedly throughout that release to describe how individual NRSROs should make information available on a website.<sup>52</sup> In these instances, the Commission’s stated intention has been to make it easier for investors to access specific information about individual NRSROs.<sup>53</sup>

We believe naming the names of credit rating agencies would help hold rating agencies accountable, and potentially would deter violations of law and other problematic activity. Investors would be able to determine which credit rating agencies have committed certain violations, assess them over time, and reduce their reliance on credit ratings based on this information. We also believe the credit rating agencies would become more accountable for their failures, and should be less inclined to engage in prohibited conduct. We do not believe naming the names of credit rating agencies would present the same kinds of concerns that support secrecy in other regulatory contexts, such as bank examinations, where there is run risk, or with respect to other regulated entities, where the destruction of a firm’s reputational capital could precipitate a systemic collapse.

Accordingly, our first proposal is straightforward: require that the OCR follow Congress’s mandate and include the names of NRSROs in its findings.<sup>54</sup> We believe this

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<sup>49</sup> Dodd-Frank Act § 932.

<sup>50</sup> *See* 15 U.S.C. § 780-7(q)(2)(D).

<sup>51</sup> *See* National Recognized Statistical Rating Organizations, Exchange Act Release No. 34-72936, 109 SEC Docket 3429 (Oct. 14, 2014).

<sup>52</sup> *See id.*

<sup>53</sup> *See id.*

<sup>54</sup> As a secondary matter, we recommend providing the OCR with greater resources, independence, capacity, and authority. As an office within the Commission, the OCR does not have the ability to bring enforcement actions. Near the beginning of the 2009 Senate hearings on credit ratings, Senator Christopher Dodd, the co-author of Dodd-Frank, cited a white paper written for the Council of

proposal should be implemented through a stated change in policy, and that there should be no discretion with respect to the practice of naming names. This proposal should not be difficult: indeed, the Commission’s Investor Advisory Committee recommended precisely this change in 2021, and included a number of specific and straightforward details regarding implementation.<sup>55</sup>

### III. Clarify that NRSROs Are Subject to Liability under Section 11

Our second proposal relates to the accountability of credit rating agencies. Scholars have considered the extent to which the threat of liability is a viable enforcement mechanism to promote efficiency and fairness in financial markets.<sup>56</sup> Several commentators have addressed the extent to which “gatekeepers,” including credit rating agencies, should be subject to civil liability,<sup>57</sup> and the limitations of reputation as a constraint.<sup>58</sup> Dodd-Frank included two important provisions designed to increase the accountability of credit rating agencies by removing the privileged treatment they had enjoyed under the securities laws. We next address the first, related to Section 11 of the Securities Act of 1933. Then we turn to Regulation FD.

Perhaps the most significant accountability change in Dodd-Frank was repeal of Rule 436(g).<sup>59</sup> Rule 436(g) previously had insulated NRSROs from liability as experts under Section 11 of the Securities Act of 1933, which provides for liability for misstatements (such as false credit ratings) that are included or incorporated by reference in a registration statement or

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Institutional Investors that advocated an independent, free-standing office of credit rating agency oversight. Senator Dodd noted that one key element of the reforms was the creation of “a single independent credit rating agency oversight board,” similar to the Public Company Accounting Oversight Board for accounting. *See Examining Proposals to Enhance the Regulation of the Credit Rating Agencies: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 111th Cong. 8 (2009) (statement of Sen. Chris Dodd). Congress rejected this proposal, but the Commission could take steps to bolster the OCR. In addition to providing personnel and resources, the Commission could act internally to facilitate enforcement actions based on misconduct uncovered by the OCR.

<sup>55</sup> *See* Recommendation of the Market Structure Subcommittee of the SEC Investor Advisory Committee regarding Credit Rating Agencies, Mar. 11, 2021, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210311-credit-rating-agencies-recommendation.pdf>.

<sup>56</sup> *See* Donald C. Langevoort, *Rule 10b-5 As an Adaptive Organism*, 61 *FORDHAM L. REV.* S7 (1993); Jennifer H. Arlen and William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 *U. ILL. L. REV.* 691 (1992); John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 *COLUM. L. REV.* 1534 (2006); Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 *WISC. L. REV.* 333 (2009).

<sup>57</sup> *See* Frank Partnoy, *Barbarians at the Gatekeepers?: A Proposal for A Modified Strict Liability Regime*, 79 *WASH. U. L.Q.* 491 (2001); Assaf Hamdani, *Gatekeeper Liability*, 77 *S. CAL. L. REV.* 53 (2003); John C. Coffee, *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 *B.U. L. REV.* 301 (2004); John C. Coffee, Jr., *Partnoy’s Complaint: A Response*, 84 *B. U. L. REV.* 377 (2004); Alessio M. Paccès and Alessandro Romano, *A Strict Liability Regime for Rating Agencies*, 52 *AM. BUS. L.J.* 673 (2015); Stavros Gadinis & Colby Mangels, *Collaborative Gatekeepers*, 73 *WASH. & LEE L. REV.* 797 (2016).

<sup>58</sup> *See* Jonathan Macey, *The Value of Reputation in Corporate Finance and Investment Banking (and the Related Roles of Regulation and Market Efficiency)*, 22 *J. APPLIED CORP. FIN.* 18 (2010); Jonathan Macey, *The Demise of the Reputational Model in Capital Markets: The Problem of the “Last Period Parasites,”* 60 *SYRACUSE L. REV.* 427, 432 (2010).

<sup>59</sup> *See* Dodd-Frank Act § 939G.

prospectus. Specifically, Rule 436(g) exempted NRSRO credit ratings from being deemed part of a registration statement or prospectus. As a result, NRSROs were not considered experts subject to Section 11.

The repeal of Rule 436(g) followed an October 2009 Commission concept release on credit ratings that included a similar repeal proposal.<sup>60</sup> The concept release made it clear that repeal of Rule 436(g) would significantly increase the liability risks of NRSROs.<sup>61</sup> However, the Commission did not act on its concept release. In passing Dodd-Frank, Congress effectively made the Commission's concept release law, eliminating the differential treatment of NRSROs and non-NRSROs under Section 11. During the debate about the Commission's concept release and Dodd-Frank's accountability provisions, NRSROs threatened to stop providing ratings if they were subject to liability as experts under Section 11.<sup>62</sup>

After the passage of Dodd-Frank, the NRSROs followed through on their threats. They refused to provide consents with respect to new issues of investment grade debt and asset-backed securities. As a result, some companies publicly stated that they would be unable to raise capital in offerings registered under the Securities Act. The repeal of Rule 436(g) immediately became a game of credit ratings chicken.<sup>63</sup>

On July 22, 2010, the Division of Corporation Finance issued a "no-action" letter to Ford Motor Credit Company LLC and Ford Credit Auto Receivables Two LLC, permitting them to omit credit ratings disclosure from a prospectus. The relief was temporary (it was scheduled to expire on January 24, 2011), but the Commission subsequently cemented the relief, making it clear that NRSROs would not be subject to liability under Section 11.<sup>64</sup>

Many academics saw this regulatory response to Dodd-Frank's elimination of Rule 436(g) as extraordinary. There should have been nothing for the Commission to implement in response to the elimination of Rule 436(g). Congress could not have been clearer when it said Rule 436(g) "shall have no force or effect." Yet the Commission responded by overriding that explicit and clear congressional command with a regulatory veto.

The Commission's action wasn't without a rationale: there was a concern that certain parts of the asset-backed securities markets would not properly function if the Commission implemented the Dodd-Frank mandate. It is unclear whether those markets in fact would not have properly functioned, or whether the markets might have been transformed in ways that

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<sup>60</sup> Concept Release on Possible Rescission of Rule 436(g) under the Securities Act of 1933, Release Nos. 33-9071; 34-60798, 96 S.E.C. Docket 2719 (Oct. 7, 2009).

<sup>61</sup> *See id.* at 3-4 ("Rescinding the exemption would cause NRSROs to be included in the liability scheme for experts set forth in Section 11, as is currently the case for credit rating agencies that are not NRSROs."); *id.* at 16 (noting "we believe that rescinding Rule 436(g), and therefore potentially increasing the risk of liability under the federal securities laws, could significantly improve investor protection").

<sup>62</sup> Danielle Carbone, *The Impact of Dodd-Frank Act's Credit Rating Agency Reform on Public Companies*, 24 INSIGHTS 1, 1 (2010).

<sup>63</sup> *See id.* at 2.

<sup>64</sup> *See id.*

would have made them fairer and more efficient. Nevertheless, in our view, the Commission at that time flouted the obvious intent of Congress. This Commission has an opportunity to reverse this stance, consistent with Dodd-Frank.

We understand claims that if NRSROs were subject to Section 11 liability, they might refuse to give ratings in some circumstances and accordingly that certain markets, such as asset-backed securities, could contract. We also believe that some rating agencies, though perhaps not all, might be willing to consent to include their credit rating in a prospectus or registration statement and thereby pledge their reputational capital and expose themselves to potential future liability, and thereby improve the expected quality of their ratings (such ratings would “price in” the risk associated with future litigation, a risk that is not priced in now). Thus, NRSROs continue to act as dysfunctional regulatory license providers, instead of information intermediaries.

In practical terms, our proposed clarification would reduce the perverse incentives that arise because NRSROs are not concerned about undertaking sufficient work and investigation to satisfy a potential “due diligence” defense in litigation. To satisfy this defense, an agency would have needed to show that “after reasonable investigation, [it had] reasonable ground to believe and did believe . . . that the [credit ratings] therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”<sup>65</sup> Effectively, the current policy in place signals to NRSROs that such reasonable grounds are not necessary and that there is no need for rating agency due diligence. Because of this message, the credit rating agencies enjoy the profits from their ratings without the risk of liability as experts under Section 11, even though Dodd-Frank clearly provides that they should be subject to such risk. Given the current approach, it is not surprising that the informational value of credit ratings would decline after Dodd-Frank.

Accordingly, our second proposal is straightforward: the Commission should make it clear that NRSROs are subject to liability under Section 11. The reform we suggest could be accomplished through a policy statement, and does not require new rules. The Commission also could simply repeal its 2010 “no-action” letter described above.

#### **IV. Clarify How Regulation FD Applies to NRSROs.**

Section 939B of Dodd-Frank required that the Commission revise Regulation Fair Disclosure, known as Regulation FD, to remove the exemption for entities whose primary business is credit ratings.<sup>66</sup> Regulation FD provides that when an issuer privately discloses material nonpublic information to certain persons, the issuer must also publicly disclose that information.<sup>67</sup> Regulation FD was promulgated in 2000 to address the problem of “selective

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<sup>65</sup> 15 U.S.C. § 77k(b)(3) (2016).

<sup>66</sup> See Dodd-Frank Act § 939B.

<sup>67</sup> Regulation FD prohibits covered issuers from selecting disclosing to four categories of persons: (i) broker-dealers and their associated persons, (ii) investment advisers and institutional investment managers and their associated persons, (iii) investment companies and their associated persons, and (iv) holders of the issuer’s securities, under circumstances in which it is reasonably foreseeable that the holder will trade on the information. See 17 C.F.R. § 243.100.

disclosure,” when issuers privately disclosed information in circumstances that created unfair advantages for certain persons, including advantages those persons might gain by trading securities or providing advice based on the information.<sup>68</sup>

During and before the financial crisis, Regulation FD had explicitly exempted credit rating agencies.<sup>69</sup> As a result, issuers were free to disclose nonpublic information to credit rating agency employees, who could then use that information in their rating evaluations. During 2005, Congress heard evidence about Regulation FD and the credit rating agencies, but decided in its 2006 legislation to leave the exemption intact.<sup>70</sup> On April 15, 2009, the Commission conducted a Roundtable on Issues Related to the Oversight of Credit Rating Agencies, and experts submitted evidence about the likely effects of removing the Regulation FD exemption.<sup>71</sup> This topic also was discussed briefly during the Dodd-Frank hearings,<sup>72</sup> when Representative Jackie Speier of California questioned the CEOs of S&P, Moody’s and Fitch (Deven Sharma, Raymond W. McDaniel, and Stephen W. Joynt, respectively) about the Regulation FD exemption.<sup>73</sup>

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<sup>68</sup> Selective Disclosure & Insider Trading, Exchange Act Release No. 33-7881, 73 SEC Docket 3 (Aug. 15, 2000), at 51719.

<sup>69</sup> *See id.*

<sup>70</sup> *See Legislative Solutions for The Rating Agency Duopoly: Hearing Before the H. Subcomm. on Capital Markets, Insurance & Government Sponsored Enterprises, H. Comm. on Fin. Serv., 109th Cong. (2005).*

<sup>71</sup> *See FRANK PARTNOY, RETHINKING REGULATION OF CREDIT RATING AGENCIES: AN INSTITUTIONAL INVESTOR PERSPECTIVE 13 (2009) (submitted as an exhibit as part of the SEC Roundtable); see also Professor Frank Partnoy, Statement to the SEC Roundtable on Issues Related to the Oversight of Credit Rating Agencies, (Apr. 15, 2009) (noting that “Congress already has begun debating the extent to which the rating agencies should be held accountable as gatekeepers, and courts have recognized the errors in previous cases. Rating agencies should not be exempt from securities fraud liability, and they should not enjoy any special privilege over other gatekeepers in Section 11 of the Securities Act of 1933, Regulation FD, or elsewhere.”).*

<sup>72</sup> There is only one reference to Regulation FD in the legislative history of Dodd-Frank. *See Law Librarians’ Society of Washington, DC, Dodd-Frank Wall Street Reform and Consumer Financial Protection Act: A Brief Legislative History, LLSDC, <http://www.llsdc.org/dodd-frank-legislative-history>.*

<sup>73</sup> *See Reforming Credit Rating Agencies: Hearing before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises, H. Comm. on Fin. Serv., 111th Cong. 38 (2009).* The CEOs’ responses to Representative Speier suggested that there would not be negative consequences to removal of the Regulation FD exemption, because the rating agencies could function well, and previously had functioned well, without access to inside information from issuers:

Mr. MC DANIEL. We operated for 90 years before regulation FD became effective. I think we were able to do a very fine job during that period, and I think we would be able to operate without regulation FD exemption now. ...

Mr. SHARMA. Ratings are forward looking, and information that allows us—that gives us more insight as to the future helps us to make better decisions. ...

Mr. JOYNT. I would agree. I think that regulation was passed to allow issuers to more freely communicate with rating agencies so they can make better decisions. ...

Ms. SPEIER. But we have lots of examples where it wasn’t used in that way. So the question is, is it going to hurt your business if we get rid of that exemption?

Mr. JOYNT. I believe we could continue to offer educated opinions.

Id.

After Dodd-Frank passed, the credit rating agencies sought clarity from the Commission in its release implementing Section 939B that issuers submitting material nonpublic information to NRSROs solely for the purpose of obtaining credit ratings would not violate Regulation FD.<sup>74</sup> Specifically, the particular regulation at issue, Rule 100(b)(2)(iii), provided that the Regulation FD requirement to disclose information publicly would not be triggered if a selective disclosure was made to an NRSRO. The credit rating agencies sought clarity that issuers did not need to worry about the removal of this provision, because there still would be other bases for issuers to selectively disclose inside information to NRSROs.

In its release implementing Section 939B, the Commission deleted Rule 100(b)(2)(iii), the provision exempting NRSROs, but discussed in a footnote the potential circumstances under which NRSROs could continue to receive selective disclosures of material non-public information.<sup>75</sup> Essentially, the suggestion was that NRSROs could claim exemption as temporary insiders, like attorneys, investment bankers, and accountants, who remained exempt from Regulation FD.

Subsequently, the leading credit rating agencies, and their lawyers, assured issuers that, notwithstanding the regulatory changes, issuers could continue to disclose inside information to NRSROs.<sup>76</sup> They amended internal policies regarding trading based on material nonpublic information and the handling of confidential information to match the language in the extant Regulation FD exceptions.<sup>77</sup> Law firms advising issuers opined that the changes in Regulation FD would have little or no impact on selective disclosures made to credit rating agencies.<sup>78</sup> One prominent law firm suggested that the Commission's actions – and the rating agencies' positions – were potentially contrary to Congressional intent, warning: “Much ado about nothing? Perhaps.

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<sup>74</sup> See Letter from Vickie A. Tillman, Executive Vice President, Standard and Poor's Investment Ratings Services (Mar. 27, 2009), <http://www.sec.gov/comments/s7-04-09/s70409-18.pdf>; Letter from Michel Madelain, Chief Operating Officer, Moody's Investor Service (Mar. 28, 2009), <http://www.sec.gov/comments/s7-04-09/s70409-20.pdf>.

<sup>75</sup> Footnote 9 stated: “Regulation FD also provides exemptions for communications made to a person who owes the issuer a duty of trust or confidence – i.e., a ‘temporary insider’ – such as an attorney, investment banker, or accountant ..., to any person who expressly agrees to maintain the information in confidence ..., and in connection with most offerings of securities registered under the Securities Act.... These exemptions are unaffected by the Act.” Removal from Regulation FD of the Exemption for Credit Rating Agencies, Exchange Act Release No. 33-9146, 99 SEC Docket 1503, at n. 9 (Sept. 29, 2010).

<sup>76</sup> According to one law firm advising issuers, “The NRSROs that have publicly addressed the issue do not believe that the removal of the exemption will affect the way in which issuers share material nonpublic information with the rating agencies as part of the ratings process. In this regard, they do not believe that they fall within any of the enumerated categories of persons to whom selective disclosure is prohibited and their policies prohibit trading on material nonpublic information. In addition, the engagement letter that the rating agency enters into with the issuer contains confidentiality provisions which should allay concerns that companies may nonetheless have about the effect of the removal of the exemption.” Carbone, *Impact*, at 5.

<sup>77</sup> See, e.g., Press Release, Fitch Ratings, Fitch Comments on U.S. Financial Reform Act's Implications for Credit Rating Agencies (Jul. 19, 2010) (“To the greatest extent possible, Fitch will work with the issuer community to put in place appropriate mechanisms so that Fitch can continue to receive confidential information as part of the rating process.”).

<sup>78</sup> See *id.* (relying on exemption for disclosures made in confidence).

However, the directive to the SEC to remove the rating agency exemption may well evidence an intent by the legislators to require the public disclosure of material nonpublic information provided to the rating agencies in certain circumstances. It is uncertain whether Congress will be satisfied by the mere repeal of Rule 100(b)(2)(iii) and the continuation of business as usual.”<sup>79</sup>

This uncertainty remains years later. Our views differ regarding optimal policy with respect to Regulation FD and the credit rating agencies. Some of us see value in the credit rating agencies being able to consider additional information under Regulation FD. Others of us believe that, consistent with the language in Section 939B, Regulation FD prohibits issuers from disclosing inside information to NRSROs. We all agree that the markets would benefit from the Commission clarifying how it views this issue, to address the lingering uncertainty. As with our other recommendations, we believe the Commission could make this clarification in a straightforward way, in a policy statement, without the need to propose new rules.

We thank the Commission for its consideration of our petition.

Respectfully,

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<sup>79</sup> Janette A. McMahan & Kelly A. Schell, *Much Ado About Nothing?*, KIRKLAND ALERT, KIRKLAND & ELLIS LLP, Oct. 2010, at 2.



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