CFA Consumer Federation of America

November 20, 2017

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington D.C. 20549-1090

Dear Chairman Clayton:

We are writing to bring to your attention recent research by University of San Diego Law Professor Frank Partnoy describing serious shortcomings in the SEC's implementation of credit rating agency reforms mandated in the Dodd-Frank Act.[1] The paper describes several areas where the Securities and Exchange Commission (SEC) has either failed to carry out reforms mandated by Congress or implemented those reforms in ways that undermine their effectiveness. While all deserve serious consideration, one practice identified by Professor Partnoy would be particularly easy to fix: failure to identify the specific credit rating agencies whose regulatory violations are cited in annual examination reports by the Office of Credit Ratings (OCR). We urge you to change this practice.

As you know, shoddy and abusive practices at credit rating agencies are generally agreed to have played a central role in triggering the recent financial crisis. Among the problems identified in the years leading up to the crisis were a willingness among ratings agencies to abandon their ratings methodologies and violate their own policies and procedures in order to arrive at the positive ratings that were crucial to winning market share in the lucrative business of rating mortgage-backed securities and collateralized debt obligations. As part of its package of credit rating agency reforms, Congress created the OCR and required it to conduct annual examinations of all Nationally Recognized Statistical Rating Organizations (NRSROs). It required, moreover, that those examinations focus specifically on practices, such as those mentioned here, that had been identified as key contributors to widespread ratings failures.[2] Finally, it required OCR to publish an annual report summarizing its essential findings, describing NRSRO responses to material regulatory deficiencies, if any, and indicating whether the NRSROs have appropriately addressed OCR's prior recommendations.

Since that time, the Commission has released six such reports, summarizing examination results from 2011 through 2016. A seventh is presumably soon to be released. In each case, the reports

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[1] Frank Partnoy, "What's (Still) Wrong with Credit Ratings," San Diego Legal Studies Paper No. 17-285, 2017, 92 Wash. L. Rev. 1407, Oct. 3, 2017, http://bit.ly/2izCTMY.

[2] Examinations are required to include a review of the following eight areas: whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; the management of conflicts of interest by the NRSRO; the implementation of ethics policies by the NRSRO; the internal supervisory controls of the NRSRO; the governance of the NRSRO; the activities of the designated compliance officer ("DCO") of the NRSRO; the processing of complaints by the NRSRO; and the policies of the NRSRO governing the post-employment activities of its former personnel.

have detailed serious violations by ratings agencies, including by the "larger" NRSROs that continue to play a central role in our financial system and economy. Violations cited in the reports have included, for example, failure by the NRSRO to follow its rating methodology, changes to ratings decisions by senior personnel in contravention of the NRSRO's policies and procedures, and misapplication of ratings criteria. OCR continues to find similar deficiencies in other areas as well, such as conflicts of interest. "In sum," as Professor Partnoy writes, "NRSRO policies remain deeply flawed." With the exception of a 2015 settlement with S&P, however, the Commission appears to have done little to hold the ratings agencies and their executives to account for these continued violations.

Meanwhile, users of ratings are left in the dark with regard to which ratings agencies are involved in the reported regulatory failures. That's because, despite a congressional mandate to report its essential examination findings to the public in "an easily understandable format," the Commission has chosen to hide the identities of the NRSROs that have committed the various violations described in the reports. The Commission has also denied a request by Professor Partnoy under the Freedom of Information Act for the identities of the ratings agencies cited in its 2015 report.[3] As Professor Partnoy writes, these transparency failures are "contrary to the SEC's own 2014 release implementing its new NRSRO rules, where it repeatedly emphasized the importance of making information about each agency easily accessible." We urge you to reverse that trend by both providing the requested information from past reports and by ensuring that future reports identify transgressors.

Despite efforts to reduce the influence of credit ratings on our financial system, they continue to play a central role. Efforts to wean the system off reliance on ratings have proven ineffective, and proposals to change the business model to make it more independent have failed to take hold. That leaves SEC oversight as the only meaningful check on improper conduct by the ratings agencies that could once again put our financial system at risk. We therefore urge you to use every tool at your disposal to increase the rigor of that oversight, including those discussed in this research by Professor Partnoy. Publishing the identities of ratings agencies that have failed to adhere to applicable regulatory requirements would be a meaningful first step toward bringing increased accountability in this crucial area.

Thank you for your attention to our concerns.

Respectfully submitted,

Barbara Roper

Barbara Roper
Director of Investor Protection

Micah Hauptman

Micah Hauptman
Financial Services Counsel

cc: The Honorable Michael Piwowar, Commissioner
The Honorable Kara Stein, Commissioner

[3] Partnoy at 1429, fn 107.