



May 18, 2009

The Honorable Paul Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kanjorski:

The Association for Financial Professionals (AFP) welcomes the opportunity to provide formal comments on the Capital Markets Subcommittee's hearing to examine the need for more effective regulation of the credit rating agencies. We appreciate the chance to provide insights and suggestions from the end-user perspective.

As the global resource and advocate for the finance profession, AFP serves over 16,000 members who manage and safeguard the financial assets of more than 5,000 U.S. organizations. Many of our members are responsible for issuing short- and long-term debt and for managing the corporate cash, 401(k) and pension assets of their organizations. In these fiduciary capacities, our members are significant users of the credit rating agencies. Acting as both investors and issuers of debt, our members represent a balanced view of the credit ratings process, and have a significant stake in the outcome of the reform of rating agency practices and regulation.

AFP believes that the credit rating process and investor confidence in those ratings are vital to efficient global capital markets, and that it is necessary that the ratings produced by the Nationally Recognized Statistical Rating Organizations (NRSROs) be sound and reliable. Unfortunately, we believe that the current credit rating agency processes and business models are neither sound nor reliable. In fact, the system is broken. The time has long passed for incremental reform. A new model is needed to address widely-recognized flaws in the credit ratings business and restore investor confidence in credit ratings. The credit rating system must be fundamentally overhauled.

Since 2002, AFP has been a vocal advocate for the reform of the credit ratings industry. During that time, we conducted several surveys that found that both issuers of corporate/municipal debt and investors of corporate cash and pension assets believe: 1) the information provided by credit rating agencies is neither timely nor accurate, 2) the rating agencies are primarily serving the interest of their shareholders and other parties rather than investors, and 3) the SEC or some other regulatory body must increase its oversight of rating agencies and take steps to foster greater competition in the market for credit rating information. In April of 2004, AFP and treasury associations from Europe issued the *Code of Standard Practices for Participants in the Credit Rating Process*, which preceded the *Code of Conduct Fundamentals for Credit Rating Agencies* issued by the International Organization of Securities Commissions (IOSCO).

While AFP believes that the *Credit Rating Agency Reform Act of 2006* (CRARA) and the SEC rules implementing the Act made significant strides toward removing barriers to competition the SEC had imposed, more work must be done to adequately address deficiencies with the current model in place. Regrettably, passage of the *Credit Rating Agency Reform Act of 2006* has not led to real competition in the credit ratings market, nor has it improved the ability of the three dominant rating agencies (Moody's, S&P and Fitch) to produce timely and accurate ratings. While the three dominant rating agencies continue to be complicit in one market crisis after another, their fee structure has continued to rise. The recent market turmoil and disruptions in the credit markets provide strong empirical evidence that the rules do not go far enough – **significant reform** is necessary in order to fix this inherently broken system.

Therefore, AFP is proposing the following changes and enhancements to the current model. We realize that additional work will need to be done should either of these ideas materialize into action, but it is our hope that these suggestions can serve as the foundation for meaningful dialogue and deliberative action towards the necessary reform of the CRAs. AFP has proposed two ideas for the rating agencies that are worthy of further consideration: a) create a stand-alone model, where the only activities of the enterprise would be credit ratings; and b) implement rules that direct government support of the other non-major NRSROs.

Our first proposal is to implement a model that is similar in nature to a utility to support ratings organizations whose sole business purpose would be to provide credible and reliable ratings. These new ratings organizations could be financed by a transaction fee, which could be levied upon both, investors and issuers alike. Rating agencies operating under this model would be able to interact with and advise organizations being rated, but could not charge fees for providing advice, as Moody's, S&P, and Fitch currently do today.

AFP believes this model is a viable way to compensate a ratings organization that agrees to provide credible and reliable ratings as their sole business purpose. With this stand-alone model, most of the conflicts of interest that the current CRAs have would be removed. The key to making this model work is to have it funded by the transaction fee. Under the current system, it is our view that whether the fees are paid by the issuer/structurer or the investor, there are inherent biases in place. In the issuer-paid model, there will be pressure from issuers for the CRA to give the highest rating and to maintain that rating in order to lower borrowing costs. In an investor or subscription-paid model, there may be pressure for the initial rating to be as low as possible to maximize the yield on purchased debt. Subsequently, investors may push for higher or at the very least stable ratings in order to increase or protect the value of their investments. In either scenario, potential conflicts exist that could obscure the outcome of an unbiased, thorough credit analysis. However, we believe the stand-alone model funded by transaction fees would significantly mitigate conflicts of interest issues that currently exist.

By creating a funding source that is beyond the influence of both issuers and investors, the focus of the CRAs will be on producing the most accurate and timely credit analysis rather than satisfying the desires of any other vested interest. Under this model, the SEC would still have to exercise vigorous oversight of the rating agencies to ensure that they are fulfilling their mission of providing reliable ratings and are held accountable for inaccurate ratings.

The other proposal we believe is worth exploring would be for the U.S. government to require itself, and any federal programs that require credit ratings, as well as any business that has had a capital infusion from the U.S. government, to utilize at least one NRSRO, other than the dominant three, as additional credit analysis providers when issuing debt. This departure from tradition by such a key market participant would encourage the development of a truly competitive environment and give credibility to new rating agencies that have not had an opportunity to establish their bona fides on the open market.

Given the dominant market position that S&P, Moody's and Fitch currently possess, the possibility of one of the alternative NRSROs growing to the point of being an equal competitor seems remote. In fact, the U.S. government's reliance on the dominant three severely erodes or eliminates the benefits of competition envisioned by the CRARA by treating other NRSROs as inferior to the dominant three. The U.S. government must break its own addiction to S&P, Moody's and Fitch due to their history of poor performance – and should not be rewarding them for past failures. The government, including the Treasury Department, must immediately begin to accept alternative NRSROs and direct some ratings business to these NRSROs rather than relying solely on ratings provided by S&P, Moody's and Fitch. We further propose that federal agencies be required to utilize at least one alternative NRSRO for all transactions with underlying assets of \$50 million or more.

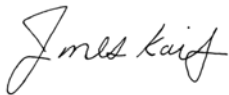
Corporate America currently has the ability to utilize one of the alternative NRSROs. But the reality is that this is unlikely to occur until these entities are viewed by the U.S. government as being on a level playing field with the dominant three. In the current climate of risk aversion, financial executives are unlikely to recommend the use of a rating agency for their debt issuance or investment decisions that Federal agencies treat as inferior to the dominant three.

AFP fully supports increased disclosure requirements, but argues for model-agnostic disclosure – it must be the same across the board for all NRSROs regardless of how they are compensated. Above all, whether we move to a different rating agency model or not, regulators must enforce strong anti-conflict of interest rules. Recent history has shown that NRSRO's cannot or will not police themselves.

The rating agencies are an ingrained component of the investment decision process, but they have clearly failed to provide accurate and timely information to investors over most of this current decade. Market participants have been severely punished during this time, while the dominant three management teams and their shareholders have benefited greatly from 'cranking out' ratings that have turned out to be suspect at best. We must ensure that reform of the credit rating system is of the highest priority to restore confidence in our capital markets.

Thank you for the opportunity to provide AFP's perspective and feedback on oversight of the credit rating agencies from the end-user perspective.

Sincerely,



James A. Kaitz
President and CEO
Association for Financial Professionals