SIFMA

Securities Industry and Financial Markets Association

October 25, 2010

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Docket Number OCC-2010-0016
RIN 1557-AD35

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AD62

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1391
RIN 7100-AD53

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2010-0027
RIN 1550-AC43

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to comment on the advanced notice of proposed rulemaking (the "**ANPR**") issued jointly on August 25, 2010 by the Office of the Comptroller of the Currency (the "**OCC**"), the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), and the Office of Thrift Supervision (the "**OTS**," and, together with the OCC, the Federal Reserve and the FDIC, the "**agencies**") to implement the mandate in Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). Section 939A requires the agencies to review references to, and requirements regarding, credit ratings in any agency regulation that requires the use of an assessment of creditworthiness of a security or

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

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money market instrument, to remove references to or requirement of reliance on such credit ratings in such regulations and to substitute standards of creditworthiness determined by each agency as appropriate for its regulations.[2] The ANPR requests comment on alternatives to the use of credit ratings in the agencies' risk-based capital rules, market risk rules and advanced approaches rules (collectively, the "**risk-based capital standards**"), including in the Basel Committee on Banking Supervision's recently proposed changes to the Basel Capital Accord, which could affect the agencies' risk-based capital standards.

We support the efforts of Congress, the U.S. Securities and Exchange Commission (the "**SEC**") and international regulators to improve the accountability of rating agencies and increase transparency and competition within the market. We support parallel efforts by Congress, banking agencies, the Financial Stability Board and the Basel Committee to reduce the risk of undue reliance on external credit ratings, particularly for complex securitization exposures. However, we are concerned that the agencies' proposals in the ANPR could go too far and effectively prohibit the use of external credit ratings as one element of creditworthiness for purposes of the risk-based capital standards. We respectfully submit that nothing in the statutory language or the legislative history of Section 939A requires this result, and we encourage the agencies to urge Congress to amend the statute to clarify that credit ratings can be used as an element of creditworthiness, as described in more detail below.

I. Executive Summary

In implementing Section 939A of the Dodd-Frank Act, we believe that the agencies should read the statute—consistent with its plain meaning—to require removal of references to credit ratings, but permit the replacement standards to employ credit ratings as an element of creditworthiness to the extent their use has

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[2] Specifically, Section 939A of the Dodd-Frank Act requires each Federal agency to review:

(1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and
(2) any references to or requirements in such regulations regarding credit ratings.

In addition, each Federal agency

> shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. In making such determination, such agencies shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness.

Pub. L. No. 111-203, § 939A, 124 Stat. 1376, 1887 (2010).

been properly assessed and/or evaluated by the specific banking organization. As described below, this reading is consistent with the legislative history and would advance the policy goals of the statute.

We propose that the agencies design replacement standards with the following considerations in mind:

- Replacement standards should be tailored to fit the appropriate risk-based capital standards. Consequently, to the extent that the banking agencies are seeking to develop replacement standards for references to credit ratings in the Basel I risk-based capital adequacy guidelines (*e.g.*,12 C.F.R. Part 225, Appendix A), the standards should be consistent with the use of exposure category risk weights under those guidelines. By the same token, to the extent the banking agencies are seeking to develop replacement standards for references to credit ratings in the Basel II risk-based capital adequacy guidelines (*e.g.*,12 C.F.R. Part 225, Appendix G), the standards should be consistent with the use of exposure-specific risk weights under the internal-ratings-based and advanced measurement approaches.

- Credit ratings should be a permissible input in any replacement standard. Credit ratings are useful tools in evaluating the creditworthiness of an issuer, and abandoning credit ratings entirely would impose undue cost on banking organizations.

- The replacement standards should implement a sliding scale that would determine the degree to which a banking organization could rely on credit ratings, additional information or other approaches to measuring creditworthiness, based on a range of factors related to the exposure.

Replacement standards which satisfy the foregoing requirements further each of the guiding principles set forth in the ANPR. In addition, such standards also allow the U.S. to implement the proposed reforms to the Basel Capital Accord ("**Basel III**") consistently with other nations.

II. Legislative Background

As noted above, while the agencies are required under Section 939A(b) of the Dodd-Frank Act to modify their relevant regulations by "removing any reference to or requirement of reliance on credit ratings" and to substitute such "standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations," we respectfully submit that nothing in Section 939A proscribes the use of credit ratings altogether in any substitute standard of creditworthiness. Section 939A(b) of the Dodd-Frank Act leaves the appropriateness of each standard of creditworthiness to the discretion of the respective Federal agency, which must seek to establish, to the extent feasible, uniform standards of creditworthiness and take into account the entities regulated and the purposes for which such entities would rely on such standards. Allowing for credit ratings as an element, but not the sole element, in a new standard of creditworthiness, is consistent with the plain meaning of Section 939A(b).

The legislative history does not show any intent to ban credit rating references completely.[3] Rather, it supports a reading which allows the use of credit rating references in new credit worthiness standards, so long as the new standards foster a competitive market with alternatives to credit ratings. Section 939A of the Dodd-Frank Act can be traced back to the financial regulatory reform bill passed by the House of Representatives on December 11, 2009.[4] The House bill used almost identical wording to Section 939A of the Dodd-Frank Act, except that it mandated review and modifications only for regulations of an enumerated list of Federal agencies, subjecting the use of credit ratings by other agencies to review by the U.S. Government Accountability Office instead.

The bill reported out of the Senate Banking Committee on April 30, 2010 also included language regarding the removal of references to credit ratings. Section 939(d) of the Senate Banking Committee bill would have removed any reference to credit ratings or any requirement relating to credit ratings *and* required agencies to amend regulations to require the use of a standard of creditworthiness that is "not related" to credit ratings, and that the relevant agency determined was appropriate.[5] The Senate Banking Committee bill would have included a limited exception if there were no reasonable alternative standard that could replace a credit rating.[6]

The relevant language in Section 939(d) of the Senate Banking Committee bill was dropped before the full bill was passed by the Senate on May 20, 2010. This change in the statutory language is relevant to gleaning the legislative intent behind the final section. Unlike Section 939(d) of the Senate Banking Committee bill, Section 939A(b) of the Dodd-Frank Act leaves the new standards of creditworthiness in the discretion of the respective Federal agency and does not mandate that the new standards be unrelated to credit ratings. The Dodd-Frank Act, unlike the Senate

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[3] We note that neither the statute nor the legislative history provides a definition of "credit rating."

[4] *See* Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 6010 (as passed by the House of Representatives Dec. 11, 2009). A similar section was contained in a bill previously introduced by Representative Spencer Bachus (R-AL). *See* Consumer Protection and Regulatory Enhancement Act, H.R. 3310, 111th Cong. §§ 602-603 (as introduced July 23, 2009).

[5] *See* S. 3217, 111th Cong. § 939(d)(2) (as reported by S. Comm. on Banking, Housing, and Urban. Affs., April 30, 2010).

[6] *Id.* § 939(d)(3).

Banking Committee bill, does not limit the agencies' discretion in that regard.[7] The change in the statutory language, and the omission of the limitation which appears in the Senate Banking Committee version of the provision, suggests that the legislative intent was not to limit the use of credit ratings under the new standards. The Senate bill formed the basis of the Conference base text and was subsequently amended by House conferees to reflect the final statutory text.

In other words, the Senate specifically considered mandating a new creditworthiness standard that could not have been "related to" credit ratings, but it ultimately decided not to do so. The House never proposed that new standards must be unrelated to credit ratings. As a result, it seems clear that Congress' intent was not to prohibit any new creditworthiness standard from making any use of credit ratings at all.

In discussing their offer to the Conference base text, House conferees suggested that their amendment served to remedy past over-reliance on ratings and to foster a competitive market with alternatives to credit ratings.[8] They opposed a solution in which a rating agency was assigned to put its imprimatur on instruments, a solution criticized as the "federal government's Good Housekeeping seal of approval for the rating agencies and their products."[9]

The prevention of over-reliance on external credit ratings, and the fostering of competition by avoiding an implicit government seal of approval on the rating agencies themselves, can be seen as the twin policy goals of Section 939A of the Dodd-Frank Act. Both of these goals can be served if the agencies implement Section 939A by developing new creditworthiness standards for use in their regulations that permit or require, as appropriate, other elements to be used by

[7] Although Section 939A does not contain an exemption for instances in which there is no reasonable alternative to credit ratings, because it gives the agencies greater latitude than S. 3217, there was no need for such an exception.

[8] This statement was made by Congressman Ed Royce (R-CA). *See House-Senate Conference Committee Holds a Meeting on the Wall Street Reform and Consumer Protection Act*, 111th Cong. *69 (June 15, 2010) (LexisNexis, CQ Transcriptions). Congressman Royce advocated that alternative risk indicators must replace "this government-created oligopoly," and described a more competitive market with alternatives to the NRSRO's ratings as the most effective alternative. *Id.* In response, Chairman Barney Frank (D-MA) stated "we mandate that the regulators remove any reliance on ratings and tell them to come up with the kind of alternative measures the gentleman mentioned, whether it's spreads or whatever." *Id.*

[9] According to Congressman Spencer Bachus (R-AL), such an implied seal of approval "contributed significantly to the mispricing of risk and subsequent collapse of market confidence during the financial crisis." *Id.*, at *68. Congressman Bachus further described the House position as "ensuring that we do not concur in the Senate position of having the government essentially assign a rating agency to put their imprimatur on it and have once again an implied government seal of approval." *Id.*, at *71.

banking organizations in addition to credit ratings, but without banning the use of external credit ratings altogether. As long as the use of credit ratings is subject to a requirement on the part of the banking organization to assess the appropriateness of reliance on an external credit rating and/or to evaluate the rating, as applicable, we believe any new creditworthiness standard permitting the use of credit ratings would be consistent with the Congressional mandate underlying Section 939A. To reinforce this interpretation, we encourage the agencies to urge Congress to amend the statute to clarify that credit ratings are a permissible input in any creditworthiness standard adopted by the agencies, as described in more detail below.

III. Proposed New Creditworthiness Standards

a. Standards should be tailored to fit the appropriate risk-based capital standards

SIFMA believes that the creditworthiness standards that replace sole reliance on ratings in risk-based capital standards should be tailored to fit the appropriate risk-based capital standards.

The Basel I risk-based capital standards, such as those for bank holding companies contained in 12 C.F.R. Part 225, Appendix A, generally provide for risk weights to be determined by exposure category. Any creditworthiness standards that replace sole reliance on credit ratings in the Basel I capital adequacy guidelines should be consistent with allowing for the continued use of exposure categories to determine risk weights. The replacement standards should not require depository institution holding companies and insured depository institutions that are subject to the Basel I capital adequacy guidelines (and not the Basel II capital adequacy guidelines) to effectively adopt and invest in the more complex and sophisticated risk management systems that are required for the Basel II internal-ratings-based and advanced measurement approaches.

At the same time, SIFMA believes it would be inappropriate for the replacement standards to prevent or otherwise be inconsistent with the use of exposure-specific risk weights under the Basel II risk-based capital standards, such as those for bank holding companies contained in 12 C.F.R. Part 225, Appendix G. Depository institution holding companies and insured depository institutions that are subject to or qualify for the Basel II capital adequacy guidelines should not be forced to return to the use of exposure categories to determine risk weights for those exposures that can currently be risk weighted on an exposure-specific basis.

For institutions subject to the Basel II capital adequacy guidelines, risk weight categories, even if expanded in number, would be a rudimentary tool to replace credit ratings, and would discourage more analytical, sophisticated differentiation of risk, because the capital charge remains the same for assets within the same category. Compared to an exposure-specific approach, an exposure category approach insufficiently recognizes that similar instruments issued by similar categories of issuers may nevertheless pose different types of risk, because of, for example, different terms within the same types of instruments, different financial conditions of individual issuers, and different country risks (legal, political, economic), to name just a few variables.

An approach based solely on risk weightings by exposure category would be at odds with the Basel II capital adequacy guidelines, which recognize the merits of a more differentiated, granular approach to measuring credit and other types of risk. To rely on exposure category standards would not only be at variance with the direction taken by other countries that have adopted Basel II and will adopt Basel III, but would also penalize U.S. institutions that have already invested in the tools and resources necessary to adopt the internal-ratings-based and advanced measurement approaches.

b. Credit ratings should continue to be a permissible input

Credit ratings and other analytical data prepared by third-party service providers remain essential in the capital markets' determination of the creditworthiness of an issuer, and are and will continue to be very useful tools in allowing a banking organization to determine the creditworthiness of an issuer in measuring regulatory capital.

Among other advantages, credit ratings represent independent third-party assessments that are transparent, easily comparable and easily available. In particular, rating agencies and other third-party service providers reduce information costs, and promote liquid markets, using the advantage of economies of scale, particularly in collecting and analyzing large amounts of data.

In addition, as a result of the implementation of other provisions of the Dodd-Frank Act, rating agencies will be subject to greater regulation, including disclosure requirements that will improve the availability and transparency of their data. For example, Section 932 of the Dodd-Frank Act requires each nationally recognized statistical rating organizations ("**NRSROs**") to publicly disclose the assumptions underlying the credit rating procedures and methodologies and the data relied upon to determine the credit rating, as well as "information that can be used by investors and other users of credit ratings to better understand credit ratings in each class." In addition, on October 4, 2010, the SEC issued proposed new regulations governing asset-backed securities pursuant to Section 943 of the Dodd-Frank Act, including amendments that would, among other things, significantly broaden the scope of disclosures required for privately placed asset-backed securities. The new regulations would potentially be in addition to amendments to Regulation AB and private placement safe harbors proposed by the SEC on April 7, 2010.

SIFMA believes that abandoning credit ratings and requiring banking organizations to produce their own replacement for external ratings could be prohibitively expensive. For banking organizations with large trading books, the costs of building the necessary infrastructure to apply internal-ratings-based standards to all assets would be extremely time-consuming and expensive. Small banking organizations may not have the resources to develop internal systems applicable to the full breadth of rated assets they currently hold and, as a result, may exit certain asset classes entirely. The added expense to both large and small banking organizations may dampen their interest in markets affected by the ANPR. This reduction in demand would reduce liquidity for a variety of instruments, and consequently would also reduce the extent to which these instruments could be used to diversify and hedge risk. Lastly, a full prohibition on the use of credit ratings would negatively affect the transparency of the capital adequacy guidelines, heightening the costs of supervisory review.

Credit rating agencies need not be NRSROs, but the diligence thresholds for banking organizations relying on non-NRSROs would be higher to take into account the fact that these entities do not comply with the SEC's regulation for NRSROs. Permitting the use of credit rating agencies other than NRSROs would advance the policy goal of Section 939A of increasing competition in the rating agency market.

SIFMA believes that the advantages of using credit ratings should continue to be available to banking organizations in assessing and measuring credit and other types of risk and to the agencies in supervising the banking organizations. We will discuss in the next section how the new creditworthiness standards could incorporate the use of external credit ratings and other third-party data as elements in measuring and assessing credit risk.

c. *Proposal for new creditworthiness standards*

SIFMA believes that the agencies should replace the current references to credit ratings in their regulations with new creditworthiness standards that would not permit banking organizations merely to rely on credit ratings, but would, depending on the exposure, range from (1) permitting the use of (a) credit ratings and (b) additional information, whether from external service providers or developed internally (in each case, provided that the organization had made an assessment that reliance on credit ratings and/or such additional information was appropriate, or had evaluated such ratings or information, as applicable) to (2) permitting the use of other approaches, such as internal risk models or a simplified supervisory formula approach. Banking organizations would also be required to develop and implement appropriate policies and procedures to ensure their implementation of the applicable creditworthiness standards were consistent with safety and soundness standards.

In effect, the agencies' new standards should implement a sliding scale that would determine the degree to which a banking organization could rely on credit ratings, additional information or other approaches to measuring creditworthiness, based on such factors related to the exposure as:

- the complexity and structural features of the asset;
- the liquidity of the asset;
- the availability of market information about the asset;
- the availability of information relating to the pools of assets underlying the exposure, if relevant; and
- the suitability of models and methodologies used by rating agencies or other third-party service providers in measuring or providing information about the creditworthiness of the asset.

At one end of the spectrum are assets for which credit ratings are reliable and suitable. For these assets, banking organizations will be required to assess the degree to which reliance on credit ratings and/or additional external or internal analyses was appropriate for the specific exposure. A banking organization may determine that the creditworthiness analysis consists of the external rating, supplemented with an evaluation of the third party provider's fitness in rating certain categories of exposures. A banking organization would also be required to at least periodically evaluate the rating agency's methodology to confirm that the methodology is consistent with the organization's internal views of the credit exposure of the asset.

For assets for which the indicators suggest that credit ratings may not be relied on to the same degree, banking organizations may be required to rely on additional information or perform additional external analyses.

Specific additional inputs to supplement credit ratings could include:

- **Generally** – information available from the rating agencies, expected loss estimates, market information related to credit risk spreads, market prices, market measures of liquidity or volatility, and publicly available information on the issuer.
- **For sovereign exposures** – country risk classifications and macroeconomic indicators such as debt ratios, growth rates, debt maturity characteristics and income projections.
- **For PSE exposures** – PSE-specific credit indicators such as debt to revenues, etc., plus an assessment of the inputs for sovereign exposures for the relevant country of the PSE.

- **For bank and corporate exposures** – publicly available issuer-specific information.

- **For collateral and guarantees** – information based on the nature of the collateral or the identity of the guarantor.

Generally, banking organizations should be allowed to obtain additional information from third-party service providers or vendors, including rating agencies, provided the organizations have internally determined that the source is reliable for the type of instrument and information sought. The standards of diligence should be influenced by whether the third-party service provider is regulated as an NRSRO, and therefore itself subject to strict regulation and supervision.

At the other end of the spectrum, for complex, relatively illiquid instruments such as certain securitization exposures, a number of different alternatives could be adopted for new creditworthiness standards, including:

- A combination of credit ratings and additional information, including expected loss estimates, market information related to credit risk spreads, market prices, market measures of liquidity or volatility, and publicly available information on the issuer, all of which would have to be evaluated by the banking organization for appropriateness of reliance.

- The use of probability-of-default and loss given default estimates, either developed by banking organizations internally or from third-party providers whose estimates have been properly evaluated, to arrive at expected loss measures associated with specific risk weightings.

- The use of internal models which accurately reflect probability of default and loss given default. The standard could require, among other things, consistency between the standards for a banking organization's internal credit assessments and its internal risk management process, management information reporting systems and capital adequacy assessment processes. In addition, it could require the banking organization to have an effective system of controls and oversight that ensures compliance with operational requirements, and requires the bank holding company to have an audit function to assess at least annually whether the controls over the internal credit assessment process are functioning as intended. Furthermore, it could require the review and update of each internal credit assessment whenever new material information is available, but no less frequently than annually, and the ongoing assessment of the internal credit assessment process.

- A simplified version of the supervisory formula approach ("**SFA**") that is available to banking organizations applying Basel II's advanced approach rules. This approach would employ the same inputs as SFA (*i.e.*, amount of the underlying exposures, tranche percentage, capital that would be required to be held against the underlying exposures, thickness of tranche, effective number of exposures, and exposure-weighted average loss given default), but permit banking organizations to rely on simplifying assumptions, particularly in calculating the capital required against underlying exposures.

- An independent credit analysis performed for the banking organization, or jointly for any number of interested banking organizations by another credit analysis provider. This credit analysis would be paid for by the bank(s), not the issuer. Such an approach could enhance competition in the area of credit ratings, and thus be consistent with one of the policies underlying Section 939A.

The creditworthiness standard could include any one or all of the foregoing based on an assessment by the banking organization and its supervisor that the approach was appropriate.

A modified sliding scale approach would apply to the determination of whether guarantees or collateral are eligible. The Basel II advanced approach rules employ credit ratings as a threshold to determine whether the guarantees or collateral are eligible for purposes of a banking organization's risk weighting calculation. In calculating the threshold, banking organizations should be permitted to use external credit ratings to a greater extent than they would if the relevant collateral were an asset held directly, and should have the option to use internal credit ratings. The credit rating in this case serves only to determine collateral eligibility, not the creditworthiness of the asset.

IV. Furthering the Guiding Principles of the ANPR

SIFMA believes that creditworthiness standards established in the manner described above would be fully consistent with and further the "guiding principles" set forth by the ANPR, as follows:

- The standards—whether through additional exposure categories (Basel I) or exposure-specific approaches (Basel II)—appropriately distinguish the credit risk associated with a particular exposure within an asset class. Requiring banking organizations to apply an appropriately evaluated, exposure-specific standard permits granularity in risk assessments and aligns regulatory capital measures of risk with actual risk management decisions.

- The standards promote transparency in risk assessments and permit appropriate supervisory review. The presence and evaluation of credit ratings is crucial to ensure the quality, transparency and consistency of capital standards. Credit ratings as an input advance transparency and consistency of capital standards because these inputs are available to all banking organizations and bank supervisors. Furthermore, the revisions to the regulation of NRSROs in response to the financial crisis enable their regulator to ensure that issued credit ratings adhere to a transparent methodology and are more easily replicable and reviewable.

- The standards allow for timely and accurate measurement of changes in creditworthiness, while not causing undue volatility and pro-cyclicality in credit levels. Employing credit ratings, along with additional inputs, in credit analyses furthers these objectives. Credit rating agencies review credit ratings frequently to determine whether a particular credit rating is appropriate for a given product, considering information disclosed in public reports, material changes relevant to the issuer and market conditions. Credit rating agencies also frequently review their rating models to ensure that the models are functioning appropriately. The fact that credit ratings are based on long-term views of creditworthiness ensures that market volatility does not unduly affect regulatory capital standards.

- The standards minimize opportunities for regulatory capital arbitrage by aligning measurements of risk-based capital measures with risk management measures, thereby reducing the possibility that a banking organization can invest in a risky asset without the requisite capital charge.

- The standards avoid undue costs on banking organizations by permitting them to employ properly evaluated credit ratings in their risk assessments. SIFMA believes that complete abandonment of credit ratings would impose unjustified cost on banking organizations, banking supervisors and market liquidity.

V. Consistency with International Capital Standards

SIFMA believes that the agencies should consider consistency with international capital standards as a goal of the new creditworthiness standards, and permit the United States to implement the changes to risk-based capital rules required by the revisions to Basel II and Basel III. The Basel II market risk rules and proposed Basel III are already tackling the issue of undue reliance on external credit ratings by requiring banking organizations to supplement regulatory capital requirements based on externally rated securitizations with their own credit analysis and capital estimates of the exposure.

Without a broadly consistent global approach to creditworthiness standards for securities, including securitizations, the agencies run the risk of encouraging regulatory arbitrage and of accentuating systemic risk. The agencies would not be able to create regulations that fully incorporate the internationally agreed standards. In the absence of a commonly used "language" with reference to ratings both in the U.S. standards and their non-U.S. counterparts, it would be extremely difficult if not impossible to achieve an accurate implementation of Basel standards in the United States.

At the very least, we urge the agencies to delay rulemaking until consensus emerges among international banking supervisors which are currently reviewing the role of credit ratings in capital adequacy standards. On October 20, 2010, the Financial Stability Board presented principles that call on authorities to reduce reliance on credit ratings, including in the area of prudential supervision of banking organization.[10] The principles call for the replacement of references to ratings with suitable alternative standards of creditworthiness where possible, and for banking organization and other market participants to make their own credit assessments instead of relying solely or mechanically on ratings. SIFMA believes that the proposal presented in this letter would be consistent with these principles. A process of addressing undue reliance on external credit ratings is under way in the European Union[11] and other jurisdictions.[12] There are considerations to require rating agencies to comply with the International Organization of Securities Commissions' Code of Conduct in order for their ratings to be used for Basel II purposes. The rule changes, including new credit analysis factors, developed by the United States should draw on these efforts to improve the use of credit ratings.

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[10] Press Release, Fin. Stability Bd., Financial Stability Board Meets in Seoul (Oct. 20, 2010), *available at* http://www.financialstabilityboard.org/press/pr_101020.pdf.

[11] *See* COMM. OF EUR. BANKING SUPERVISORS, CONSULTATION PAPER ON GUIDELINES TO ARTICLE 122A OF THE CAPITAL REQUIREMENTS DIRECTIVE (CP40) (July 1, 2010), *available at* http://www.c-ebs.org/documents/Publications/Consultation-papers/2010/CP40/CP40.aspx. The European Commission has recognized the challenges of instead removing credit rating references outright. A recent European Commission paper is cited by Reuters as follows: "A simple removal of references to ratings in existing EU and national legislation would not appear feasible without establishing a valid alternative or providing for an intermediate solution." Huw Jones, *EU to Discuss Curbs to Limit Rating Agency Role*, REUTERS (Sept. 29, 2010).

[12] For an overview, see INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: SOVEREIGNS, FUNDING, AND SYSTEMIC LIQUIDITY ch. 3, at 9 (Oct. 2010), *available at* http://www.imf.org/external/pubs/ft/gfsr/2010/02/index.htm.

VI. Timing

SIFMA encourages the agencies to implement Section 939A in coordination with the implementation for Basel II and III, for which national rulemaking is scheduled to be in place by the end of 2011 (enhancements to Basel II) or the end of 2012 (Basel III), with an appropriate phase-in period and/or grandfathering of existing positions.

Assuming that the banking agencies agree with SIFMA's proposed interpretation of Section 939A, this time period should provide banks with a sufficient transition period to develop appropriate risk management and evaluation techniques. However, if the banking agencies interpret Section 939A as prohibiting banking organizations from using credit ratings at all in making creditworthiness assessments, banking organizations will need a significantly longer time period to put in place platforms capable of addressing the new creditworthiness standards.

Either approach would be consistent with the timeline set forth in Section 939A, which does not set a deadline for the agencies' revisions to the capital adequacy rules, but merely requires a review of existing regulations by July 21, 2011.[13]

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SIFMA thanks you for the opportunity to comment on the agencies' ANPR. If you have any questions, please do not hesitate to call me at 202-962-7400 or SIFMA's counsel, Luigi L. De Ghenghi, Davis Polk & Wardwell LLP, at 212-450-4296.

Sincerely,

Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy
Securities Industry and Financial Markets Association

[13] Pub. L. No. 111-203, § 939A, 124 Stat. 1376, 1887 (2010).