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Mary Schapiro, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Rating Agency Consents and Regulation AB

Dear ~~Ms. Schapiro~~, Ms. Schapiro —

Since the onset of the subprime lending crisis in 2007, the Massachusetts Office of the Attorney General has developed an ongoing interest in Regulation AB under the Securities Act of 1933 (the "Securities Act"). Regulation AB forms the centerpiece of the SEC's investor protection regime for the asset-backed securitization markets. In our investigations, we have found that the public securitization model requires strengthening, and has previously "passed the risk of poor lending decisions on to investors, removed incentives for real loan underwriting at the retail level, and fueled a boom in thinly-capitalized mortgage originators that were never destined to survive a downturn."[1] For this reason we welcomed action by the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter "Dodd-Frank" or the "Dodd-Frank Act") to impose a duty of competence on credit rating agencies effective July 22, 2010.

We write now with regard to two no-action letters issued in 2010 by the SEC's Division of Corporation Finance to Ford Motor Credit. These letters state that the Division will not recommend enforcement action if issuers of asset-backed securities ("ABS") do not comply with the ratings disclosure requirements of Regulation AB, and thus fail to secure for investors the duty of competence mandated by Section 11 of the Securities Act. Since last July, many issuers have registered asset-backed securities without the required ratings disclosure and consents by rating agencies to Section 11 liability.

As a matter of policy, we believe that creating a duty of competence for rating agencies under Section 11 is a good thing. We believe that Congress rescinded the rating agencies' exemption from liability with the expectation that this would result in rating agency liability. While the Commission, in its prosecutorial discretion, may decide it will not bring enforcement action in a given area, we are concerned about the no-action letters for two reasons. First, we believe the SEC's decision to take no action in this area undermines recent Congressional reform and is inconsistent with Congressional intent. Second, the Commission's no-action letters to Ford

[1] Comment Letter of Attorney General Martha Coakley on Proposed Rule Concerning Asset-Backed Securities, Release Nos. 33-9117; 34-61858, Aug. 2, 2010.

Motor Credit have resulted in significant uncertainty for both governmental actors and private parties. Legally, no-action letters are expressions of enforcement policy. In practice, they are public statements by SEC staff often taken to imply legal interpretations and administrative action they do not contain. Yet the Commission's exercise of prosecutorial discretion does not affect whether SEC regulations and the federal securities laws are being violated. We urge the Commission to enforce Regulation AB in its entirety, in particular with regard to the prospectus disclosure of ratings, as well as to clarify the duties of issuers.

I. The Concept Release

As you know, the SEC exempted ratings by nationally recognized statistical rating organizations ("NRSROs") from Section 11 liability for a period of 28 years. From 1982 until July 22, 2010, Rule 436(g) under the Securities Act provided that NRSRO ratings disclosed in a registration statement "shall not be considered a part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Act." The Commission began public deliberations regarding eliminating this exemption by issuing a Concept Release on the Rescission of Rule 436(g) (the "Concept Release") in October 2009, citing investigations and studies pointing to aspects of rating agency involvement in the financial crisis.[2] The Commission and commenters on the Concept Release agreed on the Securities Act mechanics: If the Rule 436(g) exemption did not apply, NRSROs would be treated in the same manner as non-NRSRO rating agencies,[3] namely as experts under Section 7 of the Securities Act.[4] If an asset-backed issuer were to include ratings from an NRSRO in a registration statement, as Regulation AB generally requires,[5] the issuer would be required to file a consent by the rating agency to be named as an expert. By this consent, a rating agency would accept liability (as do lawyers, accountants, engineers, appraisers and other experts) for failure to meet the standard of competence imposed by Section 11 of the Securities Act.[6] The 1933 House report on the

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[2] Concept Release on Possible Rescission of Rule 436(g) Under the Securities Act of 1933, Release Nos. 33-9071; 34-60798; IC-28943 (Oct. 7, 2009). Investigations and studies cited include Roger Lowenstein, *Triple-A Failure,* N.Y. TIMES MAGAZINE, Apr. 27, 2008, and Frank Partnoy, *Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective,* April 2009, available at http://www.cii.org/UserFiles/file/CRAWhitePaper04-14-09.pdf (white paper commissioned by Council of Institutional Investors).

[3] The market for and use of non-NRSRO ratings is extremely small. Except where otherwise indicated, "rating agencies" in this letter refer to NRSROs.

[4] Section 7(a) of the Securities Act states, in relevant part: "If. . .any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement."

[5] Item 1103(a)(9) of Regulation AB requires, with regard to the prospectus summary, "Indicate whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies. If so, identify each rating agency and the minimum rating that must be assigned." Item 1120 of Regulation AB requires, with regard to the prospectus, "Disclose whether the issuance or sale of any class of offered securities is conditioned on the assignment of a rating by one or more rating agencies, whether or not NRSROs. If so, identify each rating agency and the minimum rating that must be assigned. Describe any arrangements to have such rating monitored while the asset-backed securities are outstanding." The adopting release for current Regulation AB states that Item 1120 "codifies current industry practice[.]" Asset-Backed Securities, Release Nos. 33-8518; 34-50905 (Dec. 22, 2004) (citation omitted).

[6] Section 11(a)(4) imposes liability on, among others, "any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement."

Securities Act explains that Section 11 liability "throws upon originators of securities a duty of competence as well as innocence which the history of recent spectacular failures overwhelmingly justifies."[7]

The Concept Release summarizes: "Rescinding the exemption [of Rule 436(g)] 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."

The Commission has made eleven comment letters publicly available on the Concept Release. Of these eleven, five were submitted by employees and consultants of the four major rating agencies (S&P, Moody's, Fitch and DBRS) and opposed rescission. The letters suggested the possibility of NRSROs refusing to consent to liability and withdrawing from certain markets.[8] The letters were also pessimistic at times about the ability of rating agencies to prove their diligence and competence in court. Laurence Tribe and Thomas Goldstein, writing "as legal consultants to Moody's Investors Service," assert: "There is a substantial risk that NRSROs simply could not prepare ratings when threatened with crushing liability to issuers and to the entire investing community in lawsuits in which the plaintiffs bore no burden of proving fault and in which the rating agency bore the burden of proving that it was not negligent but instead exercised due care."[9]

This and the other rating agency letters' assertions of "crushing" potential liability for incompetence echo similar historical industry complaints about Section 11 that have been made periodically without factual support. As Loss and Seligman note, "Section 11 was the *bête noire* that was going to stifle legitimate financing—and that did not produce a substantial recovery for 30 years."[10]

The New York City Bar Committee on Securities Regulation also opposed rescission. The Securities Industry and Financial Markets Association expressed ambivalence, noting that its member securities firms, banks, and asset managers agreed on the need for more accountability for rating agencies but disagreed on whether to support Section 11 liability.[11]

[7] H.R. REP. NO. 85, 73d Cong., 1st Sess. 9 (1933), quoted in 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4267 (3d ed. 2004). The Concept Release underscores this point: "Section 11 was enacted so that those persons with a direct role in a registered offering would be subject to a rigorous standard of liability to assure that disclosure regarding securities is accurate."

[8] *See, e.g.,* Comment Letter of Michel Madelain, Chief Operating Officer, Moody's Investors Service, on Concept Release, Dec. 14, 2009 ("imposing expert liability on NRSROs likely would lead to a contraction in rating coverage and a corresponding contraction in the availability of credit, especially for smaller entities").

[9] Comment Letter of Laurence Tribe and Thomas Goldstein on Concept Release, Dec. 14, 2009.

[10] 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4247-48 (3d ed. 2004) (also noting "scant litigation history").

[11] "We believe that there is a common desire in the industry to hold credit rating agencies more accountable for their ratings but some members of the Task Force expressed the view that expert liability may not be the appropriate avenue to achieve that accountability. [However, f]ailure to meet requirements for higher accountability may in the end be worthy of imposition of greater liability." Comment Letter of Sean C. Davy, Securities Industry and Financial Markets Association, on Concept Release, Dec. 14, 2009.

The remaining four commenters supported rescission. They were the Investment Company Institute, CalPERS, the Council of Institutional Investors, and the think tank Demos. The first three groups together represent entities with trillions of dollars in assets under management and tens of millions of investors. Relevant statements from the four comment letters include:

> CalPERS: "CalPERS believes that liability under Section 11 of the 1933 Act for intentional misconduct, recklessness and negligence [should] be extended to CRAs [credit rating agencies] by the elimination of the Rule 436(g) exemption[.] In CalPERS' view, this would represent a large step forward in deterring harmful conduct by the CRAs in the area of structured finance."[12]
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> The Investment Company Institute: "The Institute believes that rescinding the exemption for NRSROs from Section 11 liability...should help to improve the competitive landscape for rating agencies and, consequently, ratings quality."[13]
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> The Council of Institutional Investors: "The birth of the SEC's NRSRO designation in the 1970s transformed credit rating agencies from suppliers of information to financial gatekeepers. By registering as NRSROs and accepting the associated quasi-governmental power, credit rating agencies have a responsibility to ensure that their ratings are arrived at fairly and are accurate. However, NRSROs have generally escaped accountability for their shoddy performance and poorly managed conflicts of interest, at least in part because of their...exemption from liability. [T]he Council believes that eliminating the exemption from liability afforded to NRSROs under Section 11 would provide an incentive for those select rating agencies to be more diligent in their ratings processes, which[,] in turn, would better protect investors."[14]
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> Demos: "I would like to argue in favor of proposed steps, including rescission of Rule 436(g), to put the NRSROs on more of an equal footing, for liability purposes, with other participants in the securities issuance process. ... NRSROs 'participated in creating monstrous structured finance transactions with absurdly high ratings based on models and assumptions they knew or should have known were unreasonable,' one expert on the NRSRO's has written."[15]

The rulemaking process that began with the Concept Release was brought to a speedy conclusion by statute. Section 939G of the Dodd-Frank Act provided: "Rule 436(g), promulgated by the Securities and Exchange Commission under the Securities Act of 1933, shall have no force or effect."

The legislative history of Section 939G of the Dodd-Frank Act is consistent with the debate over the Concept Release. Both supporters and opponents agreed that its purpose and result were to impose Section 11 liability on rating agencies. Congresswoman Bean supported what would become Section 939G, stating, "This bill answers with strong protections for American families [including] rating agency liability and reform."[16]

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[12] Comment Letter of Anne Simpson, Senior Portfolio Manager, California Public Employees' Retirement System (CalPERS), on Concept Release, April 21, 2010. CalPERS is "the largest public pension fund in the United States with approximately $210 billion in global assets invested on behalf of 1.6 million beneficiaries."

[13] Comment Letter of Karrie McMillan, General Counsel, Investment Company Institute, on Concept Release, Dec. 14, 2009. "Members of ICI manage total assets of $11.33 trillion and serve almost 90 million shareholders."

[14] Comment Letter of Laurel Leitner, Senior Analyst, Council of Institutional Investors, on Concept Release, Dec. 14, 2009. "[T]he Council of Institutional Investors [is] a nonprofit association of corporate, public and union pension funds with combined assets that exceed $3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers."

[15] Comment Letter of James Lardner, Senior Policy Analyst, Demos, on Concept Release, Feb. 26, 2010, quoting Partnoy, *supra* note 2.

[16] 156 CONG. REC. H5219 (June 30, 2010).

Congressman Kevin McCarthy introduced an amendment, subsequently voted down, to delete what would become Dodd-Frank Section 939G, characterizing the rescission of Rule 436(g) as "increased liability language."[17] Senator Shelby, who has experience in the ratings agency space from his role as sponsor of the Credit Rating Agency Reform Act of 2006, also referred to Dodd-Frank's provisions as resulting in "heightened liability standards" for rating agencies.[18] The Dodd-Frank Act itself notes, in the findings of Section 931 (emphasis supplied):

> (4) Because credit rating agencies perform evaluative and analytical services on behalf of clients, much as other financial 'gatekeepers' do, the activities of credit rating agencies are fundamentally commercial in character and *should be subject to the same standards of liability and oversight as apply to auditors, securities analysts, and investment bankers.*
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> (5) In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. *Such inaccuracy necessitates increased accountability on the part of the credit rating agencies.*

II. The Response by Rating Agencies and the SEC to Dodd-Frank Section 939G

In the week preceding the effective date of Section 939G, the major rating agencies issued public statements in succession, doing what they had implied they would do in their comments on the Concept Release: refuse to consent to allow their ratings to be included in registration statements.[19] Regulation AB, however, requires that a prospectus for an asset-backed offering disclose ratings whenever an issuance or sale is conditioned on the assignment of a rating. Thus, all offerings stopped on the public asset-backed securitization markets for the day of July 22, 2010.[20]

At this point, the SEC had multiple options available to it consistent with Congressional intent. The first would have been to give the market an opportunity to find suitable prices for the new Section 11 liability for rating agencies. The second would have been to lower barriers to entry for NRSROs, and to recognize one or more new NRSROs prepared to consent to Section 11 liability. A third option, albeit one with legal risk, would have been for the SEC to use its statutory exemptive authority to override Congressional intent through a rulemaking process to exempt asset-backed offerings from ratings disclosure requirements contemplated by Dodd-Frank.[21] The SEC pursued none of these options. Instead, on July 22, the Division of Corporation

[17] H.R. REP. NO. 370, 111th Cong., 1st Sess. 12 (2009).

[18] 156 CONG. REC. S4076 (May 20, 2010).

[19] Moody's Investors Service Special Comment, Moody's to Begin Implementing Changes Relating to U.S. Regulatory Reform Act, July 15, 2010; Letter from Deven Sharma, President of Standard & Poor's, July 16, 2010; DBRS Comments on U.S. Financial Reform Legislation, July 20, 2010; Fitch Releases Market Letter with Perspectives on Implementing Dodd-Frank Act, July 23, 2010.

[20] Anusha Shrivastava, *Bond Sale? Don't Quote Us, Request Credit Firms,* WALL STREET J., July 21, 2010, available at http://online.wsj.com/article/SB10001424052748704723604575379650414337676.html.

[21] In 1996, the National Securities Markets Improvement Act ("NSMIA") granted the SEC general exemptive authority under Section 28 of the Securities Act to exempt issuers and securities, by rule or regulation, from the requirements of the Securities Act, as well as rules and regulations thereunder, whenever an exemption "is necessary or appropriate in the public interest, and is consistent with the protection of investors." Section 2(b) of the Securities Act, as amended by NSMIA, requires that whenever the Commission determines "whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." Although the SEC has authority to

Finance released a no-action letter to Ford Motor Credit (the "July 22 Letter") stating that the Division would not recommend enforcement action regarding the ratings disclosure requirements of Regulation AB.[22]

The July 22 Letter makes no reference to the guidance sought by the incoming letter (no-action regarding a single registrant's offerings), the identity of the inquiring Ford entities, or the facts at all. It does not analyze the law except to restate its plain requirements: Provisions in Regulation AB explicitly require the inclusion of ratings in most asset-backed prospectuses. The letter reaffirms the Commission's interpretation of those provisions as requiring the inclusion of ratings. The letter then observes that the rating agencies have refused to consent to the investor protections mandated by Dodd-Frank: "We note that the NRSROs have indicated that they are not willing to provide their consent at this time." The letter concludes, "In order to facilitate a transition for asset-backed issuers, the Division will not recommend enforcement action to the Commission if an asset-backed issuer as defined in Item 1101 of Regulation AB omits the ratings disclosure required by Item[s] 1103(a)(9) and 1120 of Regulation AB from a prospectus that is part of a registration statement relating to an offering of asset-backed securities." The incoming letter requested an indication of non-enforcement regarding a single entity, Ford Credit Auto Receivables Two LLC. The response addressed itself to a multi-trillion dollar market.

The enforcement position expressed in the July 22 Letter was time-limited "[i]n order to facilitate a transition for asset-backed issuers," and expired, by its terms, on January 24, 2011. A "replacement letter" issued on November 23, 2010 contains substantially similar language, notes the ongoing refusals by the rating agencies, expresses the SEC's need for "adequate time to complete the regulatory actions required by the Dodd-Frank Act," and extends the no-action position indefinitely, "[p]ending further notice."[23]

Neither the Ford Letters nor our discussion with the staff disclose any activity to bring practices in line with the clear intent of Dodd-Frank.

III. No-Action Letters Are Informal, Non-Binding Statements by SEC Staff

The SEC's no-action guidance is, as the Ford Letters note, a statement of staff enforcement intent. It does not change the law. Indeed, it is not binding on the Commission. Section 939G of the Dodd-Frank Act was self-executing, with immediate legal effect.[24] Nonetheless, no-action letters often set the tone for market practice, and a no-action letter's

issue exemptive orders under other securities laws, such as the Securities Exchange Act of 1934, the Securities Act authorized SEC exemptions only by rule or regulation, not by order. *See, e.g.*, THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 281-82, 282 n. 5 (4th ed. 2002) (noting that the SEC has received "no grant of power to individualize exemptions on an ad hoc basis under the 1933 Act"). The case law on the scope of the Commission's Section 28 authority is limited, and to our knowledge has not addressed the use of Securities Act exemptions in tension with recent Congressional action.

[22] Ford Motor Credit, SEC No-Action Letter (pub. avail. July 22, 2010).

[23] Ford Motor Credit, SEC No-Action Letter (pub. avail. Nov. 23, 2010) (together with the July 22 Letter, hereinafter "the Ford Letters"), which "[r]eplaces Staff Response Letter of July 22, 2010." To our knowledge a no-action "replacement letter," effectively addressed to the financial markets at large, with no new inquiry from any party or at least none made public, is without precedent.

[24] Section 4 of the Dodd-Frank Act states: "Except as otherwise specifically provided in this Act or the amendments made by this Act, this Act and such amendments shall take effect 1 day after the date of enactment of this Act." The Dodd-Frank Act was signed into law by President Obama on July 21, 2010.

endorsement of a practice is often viewed as suggesting the practice's legality. Thus, the SEC has opened a divide between the plain language of the federal securities laws and its own regulations, on the one hand, and market practice guided by informal SEC staff compliance statements, on the other.

The Commission itself has repeatedly emphasized that no-action letters do not have legal force, cannot set precedent, and cannot bind the Commission. [25] Because all SEC public documents from no-action letters on up involve a significant degree of internal administrative review, however, investors, market actors and even legal practitioners sometimes view these documents as being substantial in legal significance. This conflation is usually unimportant to the extent that the SEC backs up its informal, non-binding guidance with statutorily and administratively authorized agency action.[26] That has not happened in the present case, and the SEC's stance can catalyze significant confusion.

Although the SEC has no duty to interpret the law in its no-action letters, the SEC's exercise of prosecutorial discretion memorialized in a no-action letter hopefully dovetails with the SEC's view of the underlying law. We have been unable, however, to identify any plausible legal basis for the guidance by the staff that ABS issuers need not include credit ratings in their

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[25] "The Commission has always been careful to state in its releases dealing with the publication of 'no-action' letters that '[i]t should be recognized that no-action and interpretative responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission.' [...] In only a very few instances does the Commission itself see any of these 'no-action' responses; those which do come to its attention, moreover, do not have binding effect either as precedent or as a foreclosure of later proceedings." Lewis D. Lowenfels, *SEC "No-Action" Letters: Some Problems and Suggested Approaches,* 71 COLUM. L. REV. 1256, 1257 n. 4, 1258 (1971) (citation omitted), quoting from Public Availability of Requests for No-Action and Interpretative Letters and the Responses Thereto by the Commission's Staff, Release Nos. 33-5073; 34-8931; 35-16778; IA-265; IC-6111 (July 14, 1970). For a discussion of ways in which no-action letters lack legal force, *see* Thomas P. Lemke, *The SEC No-Action Letter Process,* 42 BUS. LAW. 1019, 1042-1044 n. 116-128 (1987) and sources cited (the "Commission has repeatedly cautioned that it is not bound by staff no-action letters," and denies equitable estoppel applies to no-action responses). The view that no-action letters lack legal force was emphasized by former SEC Chariman Manuel Cohen: "In 1967, during a panel discussion sponsored by the Section of Administrative Law of the American Bar Association, administrative law scholar Kenneth Culp Davis contended that "[no-action] interpretations are law." Manuel Cohen, then Chairman of the Securities and Exchange Commission[,] objected vehemently to this characterization and retorted that the SEC's bevy of no-action letters 'may be lore, l-o-r-e, but it is not law.'" *See* Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework,* 83 CORNELL L. REV. 921 (1998), at 923 (citations omitted) and generally (providing an overview of the deference courts have given interpretations contained in no-action letters). For a current treatise discussion of the history and character of no-action letters, *see* LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, 1 SECURITIES REGULATION 813-18 n. 29 (4th ed. 2006).

[26] For example, the SEC long used no-action letters to effectively certify NRSROs, based on the view that the Commission had no statutory authority to affirmatively certify them. The Credit Rating Agency Reform Act of 2006 then granted the SEC authority to regulate rating agencies, noting among its "Findings" that "the Commission has indicated that it needs statutory authority to oversee the credit rating industry." Going forward, the Credit Rating Agency Reform Act authorized the SEC to certify NRSROs via rules and forms. Looking backward, the Act exempted from the certification requirement credit rating agencies that had already received no-action letters, endowing those no-action letters (each stating that the staff would not recommend enforcement action against any broker or dealer that considered ratings by a given credit rating agency to be ratings from an NRSRO) with legal significance. In a rulemaking complying with the requirements of the Credit Rating Agency Reform Act, the SEC observed that the no-action process "has been criticized as lacking transparency[.]" Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Release No. 34-55857 (Jun. 5, 2007).

prospectuses.[27] We are aware of one other instance in which the staff has taken a no-action position regarding Dodd-Frank and ratings disclosure requirements. In that no-action letter, the staff indicated that it would not recommend enforcement of a rule requiring accountability of money market fund boards in selecting NRSROs.[28] In support of this stance, the staff invoked certain future regulatory revisions mandated by Dodd-Frank Section 939A.[29] We take no position on the staff's stance with regard to Section 939A and money market fund boards. We do note, however, that reliance on Section 939A would be misplaced at present with regard to ABS issuers' ratings disclosure obligations.[30]

Moreover, Dodd-Frank emphasizes the "sense of Congress" that preventing misconduct by rating agencies is an important area for investor protection.[31] Although it is rarely incumbent

[27] In addition to the Ford Letters, the staff of the Division of Corporation Finance has stated, in Question 233.04 of its Compliance and Disclosure Interpretations (further discussed *infra*), "For an issuer subject to Regulation AB disclosure requirements: The staff anticipates that its letter to Ford Motor Credit Company LLC (July 22, 2010) should make it unnecessary for ABS issuers to include references to ratings in ABS registration statements or prospectuses as set forth in that letter." Disclosure Question 233.04 (July 27, 2010), available at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm. Like no-action letters, Compliance and Disclosure Interpretations are non-binding staff guidance. Unlike no-action letters, they are not signed. Compliance and Disclosure Interpretations "reflect the views of the staff of the Division of Corporation Finance. They are not rules, regulations, or statements of the Commission. Further, the Commission has neither approved nor disapproved these interpretations. ... [T]hey are not binding due to their highly informal nature. Accordingly, these responses are intended as general guidance and should not be relied on as definitive." Quoted from http://www.sec.gov/divisions/corpfin/cfguidance.shtml.

[28] Investment Company Institute Designated NRSROs, SEC No-Action Letter (pub. avail. Aug. 19, 2010): "The Commission required money market fund boards to designate NRSROs, among other reasons, in order to shift to the board the responsibility for deciding which NRSROs the board would use in determining whether a security is an eligible security for purposes of rule 2a-7. In light of the requirements in section 939A of the Act, we agree that such a shift would not be a useful exercise pending the Commission review."

[29] Section 939A of the Dodd-Frank Act requires federal agencies, including the SEC, to modify rules and regulations by July 2011 to replace "any reference to or requirement of reliance on credit ratings" with references to "uniform standards of credit-worthiness," not yet promulgated. Our understanding of this provision is that the aim of Congress is to reduce reliance on credit ratings over time, in particular where such reliance is currently mandated by federal regulations. We expect, however, that many entities in the market will continue to rely on credit ratings. This expectation is reflected in other provisions of Dodd-Frank. Section 939F, for example, requires the SEC to establish by rulemaking "a system for the assignment of nationally recognized statistical rating organizations to determine the initial credit ratings of structured finance products, in a manner that prevents the issuer, sponsor, or underwriter of the structured finance product from selecting the nationally recognized statistical rating organization that will determine the initial credit ratings and monitor such credit ratings." Implicit in this provision is the assumption that structured finance issuances will continue to involve commissioning and monitoring credit ratings from NRSROs.

[30] We note that the SEC's proposed amendments to Regulation AB, released before the adoption of Dodd-Frank, make Regulation AB's use of credit ratings more uniform, but leave unchanged the requirements for prospectus disclosure of ratings. In particular, Items 1103(a)(9) and 1120 are unchanged: "INFORMATION REQUIRED IN PROSPECTUS...information required by...Item 1103 of Regulation AB (17 CFR 229.1103) and [i]nformation required by Item 1120 of Regulation AB (17 CFR 229.1120), Ratings." Asset-Backed Securities, Release Nos. 33-9117; 34-61858 (Apr. 7, 2010). At present, the existing regulations apply. In the future, the SEC may conclude that these regulations should be changed in consequence of Dodd-Frank Section 939A. In future rulemakings, we hope that the SEC will take into account our view that ratings information is material to investors, and that an adequate disclosure regime will cause ratings to be disclosed in the statutory prospectus for asset-backed securities.

[31] Dodd-Frank Section 939H, "Sense of Congress," states: "It is the sense of Congress that the Securities and Exchange Commission should exercise the rulemaking authority of the Commission...to prevent improper conflicts of interest arising from employees of nationally recognized statistical rating organizations providing services to issuers of securities that are unrelated to the issuance of credit ratings, including consulting, advisory, and other services." One key way to deter the creation of such conflicts and lessen the likely mistreatment of investors in situations where potential conflicts may arise is Section 11 liability.

on an administrative agency to justify its enforcement guidance, such justifications are helpful when, as here, the guidance addresses a multi-trillion dollar market. The Ford Letters neither offer a legal interpretation, nor in the alternative do they make clear that the ratings disclosure requirements of Regulation AB remain intact. To the extent that the prospectus disclosure of ratings remains required by Regulation AB, the possibility of issuer liability for material omissions is evident. The SEC should address this situation to end confusion in the marketplace.

IV. Assessment

We are mindful of the SEC's desire to maintain and encourage functioning public securitization markets. Such concerns are expressed in the staff's Ford Letters. There, the staff opined that, so long as rating agencies continue to refuse to provide consents, the lesser evil may be to allow registered securitizations to go forward under the *status quo ante,* with investors receiving the protections of the federal securities laws with the glaring exception of the new protections pursuant to Section 939G of Dodd-Frank.

The SEC may have the authority to change federal requirements and legalize this outcome by suspending Items 1103(a)(9) and 1120 of Regulation AB by rule or regulation. To our knowledge, it has pursued no such action.[32] With due respect to the challenges faced by financial regulators today, we are concerned with the approach chosen by the Division of Corporation Finance. Multi-billion dollar registrants have represented to their shareholders that the SEC has "permitted" or "allowed" them or their affiliates to cease complying, or "relieved" them from compliance, with elements of Regulation AB.[33] Yet, as a former Chief Counsel of the Division of Investment Management has written, "a favorable no-action letter does not insulate the recipient from a private litigant who wishes to argue that the same transaction constitutes a violation of the law," and the "Commission itself has stated that no-action letters are not intended to affect the rights of private parties."[34]

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[32] As observed in note 21, *supra,* the Commission can issue Securities Act exemptions only by rule or regulation, not by order. To the extent rapid action may be called for, we note that the Commission has used interim temporary rulemakings often in recent years.

[33] *See, e.g.,* Ally Financial Inc., Form 10-Q filed Aug. 6, 2010, available at http://edgar.sec.gov/Archives/edgar/data/40729/000119312510181437/d10q.htm ("The Securities and Exchange Commission (SEC) has issued guidance *permitting issuers* for six-month period [sic] to omit credit ratings from certain registration statements filed under the SEC's Regulation AB," emphasis supplied), Ford Motor Co., Form 10-Q filed Aug. 6, 2010, available at http://edgar.sec.gov/Archives/edgar/data/37996/000115752310004856/a6384925.htm ("on July 22, 2010, the Securities and Exchange Commission granted 'no-action' relief by *allowing omission* of the required credit rating disclosures from registration statements," emphasis supplied) *and* American Express Co., Form 10-Q filed Aug. 5, 2010, available at http://edgar.sec.gov/Archives/edgar/data/4962/000095012310072749/c02607e10vq.htm ("the SEC staff has *effectively relieved issuers* from the ratings disclosure requirement," emphasis supplied). The Wall Street Journal appears to be under this apprehension as well. Anusha Shrivastava, *Asset-Backed Issuance Hampered by New Dodd-Frank Uncertainty,* WALL STREET J., Jan. 13, 2011, available at http://online.wsj.com/article/BT-CO-20110113-714273.html ("The market froze and issuers like Ford Motor Co. [sic; Ford Motor Credit] held back on issuing bonds until the Securities and Exchange Commission issued a letter *granting a six month reprieve* from the requirement. Eventually, in November, the SEC *extended the waiver indefinitely,* allowing bond sales to go through without the use of credit ratings in bond-offering documents," emphasis supplied).

[34] Lemke, *supra* note 25, at 1042-43 (citations omitted).

The law requires asset-backed issuers to disclose ratings, obtain rating agency consents, and thus secure Section 11 protections for investors. Yet, based on the Ford Letters, many issuers are receiving a different message. The Division of Corporation Finance may have exacerbated confusion in this area with five new Compliance and Disclosure Interpretations ("C&DIs"), issued on July 27, 2010.[35] Taken together with the Ford Letters, the only authority they cite, the C&DIs create a compliance scheme not contained in the applicable regulations, suggesting alternatives to Items 1103(a)(9) and 1120 to be observed in issuer-by-issuer consultation with the Division.[36] Like the no-action letters, this compliance scheme encourages the misapprehension that it is lawful to issue asset-backed securities without complying with the ratings disclosure requirements of Regulation AB. In fact, the situation is one where such issuances will not lead to staff recommendation of Commission enforcement, but the issuances may remain in violation of the Securities Act, which can be enforced by both governmental actors and by private parties.

V. Conclusion

In the Dodd-Frank Act, the clear intent of Congress was to provide investors with a much-needed requirement of rating agency competence. We are concerned that the SEC has defeated this intent. We are also concerned that the SEC, by partially suspending enforcement but not altering the requirements or applicability of Regulation AB, may be viewed as having given its imprimatur to material omissions in registration statements for asset-backed securities. If this is the case, asset-backed issuances may pose novel legal questions under state and federal law. Whenever an issuer finds it necessary to use ratings to sell asset-backed securities, the issuer should proceed in accordance with the federal securities laws, SEC regulations and the disclosure and liability protections intended by Dodd-Frank. To the extent that issuers have not done so, it is possible that a variety of potential claims for private and public investors, including injunctive relief, rescission and other damages, may now lie, and that SEC non-enforcement may have resulted in large potential liability of asset-backed issuers and underwriters for failing to state required facts.

We ask the Commission to enforce Regulation AB in its entirety and in a manner consistent with the intent of the Dodd-Frank Act. Although we are aware that the rating agencies declined to participate in the securitization markets for the day of July 22, 2010, we believe that the SEC should let the market set rating agency pricing reflecting the Section 11 duty of competence. Calculating risk of loss is the business of the rating agencies.

If the SEC believes that market prices will be too high, such that rating agency liability will cause intolerable disruption in the market, it should forthrightly address the situation and assert the legality of the current practices it has encouraged. The courts can then establish whether the SEC's position comports with Dodd-Frank Section 939G. Such an approach would at least lessen confusion among issuers and investors.

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[35] New questions 233.04 through 233.08 of the Division of Corporation Finance's Compliance and Disclosure Interpretations (all dated July 27, 2010) are available at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

[36] Our understanding of the C&DIs includes the following: (i) Without discussion of Regulation AB provisions to the contrary, the C&DIs provide that ratings no longer need be disclosed in the statutory prospectus. (ii) Ratings may be disclosed in free writing prospectuses not subject to the full statutory protections of the registration statement. (iii) "ABS issuers with questions about the need to reference ratings in their registration statements or prospectuses should contact the staff." *Id.*

We thank you for your attention to this important matter. It is our hope that, through continued cooperation and open communication, we can achieve the heightened investor protections introduced by the Dodd-Frank Act.

Respectfully submitted,

Martha Coakley
Massachusetts Attorney General