



Securities Industry Association

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July 28, 2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, D.C. 20549

Re: Rating Agencies and the Use of Credit Ratings under Federal Securities Laws
(Release Nos. 33-8236, 34-47972, IC-26066, File No. S7-12-03)

Dear Mr. Katz:

The Capital Committee of the Securities Industry Association¹ (“the Committee”) appreciates the opportunity to comment on the Securities and Exchange Commission’s (“the Commission”) concept release referenced above, and applaud the Commission’s efforts to learn more about issues relating to the credit rating agencies and their operations.² These efforts have provided valuable information to market participants with respect to the role of credit rating agencies in the operation of the capital markets.

While the concept release raises a myriad of questions concerning rating agencies, the Committee’s focus has been upon the use of credit ratings by the agencies designated as “nationally recognized statistical rating agencies” (“NRSROs”) in the Commission’s Rule 15c3-1 (the “Net Capital Rule”). The ratings are utilized in the Net Capital Rule as a means for determining regulatory capital charges on different grades of debt securities. The Committee believes that such differentiation in the determination of capital charges on the basis of credit ratings is a concept that has served markets well for over 25 years. We also note that the use of a

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker’s Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry employs nearly 700,000 individuals. Industry personnel manage the accounts of more than 92-million investors directly and indirectly through corporate, thrift, and pension plans. In 20002, the industry generated \$222 billion in U.S. revenue and \$356 billion in global revenues. (More information about SIA is available on its home page: www.sia.com)

² In addition to publication of the concept release, these efforts have included holding two full-day hearings in November 2002 to discuss a wide range of issues relating to credit rating agencies and the operation of the securities markets, and the publication of *Report on the Role and Function of Credit Rating Agencies in the Operation of Securities Markets, As Required by Section 702 (b) of the Sarbanes-Oxley Act of 2002*, January 24, 2003.

ratings approach for the determination of capital adequacy is a primary thrust of the New Basel Capital Accord ("Basel II")³ that is expected to be in use on a global basis by 2007. In light of their successful use in determining capital adequacy over more than two decades in the U.S. capital markets, and in view of the imminent adoption of ratings by what will almost surely be the most widely used capital adequacy standard on a global basis, we would strongly caution against any steps by the Commission that would have the effect of abandoning the use of credit ratings as an element of the Net Capital Rule. We note that less sophisticated and/or smaller broker-dealers would be particularly adversely impacted by the absence of publicly available ratings.

In response to the question posed in the concept release on the use of internally developed ratings, the Committee believes that reliance upon internal ratings would be appropriate for those firms that have obtained regulatory approval to do so and that have demonstrated a robust system of internal controls. We note that Basel II also would allow financial institutions that have demonstrated an effective and sophisticated infrastructure to utilize internal ratings in the determination of capital requirements.

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Thank you for the opportunity to comment on the concept release. If you have any questions regarding this letter, or if we can otherwise be of assistance, please contact SIA Senior Vice President and Director of Research, Frank A. Fernandez at (212) 618-0517 or at ffernandez@sia.com.

Very truly yours,

Cheryl Kallem
Chair
SIA Capital Committee

cc: The Honorable Chairman William H. Donaldson
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid
Annette L. Nazareth, Director, Division of Market Regulation

³ *The New Basel Capital Accord*, ("Basel II") Bank for International Settlements, April 29, 2003; *Advance Notice of Proposed Rulemaking re: U.S. Implementation of Revised Basel Accord*, Federal Reserve Board July 14, 2003.