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917-680-1465

June 14, 2021

Commissioner Allison Herren Lee
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549

Re: Public Input Welcomed in Climate Change Disclosures

Dear Commissioner Lee,

My name is Bill Harrington. I am a private U.S. citizen, financial practitioner, individual investor, pro-bono advocate for responsible finance, and member of the Wiikirating.org Experts Board.[1]

I am also a senior fellow affiliate at Croatan Institute. Croatan Institute is an independent, nonprofit research and action institute whose mission is to build social equity and ecological resilience by leveraging finance to create pathways to a just economy. We envision an equitable world where finance supports flourishing communities, vibrant places, and resilient economies.[2]

I inject accountability into the U.S. and global financial systems by pushing financial practitioners and regulators to *vastly* improve governance. My goals are to rationalize financial systems, optimize economies, and re-constitute social contracts. Financial practitioners' poor governance undermines everyone in the world by relentlessly warping price signals, directing investment to sub-optimal uses, and periodically spawning full-blown crises.

I take aim at two pervasive governance failures that generated the 2008 financial crisis, namely:

1. Credit rating inflation of bonds, issuers, and derivative counterparties in all sectors; and
2. Proliferation of deficient complex-finance products such as derivative contracts and asset-backed securities (ABS) that enable an entity to overstate potential gains and understate potential losses.[3]

PLEASE NOTE:

***Do Not Scrub My Contact Details!* I intentionally place them and all my work in the public domain because I welcome *all* inquiry from *all* persons, both human and corporate.**

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[1] Wikirating website (https://www.wikirating.org/).
[2] Croatan Institute website (http://croataninstitute.org/).
[3] Ibid., "Injecting Accountability into the U.S. and Global Financial Systems" and "Bill Harrington" bio.

My Comment Addresses Question 15 and Other Commenters' Responses.[4]

"Current Guidance on Economic Analysis in SEC Rulemakings" informs all analyses.[5]

> *"Question 15. In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?*"

MAIN POINT: The SEC Must Fix Its Governance and That of Credit Rating Companies!

To improve all disclosures by *all* fixed-income issuers and *all* derivative counterparties, the SEC must ditch post-crisis policy of designating selected credit rating companies as "nationally recognized statistical rating organizations (NRSROs)."[6] The designation bestows each NRSRO with a permanent shield against accountability when inflating credit ratings and masking credit exposures, such as those to ESG factors, in any U.S. debt or derivative market. As a result, NRSROs relentlessly understate credit risk in *all* U.S. debt and derivative markets, thereby impairing debt and derivative market efficiency, competition, and capital formation and, in turn, undermining the U.S. financial system and economy, and the prospects of every human U.S. person.[7]

> "*Many advocates behind the global ESG movement argue that prosperity alone is not a sufficient measure of society's progress, a position that I believe is unassailable . . . The task before us is to find a way to bring about lasting, positive change to our countries on a range of issues without sacrificing in the process the very means by which so many lives have been enriched and bettered.*"[8]

The SEC itself sabotages "the very means by which so many lives have been enriched and bettered" by perpetuating the charade that the NRSRO scheme promotes robust credit ratings.[9]

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[4] SEC.gov | Comments on Climate Change Disclosures.

[5] Current Guidance on Economic Analysis in SEC Rulemakings, March 16, 2012.

[6] SEC.gov | Current NRSROs.

[7] Harrington, Bill, "Open Letter from Former Rating Agency Executives on the Financial Choice Act: 'End the NRSRO certification entirely'", *LinkedIn Article*, May 1, 2017. "The NRSRO license places the government's imprimatur on credit assessments that are too often the result of sloppy procedures and/or commercial bias." (https://www.linkedin.com/pulse/open-letter-from-former-rating-agency-executives-act-bill-harrington/?trk=v-feed).

[8] SEC Commissioner Hester Peirce, "Rethinking Global ESG Metrics," April 14, 2021. (SEC.gov | Rethinking Global ESG Metrics).

[9] U.S. Securities and Exchange Commission, "Nationally Recognized Statistical Rating Organizations", Final Rule, Release No 34-72936, August 27, 2014 (updated to include Federal Register corrections dated October 14, 2014), page 48. "[U]sers of credit ratings may choose to use NRSROs over unregistered credit rating agencies because of **the NRSRO registration and oversight program,**

The SEC can stop the charade "cold turkey" simply by scrapping the NRSRO designation.[10]

At a minimum, the SEC must immediately cease long-standing policy of facilitating credit rating inflation by selectively suspending legal provisions aimed squarely at NRSROs. The SEC "scrupulously observes law that prevents it from scrutinizing the content of NRSRO *free speech* such as methodologies and rating announcements . . . [but] . . . nullifies an intentionally offsetting Dodd-Frank provision [Dodd-Frank 939g]."[11]

Dodd-Frank 939g *was* to have subjected to NRSROs to expert liability, and a level playing field viz-a-viz non-NRSROs, on July 22, 2010. Instead that morning, the SEC pre-emptively suspended enforcement of Dodd-Frank Section 939g.[12] As a result, NRSROs kept inflating ABS credit ratings and complex-finance markets rebounded at the expense of the broader economy.[13]

The SEC approved a final set of very NRSRO-friendly rules that incentivizes NRSROs to inflate credit ratings in all debt and derivative markets on August 27, 2014.[14] Partly as a result, almost all financial markets grew at the expense of the broader economy.

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which is being enhanced by the amendments and new rules being adopted today [emphasis added]." (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[10] Morgenson, Gretchen, "Should Free Markets Govern the Bond Rating Agencies?", *New York Times*, May 5, 2017. "'Why do we need to have credit ratings agencies receiving some federal license that indicates the S.E.C. approves of what they're doing?' asked Marc Joffe, a former Moody's executive who is one of the six former executives calling for an end to the licensing requirements. 'Take that away, and anyone who is providing credit assessment can compete on a level playing field.'" (https://www.nytimes.com/2017/05/05/business/07gretchen-morgenson-ratings-agencies-moodys.html).

[11] Harrington, William J., "Electronic Letter to the SEC et al (State and Federal Signatories to Moody's 2017 DoJ Settlement) 'Re Harrington Independent Flip Clause Assessments, SEC File No. 265-30, and Moody's Violation of 2017 DoJ Settlement,'" November 3, 2019, page II. **Note: U.S. Senator Josh Hawley signed the Moody's settlement in his then capacity as Missouri attorney general.** (https://www.sec.gov/comments/265-30/26530-6383231-197808.pdf).

[12] Harrington, Bill, "Can Green Bonds Flourish in a Complex-Finance Brownfield?," *Croatan Institute Working Paper*, July 2018, page 12. "[T]his author [WJH] asserted that the SEC continued to 'nullify' Dodd-Frank Section 939G. Another attendee . . . researched the assertion, conceded that it was accurate at a later session, and described the SEC machinations as follows. The SEC: unilaterally decided that Section 939G should never take effect; asked the Ford entities to submit a request for suspension; and then immediately issued the no-action letter before the provision was to have taken effect." (http://www.croataninstitute.org/publications/publication/can-green-bonds-flourish-in-a-complex-finance-brownfield).

[13] Gaillard, Norbert J. and William J. Harrington, "Efficient, commonsense actions to foster accurate credit ratings," *Capital Markets Law Journal*, Volume 11, Issue 1, January 2016, pages 38-59. (https://doi.org/10.1093/cmlj/kmv064). **Also**, Harrington, William J., "Electronic Letter to Moody's and the SEC 'Re Moody's Request for Comment 'Rating TruPS CDOs (March 9, 2020) and Comment to SEC FIMSAC (April 8, 2020)'." (https://www.sec.gov/comments/265-30/26530-7046924-215374.pdf).

[14] U.S. Securities and Exchange Commission NRSRO Rules "op. cit." For a partial critique in the final rule, search the 20 citations of "Harrington." (https://www.sec.gov/rules/final/2014/34-72936.pdf). **For**

NRSRO ESG RUSE: A Death Knell for *ALL* Disclosures—Climate, ESG, and Credit

Influential financial entities "welcome" the issuer-friendly, methodology-centric NRSRO "ecosystem" as template for a parallel "ecosystem" to evaluate climate alignment.

> "*The credit-rating ecosystem . . . lends itself to a common set of criteria and a universally accepted rating system, together facilitating comparable and decision-useful data across third-party providers . . . This same ecosystem for methodologies on climate alignment would be welcome.*"[15]

By itself, an NRSRO-*inspired* "ecosystem for methodologies on climate alignment" would adulterate climate and ESG disclosures as comprehensively as the NRSRO "credit-rating ecosystem" has adulterated both complex finance disclosures and the products themselves.[16]

Still worse, an NRSRO-*operated* "ecosystem for methodologies on climate alignment" would extend disclosure and product adulteration to *every debt sector and every derivative sector* in the world by enabling NRSROs to inflate credit ratings in every debt and derivative sector in the world. Unfortunately, NRSROs are birthing just such a "mega-NRSRO-ecosystem" by subsuming affiliates that assess climate and ESG factors.[17]

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the full critique, Harrington, William J., "Comment on SEC Proposed Rules for Nationally Recognized Statistical Rating Organizations", August 8, 2011. (https://www.sec.gov/comments/s7-18-11/s71811-33.pdf).

[15] Mann, Whitney et al, "Zeroing In: The US Financial Sector Perspective on Net-Zero Lending and Investment," *Center for Climate Aligned Finances Report*," March 2021, page 15. "Transparency and Minimum Standards: Learning from the Credit Rating Ecosystem." (https://rmi.org/insight/zeroing-in/).

[16] Fisch, Jill E. "Making Sustainability Disclosure Sustainable," 107 *Georgetown L.J.* 923 (2019), Footnote 174, page 949. "Because third party ratings appear to be independent, they can be highly influential, making their unreliability and inconsistency particularly problematic. The influence of credit rating agencies prior to the 2008 financial crisis offers a warning." (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3233053).

[17] Rosenkkoetter, Darlene, S&P Global, June 11, 2021. "S&P Global currently provides a broad range of ESG-related solutions. These include some of the following: ESG Scores and Evaluations, our Corporate Sustainability Assessment, Climate Analytics, Positive Impact Analytics, Framework Alignment Opinions, ESG Climate Indices, Green Bond Evaluations, Green Bond Alignment Opinions, and Energy Transition Pricing News and Analytics. We anticipate further enhancements to our capabilities and offerings as we continue to invest and innovate." II "We have acquired and further developed some of the most prominent data sources in ESG, climate and carbon markets including our acquisitions of Trucost (2017) and SAM of RobecoSAM (2019). Earlier this year, we announced the launch of a consolidated data sourcing initiative, Sustainable1, that is responsible for developing consistent ESG-related data sets that we can utilize across our business divisions." II "We also believe that there is a need for a global set of internationally recognized sustainability reporting standards. The initial and primary focus should be on the integration and alignment of existing standards – rather than development of new ones." (cll12-8906880-244195.pdf (sec.gov)).

To wit, each NRSRO perpetuates the same ESG ruse by cobbling together a global ESG methodology that *ostensibly* incorporates climate and ESG exposures into the determination of credit ratings.[18] In fact, each NRSRO ESG methodology does exactly the opposite, namely, permission credit rating committees to *ignore* credit exposures to climate and ESG factors.[19]

SEC / NRSRO "Anti-Governance" Plies ESG Ruse to the Hilt

"Does Moody's see irony in its proposal to bury 'transparency' as a 'sub-sub-factor'?"[20]

NRSROs parrot ESG concerns while discounting them.[21] NRSROs assign and monitor "long-term" credit ratings by assessing a "medium-term" horizon of three-to-five years.[22] NRSROs

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[18] Harrington, Bill, "Investors who want to fast-track sustainable fixed-income investments should inundate credit rating agencies with methodology critiques", *Responsible Investor*, January 28, 2020. (https://www.responsible-investor.com/articles/investors-who-want-to-fast-track-sustainable-fixed-income-investments-should-inundate-credit-rating-agencies-with-methodology-critiques). **Also**, Harrington, Bill, "Moody's ESG overhaul won't have any actual effect on credit ratings . . . ,", *Responsible Investor*, October 19, 2020. (https://www.responsible-investor.com/articles/moody-s-esg-overhaul-won-t-have-any-actual-effect-on-credit-ratings).

[19] Harrington, William J. "Electronic Submission to Moody's Investors Service 'Re Request for Comment: 'General Principals for Assessing Environmental, Social, and Governance Risks: Proposed Methodology Update', September 23, 2020'", October 19, 2020, in toto. (http://croataninstitute.org/documents/WJH_Comment_to_Moodys_RFC_-_General_Principles_for_Assessing_ESG_Risks_-_Oct_19_2020_1.pdf).

[20] Ibid., page 19.

[21] Tillier, Nadège,"ESG and credit rating agencies: the pressure accelerates", *ING*, February 22, 2021. "**So far, ESG factors haven't really been a direct component of issuers' final credit ratings"** (https://think.ing.com/articles/esg-and-credit-ratings-the-pressure-has-accelerated). **Also**, Rust, Susanna, "Fitch launches ESG credit rating 'relevance' scores," *IPE*, January 7, 2019. "[A] '5' score was for 'the very rare cases where a rating action was specifically driven by an ESG factor.'" (https://www.ipe.com/fitch-launches-esg-credit-rating-relevance-scores/10028894.article). **Also**, McRitchie, James, "Fitch Links ESG to Credit Ratings," *Corporate Governance*, January 7, 2019. Fitch Global Head of Sustainable Finance: ". . . 22% of our current corporate ratings are being influenced by E, S or G factors, **with just under 3% currently having a single E, S or G sub-factor that by itself led to a change in the rating** [emphasis added]." (https://www.corpgov.net/2019/01/fitch-links-esg-to-credit-ratings/). **Also**, DBRS Morningstar, "ESG Factors for Financial Institutions; Part 1: Environmental Factors," *Press Release*, April 27, 2021. "Banks are exposed to a number of ESG risks . . . **however, environmental risk factors have been less relevant to date for most banks currently rated by DBRS Morningstar** [emphasis added]." II Environment risks "can materialise over the medium term and affect banks' franchise (including reputation and strategy), asset quality metrics, earnings generation, and ultimately capital levels, **however, for now we anticipate banks should be able to adapt and mitigate a large part of these risks** [emphasis added]." (https://www.dbrsmorningstar.com/research/377395/dbrs-morningstar-esg-factors-for-financial-institutions-part-one-environmental-factors).

[22] Whitmarsh, Theresa (Executive Director Washington State Investment Board (WSIB)), "Electronic Letter to SEC Chair Gary Gensler," June 2, 2021, page 1. "For the WSIB and other large institutional investors with **long time horizons** [emphasis added], climate change is a systemic risk that cannot be fully addressed through diversification. Therefore, we must work to measure and manage the

retroactively "divine" ESG analysis in their credit ratings, including ones assigned a decade ago.[23] NRSROs concoct ESG "scores" that are incidental to a given credit rating.[24] NRSRO parent companies conflate ESG affiliate products with NRSRO credit ratings.[25]

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climate-related risks and opportunities of our investments as part of the effort of maximizing return at a prudent level of risk for our beneficiaries." (https://www.sec.gov/comments/climate-disclosure/cll12-8880643-240113.pdf). **Also**, Schneider, Alison, Alberta Investment Management, June 11, 2021. "We are committed to creating more sustainable and inclusive growth by integrating ESG factors into our strategies and investment decisions. By doing so, we will unlock opportunities and mitigate risks, supporting our mandates to deliver **long-term risk-adjusted returns** [emphasis added]." II "Our ability to deliver on our mandates requires increased transparency from companies to disclose their material business risks and opportunities to financial markets, and to consistently provide financially relevant, comparable and decision-useful information. The timely development of disclosure guidance is critical, considering the potential material financial risks and **long-term** [emphasis added] implications of climate change-related risks." (cll12-8906827-244153.pdf (sec.gov)). **Also**, Baillie Gifford, June 11, 2021, page 5. "As long-term investors [emphasis added], we believe it is equally important for the companies we invest in to disclose the connection between executive or employee compensation and consideration of sustainability risks including climate change risks and impacts." (cll12-8907321-244257.pdf (sec.gov)).

[23] Moody's Investors Service, "ESG factors material in 50% of public-sector rating actions in 2019 and Q1 2020," *Announcement*, November 17, 2020. "ESG factors were a material credit consideration in half of Moody's Investors Service's 6,900-plus rating actions for public-sector issuers globally . . . [however,] **ESG issues were not necessarily the key driver of those rating actions** [emphasis added]." (https://www.moodys.com/research/Moodys-ESG-factors-material-in-50-of-public-sector-rating--PBC_1254003). **Also,** Moody's Investors Service, "ESG risks material in 33% of Moody's 2019 private-sector rating announcements", *Announcement*, April 14, 2020. "ESG issues are likely to be of growing importance in our assessment of credit quality . . ." (https://www.moodys.com/research/Moodys-ESG-risks-material-in-33-of-Moodys-2019-private--PBC_1218114). **Also**, "ESG in Credit Ratings", *S&P Global Ratings*, accessed May 17, 2021. "S&P Global Ratings has long considered ESG factors in its credit ratings, and we capture ESG factors in many areas of our methodology." II "For corporate ratings, we employ our Management & Governance Credit Factors For Corporate Entities November 13, 2012." (https://www.spglobal.com/ratings/en/products-benefits/products/esg-in-credit-ratings).

[24] Harrington, "op. cit." *Responsible Investor*, October 19, 2020. Moody's "proposed ESG update will apply worldwide and will NOT change a single credit rating anywhere in the world at any time in the future. Instead, the proposal WOULD attach four new credit scores – E, S and G issuer profile scores and an ESG credit impact score – to bond issuers and structured transactions. None of the four ESG scores is a clear input into . . . a credit rating. In fact, the fourth score, the ESG credit impact score, is an after-the fact assessment of a credit rating process, as determined [solely] by a lead analyst."

[25] Rosenkkoetter, Darlene, S&P Global, June 11, 2021. "S&P Global is the world's foremost provider of credit ratings, benchmarks and analytics in the global capital and commodity markets, offering innovative Environmental, Social, Governance (ESG) solutions, with deep data and insights on critical business factors. We have been providing essential intelligence that unlocks opportunity, fosters growth, and accelerates progress for more than 160 years." II "As a user, aggregator, and provider of sustainability related information across our credit ratings, ESG and Green Bond Evaluations, benchmarks, and data businesses, we believe that it is important for corporate disclosure to be comparable, reliable, regular, relevant, and accessible." (cll12-8906880-244195.pdf (sec.gov)). **Also**,

Anyone May Read _Any_ NRSRO ESG Credit Rating Methodology to Verify the ESG Void

The following are excerpts from my *Responsible Investor* op-ed "Investors who want to fast-track sustainable fixed-income investments should inundate credit rating agencies with methodology critiques" of January 28, 2020.

> "*Current credit rating methodologies incentivize issuers to avoid investing in sustainable projects and/or pursuing ESG goals by allowing ratings committees to omit the credit impact of physical risks and other ESG exposures from their credit ratings.*"
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> II
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> "*No existing methodology requires a credit rating committee to include physical risks, let alone other ESG exposures in baseline determinations of issuers' ability to pay. Nor does any methodology specify how physical or other ESG exposures will drive issuer upgrades and downgrades today, let alone sector upgrades and downgrades over time. Instead, credit rating agencies stuff methodologies with ESG prattle that is so superficial as to allow a rating committee to entirely ignore physical and other ESG exposures in assessing issuer ability to pay*."
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> II
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> *"At most, credit ratings address physical exposures after the fact, such as when flooding, drought, fires or other headline events drive an issuer downgrade. Worse still, the non-committal methodologies — as well as credit rating agencies' bait-and-switch touting of stand-alone ESG ratings, assessments, and acquisitions — foster the illusion that credit ratings rigorously incorporate the credit impacts of physical exposures.*"

Moody's ESG Solutions Group, "Moody's Launches Comprehensive Suites of Climate Solutions," *Announcement*, March 10, 2021. "**Moody's ESG Solutions Group is a business unit of Moody's Corporation serving the growing global demand for ESG and climate insights. The group** leverages Moody's data and expertise across ESG, climate risk, and sustainable finance, and **aligns with [NRSRO] Moody's Investors Service** and Moody's Analytics to deliver a comprehensive, integrated suite of ESG and climate risk solutions including ESG scores, analytics, Sustainability Ratings and Sustainable Finance Reviewer/certifier services. **MESG includes V.E and Four Twenty Seven, both affiliates of Moody's**. [emphasis added throughout]." (https://www.businesswire.com/news/home/20210310005678/en/). **Also**, "Investor Q & A", *Morningstar*, March 12, 2021. "After acquiring DBRS and Sustainalytics . . . is the plan to focus on integrating these two companies?" (https://shareholders.morningstar.com/investor-relations/investor-qa/default.aspx).

Anyone **May Critique the ESG Void in** ***Any*** **NRSRO ESG Credit Rating Methodology**

For instance, the Sierra Club filed a critique of Moody's Investors Service "General Principles for Assessing ESG Risks: Proposed Methodology Update (September 23, 2020)" on October 22, 2020.[26] The four section headings are on pages 3-5. The excerpts are on pages 1-2.

"***Moody's Criteria Incent Climate-Harming Businesses to Push Back Against Protective Regulations***"

II

"Moody's Criteria Disproportionately Favor Businesses That Are Able to Litigate Away Critics"

II

"***Moody's Criteria Disproportionately Favor Large Businesses and Encourages Inequity***"

II

"Repairing the use of ESG in Moody's Ratings"

II

"*At the core of our comments is a concern that Moody's scoring of ESG-related topics is no more than an ESG label applied to known, tangible risks, and fails to align with the needs of investors using ESG reporting as a proxy for wise or ethical governance, long-term value creation, or strategic thinking. We ask that Moody's differentiate material financial risks, which must be addressed within the standard credit impact score ("CIS"), from currently unpriced externalities, which are material to the proposed ESG CIS. For the purposes of these comments, we focus specifically on climate-related matters, and offer recommendations on the differentiation between calculable material risks related to climate and externalities, and a method by which social costs may be priced into risk."*

II

"*ESG carries substantial and growing weight, and has impacts well outside of those that are readily calculable ー hence its use as a proxy for business judgement and management quality. Unfortunately, Moody's proposed use of ESG appears to fall short of most of these value streams, and appears to simply be a label associated with specific known calculable risks. Even more problematically, Moody's methodology exacerbates a tension between regulators charged with, amongst other tasks, minimizing social exposure to externalities, and the companies rated by Moody's.*"

II

"[T]he rubric here risks being at the least an incomplete picture of ESG, or even a mischaracterization of ESG, allowing companies with ostensibly high ESG risks a potential pass, if they reside under a lax regulatory regime, are politically influential, or are large enough. To remedy this, we pose several recommendations for Moody's consideration within the climate construct of ESG."

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[26] Available at (https://www.moodys.com/RFC/response/ViewComments/UEJDXzEyNDM0NTQ=).

The European Investment Bank also submitted a critique of Moody's ESG proposal on October 22, 2020.[27] The first two excerpts are on page 1. The third excerpt is on page 2.

> *"[W]e suggest a more transparent and granular approach, describing how ESG assessments will be incorporated in the scoring of factors and sub-factors in a scorecard or model, and providing more information on weights and thresholds, in terms of transition pathway, science-based targets and associated regulatory criteria."*
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> II
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> "*[W]e encourage greater transparency on how governance risks are assessed, giving more examples on private and public sector issuers.*"
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> II
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> "***We believe that it is not so clear here why a separate issuer profile score and credit impact score are needed. One wonders if this level of layering could cause more confusion than clarity, especially since neither necessarily has a direct impact on a credit rating*** *[emphasis added]*."

I critiqued Moody's ESG proposal on October 19, 2020.[28] (Page numbers in parentheses.)

> "*Fixed-income practitioners, financial regulators, ESG advocates and allies, and regular people require more education on the centrality of credit rating methodologies to the operations of a credit rating company*." (page 9)
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> II
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> *"Simply put, the structured finance provisions in the proposal are outright lies! As example, the following cannot possibly be true. 'For structured transactions, we consider the impact of ESG risks that are expected to unfold within the legal final maturity of the transaction' (footnote 10, page 28). The legal final maturities of some transactions, such as Navient student loan asset-backed securities, extend to 2083!*" (page 10)
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> II
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> "*What is the value of introducing four new "scores," given that there will be "no changes to outstanding ratings for all sectors globally . . . our proposed publication of CISs [ESG credit impact scores] will not change any ratings, currently or in the future*"? (page 11)
>
> II
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> "*Does Moody's intend the proposal as ESG window dressing to avoid downgrading the majority of credit ratings globally?*" (page 11)
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> II
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> "*Moody's must assess the likelihood that an issuer or bond will pay on time and in full over a longer, more meaningful horizon.*" (page 12)

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[27] Available at (https://www.moodys.com/RFC/response/ViewComments/UEJDXzEyNDM0NTQ=).

[28] Harrington Electronic Submission to Moody's Investors Service, "op. cit.", October 19, 2020. **Also,** Harrington, "op. cit." *Responsible Investor*, October 19, 2020.

Anyone **May Verify that** ***All*** **NRSROS IGNORE** ***All*** **Critiques of the ESG VOID**

Sixty-four persons and entities responded to Moody's ESG proposal. The Sierra Club, European Investment Bank, and I were among the fourteen respondents who specified that our respective replies be publicly available.[29]

Moody's Investors Service violated its own stated policy, i.e., failed its own self-governance, by *pretending* to make my response available via a bogus link. Moody's continued the pretense until I emailed a complaint to the ESG methodology authors and copied SEC staff, CFTC Commissioner Behnam, senior ESG practitioners, and a *Responsible Investor* editor.[30]

Regarding the ESG methodology, Moody's preserved the deeply flawed aspects of the deeply flawed ESG proposal. Both the final ESG methodology and the summary of comments received ignored substantive critiques by the Sierra Club, European Investment Bank, others, and me.[31]

> "**The update will have no impact on outstanding ratings for all sectors globally.**"
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> II
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> *"The key changes introduced with this methodology update are as follows: (i) Introduce three distinct environmental (E), social (S) and governance (G) issuer profile scores . . . (ii) Introduce an ESG Credit Impact Score (CIS) for certain issuers and transactions"* [32]
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> II

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[29] Moody's Investor Service, "General Principals in Assessing ESG Risks: Proposed Methodology Update", *Request for Comment / Results of Consultation*, December 14, 2020. Page 1: "Moody's received 64 comments . . . for which 50 respondents requested confidentiality. As a result, 14 of the comments are available on [Moody's website]." (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243454).

[30] Harrington, Bill, "Re Please Make My ESG Comment Response Publicly Available," Message to two Moody's ESG senior vice presidents with copy to four SEC staff, December 16, 2020, Email. "Alone of the [fourteen] public respondents, my response to Moody's ESG proposal cannot be accessed on this Moody's page. Please fix as soon as possible."

[31] Moody's Investors Service, "General Principles for Assessing Environmental, Social, and Governance Risks", *Cross-Sector Rating Methodology*, December 14, 2020. (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406). **Also**, Moody's ESG Consultation Results "op. cit.", December 14, 2020. Page 1: "Most respondents welcome Moody's proposal . . . Overall, respondents mostly asked for clarification . . ." Page 2: "A few respondents highlighted the potential benefits from ESG factors and considered that our focus is too geared towards negative risks, also arguing that governance an offset E and S risks." Page 3: "Changes were made . . . principally to increase transparency as to how IPSs and CISs relate to the credit ratings . . . IPSs are inputs to credit ratings and CISs are output of the credit rating process."

[32] Moody's Investors Service, "Moody's updates its methodology for assessing environmental, social and governance risks", *Announcement*, December 14, 2020. **Note**: Emphasis added in first excerpt. (https://www.moodys.com/research/Moodys-updates-its-methodology-for-assessing-environmental-social-and-governance--PBC_1254678).

II

"***For structured transactions, we consider the impact of ESG risks that are expected to unfold within the legal final maturity of the transaction*** *[emphasis added]*."[33]

[33] Moody's ESG Cross-Sector Methodology "op. cit.", December 14, 2020, page 26, footnote 14. **However**, mainstream financial entities refute this point repeatedly (and, perhaps, inadvertently). Gullette, Michael, American Bankers Association, June 11, 2021, pages 5-6. "**Few processes currently are in place to routinely collect much of the data from key stakeholders that are likely needed to enable comprehensive climate risk analysis by public companies.** Many of these stakeholders are individuals and privately-held organizations that are not subject to regulatory requirements to disclose data in any prescribed form, further making such an effort challenging to coordinate and execute. II "**Many financial institutions do not yet routinely collect this data in typical lending or securitization arrangements. In addition to the implementation of processes to collect such data by SEC registrants, required collection of such data will necessitate significant changes within a broad range of the securities markets, especially those involving asset-backed securities, including those of government-sponsored enterprises (such as Fannie Mae and Freddie Mac)." "[Footnote] 13**: Related to the banking industry, the Basel Committee on Banking Supervision recently noted gaps in both the quantity and quality of data within the context of measuring climate-related financial risks. See "Climate-related Financial Risks: Measurement Methodologies [emphasis added throughout]." (https://www.bis.org/bcbs/publ/d518.pdf). (cll12-8906876-244192.pdf (sec.gov)).

Mainstream ESG Coalitions Endorse SEC Endorsement of NRSRO ESG Non-Analysis

Large coalitions such as the CFTC Climate Related Market Risk Subcommittee and Ceres promote the straw horse of NRSRO "disclosure" rather than redress the ESG "content" void.[34] The disclosure straw horse helps the SEC help NRSROs perpetuate their ESG ruse.

> *"[P]lease ignore the time-wasting ESG diagnosis and recommendation for credit rating companies that recent reports by Ceres and the CFTC Climate-Related Market Risk Subcommittee make. Both misdiagnose the ESG hole in credit rating methodologies as too-little disclosure, rather than poor content. And both naively task US financial regulators such as the SEC, rather than market participants, with prodding credit rating companies to shape up. My 10-year advocacy to impose accountability on credit rating companies in the aftermath of the 2008 financial crisis shows exactly the opposite. SEC policy is to enable credit rating companies to rate exactly as they please."*[35]

The 165-page CFTC Climate Subcommittee report contained a lone NRSRO recommendation. To paraphrase: "The SEC must preserve the NRSRO system just as it is."[36]

> **"*Recommendation 4.14*:** *Regulators should require credit rating agencies to disclose the extent to which their ratings take into account climate risk, including for issuers of corporate, municipal, and sovereign debt. This should include a disclosure of applicable methodologies for those credit rating products that consider climate risk."*[37]

The recommendation is a redundant dead-end! *All* NRSROs employ disclosures as a "stay-out-of-jail" card, not a mechanism to improve content. *All* NRSROs have always disclosed *all* "applicable methodologies" for *all* credit ratings. *All* NRSRO methodologies purport to "consider climate risk" for *all* credit ratings. *All* NRSROs depend on "methodology disclosure" to assign credit ratings that almost always ignore credit exposures to climate and other ESG factors.[38]

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[34] "Managing Climate Risk in the U.S. Financial System," *Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee, U.S. Commodity Futures Trading Commission*, September 9, 2020. (https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf). Ceres, "Addressing Climate as a Systemic Risk: A Call to Action for US Financial Regulators," June 2020. (https://www.ceres.org/sites/default/files/reports/2020-06/Financial%20Regulators%20FULL%20FINAL.pdf).

[35] Harrington, "op. cit." *Responsible Investor*, October 19, 2020.

[36] CFTC Climate Subcommittee report, "op. cit."

[37] Ibid., pages 52 and 127.

[38] Harrington, "op. cit.", *Responsible Investor*, January 28, 2020. "A credit rating methodology is emphatically not a mere guideline but rather the critical safe harbor that underpins credit rating agency operations. A credit rating agency preserves immunity to most legal and regulatory penalties simply by ensuring that all committees assign all ratings in a manner consistent with applicable methodologies and processes. A credit rating that deviates from the applicable methodology is

The CFTC Climate Subcommittee failed its own self-governance by justifying unwarranted praise for NRSRO ESG efforts with brazen dissembling. To wit, the CFTC report buried the underlying source (an NRSRO ESG report), overstated the report's conclusions, lumped together the comparatively modest observations of "climate-related risks" and the vast majority of other "ESG risks," and conflated "sovereign and municipal bond ratings" with "private sector rating actions."

> "*[C]redit rating agencies have started to consider climate-related risks in their ratings. For example, one rating agency cited ESG risks as material credit considerations in a third of the more than 7,600 private sector rating actions published in 2019 (Mutua 2020). Progress has been notable in the incorporation of physical climate risk variables into sovereign and municipal bond ratings, as well as into ratings of some corporate debt.*"[39]

The citation — "(Mutua 2020)" — is merely a two-paragraph *Bloomberg News* aggregation of a Moody's ESG report that itself parrots standard NRSRO ESG double-speak. The aggregation title "Moody's Says" says it all. To paraphrase: (1) Moody's will factor ESG exposures into credit ratings at some future time and (2) Moody's has "always" factored ESG exposures into credit ratings.[40]

The Moody's announcement for the ESG report shows that the CFTC Climate Subcommittee report vastly overstated (by 600%!) the degree to which climate-related risks were a "material credit consideration in . . . rating actions for private-sector issuers."[41] Also, the Moody's ESG report solely addressed rating actions on "private-sector issuers" and did not include rating actions on public-sector issuers. Finally, according to a Moody's announcement of subsequent and entirely separate ESG report that *did* address public-sector ratings, an ESG factor that is a "material credit consideration" to a rating action is "not necessarily a key driver" of that action.

> "*ESG issues were not necessarily the key driver of those rating actions.*"[42]

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supposed to be rare and the rationale for deviation must be well-documented, including in the public rating announcement."

39 CFTC Climate Subcommittee report, "op. cit." page 46.

40 "ESG is Increasingly Important in Credit Ratings, Moody's Says", *Bloomberg News*, April 14, 2020. "'We expect ESG considerations to be of growing importance in our assessment of issuer credit quality,' the Moody's analysts wrote. '**While our ratings have always reflected our views of ESG risks** [emphasis added], the materiality of key environmental and social issues continues to increase.'"

41 Moody's Investors Service, "ESG risks material in 33% of Moody's 2019 private-sector issuer rating actions", *Announcement,* April 14, 2020. "**Of the roughly 2,500 rating actions** that cited ESG considerations . . . **[only] 16% cited environmental issues**" [emphasis added]. (https://www.moodys.com/research/Moodys-ESG-risks-material-in-33-of-Moodys-2019-private--PBC_1218114).

42 Moody's Investors Service, "ESG factors material in 50% of public-sector rating actions in 2019 and Q1 2020," *Announcement*, November 17, 2020. (https://www.moodys.com/research/Moodys-ESG-factors-material-in-50-of-public-sector-rating--PBC_1254003).

The CFTC Climate Subcommittee *Knew* Its NRSRO Recommendation Was a Dead-End

Member Martina L. Cheung's credentials —S&P Global Market Intelligence President; prior S&P Global Ratings Managing Director — meant any NRSRO recommendation *must* be a dead-end.[43]

I also mapped the NRSRO dead-end for the Climate Subcommittee before it issued the report.

> "***NRSRO credit rating companies divert capital flows from debt issuers, derivatives end-users, derivatives providers, exchanges, and other rated entities that mitigate exposures to physical risk, such as inundation by fire and water.***"
>
> ||
>
> "***An NRSRO credit rating company has a perpetual license to print methodologies, ratings, and money without meaningful accountability.***"
>
> ||
>
> "***All that an NRSRO . . . must do is facilitate public dialogue on methodologies . . .***"[44]

Afterwards, I critiqued the NRSRO recommendation in an email to the Subcommittee members."

> *"The CFTC/Ceres recommendations that the SEC will prod credit rating companies to improve is pure fantasy."*[45]

One member, Adele Morris of Brookings Institution, responded in good faith.

Predecessor Ceres Report Contained the Same Dead-End NRSRO Recommendation

> "The SEC Office of Credit Ratings should *"[i]ssue guidance encouraging credit raters to provide more disclosure on how climate risk factors are factored in ratings decisions. They could also examine the extent to which climate risk is considered by credit raters, and summarize findings in annual examination reports."*[46]

At least four CFTC Climate Subcommittee members contributed to the Ceres report: Chair Bob Litterman (Kepos Capital); Editor Leonardo Martinez-Davis (Sustainable Finance Center); Dave Jones (Nature Conservancy); and Ceres CEO and President Mindy Lubber.[47]

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[43] CFTC Climate Subcommittee report, "op. cit.", page 163, and Profile of Martina Cheung, *LinkedIn*, accessed May 18, 2021 (https://www.linkedin.com/in/martina-cheung-9897411/).

[44] Harrington, Bill. "Inundate NRSRO Credit Rating Companies with Comments to FIX Methodologies so that Measurements of Ability to Pay Derivative & Debt Obligations FULLY Incorporate Exposure to Climate Events", *Submission to CFTC Climate-Related Market Risk Subcommitte*, April 9, 2020 in toto. Quotes are from pages 2-3 (https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=62485&SearchText=).

[45] Harrington, Bill. "Re *Responsible Investor* 'Moody's ESG overhaul won't have any actual effect on credit ratings...'," Message to each CFTC Climate Subcommittee member, October 20, 2020, Email.

[46] Ceres Climate / Financial Regulation Report "op. cit.", page X and, almost identically, page 28.

[47] Ibid., page ii and CFTC Climate Subcommittee report, "op. cit.", pages 163-165.

"***Will Ceres Invite Me to Share My Deeply-Informed Views at Its Events?***"

I detailed my critique of the NRSRO ESG Ruse to a senior Ceres manager in June 2020. I also offered my critique of Ceres NRSRO recommendation to him and Ms. Lubber in an October 2020 email. The manager responded politely, but did not address my critique or my above request.[48]

Moody's Corp and V.E (Vigeo Eiris): "Ceres Company Network" Member and Vendor

> "*Ceres' in-house expertise . . . provides members the critical insights they need to strengthen performance on key 'material' environmental and social impact areas. Leveraging the Ceres Roadmap for Sustainability—our vision and practical framework for guiding corporate sustainability leadership—Ceres works with Company Network members to manage sustainability from the boardroom to the copy room, and from factories to fields.*"[49]

Moody's Corporation, a holding company that owns analytical entities, can successfully "manage sustainability from the boardroom to the copy room" simply by ring fencing "sustainability" to the narrow scope of daily corporate family operations. These consist almost entirely of people researching, meeting, and posting on Moody's websites. No Moody's entity operates "factories," cultivates "fields," holds stranded assets, or manages significant physical properties.

Indeed, the Moody's corporate family practices just such a narrowly blinkered, self-serving form of "corporate sustainability." The holding company restricts "best ESG practices" to its own "initiatives / disclosures" and unleashes the NRSRO and affiliates to embed deficient ESG "offerings and initiatives" in the global system for "assessing ESG risks and opportunities."

> "***Moody's is Committed to a Sustainable Future***
>
> "*We will continue to expand and enhance our efforts to integrate ESG best practices throughout our business and develop **and promote globally consistent standards for assessing ESG risks and opportunities** [emphasis added]*
>
> - ***Moody's Investors Service Offerings and Initiatives*** *[emphasis added]*
> - *Moody's Corporation and Corporate Social Responsibility (CSR) Initiatives / Disclosures*
> - *Moody's Corporation Acquisitions*"[50]

"Moody's Corporation Acquisitions" include SynTao Green Finance, Four Twenty Seven, Moody's Analytics, and V.E (Vigeo Eiris). The latter is sole "Research Provider" to "Ceres Roadmap 2030."[51]

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48 Harrington, Bill, " Correspondence with Mindy Lubbers and Ceres staff, October 20-26, 2020, Emails.

49 "Ceres Company Network", *Ceres,* accessed May 11, 2021. (https://www.ceres.org/networks/ceres-company-network).

50 "ESG", *Moody's Corporation*, accessed May 13, 2021. (https://esg.moodys.io/).

51 Ceres, "Ceres Roadmap 2030", October 7, 2020. (https://www.ceres.org/sites/default/files/reports/2020-10/Ceres Roadmap Summary 2030 - FINAL.pdf).

Real-World "Economic Analysis for SEC Rule-Making" to End the NRSRO System Now!

To serve the public interest and promote efficiency, competition, and capital formation in every U.S. debt and derivative sector, the SEC must end the NRSRO system immediately!

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from warped price signals, sub-optimal investment, and periodic, full-blown crises.

NRSROs routinely and relentlessly undermine Our Country's financial system and economic system by routinely and relentlessly inflating credit ratings in every debt sector and ever derivative sector. Inflated credit ratings warp price signals, divert investment to sub-optimal uses, and periodically spawn full-blown crises. The public interest demands useful price signals, not warped price signals. The public interest demands optimal investment, not sub-optimal investment. The public interest demands few full-blown crises, not periodic full-blown crises.[52]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from ineffective infrastructure investment.

A pressing need that obligates the SEC to scrap the NRSRO system right now is the likelihood that Congress will enact an infrastructure bill, potentially an enormous infrastructure bill. Inflated credit ratings — including but not limited to those of corporations, finance and insurance entities, project finance, local and state governments, and the US government itself — will exponentially lessen the effectiveness of infrastructure spending. The public interest demands that infrastructure investment be as effective as possible.[53]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from infrastructure investment that undermines climate resilience, undermines communities, and undermines governance.

The SEC must scrap the NRSRO system right now because it undermines climate resilience, communities, and governance by adulterating disclosures of exposures to climate, social, governance, and credit factors.[54] NRSROs cobble together global ESG methodologies that *ostensibly* incorporate climate and ESG exposures into the determination of credit ratings, but

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[52] Current Guidance on Economic Analysis in SEC Rulemakings, page 5. "Clearly identify the justification for the proposed rule."

[53] Ibid, page 5. "In some circumstances, there will be more than one justification for a particular rulemaking."

[54] Condon, Madison et al, "Mandating Disclosure of Climate-Related Financial Risk," *Institute for Policy Integrity and Environmental Defense Fund*, February 2021. Page 28: "Improved mandatory disclosure likely will also address a ***collective action problem*** that exists among corporations competing for investors. **Currently, managers face strong short-term incentives to keep share prices and credit ratings high, and as a result, have little reason to disclose unfavorable climate risk information if it will lead investors to favor competing corporations** However, because there are benefits to sharing information and strategies for addressing climate risk, corporations would be better off in a world where they assess risks accurately and disclose this information so as long as they have assurance that other corporations will do the same. [emphasis added throughout]." (https://policyintegrity.org/files/publications/Mandating_Climate_Risk_Financial_Disclosures.pdf).

emphatically do *not* incorporate climate and ESG exposures into the determination of credit ratings. The public interest demands NRSRO credit methodologies that rigorously incorporate climate and ESG exposures into credit ratings.[55]

The public interest also demands market practitioners who accurately distinguish and publicly describe whether NRSRO credit rating methodologies *do* rigorously incorporate climate and ESG exposures into credit ratings. The NRSRO ESG bait-and-switch hoodwinks some market participants so thoroughly that they offer unfounded NRSRO ESG testimonials.[56]

> "*Large commercial banks, institutional investors, and **credit rating agencies** [emphasis added] have quickly developed particular methodologies to assess companies' long-term management of climate risks and opportunities, which continue to evolve within the marketplace.*"
> -- Frank J. Macchiarola, American Petroleum Institute[57]

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[55] Cardano, *SEC Comments on Climate Change Disclosures,* posted April 2021. Page 4: "There is overwhelming evidence that ESG issues are financially material, and as such, institutional investors have a fiduciary duty to incorporate ESG issues in their investment decisions. Companies that measure and manage ESG issues are better placed to respond to - and to support-the sustainability transition. Equally, companies that do not account for climate change risk asset stranding. Corporate ESG disclosure is therefore a necessary prerequisite for investment decision-making." (https://www.sec.gov/comments/climate-disclosure/cll12-8680995-235621.pdf).

[56] Drew, Mary Elena and Gabriela Infante, T. Rowe Price, page 20. "I believe agencies such as Moody's and S&P are going to increasingly incorporate ESG into the ratings they award," writes Quentin Fitzsimmons, Global Fixed Income Portfolio Manager (cll12-8906961-244220.pdf (sec.gov)). **Also,** Impax Asset Management, June 9, 2021, page 2. "S&P Global also recently launched a platform called Physical Risk Analytics . . . while other credit rating agencies, including both Fitch and Moody's, have acquired physical risk analytics capacity and are on the cusp of including climate risks in credit ratings for corporates. S&P Global reported in 2017 that it had found 717 cases where environmental and climate-related risks were important factors in company analysis, and in 106 cases affected the credit ratings. That was four years ago; the numbers are doubtless higher now." **Corrections**: The S&P subsidiary Trucost, not the NRSRO S&P Global Ratings, launched Physical Risk Analytics. No NRSRO is on the "cusp of including climate risks in credit ratings." No rational is offered as to why "the numbers are doubtless higher now." (Response to the Commission's questions of March 15, 2021 (sec.gov)). American Society of Adaptation Professionals, page 3. "Rating agencies, such as Moody's, which acquired 427, a risk analytics company, is also using this data." **Corrections**: The holding company Moody's Corporation, not the NRSRO Moody's Investors Service, acquired Four Twenty Seven. Moody's Investors Service does not use Four Twenty Seven offerings as a key input to determine credit ratings. (Provide public input on climate change disclosures (sec.gov)). **Also,** Hunter, Lesley, American Council on Renewable Energy, June 11, 2021, page 8. "Additionally, CarbonCount incorporates the forward-looking emissions and power generation forecasts used by credit rating agencies." **Correction:** NRSROs do not rigorously incorporate "forward-looking emissions and power generation forecasts" into credit ratings. (cll12-8906808-244151.pdf (sec.gov)).

[57] Macchiarola, Frank J., American Petroleum Institute, June 11, 2021, page 2. (cll12-8907327-244228.pdf (sec.gov)).

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from ignoring the distortions <u>to all bond prices</u> that inflated credit ratings create.
The SEC must scrap the NRSRO system right now because inflated credit ratings distort most bond prices around the world. For a start, public corporate bond markets completely rely on inflated NRSRO credit ratings.[58] In turn, the NRSRO chokehold on public corporate bond markets means that inflated NRSRO credit ratings strongly impact all other bond markets — public and private; short-dated to extremely long-dated; NRSRO-rated and non-NRSRO-rated; sovereign, municipal, project finance, structured finance; and every other bond type.[59] The result? Distorted pricing of all credit exposures, including to climate and ESG factors, in all U.S. and global bond sectors.[60]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from ignoring the distortions <u>to all derivative pricing</u> that inflated credit ratings create.
The SEC must scrap the NRSRO system right now because inflated credit ratings of derivative counterparties, exchanges, vendors, and instruments distort derivative pricing around the world.

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from ignoring the distortions to <u>PUBLIC equity prices</u> that inflated credit ratings create.
The SEC must scrap the NRSRO system right now because inflated credit ratings distort public equity prices by masking the financial condition of most publicly traded companies. The

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[58] Chowdrhy, Sheru, "<u>Electronic Letter to SEC Chair Gary Gensler</u>," June 2, 2021, pages 1-2. "First, we believe companies can and should disclose their scope 1, 2, and 3 greenhouse gas emissions, as these data offer vital information about climate risks. . . Such disclosure would provide substantial important data to investors: **we estimated that the MSCI USD High Yield Index represents approximately $1.5 trillion of debt and roughly 2 billion metric tons of absolute, annual carbon emissions (scope 1 and scope 2)** [emphasis added]." (https://www.sec.gov/comments/climate-disclosure/cll12-8856990-239808.pdf).

[59] Haverkamp, Gerbrand, World Benchmarking Alliance, June 11, 2021, page 8. "WBA supports mandatory climate disclosure requirements that extend to both public and private companies of all sizes. This reduces the potential for private companies to be opaque regarding their climate-related impacts and gives investors and other stakeholders access to comparable data. As climate disclosures are needed by investors across all asset classes, including Equity and Fixed Income, they are also relevant for non-listed companies that issue bonds. This is in line with the feedback provided by investors to the UK government for the roll out of mandatory TCFD-aligned disclosures." (cll12-8906792-244144.pdf (sec.gov)).

[60] The Credit Roundtable, June 11, 2021, pages 1-2. "The Credit Roundtable is a group of large institutional fixed income managers including investment advisors, insurance companies, pension funds, and mutual fund firms, responsible for investing more than $4 trillion of assets. II "We believe there is an urgent need for accountability in the metrics issuers are using in the terms of debt linked to ESG issues." (cll12-8906906-244214.pdf (sec.gov)). **<u>Also</u>**., Whitmarsh, Theresa (Executive Director Washington State Investment Board (WSIB)),"<u>Electronic Letter to SEC Chair Gary Gensler,</u>" June 2, 2021, page 1. "For the WSIB and other large institutional investors with long time horizons, climate change is a systemic risk that cannot be fully addressed through diversification. Therefore, we must work to measure and manage the climate-related risks and opportunities of our investments as part of the effort of maximizing return at a prudent level of risk for our beneficiaries." (https://www.sec.gov/comments/climate-disclosure/cll12-8880643-240113.pdf).

overwhelming majority of public companies issue debt and have credit ratings from each large NRSRO. Very, very few public companies have zero long-term debt. Fewer still lack a credit rating from at least one NRSRO.[61] Accurate credit ratings will oblige public companies to disclose unfavorable climate and other ESG information.[62] The public interest demands informative prices of public equities, not distorted public equity prices that are propped up by inflated credit ratings.[63]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from ignoring distortions to PRIVATE equity prices that inflated credit ratings create.

The SEC must scrap the NRSRO system right now because inflated credit ratings of syndicated loans and collateralized loan obligations (CLOs) distort private equity prices by obscuring the financial condition of private equity firms and pension funds. The public interest demands

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[61] Kenwell, Bret, "7 Debt-Free Stocks to Buy for Peace of Mind in Volatile Markets," *InvestorPlace*, September 25, 2020. "Companies with no debt is rare in the stock market these days with low rates." (https://investorplace.com/2020/09/7-debt-free-stocks-to-buy-for-peace-of-mind-in-volatile-markets/). **Also**, Kranz, Matt, "No Debt: 11 Big US Companies Borrow Nothing," *Investor's Business Daily*, May 13, 2019. (https://www.investors.com/etfs-and-funds/personal-finance/no-debt-11-big-u-s-companies-borrow-nothing/). Of the 11 companies, 4 (Paypal Holdings Inc., PACCAR Inc, Regeneron Pharmaceuticals, and Skyworks Solutions Inc) had one or more NRSRO credit ratings as of May 24, 2021. A fifth company, Varian Medical Systems, was acquired by Siemens, which has a full set of NRSRO credit ratings.

[62] Condon, Madison et al "op. cit.", page 28.

[63] Revolving Door Project, June 11, 2021, page 3. "The SEC must also work to reverse the movement of capital out of public equity markets through regulatory exemptions, as climate financial risk is increasing with little scrutiny in the private markets. Climate and ESG disclosures for private debt offerings in particular are important to assessing risks to the banking and financial system, as without information from issuers, banks, funds, and regulators may be unable to fully and accurately assess their portfolio risks. To reverse this migration, the SEC should revise its rules to push all large companies (including the many large private companies owned by private equity firms and hedge funds) and large offerings of securities into the public market reporting regime and consider conditioning any remaining registration exemptions upon the disclosure of ESG details of the securities." cll12-8907318-244256.pdf (sec.gov)).

informative prices of private equities and robust valuations of pensions, not distorted private equity prices and unreliable pension valuations that are propped up by inflated credit ratings.[64]

The NRSRO ESG bait-and-switch worsens private equity credit inflation and undermines "increasing demand for better data from private companies."[65]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from the oligopolistic NRSRO market failure that the SEC perpetuates and market participants game rather than fix.

The SEC must scrap the NRSRO system right now because it is a massive market failure and a massive governance failure of the SEC's own making. Ending the NRSRO system will eliminate the fig leaf of "SEC oversight" that permissions market participants to evade due diligence responsibilities viz-a-viz NRSROs and thereby exempt them from market accountability.[66] SEC Office of Credit Ratings annual reports show that the NRSRO system has been an oligopoly from inception.[67] Worse still, the NRSRO system itself spurs the vast network of credit rating users — investors, issuers, and NRSROs themselves, as well as vendors to the aforementioned such as accountants, analysts, auditors, bankers, counsel, and other regulators — to relentlessly game

[64] Dubitsky, Rod, "Crossing the Rubicon: Ratings Inflation and The Fed's Misguided Support for Speculative Grade Debt and CLOs," *LinkedIn Article*, April 29, 2020. "CLOs form one leg of an Iron Triangle including Private Equity (PE) and pension funds that creates systemic risk across industries and financial institutions." II "Trillions in debt, 9 million employed by PE owned companies and many critical industries dominated by PE companies are only part of the components of systemic risk created by the Iron Triangle." II "This article, in part, draws from a report I published last month in the Journal of Structured Finance." (https://www.linkedin.com/pulse/crossing-rubicon-ratings-inflation-feds-misguided-support-dubitsky). **For the original article**, Dubitsky, Rod, "CLOs, Private Equity, Pensions, and Systemic Risk," *The Journal of Structured Finance,* Spring 2020, 26 (1) 8-28. (https://doi.org/10.3905/jsf.2020.1.098).

[65] Simpson, Paul, Chief Executive, CDP North America, page 17. "There is an increasing demand for better data from private companies so that private market investors can calculate their carbon footprint, benchmark their portfolio, and set Science Based Targets. CDP is also currently developing mechanisms to allow for new requesting authorities in private markets. This includes a private market pilot CDP is launching in 2021, where large private equity and private debt investors will request their portfolio companies to respond to a modified version of the CDP questionnaire catered to smaller, private firms." (cll12-8906810-244152.pdf (sec.gov)).

[66] Current Guidance on Economic Analysis in SEC Rulemakings, page 5. "Frequently, the proposed rule will be a response to a market failure that market participants cannot solve because of collective action problems. Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest) and asymmetric information."

[67] SEC Office of Credit Ratings, "Annual Report on NRSROS, As Required by Section 6 of the Credit Rating Agency Reform Act of 2006," December 2020, Section "IV Competition," pages 9-24. (https://www.sec.gov/files/2020-annual-report-on-nrsros.pdf.) **Also**, U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 26. In effect, less than three NRSROs constituted the entire NRSRO sector in 2007 to 2013, as measured by the Total Herfindahl-Hirschman Index Inverse Score. (https://www.sec.gov/rules/final/2014/34-72936.pdf).

the NRSRO market failure rather than fix it.[68] "[M]arket participants cannot solve," and indeed may not want to solve, SEC-induced, NRSRO market failures with the SEC blocking the way.[69]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public interest benefits from sabotaging US competitiveness.

The SEC must scrap the NRSRO system immediately because it undermines the U.S. economy and financial system both on an outright basis and viz-a-viz international competitors. For instance, Moody's promotes ESG "scores" that are not inputs to a sovereign credit rating, (which *would* help end users differentiate sovereign credits), but merely a "complementary" by-product.[70] The public interest demands credit evaluations that boost U.S. competitiveness at home and abroad by accurately depicting the credit strengths and weakness of both the U.S. and other

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[68] Re the U.S. CLO sector gaming the NRSRO oligopoly, see Harrington, William J. "Electronic Letter to CFTC, SEC, LSTA, SFA, DBRS, Fitch, Moody's and S&P 'Re Deficient Accounting, Capitalization, Credit Ratings, and Regulation of EVERY Party to a Swap Contract with a Flip Clause or Other Walk-Away Provision'," December 28, 2020. (https://www.wikirating.org/data/other/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf.) **Also**, re the Federal Reserve gaming the NRSROS oligopoly, see Pimbley, Joe and Bill Harrington, "Federal Reserve Trashes Dodd-Frank Restrictions on Credit Ratings," *Croatan View*, May 20, 2020. (https://croataninstitute.org/latest/news/federal-reserve-trashes-dodd-frank-restrictions-on-credit-ratings). **Also, for a typical NRSRO-dependent network**, CRE Finance Council, June 11, 2021, page 1. "The CRE Finance Council is the collective voice of the $4.6 trillion commercial real estate ("CRE") finance market. **Its members effectively include all of the major participants in the CRE finance industry, including** the significant portfolio, agency, multifamily, and commercial mortgage-backed securities ("CMBS") lenders; issuers of CMBS; loan and bond investors (investment grade and non-investment grade) such as insurance companies, pension funds, specialty finance companies, REITs and money managers; loan servicers; **rating agencies**; accounting firms; law firms; diligence providers; appraisers; and other CRE service providers [emphasis added throughout]." (Re: Public Input on Climate Change Disclosures (sec.gov)).

[69] Levine, Matt, "Credit Ratings Are Still Credit Ratings," *Bloomberg Opinion*, August 8, 2019. "Surely sometimes the ratings firm would decide that a bond was a double-B, and some big asset manager would call it and say 'we really like that bond and we want to put it in our investment-grade fund, can you make it a triple-B?' They might not say it like that; they might make a credit argument instead (presumably they like the bond because they think it's a good credit!), or they might just go shop for a better rating from a different ratings firm. I am not sure the dynamics would be all that different from the system we have now, and my best evidence for that is that the investors are fine with the system we have now." (https://www.bloomberg.com/opinion/articles/2019-08-08/credit-ratings-are-still-credit-ratings).

[70] Moody's Investors Service, "New scores depict varied, often credit-negative impact of ESG factors for sovereigns", *Announcement*, January 18, 2021. "'Our new ESG credit impact scores and issuer profile scores ***complement*** our previous analysis of the credit impact of ESG for sovereigns [emphasis added.'" (https://www.moodys.com/research/Moodys-New-scores-depict-varied-often-credit-negative-impact-of--PBC_1259861).

sovereigns.[71] U.S. competitiveness, including that of the NRSRO-rated U.S. funds industry, requires a broad-based commitment to race to the top, not to the bottom.[72]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public benefits from ignoring limitless first-hand information that NRSROs routinely inflate credit ratings.

Because the SEC both *greenlights* NRSROs to inflate credit ratings and observes the endless ways that the companies do so, e.g., paying lip service to ESG analysis, the SEC may cite its own first-hand knowledge of rampant credit rating inflation as "justification" for ending the NRSRO system.

The SEC may cite first-hand knowledge of its own specious "economic analysis" in support of NRSRO rulemakings that promote credit rating inflation.[73]

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[71] McKinney, Darren, L, *SEC Comments on Climate Change Disclosures*, March 29, 2021. "[C]onsider promulgating a rule that requires annual corporate filings that anticipate the imminent risks of investing in totalitarian Communist China. Yes, speech- and religion-suppressing, forced labor camp-operating, scientist- and physician-disappearing, political prisoner-torturing, hostage-taking, Hong Kong-dominating, Taiwan-threatening, militarized atoll-building, Belt and Road-coercing, and intellectual property-thieving China." II China "is also among the few places where any foreign investment of any size can be arbitrarily seized by the government without notice or recourse." (https://www.sec.gov/comments/climate-disclosure/cll12-8560170-230745.htm).

[72] Cardano, *SEC Comments on Climate Change Disclosures,* posted April 2021. Page 1: "While Cardano is a UK and European-based investor, we invest globally, including many US-domiciled funds. We see climate change as a global challenge, which is why we have interest in the SEC' s approach to climate change disclosure. We will find it increasingly hard to invest in US-domiciled funds, where sustainability-related disclosures, and in particular, climate change disclosures, fall behind that of UK and European standards." (https://www.sec.gov/comments/climate-disclosure/cll12-8680995-235621.pdf). **Also**, Verney, Paul, "Competitiveness of US funds at risk if SEC doesn't keep up with Europe on climate disclosure, warns €115bn investment house," *Responsible Investor*, April 23, 2020. "Bill Harrington . . . told *RI* that he 'strongly agreed . . . The Cardano content and standing both impress. A private company, deeply savvy in evaluating long-term investments, says that US competitiveness depends on improving climate disclosures, not ignoring them. I strongly agree.'" (https://www.responsible-investor.com/articles/competitiveness-of-us-funds-at-risk-if-sec-doesn-t-keep-up-with-europe-on-climate-disclosure-warns-eur115bn-investment-house).

[73] U.S. Securities and Exchange Commission NRSRO Rules "op. cit.." For instance, "Economic Analysis" in Section E. "Disclosure of Information About the Performance of Credit Ratings" states that accurate credit ratings may *impede* capital formation. Page 253: "In addition to these effects, the amendments may affect capital formation. Some academic research indicates that credit rating agencies should not focus exclusively on ratings accuracy, but also should consider the feedback effects of their credit ratings on the probability of survival of an issuer. Specifically, these theories suggest that if credit ratings can directly affect the default probability of an issuer, such as when a ratings downgrade itself makes it harder or more costly for a company to raise funds, then it may be optimal for credit rating agencies to delay credit rating downgrades in order to lessen the impact of such feedback on the company's prospects. If the adopted rules drive increased transparency with respect to performance, and this leads to pressures on NRSROs to assign more accurate credit ratings by making earlier downgrades, the amplified feedback effects could increase the default frequencies of issuers and other obligors." **Also**, "Economic Analysis" in Section F. "Credit Rating Methodologies"

The SEC may cite first-hand knowledge of benefits that the NRSRIO system has *not* delivered.[74]

The SEC may cite first-hand knowledge of its own NRSRO settlements and litigation.[75]

The SEC may cite first-hand knowledge of its own annual NRSRO examinations. As example: "A larger NRSRO made several errors relating to applying incorrect criteria for certain credit ratings. ***The NRSRO did not detect the errors for several years before correcting them***, resulting in credit ratings outstanding that did not accurately reflect the credit risk . . . [emphasis added]."[76]

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tallies the NRSRO obligation to impose methodological consistency on all existing credit ratings as a *new* NRSRO cost rather than an end to a one-sided benefit that NRSROs should never have enjoyed in the first place. Page 286: "The Commission believes that NRSROs will incur costs to apply material changes to ratings procedures and methodologies consistently to all current credit ratings to which the changed procedures or methodologies apply." (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[74] Ibid., "Economic Analysis" in Section F. "Credit Rating Methodologies," page 288. "First, these amendments could improve the quality and consistency of credit ratings as well as increasing the information available to users of credit ratings regarding rating procedures and methodologies. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency also could improve if this information is reflected in asset prices. Consequently, capital formation could improve as capital may flow to more efficient uses with the benefit of this enhanced information. (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[75] U.S. Securities and Exchange Commission, *Announcements*: "SEC Charges Ratings Agency [Morningstar] With Disclosure And Internal Controls Failures Relating To Undisclosed Model Adjustments," February 16, 2021; "SEC Charges Ratings Agency [KBRA] With Internal Controls Failures in Connection With Ratings of CMBS and CLO Combo Notes)," September 29, 2020; "SEC Orders Credit Rating Agency [Morningstar] to Pay $3.5 Million for Conflicts of Interest Violations," May 15,2020; "SEC Charges Moody's With Internal Controls Failures and Ratings Symbols Deficiencies," August 28, 2018; "SEC Charges Credit Rating Agency [DBRS] With Misrepresenting Surveillance Methodology," October 26, 2015; "SEC Announces Charges Against Standard & Poor's for Fraudulent Ratings Misconduct," January 25, 2015. The SEC "announced a series of federal securities law violations by Standard & Poor's Ratings Services involving fraudulent misconduct in its ratings of certain commercial mortgage-backed securities."; and "Egan-Jones and Founder Sean Egan Agree to 18-Month Bars from Rating Asset-Backed and Government Securities Issuers as NRSRO," January 22, 2013.

[76] U.S. Securities and Exchange Commission, "2020 Summary Report on Commission's Staff Examination of Each NRSRO," December 2020, page 16. Also, representative instances of failed NRSRO governance, pages 11-23: "A larger NRSRO overlooked numerous external written comments that it received in response to published requests for comment on a materially changed methodology and did not consider those comments prior to implementing the methodology, as required by its policies and procedures." / "A larger NRSRO's outside counsel conducted an investigation in response to an allegation from a former employee of the NRSRO, but did not prepare a final written report as the NRSRO's policies and procedures require." / "A smaller NRSRO's analysts regularly informed clients of a rating recommendation before the proposed rating was presented to a rating committee . . ." / "A larger NRSRO prematurely discontinued certain ratings because it was improperly informed that the entire issuances had been redeemed or repaid." / "A larger NRSRO's analysts made certain model input errors for several CLO ratings, and secondary

The SEC may also cite first-hand knowledge of NRSRO fines imposed by non-U.S. regulators.[77]

The SEC may also cite first-hand knowledge that NRSRO ESG bait-and-switch props up inflated credit ratings. For instance, NRSROs "publish commentary" on credit challenges that ESG factors pose to companies and entire industries rather than downgrade the respective credit ratings.[78]

The SEC may also cite first-hand knowledge that NRSROs continue ESG bait-and-switch while complying with non-U.S. regulator "guidance" to improve the ESG content of credit ratings.[79]

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reviewers did not identify the errors." / "A larger NRSRO did not include private credit ratings in the sample of ratings actions that a compliance monitoring group used to test analyst adherence to the NRSRO's policies and procedures and that a credit policy control group used in quarterly random testing samples." / "A larger NRSRO did not have any documented policies and procedures governing its practices with respect to assigning a certain type of corporate credit ratings." / "A larger NRSRO's Board did not approve certain procedures the NRSRO uses to determine credit ratings, such as procedures related to rating committees and rating withdrawal procedures." (https://www.sec.gov/files/nrsro-summary-report-2020.pdf).

[77] European Securities and Markets Authority, *Announcements*, "ESMA fines Moody's €3.7 million for conflicts of interest failures," March 30, 2021. "The breaches related to: 1. the issuance of credit ratings in violation of the ban on issuing new ratings on entities where a credit rating agency shareholder exceeds the 10% ownership threshold and/or is a board member of the rated entity; 2. failure to disclose conflicts of interests related to the 5% ownership threshold; and 3. inadequate internal policies and procedures to manage shareholder conflicts of interest. All the breaches were found to have resulted from negligence on the part of Moody's." **Also**, "ESMA fines Scope Ratings €640,000 for failings in covered bonds ratings," June 4, 2020; "ESMA fines Fitch €5,132,500 for breaches of conflict of interest requirements," March 28, 2019; "ESMA Fines Moody's €1.24 Million for Credit Rating Breaches," June 1, 2017; "ESMA fines Fitch Ratings Limited €1.38 million" July 21, 2016; "ESMA fines DBRS Ratings Ltd. For internal controls failings," June 29, 2015; and ESMA censures Standard & Poor's for internal control failings, June 3, 2014.

[78] "Moody's flags Big Oil's Rising Risk from climate battle," *Reuters*, May 28, 2021. "'The increasing potential for ever more stringent investor climate- and emissions-related investment thresholds are likely to lead to higher capital costs and diminished access to capital for oil companies that do not keep pace with investors' expectations for transitioning to a low carbon business model.'" (https://www.reuters.com/article/climate-change-moodys-oil-idCNL2N2NF0KZ). **Also**, Scwhartzkopff, Frances, "A warming planer is about to revolutionize how banks define risk," *Bloomberg* in *Business Standard*, May 27, 2021. "According to Fitch, the financial industry is well aware that bank capital requirements will soon reflect climate risk, even though regulators themselves haven't yet spelled out their intentions." II "'Regulators haven't been more explicit yet because they don't have the data to justify a clear approach,'' said Fitch senior director Monsur Hussain. (https://www.business-standard.com/article/international/a-warming-planet-is-about-to-revolutionise-how-banks-define-risk-121052701687_1.html).

[79] Ceres, "Addressing Climate as a Systemic Risk: A Call to Action for US Financial Regulators," June 2020, page 34. "In July 2019, ESMA issued guidance to credit rating agencies to improve transparency about when sustainability factors are driving factors in ratings action." The guidance had no impact on the ESG content of credit ratings or credit rating methodologies, as the Ceres report (perhaps inadvertently) implies and this submission explicitly demonstrates.

The SEC may cite first-hand knowledge that others' comments on climate change disclosures work equally well, if not better, as mandates to scrap the NRSRO system.[80]

NRSRO ESG credit rating methodologies contribute mightily to "what we might call the 'ESG fuzziness problem.'"[81]

"The SEC should change the culture of the agency to support informing investors about the material risks from climate change."[82] As a start, the SEC must end its NRSRO-supporting culture and scrap the NRSRO system. Robustly accurate credit ratings, *not* NRSRO credit ratings, will inform "investors about the material risks from climate change."

Scrapping the NRSRO system comports *exactly* "with the SEC's stated mission of protecting Main Street investors and maintaining fair, orderly, and efficient markets." In contrast by perpetuating the NRSRO system, the SEC will continue "eroding public trust in its capacity and willingness to serve as an apolitical, technocratic regulator of the capital markets." Protecting NRSRO earning franchises is "not merely outside the core concerns of the SEC, but in active conflict with them." The NRSRO system accurately and correctly leads "investors and the broader public to conclude that the SEC caters to Wall Street rather than Main Street.[83]

NRSROs perpetuate widespread gaming of credit ratings by making them conveniently *imprecise* for end-users and inconveniently *unintelligible* for everyone else. Imprecise evaluations undermine credit, climate, and ESG disclosures.[84] Look no further than NRSRO-parent acquisitions and development of ESG assessors: "Despite the growth of ESG-related financial products, the ESG information disclosure environment has not kept pace.[85]

(https://www.ceres.org/sites/default/files/reports/2020-06/Financial%20Regulators%20FULL%20FINAL.pdf).

[80] (SEC.gov | Comments on Climate Change Disclosures).

[81] Rose, Amanda, Professor of Law, Vanderbilt Law School, posted May 11, 2021, page 8. cll12-8785693-237729.pdf (sec.gov).

[82] Roos, Michelle, Executive Director, Environmental Protection Network, June 3, 2021, , page 3. EPN Comments on SEC Climate Change Disclosure 6/2021.

[83] Mahoney, Paul G., Professor University of Virginia and Julia D. Mahoney, John S. Battle Professor of Law, June 1, 2021, pages 1, 2-3, 4, and 4, respectively. cll12-8855236-238441.pdf (sec.gov).

[84] Eichorn, Scott and Zachary Talyor, University of Miami School of Law Investor Rights Clinic, April 30, 2021. Page 5: "Comparatively, bond markets offer a look at what can happen when the private sector is left to allocate an investment product's rating function itself: three primary market leaders developed, promulgating two unique letter-based rating systems applied to largely the same products . . . Although bond market investors have learned to translate corresponding ratings over time, similar competition in the nascent climate performance ratings market could cause significant confusion, specifically among unsophisticated investors struggling to compare inconsistent metrics. (Re: March 15, 2021 Statement Welcoming Public Input on Climate Change Disclosures (sec.gov)).

[85] Guillot, Janine, Chief Executive Officer, Sustainability Accounting Standards Board, May 19, 2021, Pages 4-5. cll12-8815762-238031.pdf (sec.gov).

There “is no reason to wait for disaster (financial and/or planetary) to strike before taking action” to scrap the NRSRO system.[86] Even more plainly: “Can we possibly meet the Ivory Soap standard and be stupid only 99.44% of the time as opposed to 100% of the time!!!!”[87] The SEC has imposed the 100% stupid standard on Our Country long enough.

All NRSRO ESG methodologies claim to assess “unknowable conditions and related investment risks that Earth's massively complex climate system may impose decades from now.” However, Moody’s ESG methodology goes furthest by confidently counting the “number of angels that can dance on the head of a pin” for structured finance issuers.[88] “[W]e consider the impact of ESG risks that are expected to unfold within the legal final maturity of the transaction.”[89] Structured finance transactions such as student loan ABS have legal final maturities of 2080 and beyond!.[90]

Inflated credit ratings of under-capitalized, overly complex structured debt products are a “lazy attempt to fix a more complex issue.”[91]

All SEC policy addresses or comprises an “inherently politicized issue.”[92] The Clayton SEC rollbacks, dilutions, delays, and exemptions to Dodd-Frank provisions are one such example. Every Sec decision obliges the regulator to “take sides in contentious policy disputes.”[93]

The SEC must scrap the oligopolistic NRSRO system immediately and cease creating “an environment that drowns out competition and reduces the opportunity for fair markets. I have found that those two things [competition and fair markets] do more to limit corruption, pollution, workplace violence and any other unwanted business practice that the government is trying to regulate.[94] Preserving the NRSRO system endangers that which “makes America special . . . our diversity of thought to create new innovations and competition driving market growth.”[95]

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[86] Barke, Jesse, April 23, 2021. (Comments of . Jesse Barke on (sec.gov)).

[87] Anonymous, May 6, 2021. Comments of N/A N/A on May. 06, 2021 (sec.gov).

[88] McKinney, Darren, L. March 29, 2021. “Were regulators even to demand that CEOs and boards of directors predict next month's weather, much less the unknowable conditions and related investment risks that Earth's massively complex climate system may impose decades from now, they may as well demand that publicly traded companies also annually declare the number of angels that can dance on the head of a pin.” (Comments of . Darren L McKinney on (sec.gov)). **Also**, Mahoney and Mahoney “op. cit.,” page 24. “It is challenging for a company to describe how it will look in 2035 or 2050 without making substantial mistakes, which may generate litigation well before those years arrive.” cll12-8855236-238441.pdf (sec.gov).

[89] Moody’s ESG Cross-Sector Methodology “op. cit.”, December 14, 2020, page 26, footnote 14.

[90] Podkul, Cezary, “A Borrower will be 114 When Bonds Backed by Her Student Loans Mature,” *Wall Street Journal*, January 9, 2020. (https://www.wsj.com/articles/a-borrower-will-be-114-when-bonds-backed-by-her-student-loans-mature-11578393002).

[91] Anonymous, May 28, 2021. Comments of Anonymous (sec.gov).

[92] Reilly, George, May 12, 2021. Comments of . George Reilly on (sec.gov).

[93] Mahoney and Mahoney “op. cit.,” page 2. cll12-8855236-238441.pdf (sec.gov).

[94] Hawkins, Roger, Individual Investor, May 24, 2021. Comments of . Roger Hawkins on (sec.gov).

[95] Wheeler, Logan, May 24, 2021. Comments of . Logan Wheeler on (sec.gov).

Accurate, i.e., *deflated* credit ratings will certainly "have a negative effect on the market value" of the many companies and entities that will be downgraded.[96] SEC policy of enabling NRSRO credit rating inflation, which in turn inflates corporate valuations, "seems to stand in the face of free market capitalism."[97] Capitalism requires accurate valuations, not convenient ones.

Scrapping the NRSRO system will help "[s]top corporate lying on climate."[98] Without the NRSRO shield, credit rating companies will either start assessing climate and other ESG exposures in assigning credit ratings, or continue pretending to do so and incur meaningful liability.

To justify preserving the no-action communication to two Ford Motor entities of November 23, 2010, the SEC must articulate and quantify the public interest benefits in the eleven-year-and-counting policy of submitting to NRSRO blackmail and exempting NRSROs from accountability in assigning ABS ratings.

"I believe policy should be set by our legislature and not at behest of Wall Street . . ."[99]

> "*Congress finds the following:*
>
> II
>
> *"(3) 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."*[100]

The SEC must immediately enact Congress's clear, unambiguous intent and allow Dodd-Frank 939G to take effect by rescinding the no-action communication addressed to two Ford Motor entities of November 23, 2010.[101] Dodd-Frank 939G subjects NRSROs to "expert liability in certain instances of assigning ABS ratings. Had the provision — Dodd-Frank Section 939G — taken automatic effect on 22 July 2010 as plainly specified, NRSROs would almost certainly have" fixed

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96 Futch, Brice, May 8, 2021. Comments of . Brice Futch on (sec.gov).

97 Hawkins, Roger "op. cit."

98 Milloy, Steve, Publisher JunkScience.com, June 1, 2021. Comments of . Steve Milloy on (sec.gov).

99 Martin, Nathan, May 11, 2021. Comments of . Nathan Martin on (sec.gov). **Also**, Current Guidance on Economic Analysis in SEC Rulemakings, pages 5-6. "Other justifications for rulemaking can include . . . interpreting provisions in statutes the Commission administers, and providing exemptive relief from statutory prohibitions where the Commission concludes that doing so is in the public interest."

100 "Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub L No 111-203, 124 Stat 1376 (2010)," Title IX, Subtitle C—Improvements to the Regulation of Credit Rating Agencies, Section 931. Findings. (https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf).

101 US Securities and Exchange Commission, "Response of the Office of the Chief Counsel, Division of Corporation Finance 'Re: Ford Motor Credit Company LLC and Ford Credit Auto Receivables Two, LLC, Incoming Letter Dated July 22, 2010,'" November 23, 2010. (https://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm).

all ABS credit rating methodologies.[102] The SEC cites only the shameful, humiliating, and ***100% UNAMERICAN*** rationale of NRSRO blackmail to justify preserving the no-action communication.[103]

The eleven-year-and-counting policy of submitting to NRSRO blackmail "presents risks to the SEC itself. The agency's claim to a degree of policy autonomy and judicial deference is based on the idea that it is a technocratic, expert body insulated from day-to-day political pressures."[104] The SEC merits ***zero*** "policy autonomy and judicial deference" if it cannot withstand multi-decade, "day-to-day" political pressures from NRSROs.

To justify preserving the NRSRO system, the SEC must articulate and quantify the public benefits from ignoring best-faith, spoon-fed information that NRSROs routinely inflate credit ratings. The SEC may cite first-hand knowledge of this submission, including all citations herein, as more irrefutable evidence that NRSROs routinely inflate credit ratings and, by so doing, undermine Our Country's economic, financial, and social systems.

The SEC may also cite first-hand knowledge of its own voluminous evasions, non-replies, and outright silence to my best faith and impeccably informed submissions, communications, and conversations with the commissioners and staff since 2011.[105] In particular, the SEC should closely review my one-sided communications with the Office of Credit Ratings and with my former Moody's colleagues Abe Putney and David Teicher.[106]

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[102] Gaillard and Harrington "op. cit." "[Section] 3. Unfinished work: new initiatives for regulators to promote rating accuracy—Let Dodd-Frank 939G take effect and subject NRSROs to meaningful liability." **Also,** Harrington Croatan Institute Working Paper "op. cit.", pages 10-12.

[103] SEC No-Action Communication to Two Ford entities "op. cit." "We understand that the rating agencies continue to indicate that that they are not willing to provide their consent at this time, and that without an extension of our no-action position, offerings of asset-backed securities would not be able to be conducted on a registered basis."

[104] Mahoney and Mahoney "op. cit.," page 25. cll12-8855236-238441.pdf (sec.gov).

[105] A search of sec.gov for "Bill Harrington," "William Harrington," and "William J. Harrington" produced 33 of my submissions and conversations on May 25, 2021. A search of my two email addresses (bill@croataninstitute.org and wjharrington@yahoo.com) on May 25, 2021 returned more than 50 email correspondences with SEC staff since August 8, 2011. **Also**, U.S. Securities and Exchange Commission NRSRO Rules "op. cit." cites many of my recommendations ("Harrington Letter" and "Harrington II Letter") and rejects all that would improve credit rating content. As example, page 267: "The commenter's suggestion for a committee assessment function addresses the performance of rating committees in determining credit ratings (that is, in applying the rating procedures and methodologies). Consequently, the Commission considers the commenter's proposal outside the scope of this rulemaking." (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[106] For instance, Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," pages 7-11. (https://www.wikirating.org/data/other/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf).

The SEC should also closely review its first-hand knowledge of national and international reporting and discussion of my work to hold NRSROs accountable.[107] I have shared many such items with the SEC many times. The SEC may also cite first-hand knowledge of its own refusal to take up my repeated good faith offers to participate in SEC forums devoted to NRSROs.[108]

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[107] Blodgett, Henry, "MOODY'S ANALYST BREAKS SILENCE: Says Rating Agency Rotten to the Core with Conflicts," *Business Insider*, April 19, 2011. (https://www.businessinsider.com/moodys-analyst-conflicts-corruption-and-greed-2011-8). **Also**, Luyendijk, Joris, "Ex-Moody's analyst: By 2006, it was toxic everywhere," *The Guardian*, December 17, 2012. (https://www.theguardian.com/commentisfree/2012/dec/17/ex-moodys-analyst-william-harrington). **Also**, Luyendijk, Joris, "'The rating agencies have been the all-purpose bogeyman for the crisis' (real-time question and answer with Bill Harrington and The Guardian readers)," December 17-20, 2012. (https://www.theguardian.com/commentisfree/joris-luyendijk-banking-blog/2012/dec/17/rating-agencies-bogeymen-william-j-harrington#comment-20107319). **Also**, Shenn, Jody, "Fitch Waivers Over Plan to Relax Derivative Rules," *Bloomberg*, May 23, 2012." (***Note, Jody Shenn is "VP-Senior Analyst, Structured Finance" at NRSRO Moody's Investors Service," per his LinkedIn profile on May 25, 2021.)*** **Also**, Marriage, Madison, "EX-Moody's staff raise alarm over ABS 'meltdown'," *Financial Times*, November 10, 2013. (https://www.ft.com/content/6b8cfc2c-4861-11e3-a3ef-00144feabdc0). Also, Pyburn, Allison, "Moody's FFELP ABS downgrades signal crack in legacy sector," *Debtwire ABS*, January 12, 2018. Moody's "downgraded 26 classes of FFELP ABS subject to CFTC swap margin posting requirements on Thursday, following years of advocacy work on behalf of former Moody's rating analyst and *Debtwire ABS* alum Bill Harrington. Harrington, now a senior fellow at Croatan Institute, lobbied the rating agencies, SEC, CFTC and others to require full collateralization of embedded ABS swaps and properly assess the risk of legacy deals which contain them." (https://www.debtwire.com/info/moodys-ffelp-abs-downgrades-signal-cracks-legacy-sector). **Also**, Morgenson Gretchen, Should Free Markets Govern the Bond Rating Agencies? "op. cit." **Also**, Thomas, Alberto and Bill Harrington, "Rating Manipulation Webinar," *Fideres*, June 30, 2020. WJH NRSRO comments from 18:00 to end. (https://fideres.com/videos/ratings-manipulation-webinar). **Also**, "New Frontiers in Fixed-Income Engagement," *Croatan Conversation*, November 18, 2020. (https://www.youtube.com/watch?v=cXGgSy5eCxg&t=2405s).

[108] Harrington, Bill, "Re Process (NOT Comment) on FIMSAC Sub-Committee on NRSROs," Message to Seven SEC Staff, November 7, 2019, Email. **Also**, Harrington, William J., "Electronic Letter 'Re Rule Comment Number 4-661'," June 3, 2013, page 2. "I attended the [May 14, 2013 SEC ABS] Roundtable as an observer after having offered to participate in Panel 3: Alternative Compensation Models. Agenda items such as a 'licensing and certification requirement for NRSRO analysts' warranted practical input from an NRSRO analyst. I also urged the SEC to invite other NRSRO analysts to participate in Panel 3 and proposed discussion themes for all three Roundtable panels. Please see Appendices A-D herein, beginning page 7. My offer to serve on Panel 3 received no SEC acknowledgment and my suggestion that other NRSRO analysts participate in the ABS Roundtable was not taken up. No NRSRO analyst was among the 26 panelists at the ABS Roundtable." (https://www.sec.gov/comments/4-661/4661-28.pdf). **Also**, Harrington, Bill, "Re Rule Comment 4-661," Message to Mr. Abe Losice, SEC Office of Credit Ratings," May 3, 2013, Email. (https://www.sec.gov/comments/4-661/4661-3.htm).

The SEC should also closely review its first-hand knowledge of my NRSRO and ABS reporting while working as a research journalist at *Debtwire ABS* from October 2015 to November 2016. I have previously shared my three, public-domain *Debtwire ABS* articles with the SEC.[109]

I will send the remainder of my *Debtwire ABS* reporting to the SEC. The reporting covers flawed NRSRO credit ratings of lease-to-own ABS, FFELP student loan ABS, Italian non-performing loan ABS, and all ABS worldwide with a flip-clause-swap-contract.

To justify preserving the NRSRO system, the SEC must articulate and quantify the public benefits from ignoring detailed academic and law enforcement maps of NRSRO credit rating inflation. The wide, wide world beyond the SEC cloister has grasped and mapped the conjoined SEC and NRSRO governance failures of the last 40 years. Because media, academicians, and others have widely publicized ongoing credit rating inflation by NRSROs, the SEC can cite unbounded public knowledge of credit rating inflation as "justification" for ending the NRSRO system.

For instance, the SEC may cite the respective U.S. Department of Justice settlements with NRSROs S&P Global Ratings and Moody's Investors Service.[110] The SEC may also cite prominent signatories to the settlements, including then California Attorney General Kamala D. Harris viz-a-viz S&P and then Missouri Attorney General Joshua Hawley viz-a-viz Moody's.[111]

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[109] Harrington, Bill, *Debtwire ABS*: "Moody's bets Germany will support Deutsche Bank derivatives above all else," October 12, 2016; "Existing ABS swaps also caught in swap margin net," August 16, 2016; and "US Margin Rules for Swaps Obliges Securitization Issuers to Overhaul Structures, Add Resource and Rethink Capital Structures," 4 November 2015. Respectively, (https://www.debtwire.com/info/moody%E2%80%99s-bets-germany-will-support-deutsche-bank-derivatives-above-all-else-%E2%80%94-analysis); (https://www.debtwire.com/info/existing-abs-swaps-also-caught-swap-margin-net-%E2%80%94-analysis); and, in Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," pages 27-31, (https://www.wikirating.org/data/other/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf).

[110] U.S. Justice Department Announcements: "Justice Department and State Partners Secure Nearly $864 Million Settlement With Moody's Arising From Conduct in the Lead-Up to the Financial Crisis," January 13, 2017. (https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-nearly-864-million-settlement-moody-s-arising); and "Justice Departments and State Partners Secure $1.375 Billion Settlement with S&P for Defrauding Investors in the Lead-Up to the Financial Crisis," February 3, 2015. (https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors).

[111] State of California Department of Justice "Attorney General Kamala D. Harris Announces $210 Million Settlement with Standard and Poor's For Inflating Mortgage-Backed Securities Ratings," *Press Release*, February 13, 2015. (https://oag.ca.gov/news/press-releases/attorney-general-kamala-d-harris-announces-210-million-settlement-standard-poor). **Also**, Taylor, Jason, "$10 Million Announced From Court Settlement To Assist With MO Budget Crunch," *Missourinet*, February 21, 2017. "Hawley announced the transfer of funds Tuesday morning in front of the state House Budget Committee. 'Those funds will be coming to general revenue, this morning, upon conclusion of my testimony.'" II "Justice has been served for those who suffered at the hands of Moody's practice of assigning inflated credit ratings to toxic

The SEC may cite academic works that demonstrate both that NRSROs routinely inflate credit ratings and that the NRSRO system has, by SEC design, failed Our Country since 1975. For instance, the SEC may cite work that indicates that the post-1975 SEC policy has "led to rating inflation."[112] The SEC may also cite work that demonstrates NRSROs inflated corporate and structured finance credit ratings during the period 1980 to 2012.[113]

The SEC may cite academic work that shows that credit rating "markets"— namely, investors and issuers — shop for and game inflated credit ratings rather than push NRSROs to assign accurate credit ratings. The SEC may cite work that shows an NRSRO can "regain market share after suffering reputational damage by issuing optimistic ratings."[114] The SEC may also cite work that shows increased NRSRO competition "coincides with lower quality ratings."[115]

The SEC may cite academic work that shows an NRSRO inflates credit ratings to boost both its own earnings and those of important shareholders. As example, the SEC may cite work that

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assets leading up to the financial crisis of 2008." (https://www.missourinet.com/2017/02/21/10-million-announced-from-court-settlement-to-assist-with-mo-budget-crunch/).

[112] Behr, Patrick, Darren J. Kisgen, and Jerome P. Taillard, "Did Government Regulations Lead to Inflated Credit Ratings?," *Management Science*, Published online December 5, 2016, Volume 64, No. 3. "SEC regulations in 1975 gave select rating agencies increased market power by increasing both barriers to entry and the reliance on ratings for regulations." II "These results indicate that the market power derived from the SEC led to ratings inflation." (https://doi.org/10.1287/mnsc.2016.2615).

[113] Cornaggia, Jess N., Kimberly J. Cornaggia, and John E. Hund, "Credit Ratings Across Asset Classes: A Long-Term Perspective," *Review of Finance*, Volume 21, Issue 2, March 2017, Pages 465–509. **Section 1. Introduction**: "Corporate bond ratings are 250% more accurate than SF [Structured Finance] ratings, yet only 91% are as accurate as municipal bond ratings." II "These results indicate corporate bonds receive more generous ratings (relative to their true credit quality) at issuance than municipal or sovereign issues throughout the sample period [1980-2010]." **Section 7. Conclusion**: "[I] issuers who are most lucrative to the rating agencies (SF products broadly, RMBS and CDOs specifically) face the most lenient rating standards at issuance, despite their relatively lower credit quality." (https://doi.org/10.1093/rof/rfx002).

[114] Baghai, Ramin P., and Bo Becker, "Reputations and credit ratings: Evidence from commercial mortgage-backed securities," *Journal of Financial Economics*, Volume 135, Issue 2, February 2020, Pages 425-444 (https://doi.org/10.1016/j.jfineco.2019.06.001).

[115] Becker, Bo and Todd Milburn, "How did increased competition affect credit ratings?," *Journal of Financial Economics*, Volume 101, Issue 3, September 2011, Pages 493-514. "Specifically, we discover that increased competition from Fitch coincides with lower quality ratings from the incumbents: Rating levels went up, the correlation between ratings and market-implied yields fell, and the ability of ratings to predict default deteriorated." (https://doi.org/10.1016/j.jfineco.2011.03.012). **Also**, Flynn, Sean and Andra Ghent, "Competition and Credit Ratings After the Fall," *Management Science*, Published online February 14, 2017, Volume 64, No. 4. "We find entrants issue higher ratings than incumbents, particularly for interest-only tranches . . . we provide suggestive evidence that incumbent rating levels become more generous as entrant market share in a product type increases." (https://doi.org/10.1287/mnsc.2016.2604).

shows Moody's inflated credit ratings after going public in 2000.[116] The SEC may also cite work that shows Moody's inflated credit ratings on "bonds issued by important investee firms" of Moody's large shareholders Berkshire Hathaway and Davis Selected Advisors.[117]

The SEC may cite academic work that an NRSRO analyst perpetuates credit rating inflation in widely varying instances such as prior to leaving an NRSRO or, alternatively, after having stayed too long. For the former, the SEC may cite work that shows that individual NRSRO analysts perpetuated credit rating inflation on behalf of post-NRSRO employers from 2005 to 2015.[118] For the latter, the SEC may cite work that shows that, for an NRSRO corporate analyst with an MBA, rating "accuracy" viz-a-viz a given corporation declines inversely with "tenure" covering it.[119]

Regarding political biases, the SEC may cite academic work that shows NRSROs may interfere with democracy by introducing "partisan discrimination into sovereign credit markets."[120]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public benefits from firsthand knowledge of the governance failure by NRSROs, the SEC itself, AIG, and most others in the financial system writ large in ignoring the negligently deficient accounting, capitalization, and credit ratings of the swap contract with a "flip clause."

The swap contract with a flip clause was *the* root cause of the 2008 financial crisis. Every pre-crisis issuer — AIG, Lehman Brothers, Goldman Sachs, and all the rest of the gang — depended

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[116] Kedia, Simi, Shivaram Rajagopal, and Xing Zhou, "Did going public impair Moody's credit ratings?," *Journal of Financial Economics*, Volume 114, Issue 2, November 2014, Pages 293-315. " . . . Moody's ratings for both corporate bonds and structured finance products are significantly more favorable to issuers, relative to S&P's, after Moody's IPO. Moreover, Moody's ratings are more favorable for clients subject to greater conflict of interest. There is little evidence that Moody's higher ratings, post-IPO, are more informative . . ." (https://doi.org/10.1016/j.jfineco.2014.07.005).

[117] Kedia, Simi, Shivaram Rajgopal, and Zing (Alex) Zhou, "Large shareholders and credit ratings," *Journal of Financial Economics*, Volume 124, Issue 3, June 2017, Pages 632-653. (https://doi.org/10.1016/j.jfineco.2017.03.007).

[118] Cornaggia, Jess, Kimberly J. Cornaggia, and Han Xia, "Revolving Doors on Wall Street," *Journal of Financial Economics*, Volume 120, Issue 2, May 2016, Pages 400-419. We "find that transitioning analysts award inflated ratings to their future employers before switching jobs." (https://doi.org/10.1016/j.jfineco.2016.01.007).

[119] Fracassi, Cesare, Stefan Petry, and Geoffrey Tate, "Does rating analyst subjectivity affect corporate debt pricing?," *Journal of Financial Economics*, Volume 120, Issue 3, June 2016, Pages 514-538. "We find evidence of systematic optimism and pessimism among credit analysts, comparing contemporaneous ratings of the same firm across rating agencies. These differences in perspectives carry through to debt prices and negatively predict future changes in credit spreads, consistent with mispricing. Moreover, the pricing effects are the largest among firms that are the most opaque, likely exacerbating financing constraints. We find that MBAs provide higher quality ratings. However, optimism increases and accuracy decreases with tenure covering the firm." (https://doi.org/10.1016/j.jfineco.2016.02.006).

[120] Barta, Zsófia and Alison Johnston, "Rating Politics? Partisan Discrimination in Credit Ratings in Developed Economies," *Comparative Political Studies*, Volume: 51, Issue: 5, pages: 587-620, April 1, 2018. (https://doi.org/10.1177%2F0010414017710263).

on a swap contract with a flip clause to issue each under-resourced complex finance product with inflated credit ratings that birthed and prolonged the financial crisis.

> "*Every party that agreed to or endorsed a flip clause generated the financial crisis. None was a blindsided casualty*."[121]

> "*The Bankruptcy Court detailed the 100% loss of contract values that the plaintiff-appellant (Lehman Brothers Special Financing) incurred under 100% of a 'multitude' of in-the-money, flip-clause-swap-contracts.*"[122]

Absent the swap contract with a flip clause, no collateralized debt obligation (CDO), no private-label residential mortgage-backed security (RMBS), and no product that owned or referenced CDOs or RMBS could have come to market.[123] In a typical, extremely head-spinning instance of negligent governance, a CDO that owned or refenced other CDOs that in turn owned or referenced RMBS nested exposure to swap contracts with flip clauses *everywhere* — in each RMBS, in each CDO that owned or referenced the RMBS, and in the CDO that owned or referenced the other CDOs.[124] AIG doubled-down on the sector-wide negligence by financing CDOs via upfront loans nested in swap contracts with flip clauses.[125]

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[121] Harrington, William J., "Motion for Leave to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities)," (Filed with the US Court of Appeals for the Second Circuit *Re: Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al*., Case No. 18-1079-bk), June 25, 2019, page 16. (WJH-Motion-to-File-Amicus-Brief-in-2nd-Circuit-Case-18-1079-bk-Lehman-Brothers-vs-the-World.pdf (croataninstitute.org)).

[122] Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," page 1. (https://www.wikirating.org/data/other/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf).

[123] Accordingly, rigorous economic analysis of the swap contract with a flip clause must tally only costs. The contract that severely damaged the US financial system and economy, and might well have destroyed them in the absence of bailouts, has no durable benefits. The swap contract with a flip clause undermines the competitiveness and efficiency of the complex finance markets and delivers only ephemeral, not durable capital formation.

[124] Complex-finance practitioners can easily replicate and disguise a similar head-spinning, nested proliferation of credit exposure to climate and ESG factors, for instance, via synthetic securities and credit default swap contracts that reference complex-finance products such as securitizations. The risk of ***under-counting credit exposures to climate and ESG factors*** is at least as great as the "double-counting" that concerns the American Bankers Association. Gullette, Michael, American Bankers Association, June 11, 2021, page 4. "Minimizing the 'double-counting' of GHGs within and across investment portfolios will need to be addressed. Double-counting can occur in emissions financing through consideration of value chains, co-financing, and the use of structured transactions, insurance, and other credit and liquidity risk-mitigating vehicles." (cll12-8906876-244192.pdf (sec.gov)).

[125] Harrington Counterproposal to SEC NRSRO Proposal August 8, 2011 "op. cit." details my first-hand experience with the AIG swaps with flip clauses, for instance on page 63. "AIG was counterparty to interest rate swaps with 50+ CDOs and other ABS transactions that had become deep-in the money,

Unfortunately, the negligently deficient accounting, capitalization, and credit rating of every party to a swap contract with a flip clause remains the generally "untold story in the collapse of AIG." [126] Likewise, the same flip clause deficiencies are the "untold story in the collapse" of Lehman Brothers, many other entities, and entire financial systems such as that of Greece.[127]

Unfortunately for Our Country, the SEC ignored all flip clause disasters in rejecting my 2018 proposal to ban "portfolio margining of swaps with flip clauses, walkaway clauses, or similar provisions."[128] Partly as a result, AIG continues to put flip clauses in the priorities of payments of its own CLOs![129]

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mark-to-market assets of AIG. In addition to providing an interest rate hedge to the transactions, AIG had also lent money to some of them at issuance. The CDOs that had borrowed in this fashion were repaying the loans through higher-than-market fixed rates that had resulted in particularly large mark-to-market assets for AIG." II "The respective swap contracts allowed the CDOs (both those that had borrowed from AIG and those that had not) to terminate the swaps without making any payment as AIG had not complied with the replacement provisions following its 2008 downgrades. If the CDOs had exercised these rights, they would have removed a large liability from the top of their waterfalls, to the benefit of their rated notes. By corollary, AIG would have recorded a 100% loss on each of the deeply-in-the-money swap assets." (https://www.sec.gov/comments/s7-18-11/s71811-33.pdf).

[126] US Government Accountability Office, "FINANCIAL CRISIS Review of Federal Reserve Board Assistance to AIG," *Report to Congressional Requesters*, Sep 2011. The GAO report discusses the same major credit exposure that the swaps with flip clauses posed to AIG but does not attribute the credit exposure to the flip clauses, or even mention them. See page 112, footnote 152. "Because AIG's credit rating had been downgraded below a specified level, the collateral managers of these CDOs had the right to direct the termination of AIG Financial Products as an interest rate swap counterparty. At issue were timing of a potential CDO liquidation and the effect that would have had on AIG Financial Products' ability to receive a swap termination payment. In deciding whether to direct liquidation, Federal Reserve Bank of New York did not discuss these matters with AIG Financial Products. As of February 5, 2009, AIG Financial Products was an interest rate swap counterparty to 72 CDOs in which ML [Maiden Lane] III was an investor, with a net exposure of about $12 billion." (https://ypfs.som.yale.edu/library/financial-crisis-review-federal-reserve-system-financial-assistance-american-international).

[127] Harrington Motion to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities) "op. cit.," pages 22-24. (WJH-Motion-to-File-Amicus-Brief-in-2nd-Circuit-Case-18-1079-bk-Lehman-Brothers-vs-the-World.pdf (croataninstitute.org)).

[128] U.S. Securities and Exchange Commission, "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers," *Final Rule*, June 21, 2019, page 149, footnote 377. (https://www.sec.gov/rules/final/2019/34-86175.pdf). **For my full proposal**, Harrington, William J., "Electronic Letter to the SEC 'Re File No. S7-08-12, Full Margin Posting + 100% Capital Charge for a Security-Based Swap with a Flip Clause or Walkaway Provision," November 18, 2018. (https://www.sec.gov/comments/s7-08-12/s70812-4663154-176520.pdf).

[129] Moody's Investors Service, "AIG CLO 2021-1, Pre-Sale Report," 2 April 2021, pages 23-25. The flip clause is comprised of: "Application of interest proceeds," Step 5; "Application of Subordinated A Note percentage of interest proceeds," Step 6; "Application of Subordinated B Note percentage of

NRSROs, which have far and away the best data on every past and present swap contract with a flip clause in the world, *should* tell the flip clause story, but doing so would crimp reliably astronomical earnings. For exactly that reason — the massive NRSRO governance failure to manage conflict-of-interest — NRSROs will continue suppressing the flip clause story. For instance, Moody's protects its commercial relationship with AIG by assigning credit ratings to AIG CLOs that ignore credit exposure to both the respective flip clauses and poor AIG governance. As justification for inflating the credit ratings of AIG CLOs, Moody's opines that AIG CLO structures (which includes the priorities of payment) and deal parties (most prominently, AIG) "largely mitigate governance risks," not create them.[130]

Since 2011, I have notified a comprehensive universe of practitioners — including academics, accountants, attorneys, bankers, credit rating and equity analysts, industry group specialists, issuers, investors, journalists, jurists, law enforcement professionals, national politicians, and regulators — that NRSROs promote negligently under-resourced swap contracts with flip clauses via interconnected, incoherent, and largely unintelligible credit rating methodologies.[131]

> "*I do this work regarding the flip clause because no other former NRSRO analyst, no current NRSRO committees, nor any other person globally assesses the flip clause objectively and publicly.*"[132]

That I must define the flip clause for financial practitioners who claim mastery of complex finance demonstrates the extent of financial sector negligence in setting the accounting, capitalization, and credit rating treatment for all parties to a swap contact with a flip clause. So too the likelihood that few will read these definitions and fewer still cold replicate them.

> "*Under a standard flip clause, an ABS priority of payments (waterfall) specifies that a deal pay a swap counterparty in one of two places based on whether the counterparty is performing or, alternatively, is insolvent, bankrupt, or similarly impaired. The deal pays*

interest proceeds," Step 4; "Application of Subordinated A Note percentage of principal proceeds," Step 9; and "Application of Subordinated B Note percentage of principal proceeds," Step 7. The report can be accessed from the accompanying *Announcement* "Moody's assigns ratings to six classes of notes issued by AIG CLO 2021-1, LLC.," 22 April 2021. (https://www.moodys.com/credit-ratings/AIG-CLO-2021-1-LLC-credit-rating-767524434). **Also**, Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," footnote 26, pages 8-9. (https://www.wikirating.org/data/other/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf).

[130] Moody's AIG CLO 2021-1 Pre-Sale Report "op. cit.," page 3. "Furthermore, the transaction structure and characteristics of the transaction parties largely mitigate governance risks."

[131] Harrington Counterproposal to SEC NRSRO Proposal August 8, 2011 "op. cit." "Search "flip clause," "replacement," "Moody's Hedge," "AIG," and "MLDP." (https://www.sec.gov/comments/s7-18-11/s71811-33.pdf).

[132] Harrington, William J., "Electronic Letter to Moody's Investors Service and the SEC Fixed Income Market Advisory Committee," April 8, 2020, page 2. (https://www.sec.gov/comments/265-30/26530-7046924-215374.pdf).

the counterparty at a very senior position while the counterparty is performing, but permanently 'flip' the payment to a deeply subordinated position once the counterparty has defaulted, entered bankruptcy, or experienced similar impairment."[133]

"[T]he servicing report for SLM Student Loan Trust 2004-10, a Navient student loan ABS deal, lists the swap counterparty AIG Financial Products on page 13 and the 16 waterfall steps in the priority of payments on page 7. Two of the 16 waterfall steps — the fourth ('D') and the thirteenth ('M') — specify payments to the swap counterparty. Together, the two steps constitute the deal's flip clause. At the fourth waterfall step, the deal pays the counterparty swap periodic payments ('D.ii') and swap termination amounts ('D.iii'), except with respect to a termination that resulted from the counterparty's default. This amount is paid at the thirteenth waterfall step, which is labelled 'remaining swap termination fees.'"[134]

On December 28, 2020, I distributed a comprehensive critique of financial sector governance failures viz-a-viz swap contracts with flip clauses. The critique consists of a 14-page assessment, a 45-item questionnaire, and seven appendices of my corroborating work.[135] As of the time of this submission, I emailed the critique to 187 practitioners, including 50 Moody's analysts and managers, 19 academics who study the 2008 crisis, and 23 members of The Systemic Risk Council.[136] I also emailed the critique to 13 people at the SEC, including Commissioners, their staff, and Office of Credit Ratings staff. As expected, none have responded.

My critique may have been news to one SEC Commissioner whose 2014 article on the AIG collapse *should* have implicated the flip-clause-swap-contract but did not even cite it despite mentioning "CDO" 28 times, "swap" 35 times, "rating" 36 times, and "RMBS" 46 times. The AIG article also mentions "accounting" 12 times without once identifying the negligently deficient AIG accounting and capitalization of its self-referencing credit exposure to 100% of asset value for each contract with a flip clause or other walk-away provision.[137]

The SEC may cite firsthand knowledge of AIG and other managers of at least 542 U.S. CLOs who perpetuate a massive, sector-wide governance failure by placing flip clauses in the respective

[133] Harrington, Bill, "Can Green Bonds Flourish in a Complex-Finance Brownfield?," *Croatan Institute Working Paper*, July 2018, page 16. (http://www.croataninstitute.org/publications/publication/can-green-bonds-flourish-in-a-complex-finance-brownfield).

[134] Ibid., page 16. The servicing report for SLM Student Loan Trust 2004-10 for the collection period January 1, 2021 to March 31, 2021: (https://images.navient.com/Investors/debtasset/SLM-Loan-Trusts/01-05/2004-10/0410QT0321.pdf).

[135] Harrington 2020 Flip Clause Critique and Questionnaire "op. cit."

[136] The Systemic Risk Council website (https://www.systemicriskcouncil.org/).

[137] Peirce, Hester, "Securities Lending and the Untold Story in the Collapse of AIG," *Mercatus Working Paper*, May 2014. (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2435161).

priorities of payment while preventing the same CLOs from complying with the swap margin rules of the SEC and other U.S. regulators.[138]

> "*No US CLO has the financial or operational capacity for the daily, two-way exchange of variation margin. Why do 75% of US CLOs have a flip clause in the priorities of payments?*"[139]

Conversely, the SEC may also cite firsthand knowledge of managers of another 180 U.S. CLOs that practice good governance by *not* placing a flip clause in the priorities of payment, but who obtain no credit rating uplift for doing so.[140]

The SEC may cite firsthand knowledge of 50 Moody's analysts and managers who can corroborate that swap contracts with a flip clause are a massive governance failure that confer no benefits but only impose costs on the U.S. economy, on the U.S. financial system, and on the prospects of every human U.S. person.

> "*Most of these people continue to vote in committees that assign a credit rating to debt issued by an entity with a flip clause in the priorities of payments. In each such instance, the committee ignores the governance failures of a party that uses a flip-clause and thereby assigns a credit rating that conflicts with Moody's global credit rating methodology*."[141]

The SEC may cite firsthand knowledge that the managers of 300-plus CDOs that either were counterparties to Lehman Brothers' swap contracts with flip clauses or owned such CDOs have firsthand knowledge of the contracts' negligently deficient accounting, capitalization, and credit ratings.[142] The managers learned that that a swap contact with a flip clause exposes all parties to

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[138] Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," footnote 26, pages 8-9.

[139] Ibid., "Questions for The Loan Syndications and Trading Association, # 17," page 19.

[140] Ibid., footnote 26, pages 8-9.

[141] Ibid., page 7. "Former colleagues who remain at Moody's and can attest to . . . my bona fides regarding the flip clause include Rodrigo Araya, Fabian Astic, Greg Bauer, Kent Becker, William Black, Rudy Bunja, David Burger, Richard Cantor, Eun Choi, Jack Dorer, Marty Duffy, Elena Duggar, Katherine Frey, Yehudah Forster, Michael Friedman, Jerry Gluck, Peter Hallenbeck, David Ham, Jian Hu, Bhargav Jhani, Ivan Jiang, Lina Kharnak, Jun Kim, Elina Kolmanovskaya, Warren Kornfeld, Steve Lioce, Arnaud Lasseron, Nicholas Lindstrom, Bill May, Edward Manchester, Maria Miagkova, Leon Mogunov, Maria Muller, Jonathan Polansky, Al Remeza, Stan Rouyer, Dan Rubock, Suzanna Sava, Jody Shenn, Julien Sieler, Teresa Stock, Yu Sun, Ramon Torres, Oksana Yerynovska, and Qian Zhu . . . [and] Mr. Swami Venkataraman and Mr. James Leaton.

[142] Harrington, William J., "Proposed Amicus Curiae Brief to the US 2nd Circuit Re: Case No. 18-1079 (Lehman vs 250 Financial Entities) - WJH V2.0 -07-30-19," (Filed with the US Court of Appeals for the Second Circuit *Re: Lehman Brothers Special Financing, Inc. against Branch Banking and Trust Company, et al.*, Case No. 18-1079-bk), June 25, 2019. Pages 1-6 contains a *partial* list of the 300-plus CDOs. (Clean-up revision dated July 30, 2019, https://croataninstitute.org/wp-content/uploads/2021/06/18-1079-bk-WJH-08-08-19-Letter-to-US-Court-of-Appeals-for-Second-Circuit-Proposed-Amicus-Curiae-Brief-Re-Case-No-18-1079.pdf.)

outsized losses of more than 100% of contract value. The SEC may also cite the vendors to the 300-plus CDOs, such as accountants, counsel, and trustees, who had a front row seat to flip clause litigation that in some cases spanned more than a decade.[143]

The SEC may cite firsthand knowledge that I briefed U.S. Congressperson Jerrold Nadler in person, and reminded him several times afterward, on the damage that swap contracts with a flip clause inflicted on our Country.[144]

To justify preserving the NRSRO system, the SEC must articulate and quantify the public benefits from ignoring the lack of third-party endorsements of the NRSRO system.

"*Saying nothing. . . sometimes says the most.*"[145]

> "*A necessary condition for inference from absence of evidence to have a respectable plausibility is that the evidence is highly expected, a situation that is not uncommon in quotidian discourse but hard to come by in scientific research.*"[146]

The SEC can apply "inference from absence of evidence" to establish that most credit rating users do not believe NRSRO credit ratings, which is perfect "justification" for scrapping the NRSRO system. The "absence of evidence" of third-party endorsements of NRSRO credit ratings and the NRSRO system unequivocally demonstrates that financial practitioners do not believe NRSRO credit ratings. Third party endorsements would be "highly expected" if practitioners *did* believe in the NRSRO system, given its centrality of NRSROs in the U.S. and global debt and derivative markets.

At best, assessments of the NRSRO system separate the "critical role" / "gatekeeper function" that credit ratings would *ideally* provide from the "necessary evil" of the NRSROs themselves. More common are bland assertions by industry practitioners that NRSROs are longstanding

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[143] Harrington 2020 Flip Clause Critique and Questionnaire "op. cit.," page 3. "The multi-billion dollars of additional losses that Lehman Brothers imposed on its already bankrupt estate via flip clauses, and the ensuing twelve years of litigation regarding the very same flip clauses, perfectly corroborate the perfect deficiency of the flip clause."

[144] Harrington, William J., "Electronic Letter to Moody's Investors Service and the SEC Fixed Income Market Advisory Committee," April 8, 2020, pages 3. "I briefed my US Congressman Jerry Nadler and his staff on the flip clause in an hour-long, inperson meeting at his Manhattan office on July 7, 2014. The delivering email copies staff of Representative Nadler." (https://www.sec.gov/comments/265-30/26530-7046924-215374.pdf). **Also**, Harrington, Bill, "Re Request that Representative Nadler Ask SEC to Include His Constituent Bill Harrington in Next PUBLIC FIMSAC Meeting," Message to three staffers of U.S. Representative Nadler with copies to six SEC staff, November 20, 2019, Email.

[145] Emily Dickinson.

[146] Wallach, Efraim, 2019. "Inference from absence: the case of archaeology," *Palgrave Communications*, Palgrave Macmillan, vol. 5(1), pages 1-10, December. (https://www.nature.com/articles/s41599-019-0307-9.pdf).

members of the gang that gets things done.[147] Most damning are "everyone knows" assessments that can be paraphrased as:

> "*Everyone knows that NRSROs inflate credit ratings of most bonds and derivative counterparties but that's okay because key constituencies such as institutional investors don't rely on inflated credit ratings except when shopping for inflated credit ratings to skirt investment guidelines that they the institutional investors have a fiduciary obligation to observe but prefer to breach in order to pay themselves higher bonuses.*"[148]

The SEC can also cite my firsthand knowledge that I have not read or heard a single public or private endorsement of either the NRSRO system or NRSRO credit ratings in my 11 years of full-time, unpaid advocacy to improve the content of credit ratings.

Similarly, the SEC can apply "inference from absence of evidence" to establish that most financial practitioners know that the swap contract with a flip clause is a governance failure that exposes all swap parties to outsized losses. This is also perfect "justification" for scrapping the NRSRO system. If practitioners believed in the swap contract with a flip clause, they would be "highly expected" to produce what they have conspicuously failed to produce: a contract that protects ABS investors as well as two-way margin posting; robust capitalizations of swap dealers; an ironclad template for an enforceable contract; an auditing protocol for issuers; cogent credit rating methodologies; rigorous academic work; and honest industry advocacy.[149]

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[147] CRE Finance Council, June 11, 2021, age 14. "For decades, CREFC has worked with key industry participants (e.g., servicers, trustees, commercial and investment banks, rating agencies, insurance companies, traders, and B-piece and investment-grade investors) to establish comprehensive and standardized disclosure frameworks, perhaps the best example of which is its development of the Investor Reporting Package in 1996." (Re: Public Input on Climate Change Disclosures (sec.gov)).

[148] Levine, Matt, "Credit Ratings Are Still Credit Ratings," *Bloomberg Opinion*, August 8, 2019. "The basic story is: 1. Credit ratings have bad incentives and a salient recent history of bad performance. 2. Everyone who invests in bonds knows this and is reminded of it constantly. 3. Their reliance on issuer-paid ratings is high and growing." (https://www.bloomberg.com/opinion/articles/2019-08-08/credit-ratings-are-still-credit-ratings).

[149] Harrington Proposed Amicus Curiae Brief to the US 2nd Circuit Re: Case No. 18-1079 (Lehman vs 250 Financial Entities) "op. cit.," pages 21-22. "No issuer establishes that a flip-clause-swap-contract protects ABS investors one tenth as effectively as a swap contract with daily, two-way exchange of variation margin. II "No swap dealer such as defendant-appellee Natixis demonstrates that it robustly capitalizes the outsized exposure to its own credit profile in (fortunately, for our Country) shriveling portfolios of legacy flip-clause-swap-contracts. Nor does a swap dealer validate flip-clause-swap-contract capitalization against that of swap contracts that do not incorporate flip clauses. II "No law firm produces an ironclad template for an enforceable flip-clause-swap-contract. II "No auditor produces a protocol for valuing ABS of issuers that, respectively, are and are not parties to a flip-clause-swap-contract. II "No NRSRO publishes a cogent flip-clause-swap-contract methodology or apportions the zero-sum exposures of a flip clause to the respective ABS and swap dealer ratings. II "No academician documents the extent to which flip-clause-swap-contracts and walkaway provisions stripped assets from the Lehman Brothers estate immediately after the bankruptcy filing.

Preserving the NRSRO system and the no-action communication to two Ford Motor entities of November 23, 2010, exposes the SEC to legal challenge.

I have singular standing to sue the SEC to end the NRSRO system and to rescind the no-action communication that prevents Dodd-Frank Section 939G from taking effect. Both policies prevent me from obtaining commercial engagements to evaluate swap contracts with a flip clause.

As my work on the flip clause cited herein and throughout the public domain demonstrates, I am *the* U.S. authority on swaps with a flip clause, as well as one of the, at most, handful of global authorities on the topic.[150] I registered the "financial assessment" entity *Harrington Independent Flip Clause Assessments*, which evaluates the "rating impact of flip clauses and derivative contracts in cash flow asset-backed securities waterfalls," in New York County on November 3, 2014.[151] Since then, the NRSRO system and the no-action communication have prevented *Harrington Independent Flip Clause Assessments* from obtaining engagements by smothering market demand for accurate assessment of the out-sized credit exposures that parties to a swap with a flip clause bear.

Scrapping the NRSRO system will easily survive the strictest standard of judicial review.

The U.S. government has a *compelling interest* to use the *most direct* and the *most substantive* means to optimize the operations of the U.S. economy and the U.S. financial system and thereby advance the prospects of every human U.S. person. Ending the NRSRO system will efficiently accomplish the foregoing by improving price signals, directing investment to optimal uses, and reducing the incidence of full-blown crises.

Ending the NRSRO system is also far and away the *least restrictive means* to optimize the operations of the U.S. economy and the U.S. financial system and thereby advance the prospects of every human U.S. person. No corporate person other than NRSROs will be impacted and no human person other than NRSRO owners will be impacted.[152]

II "Lastly, no industry group discusses the flip-clause-swap-contract without lying, parroting irrelevancies, or presenting "market information" that is alarmist, fatuous, and outdated." (https://croataninstitute.org/wp-content/uploads/2021/06/18-1079-bk-WJH-08-08-19-Letter-to-US-Court-of-Appeals-for-Second-Circuit-Proposed-Amicus-Curiae-Brief-Re-Case-No-18-1079.pdf .)

[150] Harrington Motion to File an Amicus Curiae Brief Re: Case No. 18-1079 (Lehman vs 250 Financial Entities) "op. cit.," pages 13-15. "I have scrutinized the flop-clause-swap-contract from the following **18** vantages: . . ." (https://croataninstitute.org/wp-content/uploads/2021/06/WJH-Motion-to-File-Amicus-Brief-in-2nd-Circuit-Case-18-1079-bk-Lehman-Brothers-vs-the-World.pdf.

[151] Harrington, William J., "Electronic Letter to the SEC et al (State and Federal Signatories to Moody's 2017 DoJ Settlement) 'Re Harrington Independent Flip Clause Assessments, SEC File No. 265-30, and Moody's Violation of 2017 DoJ Settlement,'" November 3, 2019. Pages I-III and PDF-numbered pages 106-109 (the final four pages of document). (https://www.sec.gov/comments/265-30/26530-6383231-197808.pdf).

[152] Morrissey, Patrick, West Virginia Attorney General, *SEC Comments on Climate Change Disclosures*, March 25, 2021. Page 2: "Strict scrutiny is the highest First Amendment standard and imposes three requirements. First, the regulation must advance a compelling government interest; second, it must

DURABLE **"Efficiency, Competitiveness, and Capital Formation" Needs Commonsense Baseline and Economic Analysis Plus *ZERO* Financial Lobbying Masquerading as "Data"**

> "*It is essential that we apply rigorous economic analysis to ensure that our policymaking, enforcement decisions, and examinations are informed by the data we have available.*"
> -- SEC Chair Gary Gensler[153]
>
> "*Would Moody's Have Formed Durable Opinions Had the Proposed Rules Been Implemented in 2002*?"
> -- Bill Harrington[154]
>
> "*Calibrating the Cost/Benefit Analysis so that Findings are Defensible*"
> -- Bill Harrington[155]
>
> "*Cross-border capital flows are not in themselves good or bad. More cross-border capital flows are not unequivocally good for domestic and international commerce. Conversely, fewer cross-border capital flows are not unequivocally bad for domestic and international commerce. II "Cross-border capital flows that are in fact money laundering are bad for domestic and international commerce. Cross-border capital flows that represent informed investment decisions on one side and useful investment on the other are good for domestic and international commerce*."
> -- Bill Harrington[156]

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be directly and substantially related to advancing that end; third, it must use the least restrictive means." (https://www.sec.gov/comments/climate-disclosure/cll12-8563794-230748.pdf).

[153] U.S. Securities and Exchange Commission "Jessica Wachter Named SEC Chief and Director of the Division of Economic Risk Analysis," *Announcement*, May 3, 2021. (https://www.sec.gov/news/press-release/2021-77).

[154] Harrington Counterproposal to SEC NRSRO Proposal August 8, 2011 "op. cit.", page 4. (https://www.sec.gov/comments/s7-18-11/s71811-33.pdf).

[155] Harrington, William J., "Electronic Letter to the U.S. Commodity Futures Trading Commission 'Re RIN 3038-AD54 Capital Requirements for Swap Dealers and Major Swap Participants,'" May 4, 2017, pages 5-7. **Also**, "As a first step in calibrating the cost/benefit analysis, the Commission must adjust the baseline assumption of the cost/benefit analysis of uncleared swaps and uncleared security-based swaps by 180 degrees as follows: 'Uncleared swaps and uncleared security-based swaps that are artificially cheap increase the costs and reduce the benefits to the economy, rather than vice-versa.' In doing so, the Commission will purge the cost/benefit analysis of the marketing mantras that the financial industry represents as being empirically-driven findings." **Also,** Pages 96-97: "**Three ways to calibrate cost/benefit analysis using uncleared swaps with flip clauses**" II "1. 'The cost/benefit analysis produces a defensible finding.'" II "2. 'The CFTC Proposal, if in place in 2003, would have moderated or even prevented the financial crisis.'" II "3. 'The CFTC Proposal would have survived this cost/benefit analysis in 2003.'" II "**Otherwise, the cost/benefit analysis understates the costs and overstates the benefits to the US economy** [emphasis added]." (https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61196&SearchText).

[156] "Ibid.," page 121.

In deciding whether to scrap or preserve the NRSRO system, the SEC *should* set a commonsense, defensible "baseline against which to measure the likely economic consequences" for all U.S. debt and derivative markets, as well as for the entire Country. A commonsense, defensible baseline will obligate the SEC to conduct robust cost / benefit analysis of the main economic consequences of a post-NRSRO system — namely, ***durably increased*** "efficiency, competition, and capital formation" in all U.S. debt and derivative markets owing to greatly improved accountability by these markets' practitioners.[157]

The only credit rating outcome that will *durably* increase "efficiency, competition, and capital formation" in all U.S. debt and derivative markets is rigorously accurate credit ratings.[158]

Absent a commonsense, defensible baseline, the SEC is likely to distort its economic analysis, and make the wrong decision about the NRSRO system, by conflating "the likely economic consequences" for all U.S. debt and derivative markets with the "potential benefits and costs" to just the NRSROs themselves.[159] The SEC embedded exactly these mistakes in the 2014 NRSRO rules.[160] The results were predictable, neither the rules nor the supporting economic analysis holds up.[161]

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[157] Current Guidance on Economic Analysis in SEC Rulemakings, page 1. " . . . articulating the appropriate economic baseline against which to measure the proposed rule's likely economic impact (in terms of potential benefits and costs, including effects on efficiency, competition, and capital formation in the market(s) the rule would affect) . . ."

[158] Rigorous economic analysis of inflated credit ratings, like that of the swap contract with a flip clause, must tally only costs. Inflated credit ratings severely damaged the US financial system and economy, and might well have destroyed them in the absence of bailouts, and have no durable benefits. Inflated credit ratings undermine the competitiveness and efficiency of the U.S. economy and deliver only ephemeral, not durable capital formation.

[159] Current Guidance on Economic Analysis in SEC Rulemakings, page 10. "As others have noted, 'the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure.'"

[160] U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 130. As example, the SEC decided not to "improve the quality of ratings" because doing so might result in "more frequent suspensions" of NRSROs, "which could reduce the number of NRSROs" assigning *inaccurate* ratings! "This alternative might benefit users of credit ratings by improving the quality of credit ratings. In particular, NRSROs may have higher incentives to conform to these requirements as a result of a lower threshold for revoking or suspending their registration. However, this alternative may result in costs for NRSROs by subjecting them to more frequent suspensions and revocations, which could reduce the number of NRSROs producing credit ratings. (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[161] Ibid., pages 39-40. As demonstrated by the subsequent SEC NRSRO annual reports, settlements, and actions, the NRSRO rules did not incentivize NRSROs to either improve governance of credit rating methodologies or "avoid certain conflicts of interest." "The requirements in the amendments and new rules being adopted today that are primarily designed to enhance an NRSRO's internal governance should have economic benefits, relative to the existing baseline, in terms of promoting the integrity of

The whole Country has assumed the costs of the flawed NRSRO rules and system. As glaring evidence, the NRSRO oligopoly has remained intact and the number of NRSROs has declined since the NRSRO rules were approved. Also, U.S. capital formation remained below levels of the late 20th century and U.S. economic growth remained stagnant.[162]

> "*Market efficiency and capital formation may also be adversely impacted if lower quality information is reflected in asset prices, which may impede the flow of capital to efficient uses*."[163]

If the NRSRO system did not exist, the SEC could not justify creating the system using the economic analysis in the 2014 NRSRO rules. Fortunately, the NRSRO system itself gives the SEC "good reason" and an extremely "detailed justification" to end it without harming any U.S. human or corporate person. For instance, there is no "industrial reliance" on the NRSRO system. Even the NRSROs themselves will not be unduly harmed by an end to the NRSRO system.[164]

Because the NRSRO system impedes economic growth by warping price signals, diverting investment to sub-optimal uses, destroying market efficiency, and impeding capital formation in all U.S. debt and derivative markets, and periodically spawns full-blown crises, the SEC should set the *absence of the NRSRO system* as the baseline to "measure the likely economic consequence" from scrapping the NRSRO system.

As this submission demonstrates, the baseline of preserving the NRSRO system will be a dishonest one because the SEC *knows* that the NRSRO system does not work. Unfortunately, the

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how NRSROs determine and monitor credit ratings. In particular, there are new requirements applicable to NRSROs that assign responsibilities to an NRSRO's management and board of directors, which should promote accountability and facilitate internal oversight over the processes governing the determination of credit ratings and the implementation of the procedures and methodologies an NRSRO uses to determine credit ratings. II "There are new requirements applicable to NRSROs pursuant to which they must avoid certain conflicts of interest and have policies and procedures to take certain actions to address credit ratings that are influenced by a conflict of interest."

[162] The World Bank, "Gross Capital Formation (% of GDP) - United States," accessed June 14, 2021. (https://data.worldbank.org/indicator/NE.GDI.TOTL.ZS?locations=US). **Also**, Statista, "Annual growth of real GDP in the United States of America from 1930 to 2020", accessed June 14, 2021. (https://www.statista.com/statistics/996758/rea-gdp-growth-united-states-1930-2019/).

[163] U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 288.

[164] Shoen, Edward Joe, U-Haul, June 9, 2021, page 3. ". . . to justify a break with longstanding policy, the Commission would have to specifically confront its past findings and provide good reasons for departing from them grounded in the statutory factors." II " . . . when an agency's "new policy rests upon factual findings that contradict those which underlay its prior policy," it must "provide a more detailed justification than what would suffice for a new policy created on a blank slate' . . ." II "The SEC cannot simply ignore these serious reliance interests. See *Encino Motorcars, LLC v. Navarro,* 136 S. Ct. 2117, 2126 (2016) ('A summary discussion may suffice in other circumstances, but here-in particular because of decades of industry reliance on the Department's prior policy-the explanation fell short of the agency's duty to explain why it deemed it necessary to overrule its previous position.')." (Re: March 15, 2021 Request for Comment (sec.gov).)

SEC may conclude that published guidance *obligates* it to set the existence of the NRSRO system as the baseline.[165] If so, the SEC must honestly identify and measure "potential costs and benefits including effects on efficiency, competition, and capital formation" in all U.S. debt markets and the entire Country, rather than simply for NRSROs and NRSRO vendors.[166]

To repeat, the SEC cannot replicate the "arbitrary and capricious use of discretion" that produced the one-sided "economic analysis" in the 2014 NRSRO rule.[167] The SEC has no "justification" for doubling-down on specious economic analysis to double-down on preserving its demonstrably harmful NRSRO system.

To start, the SEC must identify the "in-plain-sight" costs to the Country from the NRSRO system for exactly what they are — *costs!* The SEC must do the same with NRSRO exploitation of artificially cheap, unearned externalities. First, identify them as such, then measure their long overdue elimination solely as a benefit to the Country and not as a cost being imposed on NRSROs.[168]

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[165] Current Guidance on Economic Analysis in SEC Rulemakings, page 6. "The economic consequences of proposed rules (potential costs and benefits including effects on efficiency, competition, and capital formation) should be measured against a baseline, ***which is the best assessment of how the world would look in the absence of the proposed action*** [emphasis added]."

[166] Ibid., page 7. "In articulating the appropriate economic baseline for a rulemaking, rulewriting staff should work with the RSFI economists to describe the state of the world in the absence of the proposed rule, including the existing state of efficiency, competition, and capital formation, against which to measure the likely impact of the proposed rule and the principal alternative regulatory approaches. It is important to clearly describe the assumptions that underlie the description of the relevant baseline and to detail those aspects of the baseline specification that are uncertain. Defining the baseline typically involves identifying and describing the market(s) and participants affected by the proposed rule."

[167] U.S. Securities and Exchange Commission NRSRO Rules "op. cit." **For instance, "Economic Analysis" in Section E. "Disclosure of Information About the Performance of Credit Ratings" states that accurate credit ratings may *impede* capital formation.** Page 253: "In addition to these effects, the amendments may affect capital formation. Some academic research indicates that credit rating agencies should not focus exclusively on ratings accuracy, but also should consider the feedback effects of their credit ratings on the probability of survival of an issuer. Specifically, these theories suggest that if credit ratings can directly affect the default probability of an issuer, such as when a ratings downgrade itself makes it harder or more costly for a company to raise funds, then it may be optimal for credit rating agencies to delay credit rating downgrades in order to lessen the impact of such feedback on the company's prospects. If the adopted rules drive increased transparency with respect to performance, and this leads to pressures on NRSROs to assign more accurate credit ratings by making earlier downgrades, the amplified feedback effects could increase the default frequencies of issuers and other obligors." **Likewise**, every supposition that the rules would spur NRSRO competition. (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[168] U.S. Securities and Exchange Commission NRSRO Rules "op. cit." "Economic Analysis" in Section F. "Credit Rating Methodologies" tallies the NRSRO obligation to impose methodological consistency on all existing credit ratings as a *new* NRSRO cost rather than an end to a one-sided benefit that NRSROs should never have enjoyed in the first place. Page 286: "The Commission believes that NRSROs will

For instance, a massive cost of the NRSRO system is that NRSROs inflate credit ratings with impunity.

- Inflated credit ratings cannot spur durable capital formation, just the opposite! Inflated credit ratings inhibit capital formation and deform capitalism by diverting capital flows to sub-optimal uses.[169] The underlying dynamism of the U.S. economy, and not inflated NRSRO credit ratings, promote durable capital formation.
- Inflated credit ratings cannot promote efficiency in the U.S. debt and derivative markets, just the opposite! Inflated credit ratings reduce efficiency by incentivizing entities to focus on activities that NRSROs reward in higher credit ratings, rather than on activities with intrinsic utility.
- Inflated credit ratings do not promote competition in the U.S. debt and derivative markets, nor in the credit rating sector, either! The three NRSROs Fitch Ratings, Moody's Investors Service, and S&P Global Ratings assigned 95% of all outstanding NRSRO credit ratings as of December 31, 2019, compared with 97% when the SEC adopted its final NRSRO rules in August 2014.[170] Similarly, the SEC registered nine NRSROs at the time of this submission, compared with NRSROs when the SEC adopted its final NRSRO rule.[171]

Finally, the SEC must acknowledge that the NRSRO system imposes no material costs on the NRSROs themselves.[172] As evidence, simply cite NRSRO earnings over the last decade!

In essence, the entire concept of "costs," "benefits" and "effects related to efficiency, competition, and capital formation" are specious in the oligopolistic NRSRO sector. No single or series of tweaks to the failed system will bolster "capital formation." Is "capital formation" even valid if based on inflated credit ratings? Might "capital formation" have been even greater in the absence of the NRSRO system? Ditto "enhancing accountability, competition, and efficiency."

Finally, there is nothing "reasonable" in "economic analysis" that ostensibly addresses "efficiency, competition, and capital formation" but in fact presents a series of possible

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incur costs to apply material changes to ratings procedures and methodologies consistently to all current credit ratings to which the changed procedures or methodologies apply."

[169] Hold for less accurate information?

[170] SEC Office of Credit Ratings, "Annual Report on NRSROS, As Required by Section 6 of the Credit Rating Agency Reform Act of 2006," December 2020, page 11. (https://www.sec.gov/files/2020-annual-report-on-nrsros.pdf.) U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 25. (https://www.sec.gov/rules/final/2014/34-72936.pdf).

[171] SEC.gov | Current NRSROs and U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 21.

[172] U.S. Securities and Exchange Commission NRSRO Rules "op. cit.," page 37. "Nonetheless, the Commission recognizes – as reflected in the economic analysis – that the amendments and rules establish a substantial package of new requirements applicable to NRSROs and that complying with these requirements will entail significant costs to NRSROs."

outcomes, some of which are directly contradictory, as “straw arguments” to provide rationales for rejecting an alternative provision.[173]

> “The quality of credit ratings could increase as a result. This alternative also might decrease the quality of credit ratings in certain circumstances . . .”[174]

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[173] Current Guidance on Economic Analysis in SEC Rulemakings, page 9. “Analyze the economic consequences of the proposed rule and the principal regulatory alternatives.”

[174] U.S. Securities and Exchange Commission NRSRO Rules “op. cit., page 159. “There are a number of reasonable alternatives to the amendments and new rule, as adopted. First, the Commission could require that NRSROs immediately place on credit watch or review credit ratings that are determined by a look-back review to have been influenced by a conflict of interest (as was proposed). This alternative might further benefit users of credit ratings by alerting them sooner of conflicted credit ratings, limiting the potential risk that investors and users of credit ratings might make credit-based decisions using incomplete, biased, or inaccurate information, and thereby reduce the risk of mispricing due to the use of such incomplete, biased, or inaccurate information. It also might increase the incentives of NRSROs to develop and adhere to rating policies and procedures that further decrease the chance that conflicts of interest may influence credit ratings. ***The quality of credit ratings could increase as a result. This alternative also might decrease the quality of credit ratings in certain circumstances if it causes NRSROs to further reduce the use of subjective judgment in rating methodologies relative to the amendments and new rule*** [emphasis added]. This alternative might also result in additional costs for NRSROs and users of credit ratings. First, the NRSRO would need to expend resources to develop, modify, and enforce policies and procedures ensuring that it immediately places such conflicted ratings on credit watch or review in addition to documenting and retaining these policies and procedures pursuant to the amendments to Rule 17g-2. Second, if a look-back review determined that a conflict influenced a credit rating, the NRSRO would need to expend resources to place the credit rating on watch or review.”