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Union Calendar No. 306

109TH CONGRESS
2D SESSION

H. R. 2990

[Report No. 109–546]

To improve ratings quality by fostering competition, transparency, and accountability in the credit rating agency industry.

IN THE HOUSE OF REPRESENTATIVES

JUNE 20, 2005

Mr. FITZPATRICK of Pennsylvania introduced the following bill; which was referred to the Committee on Financial Services

JULY 7, 2006

Additional sponsors: Mr. BAKER, Mr. FEENEY, Mr. OXLEY, Mr. AKIN, Mr. GARRETT of New Jersey, Mr. DAVIS of Kentucky, Mr. GERLACH, Mr. ENGLISH of Pennsylvania, Mr. FOLEY, Mr. BARRETT of South Carolina, Ms. HART, Mr. GILLMOR, Mr. CASTLE, Mr. MCHENRY, and Mr. BLUNT

JULY 7, 2006

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on June 20, 2005]

A BILL

To improve ratings quality by fostering competition, transparency, and accountability in the credit rating agency industry.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; REFERENCES.

(a) SHORT TITLE.—This Act may be cited as the "Credit Rating Agency Duopoly Relief Act of 2006".

(b) REFERENCES.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

SEC. 2. FINDINGS.

Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission made pursuant to section 702 of the Sarbanes-Oxley Act of 2002 (116 Stat. 797), hearings before the House Committee on Financial Services during the 108th and 109th Congresses, comment letters to the concept releases and proposed rules of the Securities and Exchange Commission, and facts otherwise disclosed and ascertained, the Congress finds that—

(1) credit rating agencies are of national concern, in that, among other things—

(A) their ratings, publications, writings, analyses, and reports are furnished and distributed, and their contracts, subscription agree-

ments, and other arrangements with clients are negotiated and performed, by the use of the mails and means and instrumentalities of interstate commerce;

(B) their ratings, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities traded on securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System;

(C) the foregoing transactions occur in such volume as substantially to affect interstate commerce, and securities markets, the national banking system, and the national economy; and

(D) their regulation serves the compelling interest of investor protection; and

(2) the Securities and Exchange Commission—

(A) has, through its designation of certain credit rating agencies as nationally recognized statistical rating organizations, created an artificial barrier to entry for new participants; and

(B) will, in its latest proposed rule defining nationally recognized statistical rating organizations, codify and strengthen this barrier.

SEC. 3. DEFINITIONS.

Section 3(a) (15 U.S.C. 78c(a)) is amended by adding at the end the following new paragraphs:

"(60) CREDIT RATING.—The term 'credit rating' means an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.

"(61) CREDIT RATING AGENCY.—The term 'credit rating agency' means any person—

"(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee;

"(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and

"(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.

"(62) NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION OR NRSRO.—The term 'nation-

ally recognized statistical rating organization' means a credit rating agency that—

"(A) has been in business for at least three consecutive years; and

"(B) is registered under section 15E.

"(63) PERSON ASSOCIATED WITH A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION.—The term 'person associated with a nationally recognized statistical rating organization' means any partner, officer, director, or branch manager of such nationally recognized statistical rating organization (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such nationally recognized statistical rating organization, or any employee of such nationally recognized statistical rating organization.".

SEC. 4. REGISTRATION OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.

(a) AMENDMENT.—The Securities Exchange Act of 1934 is amended by inserting after section 15D (15 U.S.C. 78o–6) the following new section:

"SEC. 15E. REGISTRATION OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.

"(a) REGISTRATION PROCEDURES.—

"(1) FILING OF APPLICATION FORM.—A credit rating agency that elects to be treated as a nationally recognized statistical rating organization for the purposes of Federal statutes, rules, and regulations may be registered by filing with the Commission an application for registration in such form and containing such of the following and any other information and documents concerning such organization and any persons associated with such organization as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors:

"(A) any conflicts of interest relating to the issuance of credit ratings by a nationally recognized statistical rating organization;

"(B) the procedures and methodologies such nationally recognized statistical rating organization uses in determining credit ratings;

"(C) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods of such nationally recognized statistical rating organization;

"(D) policies or procedures adopted and implemented by such nationally recognized statistical rating organization to prevent the misuse

in violation of this title (or the rules and regulations thereunder) of material, non-public information; and

"(E) the organizational structure of such nationally recognized statistical rating organization.

"(2) REVIEW OF APPLICATION.—

"(A) INITIAL DETERMINATION.—Within 90 days of the date of the filing of such application (or within such longer period as to which the applicant consents) the Commission shall—

"(i) by order grant such registration; or

"(ii) institute proceedings to determine whether registration should be denied.

"(B) CONDUCT OF PROCEEDINGS.—Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing and shall be concluded within 120 days of the date of the filing of the application for registration. At the conclusion of such proceedings the Commission, by order, shall grant or deny such registration. The Commission may extend the time for conclusion of such proceedings for up to 90 days if it finds good cause for such

extension and publishes its reasons for so finding or for such longer period as to which the applicant consents.

"(C) GROUNDS FOR DECISION.—The Commission shall grant such registration if the Commission finds that the requirements of this section are satisfied. The Commission shall deny such registration if it does not make such a finding or if it finds that if the applicant were so registered, its registration would be subject to suspension or revocation under subsection (b).

"(3) PUBLIC AVAILABILITY OF INFORMATION.—Subject to section 24, the Commission, by rule, shall require a nationally recognized statistical rating organization, upon the granting of registration under this section, to make the information and documents filed with the Commission in its application for registration, or in any amendment filed under subsection (b)(1) or (2), publicly available on the website or comparable readily accessible means of such nationally recognized statistical rating organization.

"(b) UPDATE OF REGISTRATION.—

"(1) UPDATE.—Each nationally recognized statistical rating organization shall promptly amend its application for registration under this section if any

information or documents provided therein become materially inaccurate, except that a nationally recognized statistical rating organization is not required to amend the information required to be filed under subsection (a)(1)(C) by a filing under this paragraph, but shall amend such information in such organization's annual filing under paragraph (2) of this subsection.

"(2) CERTIFICATION.—Not later than 90 days after the end of each calendar year, each nationally recognized statistical rating organization shall file with the Commission an amendment to its registration, in such form as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors—

"(A) certifying that the information and documents in the application for registration of such nationally recognized statistical rating organization continue to be accurate; and

"(B) listing any material changes that occurred to such information or documents during the previous calendar year.

"(c) ACCOUNTABILITY FOR RATINGS PROCEDURES.—

"(1) AUTHORITY.—The Commission shall have the authority under this Act to take action against

any nationally recognized statistical rating organization if such nationally recognized statistical rating organization issues credit ratings in contravention of those procedures, criteria, and methodologies that such nationally recognized statistical rating organization—

"(A) includes in its application for registration under this section; or

"(B) makes and disseminates in reports pursuant to section 17(a) or the rules and regulations thereunder.

"(2) LIMITATION.—The rules and regulations applicable to nationally recognized statistical rating organizations the Commission may prescribe pursuant to this Act shall be narrowly tailored to meet the requirements of this Act applicable to nationally recognized statistical rating organizations and shall not purport to regulate the substance of credit ratings or the procedures and methodologies by which such nationally recognized statistical rating organizations determine credit ratings.

"(d) CENSURE, DENIAL, OR SUSPENSION OF REGISTRATION; NOTICE AND HEARING.—The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceed-

ing 12 months, or revoke the registration of any nationally recognized statistical rating organization if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, whether prior to or subsequent to becoming so associated—

"(1) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), (E), (H), or (G) of paragraph (4) of section 15(b), has been convicted of any offense specified in subparagraph (B) of such paragraph (4) within 10 years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct, or practice specified in subparagraph (C) of such paragraph (4);

"(2) has been convicted during the 10-year period preceding the date of filing of any application for registration, or at any time thereafter, of—

"(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4)(B); or

"(B) a substantially equivalent crime by a foreign court of competent jurisdiction; or

"(3) is subject to any order of the Commission barring or suspending the right of the person to be associated with a nationally recognized statistical rating organization.

"(e) WITHDRAWAL FROM REGISTRATION.—A nationally recognized statistical rating organization registered under this section may, upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any nationally recognized statistical rating organization is no longer in existence or has ceased to do business as a credit rating agency, the Commission, by order, shall cancel the registration of such nationally recognized statistical rating organization.

"(f) REPRESENTATIONS.—

"(1) REPRESENTATIONS OF SPONSORSHIP BY UNITED STATES OR AGENCY THEREOF.—It shall be unlawful for any nationally recognized statistical rating organization registered under this section to represent or imply in any manner whatsoever that such nationally recognized statistical rating organization

has been designated, sponsored, recommended, or approved, or that such nationally recognized statistical rating organization's abilities or qualifications have in any respect been passed upon, by the United States or any agency, any officer, or any employee thereof.

"(2) REPRESENTATION AS NRSRO OF UNREGISTERED CREDIT RATING AGENCIES.—It shall be unlawful for any credit rating agency to represent or imply in any manner whatsoever that such credit rating agency has been designated, sponsored, recommended, or approved, or that such credit rating agency's abilities or qualifications have in any respect been passed upon, by the United States or any agency, any officer, or any employee thereof. It shall be unlawful for any credit rating agency that is not registered under this section as a nationally recognized statistical rating organization to state that such credit rating agency is a nationally recognized statistical rating organization under this Act.

"(3) STATEMENT OF REGISTRATION UNDER SECURITIES EXCHANGE ACT OF 1934 PROVISIONS.—No provision of paragraph (1) shall be construed to prohibit a statement that a nationally recognized statistical rating organization is a nationally recognized statistical rating organization under this Act, if such

statement is true in fact and if the effect of such registration is not misrepresented.

"(g) PREVENTION OF MISUSE OF NONPUBLIC INFORMATION.—Each nationally recognized statistical rating organization shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such nationally recognized statistical rating organization's business, to prevent the misuse in violation of this title, or the rules or regulations thereunder, of material, nonpublic information by such nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization. The Commission, as it deems necessary or appropriate in the public interest or for the protection of investors, shall adopt rules or regulations to require specific policies or procedures reasonably designed to prevent misuse in violation of this title (or the rules or regulations thereunder) of material, nonpublic information.

"(h) MANAGEMENT OF CONFLICTS OF INTEREST.—Each nationally recognized statistical rating organization shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such nationally recognized statistical rating organization and affiliated persons and affiliated companies of such nationally recognized statistical

rating organization, to address and manage the conflicts of interest that can arise from such business. The Commission, as it deems necessary or appropriate in the public interest or for the protection of investors, shall adopt rules or regulations to prohibit, or require the management or disclosure of, any conflicts of interest relating to the issuance of credit ratings by a nationally recognized statistical rating organization including, without limitation, conflicts of interest relating to—

"(1) the manner in which a nationally recognized statistical rating organization is compensated by the obligor, or any affiliate of the obligor, for issuing credit ratings or providing related services;

"(2) the provision of consulting, advisory, or other services by a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, to the obligor, or any affiliate of the obligor;

"(3) business relationships, ownership interests, or any other financial or personal interests between a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, and the obligor, or any affiliate of the obligor; and

"(4) any affiliation of a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, with any person that underwrites the securities or money market instruments that are the subject of a credit rating.

"(i) PROHIBITED CONDUCT.—

"(1) PROHIBITED ACTS AND PRACTICES.—The Commission may adopt rules or regulations to prohibit any act or practice relating to the issuance of credit ratings by a nationally recognized statistical rating organization that the Commission determines to be unfair, coercive, or abusive, including any act or practice relating to—

"(A) seeking payment for a credit rating that has not been specifically requested by the obligor—

"(i) from an obligor; or

"(ii) from an affiliate of an obligor, unless—

"(I) the organization is organized under subsection (a)(1)(E) to receive fees from investors or other market participants, or a combination thereof; and

"(II) the affiliate is such an investor or participant;

"(B) conditioning or threatening to condition the issuance of a credit rating on the obligor's, or an affiliate of the obligor's, purchase of other services or products, including pre-credit rating assessment products, of the nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization;

"(C) lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool unless a portion of the assets within such pool also is rated by the nationally recognized statistical rating organization;

"(D) modifying or threatening to modify a credit rating or otherwise departing from its adopted systematic procedures and methodologies in determining credit ratings, based on whether the obligor, or an affiliate of the obligor, pays or will pay for the credit rating or any other services or products of the nationally recognized statistical rating organization or any person associ-

ated with such nationally recognized statistical rating organization.

"(2) RULE OF CONSTRUCTION.—Nothing in paragraph (1), or in any rules or regulations adopted thereunder, shall be construed to modify, impair, or supersede the operation of any of the antitrust laws. For the purposes of the preceding sentence, the term 'antitrust laws' has the meaning given it in the first section of the Clayton Act (15 U.S.C. 12), except that such term includes section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent such section 5 applies to unfair methods of competition.

"(j) DESIGNATION OF COMPLIANCE OFFICER.—Each nationally recognized statistical rating organization shall designate an individual responsible for administering the policies and procedures that are required to be established pursuant to subsections (g) and (h), and for ensuring compliance with the securities laws and the rules and regulations thereunder, including those promulgated by the Commission pursuant to this section.

"(k) STATEMENTS OF FINANCIAL CONDITION.—Each nationally recognized statistical rating organization shall, on a confidential basis, file with the Commission, at intervals determined by the Commission, such financial statements, certified (if required by the rules or regulations of

the Commission) by an independent public accountant, and information concerning its financial condition as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(l) ELIMINATION OF COMMISSION DESIGNATION PROCESS FOR NRSRO'S.—

"(1) CESSATION OF DESIGNATION.—Within 30 days after the enactment of the Credit Rating Agency Duopoly Relief Act of 2006, the Commission shall cease to designate persons and companies as nationally recognized statistical rating organizations, as that term is used under rule 15c3–1 of the Commission's rules (17 CFR 240.15c3–1).

"(2) PROHIBITION ON RELIANCE ON NO-ACTION RELIEF.—The no-action relief that the Commission has granted with respect to the designation of nationally recognized statistical rating organizations, as that term is used under rule 15c3–1 of the Commission's rules (17 CFR 240.15c3–1), shall be void and of no force or effect.

"(3) NOTICE TO OTHER AGENCIES.—Within 30 days after the date of enactment of the Credit Rating Agency Duopoly Relief Act of 2006, the Commission shall give notice to the Federal agencies which employ the term 'nationally recognized statistical rating or-

ganization' (as that term is used under rule 15c3–1 of the Commission's rules (17 CFR 240.15c3–1)) in their rules and regulations regarding the actions undertaken pursuant to this section.

"(4) REVIEW OF EXISTING REGULATIONS.—Within 180 days after the date of enactment of the Credit Rating Agency Duopoly Relief Act of 2006, the Commission shall review its existing rules and regulations which employ the term 'nationally recognized statistical rating organization' or 'NRSRO' and promulgate new or revised rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.".

(b) CONFORMING AMENDMENTS TO THE 1934 ACT.—

(1) Section 15(b)(4)(B)(ii) (15 U.S.C. 78o(b)(4)(B)(ii)) is amended by inserting "nationally recognized statistical rating organization," after "transfer agent,".

(2) Section 15(b)(4)(C) (15 U.S.C. 78o(b)(4)(C)) is amended by inserting "nationally recognized statistical rating organization," after "transfer agent,".

(3) Section 21B(a) (15 U.S.C. 78u–2(a)) is amended by inserting "15E," after "15C,".

(c) OTHER CONFORMING AMENDMENTS.—

(1) Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)) is amended by adding at the end the following new paragraph:

"(53) The term 'credit rating agency' has the same meaning as given in section 3 of the Securities Exchange Act of 1934.".

(2) Section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(a)) is amended by inserting "credit rating agency," after "transfer agent,".

(3) Section 9(a)(2) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(a)) is amended by inserting "credit rating agency," after "transfer agent,".

(4) Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)) is amended by adding at the end the following new paragraph:

"(28) The term 'credit rating agency' has the same meaning as given in section 3 of the Securities Exchange Act of 1934.".

(5) Section 203(e)(2)(B) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended by inserting "credit rating agency," after "transfer agent,".

(6) Section 203(e)(4) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended by inserting "credit rating agency," after "transfer agent,".

(7) Section 1319 of the Housing and Community Development Act of 1992 (12 U.S.C. 4519) is amended by striking "effectively" and all that follows through "broker-dealers" and inserting "that is a nationally recognized statistical rating organization, as such term is defined in section 3(a) of the Securities Exchange Act of 1934".

(8) Section 439 of the Higher Education Act of 1965 (20 U.S.C. 1087–2) is amended in subsection (r)(15)(A) by striking "means any entity recognized as such by the Securities and Exchange Commission" and inserting "means any nationally recognized statistical rating organization as that term is defined under the Securities Exchange Act of 1934".

(9) Section 601(10) of title 23, United States Code, is amended by striking "identified by the Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization" and inserting "registered with the Securities and Exchange Commission as a nationally recognized statistical rat-

ing organization as that term is defined under the Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.)".

SEC. 5. ANNUAL AND OTHER REPORTS.

Section 17(a)(1) (15 U.S.C. 78q(a)(1)) is amended by inserting "nationally recognized statistical rating organization," after "registered transfer agent,".

SEC. 6. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of credit rating agencies;

(B) the present and future impact of the condition described in subparagraph (A) on the securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing credit rating services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among credit rating agencies, including—

(A) higher costs;

(B) lower quality of services;

(C) anti-competitive practices;

(D) impairment of independence; and

(E) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among credit rating agencies.

(b) CONSULTATION.—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Securities and Exchange Commission;

(2) the Department of Justice; and

(3) any other public or private sector organization that the Comptroller General considers appropriate.

(c) REPORT REQUIRED.—Not later than 180 days after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 7. EFFECTIVE DATE.

The amendments made by sections 4 and 5 shall take effect on January 1, 2008, except as otherwise provided in paragraphs (1), (3), and (4) of subsection (l) of section 15E of the Securities Exchange Act of 1934 (as added by such amendments), and except that the Securities and Exchange Commission is authorized to prescribe rules and regulations to carry out such amendments beginning on the date of enactment of this Act.

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