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17 CFR Parts 232, 240, 249, et al.
Nationally Recognized Statistical Rating Organizations; Final Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 232, 240, 249, and 249b

[Release No. 34–72936; File No. S7–18–11]

RIN 3235–AL15

Nationally Recognized Statistical Rating Organizations

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') and to enhance oversight, the Securities and Exchange Commission (''Commission'') is: adopting amendments to existing rules and new rules that apply to credit rating agencies registered with the Commission as nationally recognized statistical rating organizations (''NRSROs''); adopting a new rule and form that apply to providers of third-party due diligence services for asset-backed securities; and adopting amendments to existing rules and a new rule that implement a requirement added by the Dodd-Frank Act that issuers and underwriters of asset-backed securities make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. The Commission also is adopting certain technical amendments to existing rules.

DATES: This rule is effective November 14, 2014; except the amendments to § 240.17g–3(a)(7) and (b)(2) and Form NRSRO, which are effective on January 1, 2015; and the amendments to § 240.17g–2(a)(9), (b)(13) through (15), § 240.17g–5(a)(3)(iii)(E), (c)(6) through (8), § 240.17g–7(a) and (b), and Form ABS–15G, which are effective June 15, 2015. The addition of §§ 240.15Ga–2, 240.17g–8, 240.17g–9, 240.17g–10, and Form ABS Due Diligence–15E are effective June 15, 2015.

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SUPPLEMENTARY INFORMATION: The Commission, with respect to NRSROs, is adopting amendments to rules 17 CFR 232.101 (''Rule 101 of Regulation S–T''), 17 CFR 240.17g–1 (''Rule 17g–1''), 17 CFR 240.17g–2 (''Rule 17g–2''), 17 CFR 240.17g–3 (''Rule 17g–3''), 17 CFR 240.17g–5 (''Rule 17g–5''), 17 CFR 240.17g–6 (''Rule 17g–6''), 17 CFR 240.17g–7 (''Rule 17g–7''), and 17 CFR 249b.300 (''Form NRSRO''); and is adopting new rules 17 CFR 240.17g–8 (''Rule 17g–8'') and 17 CFR 240.17g–9 (''Rule 17g–9'').

In addition, the Commission, with respect to providers of third-party due diligence services for asset-backed securities, is adopting new rules 17 CFR 240.17g–10 (''Rule 17g–10'') and 17 CFR 249b.500 (''Form ABS Due Diligence–15E'').

Finally, the Commission, with respect to issuers and underwriters of asset-backed securities, is adopting amendments to 17 CFR 249.1400 (''Form ABS–15G'') and is adopting new rule 17 CFR 240.15Ga–2 (''Rule 15Ga–2'').

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I. Introduction

A. Background

The Dodd-Frank Act,[1] through Title IX, Subtitle C, ''Improvements to the Regulation of Credit Rating Agencies,'' among other things, establishes new self-executing requirements applicable to NRSROs and requires that the Commission adopt rules applicable to NRSROs in a number of areas.[2] It also requires certain studies relating to NRSROs.[3] The NRSRO provisions in the Dodd-Frank Act augment the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act of 2006''), which established a registration and oversight program for NRSROs through self-executing provisions added to the Exchange Act and implementing rules adopted by the Commission under the Exchange Act, as amended by the Rating Agency Act of 2006.[4] Title IX, Subtitle C of the Dodd-Frank Act also provides that the Commission shall prescribe the format of a certification that providers of third-party due diligence services must provide to each NRSRO producing a credit rating for an asset-backed security to which the due diligence services relate.[5] Finally, Title IX, Subtitle C of the Dodd-Frank Act establishes a new requirement for issuers and underwriters of asset-backed securities

[1] Public Law 111–203, 124 Stat. 1376, H.R. 4173 (July 21, 2010).

[2] *See* Public Law 111–203, 931 through 939H. In addition, Title IX, Subtitle D, ''Improvements to the Asset-Backed Securitization Process,'' contains section 943, which provides that the Commission shall adopt rules, within 180 days, requiring an NRSRO to include in any report accompanying a credit rating of an asset-backed security a description of the representations, warranties, and enforcement mechanisms available to investors and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities. *See* Public Law 111–203, 943. On January 20, 2011, the Commission adopted Rule 17g–7 to implement section 943. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* Securities Act of 1933 (''Securities Act'') Release No. 9175 (Jan. 20, 2011), 76 FR 4489 (Jan. 26, 2011). Prior to enactment of the Dodd-Frank Act and the adoption of Rule 17g–7, the Commission proposed a different rule to be codified at 17 CFR 240.17g–7. *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* Securities Exchange Act of 1934 (''Exchange Act'') Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008). This proposed rule would have required an NRSRO to publish a report containing certain information with the publication of a credit rating for a structured finance product or, as an alternative, use ratings symbols for structured finance products that differentiate them from the credit ratings for other types of debt securities. *See id.* In November 2009, the Commission announced it was deferring consideration of action on that proposal and separately proposed a different rule to be codified at 17 CFR 240.17g–7 that would have required an NRSRO to annually disclose certain information. *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 61051 (Nov. 23, 2009), 74 FR 63866 (Dec. 4, 2009). As discussed above, a different rule from either of these proposals ultimately was adopted and codified at 17 CFR 240.17g–7 in January 2011. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR 4489.

[3] *See* Public Law 111–203, 939(h), 939C, 939D, 939E, 939F. Pursuant to section 939(h) of the Dodd-Frank Act, the Commission submitted a staff report to Congress on standardizing credit rating terminology. *See Report to Congress Credit Rating Standardization Study As Required by Section 939(h) of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Sept. 2012), *available at http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf* (''2012 Staff Report on Credit Rating Standardization''). Pursuant to section 939F of the Dodd-Frank Act, the Commission submitted a staff report to Congress on the feasibility of establishing a system for assigning NRSROs to determine credit ratings for structured finance products. *See Report to Congress on Assigned Credit Ratings As Required by Section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dec. 2012), *available at http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf* (''2012 Staff Report on Assigned Credit Ratings''). Pursuant to section 939C of the Dodd-Frank Act, the Commission submitted a staff report to Congress on the independence of credit rating agencies. *See Report to Congress on Credit Rating Agency Independence Study As Required by Section 939C of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Nov. 2013), *available at http://www.sec.gov/news/studies/2013/credit-rating-agency-independence-study-2013.pdf* (''2013 Staff Report on Credit Rating Agency Independence'').

[4] *See* Public Law 109–291 (2006). The Rating Agency Act of 2006, among other things, amended section 3 of the Exchange Act to add definitions, added section 15E to the Exchange Act to establish self-executing requirements for NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs, amended section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over NRSROs, and amended section 21B(a) of the Exchange Act to provide the Commission with the authority to assess penalties ''against any person'' in administrative proceedings instituted under section 15E of the Exchange Act. *See* Public Law 109–291, 3 and 4; 15 U.S.C. 78c; 15 U.S.C. 78o–7; 15 U.S.C. 78q; 15 U.S.C. 78u–2. The Commission adopted rules to implement a registration and oversight program for NRSROs in June 2007. *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007). The implementing rules were Form NRSRO, Rule 17g–1, Rule 17g–2, Rule 17g–3, Rule 17g–4, Rule 17g–5, and Rule 17g–6. The Commission has twice adopted amendments to some of these rules. *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 59342 (Feb. 2, 2009), 74 FR 6456 (Feb. 9, 2009); *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009).

[5] *See* Public Law 111–203, 932(a)(8) (adding new paragraph (s)(4)(C) to section 15E of the Exchange Act); 15 U.S.C. 78o–7(s)(4)(C)).

to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[6]

On May 18, 2011, the Commission proposed for comment amendments to existing rules and new rules in accordance with Title IX, Subtitle C of the Dodd-Frank Act and to enhance oversight of NRSROs.[7] The Commission received a number of comment letters in response to the proposals.[8] The comments on specific proposals are summarized below in the corresponding sections of this release discussing the proposals and the amendments and new rules being adopted today.

B. Economic Analysis

The Commission has performed an economic analysis in connection with today's adoption of the amendments and new rules discussed in section II. of this release. The economic analysis is reflected in this section I.B. of the release as well as throughout the rest of the release.[9]

1. Guiding Principles

Title IX, Subtitle C of the Dodd-Frank Act mandates that the Commission prescribe rules to improve regulation of NRSROs.[10] Section 931 of the Dodd-Frank Act, ''Findings,'' introduces Title IX, Subtitle C of the Dodd-Frank Act and provides context to what motivated Congress to enact these provisions with respect to NRSROs.[11] In particular, Congress found:

- Because of the systemic importance of credit ratings and the reliance placed on credit ratings by individual and institutional investors and financial regulators, the activities and performances of credit rating agencies, including NRSROs, are matters of national public interest, as credit rating agencies are central to capital formation, investor confidence, and the efficient performance of the U.S. economy.[12]
- Credit rating agencies, including NRSROs, play a critical ''gatekeeper'' role in the debt market that is functionally similar to that of securities analysts, who evaluate the quality of securities in the equity market, and auditors, who review the financial statements of firms. Such role justifies a similar level of public oversight and accountability.[13]
- Because credit rating agencies perform evaluative and analytical services on behalf of clients, much as

[6] *See* Public Law 111–203, 932(a)(8) (adding new paragraph (s)(4)(A) to section 15E of the Exchange Act); 15 U.S.C. 78o–7(s)(4)(A).

[7] *See Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 64514 (May 18, 2011), 76 FR 33420 (June 8, 2011). The Commission also proposed technical amendments to its existing NRSRO rules. *Id.*

[8] *See* letter from Jeffrey W. Rubin, Chair, Business Law Section, American Bar Association, dated Aug. 19, 2011 (''*ABA Letter*''); letter from Bruce E. Stern, Chairman, Association of Financial Guaranty Insurers, dated Aug. 8, 2011 (''*AFGI Letter*''); letter from Gerald W. McEntee, President, American Federation of State, County and Municipal Employees, dated Aug. 5, 2011 (''*AFSCME Letter*''); letter from Marcus Stanley, Policy Director, Americans for Financial Reform, dated Apr. 1, 2014 (''*AFR II Letter*''); letter from Daryl Schubert, Chair, Auditing Standards Board, American Institute of Certified Public Accountants, dated Aug. 10, 2011 (''*AICPA Letter*''); letter from Larry G. Mayewski, Executive Vice President, A.M. Best, dated Aug. 8, 2011 (''*A.M. Best Letter*''); letter from the Honorable Robert E. Andrews, U.S. Congress, House of Representatives, dated Mar. 3, 2012 (''*Andrews Letter*''); letter from Tom Deutsch, Executive Director, American Securitization Forum, dated Aug. 8, 2011 (''*ASF Letter*''); letter from Chris Barnard dated June 30, 2011 (''*Barnard Letter*''); letter from Joel Barton dated Aug. 8, 2011 (''*Barton Letter*''); letter from Marie Benson dated June 16, 2011 (''*Benson Letter*''); letter from Dennis M. Kelleher, President & CEO, and Stephen W. Hall, Securities Specialist, Better Markets, Inc., dated Aug. 8, 2011 (''*Better Markets Letter*''); letter from Zenia Brown dated May 21, 2011 (''*Brown Letter*''); letter from John J. Cadigan, General Partner, CECO LLC, dated June 15, 2011 (''*Cadigan Letter*''); letter from Nancy Campbell dated Sept. 29, 2011 (''*Campbell Letter*''); letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, and Marcus Stanley, Policy Director, Americans for Financial Reform, dated Aug. 8, 2011 (''*CFA/AFR Letter*''); letter from Micah Hauptman, Financial Services Counsel, and Barbara Roper, Director of Investor Protection, Consumer Federation of America, dated Mar. 3, 2014 (''*CFA II Letter*''); letter from Robert M. Chandler dated June 8, 2011 (''*Chandler Letter*''); letter from Laurel Leitner, Senior Analyst, Council of Institutional Investors, dated Aug. 8, 2011 (''*CII Letter*''); letter from Susan R. Clark dated June 17, 2011 (''*Clark Letter*''); letter from Steven Cohen, Senior Vice President and General Counsel, Clayton Holdings LLC, dated Aug. 8, 2011 (''*Clayton Letter*''); letter from Gregory W. Smith, Chief Operating Officer, General Counsel, Colorado Public Employees Retirement Association, dated Aug. 8, 2011 (''*COPERA Letter*''); letter from Dave Cowen dated May 23, 2011 (''*Cowen Letter*''); letter from Stephen M. Renna, Chief Executive Officer, CRE Finance Council, dated Aug. 8, 2011 (''*CRE Letter*''); letter from Gary D. Cristofani dated July 28, 2011 (''*Cristofani Letter*''); letter from William Michael Cunningham, Creative Investment Research, Inc., dated May 23, 2005 (''*Cunningham I Letter*''); letter from William Michael Cunningham, Creative Investment Research, Inc., dated July 4, 2011 (''*Cunningham II Letter*''); letter from Bonnie Davis dated June 16, 2011 (''*Davis Letter*''); letter from Theresa Day dated June 16, 2011 (''*Day Letter*''); letter from Daniel Curry, President, and Mary Keogh, Managing Director, Regulatory Affairs, DBRS, Inc., dated Aug. 8, 2011 (''*DBRS Letter*''); letter from Daniel Curry, Chief Executive Officer, and Mary Keogh, Managing Director, Global Regulatory Affairs, DBRS, Inc., dated Dec. 5, 2013 (''*DBRS II Letter*''); letter from Deloitte & Touche LLP dated Aug. 8, 2011 (''*Deloitte Letter*''); letter from Sean Egan, Egan-Jones Ratings Company, dated Aug. 5, 2011 (''*EJR Letter*''); letter from Roberta Y. Ely dated June 17, 2011 (''*Ely Letter*''); letter from Ernst & Young LLP dated Aug. 8, 2011 (''*Ernst & Young Letter*''); letter from Anne S. McCulloch, Senior Vice President and Deputy General Counsel, Federal National Mortgage Association, dated Aug. 8, 2011 (''*Fannie Mae Letter*''); letter from Charles D. Brown, General Counsel, Fitch, Inc., dated Aug. 5, 2011 (''*Fitch Letter*''); letter from Marianne Freebury dated June 16, 2011 (''*Freebury Letter*''); letter from Richard M. Whiting, Executive Director and General Counsel, The Financial Services Roundtable, dated Aug. 8, 2011 (''*FSR Letter*''); letter from Myrna D. Gardner dated June 14, 2011 (''*Gardner Letter*''); letter from Corrine M. Garza dated June 14, 2011 (''*Garza Letter*''); letter from David Gaus dated Nov. 1, 2012 (''*Gaus Letter*); letter from William J. Harrington, dated Aug. 8, 2011 (''*Harrington Letter*''); letter from William J. Harrington dated May 29, 2014 (''Harrington II Letter''); letter from Karrie McMillan, General Counsel, Investment Company Institute, dated Aug. 8, 2011 (''*ICI Letter*''); letter from KPMG LLP dated Aug. 8, 2011 (''*KPMG Letter*''); letter from Markus Krebsz dated Nov. 4, 2010 (''*Krebsz Letter*''); letter from Jules B. Kroll, Chairman and CEO, Kroll Bond Rating Agency, Inc., dated Aug. 8, 2011 (''*Kroll Letter*''); letter from Jules B. Kroll, Chairman and CEO, Kroll Bond Rating Agency, Inc., dated August 19, 2014 (''Kroll II Letter''); letter from Francis Lambert dated Aug. 8. 2011 (''*Lambert Letter*''); letter from Kashif Latif dated May 19, 2011 (''*Latif Letter*''); letter from the Honorable Carl Levin, U.S. Senate, Permanent Subcommittee on Investigations, dated Aug. 8, 2011 (''*Levin Letter*''); letter from Dee Longenbaugh dated June 15, 2011 (''*Longenbaugh Letter*''); letter from Ray Lynch dated June 17, 2011 (''*Lynch Letter*''); letter from Craig R. Mills, CraigRMills LLC, dated Aug. 19, 2011 (''*Mills Letter*''); letter from Michel Madelain, President and Chief Operating Officer, Moody's Investors Service, dated Aug. 8, 2011 (''*Moody's Letter*''); letter from Robert Dobilas, President, Morningstar Credit Ratings, LLC, dated Aug. 8, 2011 (''*Morningstar Letter*''); letter from Kevin Overholt dated June 14, 2011 (''*Overholt Letter*''); letter from Maneesh Pangasa dated July 29, 2011 (''*Pangasa Letter*''); letter from PricewaterhouseCoopers, LLP, dated Aug. 8, 2011 (''*PWC Letter*''); letter from William E. Reno dated June 16, 2011 (''*Reno Letter*''); letter from LaVonne L. Rhyneer dated June 17, 2011 (''*Rhyneer Letter*''); letter from Andrew M. Siff, Esquire, Siff & Associates, PLLC, dated June 13, 2011 (''*Siff Letter*''); letter from Deven Sharma, President, Standard and Poor's Ratings Services, dated Aug. 8, 2011 (''*S&P Letter*''); letter from Anne Rutledge, President, TradeMetrics Corporation, dated Aug. 8, 2011 (''*TradeMetrics Letter*''). Copies of these letters are available on the Commission's Web site at: *http://www.sec.gov/comments/s7-18-11/s71811.shtml.* In addition, in connection with the Commission's solicitation of comments on the Commission's request pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) for approval of the extension of the previously approved collection of information provided for in Rule 17a–7, several commenters submitted letters that are relevant to this rulemaking. *See* letter from Daniel Curry, President, and Mary Keogh, Managing Director, Regulatory Affairs, DBRS, Inc., dated Apr. 14, 2014 (''*DBRS PRA Letter*''); letter from Angela Y. Liang, Assistant General Counsel, Kroll Bond Rating Agency, Inc., dated Apr. 17, 2014 (''*Kroll PRA Letter*''); and letter from Michael Kanef, Chief Regulatory and Compliance Officer, Moody's Investors Service, dated Apr. 28, 2014 (''*Moody's PRA Letter*'').

[9] The discussion of the amendments and new rules in section II of this release is organized into sections that in large part are based on the distinct rulemaking mandates in Title IX, Subtitle C of the Dodd-Frank Act. *See* sections II.A. through II.M. of this release. Each section includes an economic analysis that focuses specifically on the amendments or rules being discussed in the section.

[10] *See* Public Law 111–203, 931 through 939H, entitled ''Improvements to the Regulation of Credit Rating Agencies.''

[11] *See* Public Law 111–203, 931.

[12] *See* Public Law 111–203, 931(1).

[13] *See* Public Law 111–203, 931(2).

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.[14]

• In certain activities, particularly in advising arrangers of structured financial products on potential ratings of such products, credit rating agencies face conflicts of interest that need to be carefully monitored and that therefore should be addressed explicitly in legislation in order to give clearer authority to the Commission.[15]

• In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies.[16]

The amendments and new rules being adopted today to implement sections 932, 936, and 938 of the Dodd-Frank Act are designed to address these findings of Congress. For example, they are intended to increase the integrity and transparency of credit ratings and promote public oversight and accountability of NRSROs as ''gatekeepers'' for the primary benefit of the users of credit ratings.[17] The amendments and new rules also prescribe new disclosure requirements relating to structured finance products and, in particular, asset-backed securities.[18] These requirements are designed to address concerns about the role of NRSROs in the financial crisis of 2007–2009[19] in terms of how they rated certain types of structured finance products and, in particular, the inherent conflicts of interest in rating these products.[20]

In the market for structured finance products, the pool of assets underlying or referenced by the product is often comprised of hundreds of thousands of loans, each requiring time and expense to evaluate. In these markets, the separation between the borrower and the ultimate provider of credit can introduce significant information asymmetries between the parties involved in the securitization process that creates a structured finance product[21] and investors in the product, who may have less information on the credit quality and other relevant characteristics of the asset pool.[22] Further, disclosures to investors regarding the asset pool may not be sufficiently detailed to allow investors to adequately evaluate the quality of the collateral backing the securities and, thereby, assess the credit risk of the securities. Consequently, the market for structured finance products has evolved as a ''rated'' market in which the credit risk of the products is assessed by credit rating agencies[23] and the valuations of the products depend significantly on credit ratings.[24] To curb their informational disadvantage, certain investors in structured finance products may use credit ratings to inform their investment decisions.[25]

Given that investors may not know the quality of the assets underlying structured finance products, certain originators of these assets may attempt to adversely transfer risks of poor origination decisions to investors by creating complex and opaque structured finance products.[26] This risk is especially pronounced when the originator, sponsor, depositor, or underwriter receives compensation before investors learn about the quality of the assets.[27] Because origination fees

[14] *See* Public Law 111–203, 931(3).

[15] *See* Public Law 111–203, 931(4).

[16] *See* Public Law 111–203, 931(5).

[17] *See* John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, *Turmoil in the U.S. credit markets: the role of the credit rating agencies* (Apr. 22, 2008) (testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs), p. 1, *available at http://www.banking.senate.gov/public/_files/OpgStmtCoffeeSenateTestimonyTurmoilintheUSCreditMarkets.pdf* (''Coffee Testimony I'').

[18] The term *structured finance product* as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This broad category of financial instrument includes an *asset-backed security* as defined in section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)) and other types of structured debt instruments, including synthetic and hybrid collateralized debt obligations (''CDOs''). The term *Exchange Act-ABS* as used throughout this release refers more narrowly to an *asset-backed security* as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

[19] Throughout this Release, unless indicated otherwise, when the Commission uses the term ''financial crisis'' it is referring to the financial crisis that took place between 2007 and 2009.

[20] *See* Public Law 111–203, 931 (setting forth, among other things, Congress' findings with respect to the role played by credit ratings agencies, the services provided by credit ratings agencies, certain conflicts of interests facing credit rating agencies, and inaccuracies in ratings on structured finance products).

[21] Asset-backed securitization—the process used to create asset-backed securities—is a financing technique in which financial assets are pooled and converted into instruments that may be offered and sold in the capital markets. In a basic securitization structure, an entity—often a financial institution—originates or otherwise acquires a pool of financial assets, such as mortgage loans, either directly or through an affiliate. It then sells the financial assets, again either directly or through an affiliate, for the purpose of depositing them into a specially created investment vehicle that issues securities ''backed'' by those financial assets. Payment on the asset-backed securities depends primarily on the cash flows generated by the assets in the underlying pool (and possibly other rights designed to assure timely payment, generally known as ''credit enhancements''). *See Asset-Backed Securities,* Securities Act Release No. 8518 (Dec. 22, 2004), 70 FR 1506 (Jan. 7, 2005).

[22] *See* Adam B. Ashcraft and Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit,* Staff Report, Federal Reserve Bank of New York, Working Paper No. 318 (2008). The authors identify seven information frictions that can cause moral hazard and adverse selection problems in a subprime mortgage securitization transaction.

[23] *See* Joshua Coval, Jakub Jurek, and Erik Stafford, *The Economics of Structured Finance,* 23(1) J. Econ. Perspectives 3–26 (2009).

[24] *See* Adam Ashcraft, Paul Goldsmith-Pinkham, Peter Hull, and James Vickery, *Credit Ratings and Security Prices in the Subprime MBS Market,* 101(3), Amer. Econ. Rev. 115–119 (2011).

[25] *See* Frank Partnoy, *Overdependence on Credit Ratings Was a Primary Cause of the Crisis,* in *The Panic of 2008: Causes, Consequences, and Implications for Reform* (Edward Elgar Press 2010, Lawrence Mitchell and Arthur Wilmarth, eds.). References to credit ratings in federal regulations also may have contributed to investor reliance on credit ratings. Section 939A of the Dodd-Frank Act requires each federal agency, including the Commission, to review any regulation issued by such agency that requires the use of an assessment of the creditworthiness of a security or money market instruments and any references to or requirements in such regulations regarding credit ratings. *See* Public Law 111–203, 939A. The section further provides that each such agency shall ''modify any such regulations identified by the review . . . to remove any reference to or requirement of reliance on credit ratings, and to substitute in such regulations such standard of creditworthiness as each respective agency shall determine as appropriate for such regulations.'' *Id.*

[26] *See* Chris Downing, Dwight Jaffee, and Nancy Wallace, *Is the Market for Mortgage-Backed Securities a Market for Lemons?,* 22(7) Rev. Fin. Stud. 2457–2494 (2009). The authors argue that the quality of the assets sold to investors through securitization is lower than the quality of similar assets that are not sold to investors. They find empirical support for this proposition using a comprehensive dataset of sales of mortgage-backed securities (Freddie Mac Participation Certificates) to special-purpose vehicles over the period 1991 through 2002.

[27] Several parties may be involved in the securitization process that creates an asset-backed security, including an originator, sponsor, depositor, issuing entity, underwriter, and arranger. *See generally Asset-Backed Securities,* 70 FR at 1508. The originator is the entity that creates a financial asset (for example, mortgage loan, auto loan, or credit card receivable) that collateralizes an asset-backed security through an extension of credit or otherwise and that sells the asset to be included in an asset-backed security. The sponsor is the entity that organizes and initiates the asset-backed securities transaction by transferring the financial assets underlying an asset-backed security directly or indirectly to the issuing entity. The depositor is an entity that receives or purchases the financial assets from the sponsor and transfers them to the issuing entity (in some cases the sponsor transfers the financial assets directly to the issuing entity, thereby by-passing the use of a separate depositor). The issuing entity is the trust or other vehicle created at the direction of the sponsor or depositor

Continued

are based on transaction volume and risks are transferred to investors, an originator may have the economic incentive to produce as many assets (for example, mortgage loans) as possible without adequately screening their credit quality.[28]

The rating process for structured finance products differs from the rating process for corporate bonds, whose ratings are largely based on publicly available data such as audited financial statements. The data used in rating structured finance products is primarily provided by the sponsor, depositor, or underwriter.[29] Unlike credit ratings for corporate bonds, credit ratings of structured finance products are ''highly sensitive to the assumptions of (1) default probability and recovery value, (2) correlation of defaults, and (3) the relation between payoffs and the economic states that investors care about most.'' [30] The rating process for these products may happen in the reverse of how a more traditional product is rated because the sponsor, depositor, arranger, or underwriter often decides before the structure is finalized what credit rating it would like for each tranche of securities to be issued, within the limits of what is possible, and structures the product accordingly (for example, with regard to selecting the underlying assets and establishing the credit enhancements applicable to the different tranches of securities). Concerns have been raised that the inherently iterative nature of the process between the credit rating agency and the sponsor, depositor, arranger, or underwriter may give rise to potential conflicts of interest [31] and that credit rating agencies marketing advisory and consulting services to their clients during this process may accentuate the conflict.[32]

Just prior to the financial crisis, the size of the structured finance market was considerable. New issuances of RMBS, for example, peaked in 2006 for a total of $801.7 billion.[33] Low interest rates drove investor demand for products that had high yields but also were highly rated by the credit rating agencies.[34] Mortgage originators largely exhausted the supply of traditional quality mortgages and, to keep up with investor demand for RMBS, subprime lending became increasingly popular. As the number of delinquencies on subprime mortgages suddenly soared in late 2007, RMBS lost a considerable amount of value,[35] and investors began to question the accuracy of credit ratings assigned to RMBS and CDOs linked to RMBS.[36] Certain academic studies argue that, as the structured finance market boomed between 2004 and 2007, NRSROs might have had an incentive to generate revenue by relaxing rating standards,[37] inflating credit ratings,[38] facilitating the sale of asset-backed securities by a small number of large issuers,[39] and reducing due diligence in

that owns or holds the financial assets and in whose name the asset-backed securities are issued. The underwriter is the entity that underwrites the offering of asset-backed securities and sells them to investors. The arranger is an entity that organizes and arranges a securitization transaction, but does not sell or transfer the assets to the issuing entity. It also structures the transaction and may act as an underwriter for the deal. In jurisdictions where an arranger is used, the arranger's role is similar to that of a sponsor in other jurisdictions. In some cases, a single entity may perform more than one function (for example, a financial institution may act as an originator and sponsor). The *issuer* of a structured finance product as used in this release can mean, depending on the context, the issuing entity or the person that organizes and initiates the offering of the structured finance product (for example, the sponsor or depositor). Generally, when this release discusses an issuer taking a specific action in the context of an offering of a structured finance product (for example, making a disclosure), the person that organizes and initiates the offering would be the person taking the action (as opposed to the issuing entity). Further, in the context of the discussion of Rules 17g–10 and 15Ga–2, the term *issuer* (which is defined in Rule 17g–10) includes a sponsor or depositor.

[28] *See* Amiyatosh Purnanandam, *Originate-to-Distribute Model and the Subprime Mortgage Crisis,* 24(6) Rev. Fin. Stud. 1881–1915 (2011). The author argues that, during the financial crisis, banks with high involvement in the originate-to-distribute market originated excessively poor-quality mortgages, consistent with the view that the originating banks did not expend resources to adequately screen the credit quality of their borrowers.

[29] *See Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies* (July 2008), *available at http://www.sec.gov/news/studies/2008/craexamination070808.pdf* (''2008 Staff Inspection Report''), pp. 7–10. The report describes the rating process for a residential mortgage-backed security (''RMBS'') and CDO at the three examined credit rating agencies (Standard & Poor's Ratings Services, Moody's Investor's Services, Inc., and Fitch, Inc.). For example, with respect to a involving subprime loans, the arranger of the RMBS typically initiates the rating process by sending the credit rating agency data on each of the subprime loans to be held by the trust (for example, principal amount, geographic location of the property, credit history and FICO score of the borrower, ratio of the loan amount to the value of the property, and type of loan), the proposed capital structure of the trust and the proposed levels of credit enhancement for each tranche issued by the trust. *Id.* at 7. Upon receipt of the information, the credit rating agency assigns a lead analyst who is responsible for analyzing the loan pool, the proposed capital structure, and the proposed credit enhancement levels and, ultimately, for formulating a rating recommendation to a rating committee composed of analysts and/or senior-level analytic personnel. *Id.* at 7. The rating committee votes on the credit ratings for each tranche and usually communicates its decision to the issuer. *Id.* at 9. In most cases, the issuer can appeal a rating decision, although the appeal is not always granted (and, if granted, may not necessarily result in any change in the rating decision). Typically, the credit rating agency is paid for determining the credit rating only if the credit rating is issued.

[30] *See* Coval, Jurek, and Stafford, *The Economics of Structured Finance,* p. 23. The authors argue that, ''unlike corporate bonds, whose fortunes are primarily driven by firm-specific considerations, the performance of securities created by tranching large asset pools is strongly affected by the performance of the economy as a whole.'' *Id.* at 23.

[31] *See* International Organization of Securities Commissions (''IOSCO''), *The Role of Credit Rating Agencies in Structured Finance Markets* (May 2008), p. 5 (''Some critics have argued that the inherently iterative nature of this process may give rise to potential conflicts of interest.'').

[32] *See* Coffee Testimony I, p. 3, (''Today, the rating agency receives one fee to consult with a client, explain its model, and indicate the likely outcome of the rating process; then, it receives a second fee to actually deliver the rating (if the client wishes to go forward once it has learned the likely outcome)''). Rule 17g–6 prohibits, among other things, an NRSRO from conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO. *See* 17 CFR 240.17g–6(a)(1).

[33] The total amount of new issuances is calculated by staff in the Commission's Division of Economics and Risk Analysis (''DERA'') using Asset-Backed Alert and Commercial Mortgage Alert databases. The amounts include only non-agency RMBS sold in the United States through Commission-registered offerings, Rule 144A offerings, or traditional private offerings.

[34] *See* Testimony of John B. Taylor, the Mary and Robert Raymond Professor of Economics at Stanford University and George P. Shultz Senior Fellow in Economics at Stanford's Hoover Institution, before the Subcommittee on Monetary Policy and Trade Committee on Financial Services, U.S. House of Representatives (Mar. 5, 2013), *available at http://financialservices.house.gov/uploadedfiles/hhrg-113-ba19-wstate-jtaylor-20130305.pdf.*

[35] *See* Board of Governors of the Federal Reserve System (''Federal Reserve''), *Report to the Congress on Risk Retention* (Oct. 2010), pp. 50–51 (discussing the drop in the triple-A and triple-B ABX.HE 2006–2 index (−70% by the end of 2008 for triple-A rated and −95% for triple-B rated subprime RMBS issued in 2006)).

[36] *See* IOSCO, *The Role of Credit Rating Agencies in Structured Finance Markets,* p. 2.

[37] *See* John M. Griffin and Dragon Yongjun Tang, *Did Subjectivity Play a Role in CDO Credit Ratings?,* 67(4) J. Fin. 1293–1328 (2012). The authors analyze a sample of 916 CDOs and find that a large credit rating agency frequently made positive adjustments outside its main model that resulted in increasingly larger AAA tranche sizes. These adjustments are difficult to explain by likely determinants, such as manager experience or credit enhancements, but exhibit a clear pattern: CDOs with smaller model-implied AAA sizes receive larger adjustments and CDOs with larger adjustments experience more severe subsequent downgrading.

[38] *See* Vasiliki Skreta and Laura Veldkamp, *Ratings Shopping and Asset Complexity: A Theory of Ratings Inflation,* 56 J. Monetary Econ. 678–695 (2009); Efraim Benmelech and Jennifer Dlugosz, *The Credit Rating Crisis,* NBER Working Paper No. 15045 (2009); Bo Becker and Todd Milbourn, *How Did Increased Competition Affect Credit Ratings?,* 101 J. Fin. Econ. 493–514 (2011); Andrew Cohen and Mark D. Manuszak, *Ratings Competition in the CMBS Market,* 45(1) J. Money, Credit and Banking 93–119 (2013).

[39] *See* Jie He, Jun Qian, and Philip E. Strahan, *Credit Ratings and the Evolution of the Mortgage-Backed Securities Market,* 101(3) Amer. Econ. Rev., 131–135 (2011). The authors find that in 2006 the

the presence of investors that solely rely on credit ratings.[40] The concerns about the accuracy of credit ratings fueled an emergent reluctance to invest in these products.[41] The new issuances of RMBS totaled $715.3 billion in 2007 and plunged to $34.5 billion in 2008.

In August 2007, the Commission staff initiated examinations of the three largest credit rating agencies to review their role in the turmoil in the subprime mortgage-related securities markets.[42] Among other things, these examinations revealed that the credit rating agencies struggled to adjust the number of staff and resources employed in the rating process to the increasing volume and complexity of RMBS and CDOs.[43] Certain significant aspects of the rating process and methodologies used to rate RMBS and CDOs were not documented or disclosed.[44] The credit rating agencies examined did not have specific written procedures for rating RMBS and CDOs.[45] Also, the credit rating agencies did not appear to have specific written policies and procedures to identify or address errors in their models or methodologies.[46] In certain instances, Commission staff believed that adjustments to models were made without appropriately documenting a rationale for deviations from the model.[47] Processes for performing surveillance and monitoring of outstanding credit ratings on an ongoing basis appeared to be less robust than the processes for determining initial credit ratings.[48] Moreover, in the Commission staff's view, sufficient steps were not taken to prevent considerations of fees, market share, or other business interests from influencing credit ratings or rating criteria.[49] Finally, the examined credit rating agencies appeared to solely rely on the information provided by RMBS sponsors.[50] In particular, they did not appear to verify the integrity and accuracy of such information as, in their view, due diligence duties belonged to other parties and they did not appear to seek representations from sponsors that due diligence was performed.[51]

Following the financial crisis, the Dodd-Frank Act mandated regulatory actions intended to enhance regulation, accountability, and transparency of NRSROs.[52] Generally, the majority of the rulemaking mandated by the Dodd-Frank Act addresses all classes of credit ratings, rather than credit ratings for only structured finance products.[53] In implementing the mandate, the amendments and new rules being adopted today are designed to further enhance the governance of NRSROs in their role as ''gatekeepers'' [54] and increase the transparency of the credit rating process as a whole. Further, as discussed in section II. of this release, the amendments and new rules being adopted today include new requirements designed to enhance transparency with respect to structured finance products, including requirements for NRSROs to disclose information about the performance and history of credit ratings for subclasses of structured finance products and requirements for NRSROs, issuers, underwriters, and providers of third-party due diligence services to disclose information about due diligence services performed with respect to asset-backed securities.[55]

2. Baseline

The amendments and new rules being adopted today primarily affect NRSROs, issuers, and underwriters of asset-backed securities, and providers of third-party due diligence services for asset-backed securities. To the extent that the new requirements change the business practices of the primarily affected parties, such changes may also affect clients of NRSROs (that is, obligors who pay NRSROs to obtain entity credit ratings, issuers who pay NRSROs to obtain credit ratings for their issued securities, subscribers who pay NRSROs to access credit ratings and research, and persons who pay NRSROs for other services), credit raters or credit rating agencies other than NRSROs, parties involved in asset-backed securities markets (other than issuers, underwriters, third-party due diligence providers, and NRSROs), and users of credit ratings in general.

The baseline against which economic costs and benefits, as well the impact of the amendments and new rules being adopted today on efficiency, competition, and capital formation, are measured is the situation in existence today, prior to the adoption of the amendments and rules. The baseline includes an estimate of the number of entities that will likely be directly affected by the amendments and rules and a description of the relevant features of the regulatory and economic environment in which the affected entities operate. The discussion below identifies the main features of the regulatory and economic baseline, which will be further developed in section II of this release discussing the amendments and rules, including in the

mortgage-backed securities (''MBS'') market was highly concentrated among large issuers, with the top five accounting for 39% of all newly issued securities; between 2004 and 2006, a larger fraction of MBS sold by large issuers received triple-A ratings than MBS sold by small issuers; and tranches sold by large issuers then experienced larger price drops than those sold by smaller issuers when the ''housing bubble'' began to unravel.

[40] *See* Patrick Bolton, Xavier Freixas, and Joel Shapiro, *The Credit Ratings Game,* 67(1) J. of Finance 85–111 (2012), *available at http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2011.01708.x/full.* The authors develop a model of competition among credit rating agencies that includes two types of investors with different incentives to perform due diligence: sophisticated and ''trusting'' investors. Trusting investors take credit ratings at face value because their compensation depends only marginally on the ex-post returns of the assets they manage. In the authors' view, regulation that forces money managers to only purchase investments with good credit ratings could also provide incentives to be trusting. The authors find that competition can reduce efficiency, as it facilitates rating shopping. Moreover, credit ratings are more likely to be inflated during booms and when investors are more trusting.

[41] *See* Coval, Jurek, and Stafford, *The Economics of Structured Finance.*

[42] *See* 2008 Staff Inspection Report.

[43] *See* 2008 Staff Inspection Report, p. 10–13.

[44] *See* 2008 Staff Inspection Report, p. 13.

[45] *See* 2008 Staff Inspection Report, p. 16 (''One rating agency maintained comprehensive written procedures for rating structured finance securities, but these procedures were not specifically tailored to rating RMBS and CDOs. The written procedures for the two other rating agencies were not comprehensive and did not address all significant aspects of the RMBS and/or CDO ratings process. For example, written materials set forth guidelines for the structured finance ratings committee process (including its composition, the roles of the lead analyst and chair, the contents of the committee memo and the voting process) but did not describe the ratings process and the analyst's responsibilities prior to the time a proposed rating is presented to a ratings committee.'').

[46] *See* 2008 Staff Inspection Report, p. 17.

[47] *Id.* at 19.

[48] *Id.* at 21.

[49] *Id.* at 24.

[50] *Id.* at 18.

[51] *Id.* at 18.

[52] *See* Public Law 111–203, 932, entitled ''Enhanced Regulation, Accountability, and Transparency of Nationally Recognized Statistical Rating Organizations.''

[53] One commenter suggested that the proposed rules are overly broad in their application and ''fail to sufficiently account for the differences between corporate ratings (such as financial strength ratings of insurance companies) and ratings of the structured and asset-backed financial products that contributed to the recent economic crisis.'' *See A.M. Best Letter.* The Commission notes that the amendments and new rules being adopted today reflect the statutory mandate that generally, with one exception, was not limited to certain classes of credit ratings. In particular, sections 932, 936 and 938 of the Dodd-Frank Act generally do not focus exclusively on activities relating to rating structured finance products, with the exception of section 932(s)(4) (which focuses on third-party due diligence services with respect to asset-backed securities).

[54] *See* John C. Coffee, Jr., *Gatekeepers: The Professions and Corporate Governance,* Oxford University Press (2006).

[55] *See* sections II.E.1. and II.E.2. of this release (discussing requirements for NRSROs to disclose performance statistics and rating history information for subclasses of structured finance products); sections II.G. and II.H. of this release (discussing requirements to disclose information about third-party due diligence services provided for asset-backed securities).

focused economic analyses that follow the discussions of the amendments and rules.

a. NRSROs

As discussed above, the Rating Agency Act of 2006, among other things, amended section 3 of the Exchange Act to add definitions, added section 15E to the Exchange Act to establish self-executing requirements for NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs, amended section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over NRSROs, and amended section 21B(a) of the Exchange Act to provide the Commission with the authority to assess penalties ''against any person'' in administrative proceedings instituted under section 15E of the Exchange Act.[56]

To implement the Rating Agency Act of 2006, the Commission adopted Rules 17g–1 through 17g–6 and Form NRSRO.[57] Section 943 of the Dodd-Frank Act mandates that the Commission adopt rules requiring an NRSRO to include in any report accompanying a credit rating of an asset-backed security a description of the representations, warranties, and enforcement mechanisms available to investors and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities.[58] In January 2011, the Commission adopted Rule 17g–7 to implement section 943.[59] The Exchange Act, Rules 17g–1 through 17g–7, and Form NRSRO represent the baseline for the amendments and new rules being adopted today in terms of requirements applicable to NRSROs.

Pursuant to section 6 of the Rating Agency Act of 2006, the Commission is required to submit an annual report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that includes the views of the Commission on the state of competition, transparency, and conflicts of interest among NRSROs.[60] In addition, section 15E(b) of the Exchange Act provides that not later than ninety days after the end of each calendar year, each NRSRO shall file with the Commission an amendment to its registration application, in such form as the Commission, by rule, may prescribe: (1) Certifying that the information and documents in the application for registration continue to be accurate; (2) listing any material change that occurred to such information or documents during the previous calendar year; and (3) amending its credit ratings performance statistics.[61] Rule 17g–1 requires these filings (''annual certifications'') to be made on Form NRSRO.[62] Further, each NRSRO is required to furnish the Commission with annual reports containing audited financial statements and information about revenues and other matters.[63] The Commission's annual reports submitted to Congress and the NRSROs' annual certifications and annual reports are an integral part of establishing the baseline for the amendments and new rules being adopted today, as discussed below.

As of today, there are ten credit rating agencies registered with the Commission as NRSROs.[64] Based on the annual reports the NRSROs furnish with the Commission, in their 2013 fiscal years, the ten NRSROs had $5.4 billion of total revenue—an approximate 6% increase over their 2012 fiscal years. In addition, based on their annual certifications, the NRSROs employed a total of 4,218 credit analysts at the end of the 2013 calendar year. Table 1 shows the number of credit analysts employed by each NRSRO at the end of the 2013 calendar year and, of the total number of credit analysts employed by the NRSROs, the percent of credit analysts at S&P, Moody's, and Fitch (90%) and the remaining seven NRSROs (10%).

TABLE 1—CREDIT ANALYSTS EMPLOYED BY NRSROS (AS OF [—])

NRSROs	Total credit analysts
S&P, Moody's, & Fitch	90%
Other NRSROs	10%
A.M. Best	123
DBRS	98
EJR	7
Fitch	1,102
HR Ratings	34
JCR	57
Kroll	58
Moody's	1,244
Morningstar	30
S&P	1,465
Total	4,218

Note: The total number of credit analysts, including credit analyst supervisors, is provided by each NRSRO in Exhibit 8 to Form NRSRO, which is available on each NRSRO's Web site.

Among other things, the operations of the ten NRSROs differ in terms of business model, classes of credit ratings for which they are registered, history of issuing credit ratings, size, and market share. Of the ten NRSROs, seven operate primarily under the issuer-pay model,[65] in which an obligor pays the NRSRO to rate it as an entity or an issuer pays the NRSRO to rate the securities it issues.[66] One NRSRO operates exclusively under the subscriber-pay model,[67] in which

[56] *See* Public Law 109–291, 3, 4; 15 U.S.C. 78c; 15 U.S.C. 78o–7; 15 U.S.C. 78q; 15 U.S.C. 78u–2.

[57] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR 33564.

[58] *See* Public Law 111–203, 943.

[59] *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR 4489.

[60] *See* Public Law 109–291, 6. The Commission staff annual reports are available at *http://www.sec.gov/ocr.*

[61] *See* 15 U.S.C. 78o–7(b).

[62] *See* paragraph (f) of Rule 17g–1. *See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33567, 33569–33582.

[63] *See* 17 CFR 240.17g–3.

[64] The ten NRSROs are: A.M. Best Company, Inc. (''A.M. Best''); DBRS, Inc. (''DBRS''); Egan-Jones Ratings Company (''EJR''); Fitch, Inc. (''Fitch''); HR Ratings de Mexico, S.A. de C.V. (''HR Ratings''); Japan Credit Rating Agency, Ltd. (''JCR''); Kroll Bond Rating Agency, Inc. (''Kroll''); Moody's Investor's Services, Inc. (''Moody's''); Morningstar Credit Ratings, LLC (''Morningstar''); and Standard & Poor's Ratings Services (''S&P''). *See* Commission staff, *Annual Report on Nationally Recognized Statistical Rating Organizations* (Dec. 2013), p. 6, *available at http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf.* (''2013 Annual Staff Report on NRSROs'').

[65] The seven NRSROs are A.M. Best, DBRS, Fitch, HR Ratings, JCR, Moody's, and S&P. *See* 2013 Annual Staff Report on NRSROs, p. 6.

[66] The issuer-pay model often raises concerns of potential conflicts of interest because the collection of fees from rated entities and issuers of rated securities, as a principal source of revenue, may provide an NRSRO with an economic incentive to issue inflated ratings as a way to promote business with its clients. Several academic studies try to answer theoretically and empirically the question of whether reputational concerns of a credit rating agency effectively neutralize potential conflicts of interest in the issuer-pay model. The conclusions of these studies are neither unanimous nor definite. For example, recently, Kashyap and Kovrijnykh (2013) found that, under the issuer-pay model, a credit rating is less accurate than under the subscriber-pay model. However, the authors found that subscribers tend to ask for a credit rating inefficiently (that is, when the expected quality of the rated entity or security is sufficiently high) and that the subscriber-pay model suffers from a potential free-riding problem. Cole and Cooley (2014) argue that much of the regulatory concerns with the conflict created by issuers paying for ratings are a distraction. The authors argue that in equilibrium, reputation ensures that credit ratings have value and reflect sound assessments of creditworthiness. Regulatory reliance on credit ratings and the importance of risk-weighted capital in prudential regulation more likely contributed to distorted credit ratings than the matter of who pays for them. *See* Anil Kashyap and Natalia Kovrijnykh, *Who Should Pay for Credit Ratings and How?,* NBER working paper No. 18923 (Mar. 2013); Harold Cole and Thomas F. Cooley, *Rating Agencies,* NBER working paper No. 19972 (Mar. 2014).

[67] The one NRSRO is EJR. *See* 2013 Annual Staff Report on NRSROs, p. 6.

subscribers pay a fee to access the credit ratings issued by the NRSRO.[68] Two NRSROs previously operated primarily under the subscriber-pay model but for several years have been issuing an increasing number of credit ratings paid for by the obligor being rated or the issuer of the securities that are rated.[69]

The ten NRSROs also differ by the scope of their business and, in particular, by whether their operations include products and services other than credit ratings,[70] which can be provided through business lines, segments, groups, or divisions within the NRSROs or through affiliated companies or other businesses not within the NRSRO.[71] For credit ratings, there are five classes of credit ratings for which a credit rating agency can be registered as an NRSRO: (1) Financial institutions, brokers, or dealers; (2) insurance companies; (3) corporate issuers; (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, ''as in effect on the date of enactment of this paragraph''); and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.[72] Eight of the NRSROs are registered in multiple classes, while two NRSROs are registered in one class.[73] Table 2 shows the approximate number of outstanding credit ratings as reported by each NRSRO in its annual certification for the 2013 calendar year end, in each of the five categories for which the NRSRO is registered.

TABLE 2—APPROXIMATE NUMBER OF NRSRO CREDIT RATINGS OUTSTANDING BY CLASS OF CREDIT RATING (AS OF [DECEMBER 31, 2013])

NRSROs	Financial institutions	Insurance companies	Corporate issuers	Asset-backed securities	Government securities	Total ratings
S&P, Moody's, & Fitch	84%	74%	92%	90%	99%	97%
Other NRSROs	16%	26%	8%	10%	1%	3%
A.M. Best	N/R	4,492	1,653	56	N/R	6,201
DBRS	13,624	150	3,790	10,706	16,038	44,308
EJR	104	46	877	N/R	N/R	1,027
Fitch	49,821	3,222	15,299	53,612	204,303	326,257
HR Ratings	N/R	N/R	N/R	N/R	189	189
JCR	150	27	463	N/R	56	696
Kroll	15,982	44	2,749	1,401	25	20,201
Moody's	53,383	3,418	40,008	76,464	728,627	901,900
Morningstar	N/R	N/R	N/R	11,567	N/R	11,567
S&P	59,000	7,200	49,700	90,000	918,800	1,124,700
Total	192,064	18,599	114,539	243,806	1,868,038	2,437,046

Note: The approximate number of NRSRO credit ratings outstanding as of December 31, 2013 is provided by each NRSRO in its annual certification, which is available on each NRSRO's Web site. ''N/R'' indicates that an NRSRO is not registered for that class of credit rating.

As shown in Table 2, S&P has the greatest number of outstanding credit ratings in each of the five classes. S&P, Moody's, and Fitch are the top three producers of credit ratings in every class of credit ratings except for insurance companies (in this class, A.M. Best has the second highest number of outstanding credit ratings after S&P). Overall, S&P accounts for about 46% of the total NRSRO credit ratings outstanding, followed by Moody's (37%) and Fitch (13%), implying that two NRSROs (S&P and Moody's) account for 83% of all credit ratings outstanding and three NRSROs (S&P, Moody's, and Fitch) account for approximately 97%. Also, as discussed above, Table 1 shows that these three NRSROs employ 90% of the total number of NRSRO credit analysts. Comparing the number of credit ratings outstanding for established NRSROs and newly registered NRSROs may not provide a complete picture of competition in the industry. The incumbent NRSROs (particularly S&P, Moody's, and Fitch) have a longer history of issuing credit ratings, and their credit ratings include those for

[68] *See* 2013 Annual Staff Report on NRSROs, p. 23. The subscriber-pay model also is subject to potential conflicts of interest. *See id.* at p. 23. For example, the NRSRO may be aware that an influential subscriber holds a securities position (long or short) that could be advantaged if a credit rating upgrade or downgrade causes the market value of the security to increase or decrease; or that the subscriber invests in newly issued bonds and would obtain higher yields if the bonds were to have lower credit ratings. Another example of a conflict in the subscriber-pay model is that the NRSRO may be aware that a subscriber wishes to acquire a particular security but is prevented from doing so because the credit rating of the security is lower than internal investment guidelines or an applicable contract permit.

[69] The two NRSROs are Kroll and Morningstar. *See* 2013 Annual Staff Report on NRSROs, p. 7.

[70] Ancillary services often raise concerns of potential conflicts of interest because, for example, an NRSRO might issue a more favorable credit rating to an issuer in exchange for purchasing ancillary services, or an issuer that purchases a large amount of ancillary services might pressure the NRSRO to issue a more favorable credit rating for the issuer. *See* 2013 Staff Report on Credit Rating Agency Independence, pp. 21–24. Another concern with respect to ancillary services is that they might have involved an NRSRO making recommendations on the structure of a security to be rated. *Id.* at 22–23. Paragraph (c)(5) of Rule 17g–5 prohibits an NRSRO from issuing or maintaining a credit rating with respect to an obligor or security where the NRSRO or a person associated with the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. *See* 17 CFR 240.17g–5(c)(5). In addition, Rule 17g–6 prohibits, among other things, an NRSRO from: (1) Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO; (2) issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO; and (3) modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the NRSRO's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO. *See* 17 CFR 240.17g–6.

[71] *See* 2013 Staff Report on Credit Rating Agency Independence, p. 19.

[72] *See* 15 U.S.C. 78c(a)(62) (defining the term *nationally recognized statistical rating organization*).

[73] *See* 2013 Annual Staff Report on NRSROs, p. 8.

debt obligations and obligors that were rated long before the establishment of the newer entrants.[74]

Recent trends in the industry structure are shown in Table 3, which reports the inverse of the Herfindahl-Hirschman Index (HHI) as a measure of industry concentration by rating class.[75] The HHI inverse is calculated from 2007 to 2013 for credit ratings outstanding as reported by the NRSROs in each rating class. Table 3 shows that the NRSRO industry concentration for all rating classes has moderately increased as suggested by the decrease in the HHI inverse since 2010. Despite a monotonic increase in competition in the rating class of asset-backed securities, the NRSRO industry remains concentrated, with the three largest NRSROs accounting for approximately 95% of the NRSROs' 2013 fiscal year total revenue, based on the annual reports the NRSROs furnish to the Commission.

TABLE 3—INVERSE OF HERFINDAHL-HIRSCHMAN INDEX BY CLASS OF CREDIT RATING

Year	Financial institutions	Insurance companies	Corporate issuers	Asset-backed securities	Government securities	Total ratings
2007	3.37	4.02	3.27	2.71	2.35	2.65
2008	3.72	4.05	3.79	2.82	2.83	2.99
2009	3.85	3.84	3.18	3.18	2.65	2.86
2010	3.99	3.37	3.17	3.20	2.69	2.88
2011	4.16	3.76	3.02	3.38	2.47	2.74
2012	4.04	3.72	3.00	3.44	2.50	2.75
2013	3.99	3.68	3.03	3.48	2.46	2.72

Note: The inverse of HHI is determined using the approximate numbers of NRSRO credit ratings outstanding reported in the Commission staff annual reports on NRSROs published in June 2008, September 2009, January 2011, March 2012, December 2012, and December 2013. For the 2013 calendar year end, the inverse of HHI is calculated using the number of outstanding credit ratings reported by NRSROs in their annual certifications.

In particular, for the asset-backed security class—which includes, among other things, RMBS, commercial mortgage backed securities (''CMBS''), and consumer finance and other asset-backed securities—Table 4 below shows the number of credit ratings outstanding from 2007 to 2013. The total number of outstanding credit ratings has significantly decreased (by 38%) since 2007, mostly due to pay-downs of existing asset-backed securities that have not been replaced by newly issued asset-backed securities that are rated by NRSROs.[76] While the three largest NRSROs accounted for 97% of the outstanding credit ratings for asset-backed securities in 2007, this number decreased to 90% in 2013.

TABLE 4—APPROXIMATE NUMBER OF CREDIT RATINGS OUTSTANDING IN THE ASSET-BACKED SECURITY CLASS

NRSROs	2007	2008	2009	2010	2011	2012	2013
S&P, Moody's, & Fitch	97%	96%	94%	94%	91%	91%	90%
Other NRSROs	3%	4%	6%	6%	9%	9%	10%
A.M. Best	54	54	54	54	56	55	56
DBRS	840	7,470	8,430	10,091	9,889	10,054	10,706
EJR	—	14	14	13	13	N/R	N/R
Fitch	72,278	77,480	69,515	64,535	58,315	56,311	53,612
HR Ratings	—	—	—	—	—	N/R	N/R
JCR	68	71	64	N/R	N/R	N/R	N/R
Kroll	246	0	0	0	40	352	1,401
Moody's	110,000	109,261	106,337	101,546	93,913	82,357	76,464
Morningstar	10,235	9,200	8,856	8,322	16,070	13,935	11,567
R&I	214	210	186	N/R	—	—	—
S&P	197,700	198,200	124,600	117,900	108,400	97,500	90,000
Total	391,635	401,960	318,056	302,461	286,696	260,564	243,806

Note: "N/R" indicates that an NRSRO is not registered for the asset-backed security class of credit ratings and "—" indicates that the credit rating agency was not registered as an NRSRO for the applicable year. Kroll acquired LACE Financial Corp. in August 2010. Morningstar, formerly known as Realpoint LLC, changed its name in 2011. Rating and Investment Information, Inc. ("R&I") withdrew its registration as an NRSRO with the Commission in October 2011. HR Ratings became registered as an NRSRO in 2012. Statistics come from the Commission staff annual reports on NRSROs published in June 2008, September 2009, January 2011, March 2012, December 2012, and December 2013. For calendar year 2013, the statistics come from the annual certifications of the NRSROs.

In 2013, some of the relatively newer or smaller NRSROs increased their market shares in terms of rating asset-backed securities. Table 5 reports full-year credit rating agency information for 2013, compared to 2007, the year immediately prior to the financial crisis. As the total issuances of asset-backed securities decreased considerably from 2007 to 2013, DBRS has maintained its market share in rating new issuances and has become the most active participant in rating RMBS, while S&P, Moody's and Fitch have lost market shares. DBRS, Kroll, and Morningstar have gained market shares in rating CMBS after the financial crisis and have rated a significant number of newly issued CMBS in 2013. Finally, in the market for rating consumer finance and other asset-backed securities, which has

[74] *See* 2013 Annual Staff Report on NRSROs, p. 12.

[75] The inverse of HHI can be interpreted as the number of equally-sized firms necessary to replicate the degree of concentration in a particular industry.

[76] *See* 2013 Annual Staff Report on NRSROs, p. 12.

the largest number of issuances, DBRS and Kroll have increased their market shares, although S&P, Moody's and Fitch continue to play a significant role.

TABLE 5—MARKET SHARES OF CREDIT RATING AGENCIES FOR RMBS, CMBS, AND CONSUMER FINANCE AND OTHER ASSET-BACKED SECURITIES, 2013 AND 2007

Rank	NRSROs	2013 Issuance ($ mil.)	Number of offerings	Market share (%)	2007 Issuance ($ mil.)	Number of offerings	Market share (%)	2007–2013 Change (%)
Residential mortgage-backed securities								
1	DBRS	$12,501.90	50	61.4	$12,817.60	20	2.9	−2.5
2	Fitch	9,969.60	23	48.9	253,721.10	318	58.2	−96.1
3	S&P	9,597.50	23	47.1	409,532.40	534	94.0	−97.7
4	Kroll	7,908.70	17	38.8	N/A	N/A	N/A	N/A
5	Moody's	3,796.00	9	18.6	324,923.50	421	74.6	−98.8
Total		20,372.00	68	100.0	435,815.60	575	100.0	−95.3
Commercial mortgage-backed securities								
1	Moody's	$62,802.60	67	72.9	$171,787.00	61	74.6	−63.4
2	Fitch	50,447.70	56	58.6	159,687.30	60	69.4	−68.4
3	Kroll	45,140.10	55	52.4	N/A	N/A	N/A	N/A
4	S&P	34,255.20	49	39.8	202,381.00	71	87.9	−83.1
5	DBRS	18,574.90	26	21.6	13,295.30	6	5.8	39.7
6	Morningstar	17,089.00	27	19.8	N/A	N/A	N/A	N/A
Total		86,135.80	122	100.0	230,195.80	86	100.0	−62.6
Consumer finance and other asset-backed securities								
1	S&P	$134,860.60	244	69.3	$576,417.90	884	96.7	−76.6
2	Moody's	114,569.90	155	58.9	563,982.90	735	94.6	−79.7
3	Fitch	113,213.80	156	58.2	342,140.10	418	57.4	−66.9
4	DBRS	16,530.60	51	8.5	43,102.70	73	7.2	−61.6
5	Kroll	3,983.10	16	2.0	N/A	N/A	N/A	N/A
Total		194,600.70	341	100.0	596,016.20	981	100.0	−67.3

Note: A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. Market shares of individual NRSROs do not add up to 100% since more than one NRSRO may rate a particular offering. "N/A" indicates that statistics are not available for 2007. CMBS data relates to U.S. CMBS, including U.S. conduit/fusion and U.S. single borrower. Data comes from Asset-Backed Alert and Commercial Mortgage Alert Web sites, publicly available at *http://www.abalert.com/ranks.php* and *http://www.cmalert.com/ranks.php*.

b. Asset-Backed Security Issuers, Underwriters, and Third-Party Due Diligence Providers

The asset-backed security market that existed in the United States as of the end of 2013 differed significantly from the market prior to the crisis. In 2004, issuing entities of non-agency asset-backed securities held $2.6 trillion in assets, which grew to $4.5 trillion in 2007 and declined to $1.6 trillion in 2013.[77] Table 6 presents issuance amounts, number of offerings, and number of unique issuers for non-agency asset-backed securities, categorized by type of offering.[78] While new issuances of registered asset-backed securities represented the majority of offerings and totaled $1.0 trillion in 2004, they drastically dropped to $140.7 billion in 2008. In 2013, the asset-backed security market totaled $393.6 billion, of which $174.1 billion is the new issuance amount of registered asset-backed securities.

TABLE 6—ISSUANCE AMOUNT, NUMBER OF OFFERINGS, AND NUMBER OF UNIQUE ISSUERS FOR NON-AGENCY ASSET-BACKED SECURITIES

Year	Issuance amount ($ bln)				Number of offerings				Number of unique issuers			
	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total
2002	617.13	122.07	2.00	741.20	1,074	491	31	1,596	143	226	17	327
2003	790.47	149.20	0.17	939.85	1,271	589	3	1,863	139	223	3	309
2004	1,024.16	186.53	0.85	1,211.53	1,370	670	2	2,042	131	218	2	298
2005	1,450.33	322.64	3.70	1,776.68	1,594	907	3	2,504	134	300	2	376
2006	1,446.07	623.38	0.50	2,069.95	1,508	1,551	1	3,060	116	406	1	460
2007	1,048.81	518.59	0.55	1,567.95	1,088	1,102	1	2,191	111	342	1	396
2008	140.70	130.80	0.00	271.49	163	240	0	403	51	96	0	128

[77] This information is derived from data compiled by the Federal Reserve and published in quarterly Z.1 releases, which are available at *http://www.federalreserve.gov/releases/Z1/default.htm*. Statistics include private mortgage pools, consumer credit, business loans, student loans, consumer leases, and trade credit securitization.

[78] In this section of the release, the issuer of the asset-back security means the person that primarily organizes and initiates the offering of the asset-backed security, often referred to as the *sponsor*.

TABLE 6—ISSUANCE AMOUNT, NUMBER OF OFFERINGS, AND NUMBER OF UNIQUE ISSUERS FOR NON-AGENCY ASSET-BACKED SECURITIES—Continued

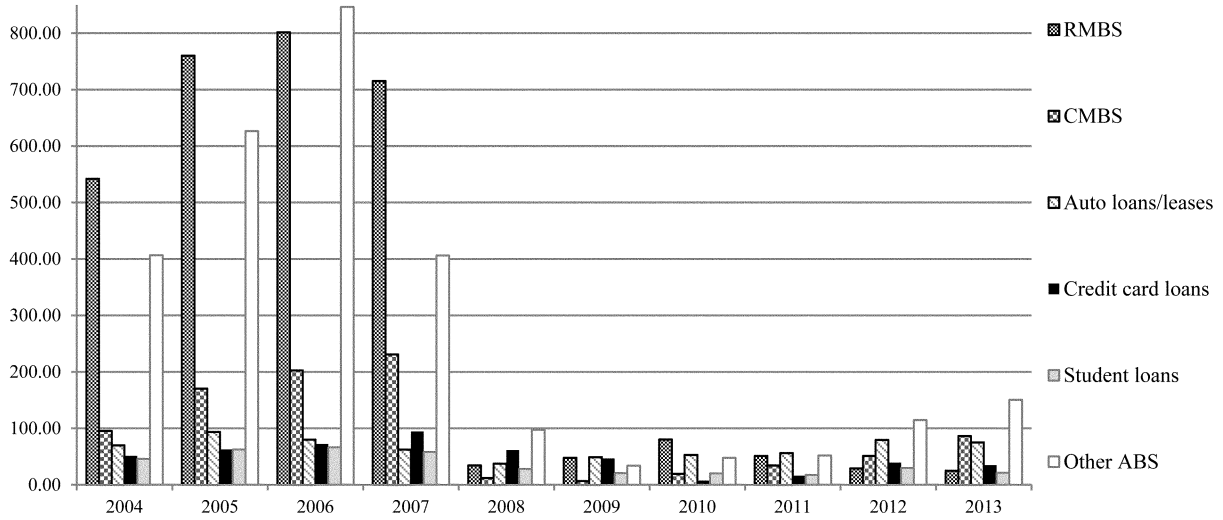
Year	Issuance amount ($ bln)				Number of offerings				Number of unique issuers			
	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total
2009	85.45	120.14	0.00	205.58	80	266	0	346	30	81	0	97
2010	51.01	163.30	14.01	228.32	65	401	4	470	29	145	1	160
2011	74.94	139.06	13.58	227.59	86	291	15	392	39	163	6	179
2012	157.15	186.53	0.00	343.68	157	465	0	622	51	242	0	270
2013	174.06	219.47	0.08	393.61	182	532	1	715	61	294	1	336

Note: Statistics are calculated by DERA using the Asset-Backed Alert and Commercial Mortgage Alert databases. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. The offerings are categorized by offering year and offering type (Commission registered, Rule 144A, or traditional private offerings). Non-agency asset-backed securities include RMBS, CMBS, and other asset-backed securities. Non-agency RMBS include residential, Alt-A, subprime RMBS, high loan-to-value (''no-equity'') loans, and non-U.S. residential loans. Auto loan asset-backed securities include asset-backed securities backed by auto loans and auto leases, both prime and subprime, motorcycle loans, recreational vehicle loans, and truck loans. The first set of columns show the total issuance amounts in billions of dollars. The second set of columns show the total number of asset-backed security offerings. The third set of columns show the number of unique issuers of asset-backed securities in each category. The number in the column ''Total'' may not be the sum of numbers in the columns ''Regist'd'', ''144A'' and ''Private'' because some issuers may initiate offerings in several categories. Only non-agency asset-backed security offerings sold in the United States and issuers of such offerings are counted.

Issuers of asset-backed securities often include banks, mortgage companies, finance companies, investment banks, and other entities that originate or acquire and package financial assets for resale as asset-backed securities.[79] As reported in Table 6, in 2004 there were 298 unique issuers, while in 2013 there were 336 unique issuers, mostly involved in Rule 144A offerings.[80] The ten most active issuers were responsible for about 30% of the total issuance amounts at the end of 2013.[81]

As noted in Figure 1 below, an analysis of the segments of the asset-backed security market shows that all segments experienced significant downturns during the crisis but only a few of them have experienced a recovery in the aftermath. Figure 1 focuses on non-agency asset-backed security offerings and reports the issuance volume by main asset classes (RMBS, CMBS, auto loans/leases, credit card loans, student loans, and other asset-backed securities).

Figure 1 - Issuance volume (in billions of dollars) of asset-backed security offerings by main asset classes, 2004-2013



Note: The offerings are categorized by offering year and underlying asset type. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. Non-agency RMBS include residential, Alt-A, and subprime RMBS, and asset-backed securities backed by home equity loans and lines of credit. Only non-agency RMBS offerings sold in the United States are counted. Auto loan asset-backed securities include asset-backed securities backed by auto loans, both prime and subprime, motorcycle loans, truck loans, and recreational vehicle loans. Data is compiled from Asset-Backed Alert and Commercial Mortgage Alert databases.

As shown in Figure 1, new issuances of non-agency RMBS in 2004 totaled $542 billion, with registered offerings representing the majority of non-agency RMBS issued before the crisis. Non-agency RMBS issuance—which totaled $715 billion in 2007—dropped drastically to $35 billion in 2008. As of the end of 2013, the non-agency RMBS

[79] *See Asset-Backed Securities,* Securities Act No. 8518 (Dec. 22, 2004), 70 FR 1506 (Jan. 7, 2005).

[80] The number of issuers varies across segments of the asset-backed security market. For example, as of December of 2013 there were twenty-two and eighty-three issuers involved in RMBS and CMBS offerings, respectively.

[81] The market share attributed to the issuer of an asset-backed security is calculated by DERA staff using the Asset-Backed Alert and Commercial Mortgage Alert databases.

market remains weak and consists almost exclusively of unregistered RMBS offerings. In particular, new issuances of non-agency RMBS totaled $25 billion in 2013, which represents about 5% of the issuance level in 2004. CMBS experienced a similar drop in issuance levels, though it has rebounded to a level that is closer to the 2004 issuance level than RMBS. In particular, CMBS issuance rose from $96 billion in 2004 to $231 billion in 2007. It then dropped to $12 billion in 2008. It was $86 billion in 2013, which is about 90% of the issuance level in 2004. The consumer finance asset-backed security market also declined drastically in terms of number of offerings and issuance volume after the financial crisis. For example, $70 billion of securities backed by auto loans and leases were issued in 2004, but issuance decreased to $38 billion in 2008. The issuances of consumer finance asset-backed securities, especially those securities backed by auto loans and leases, and other asset-backed securities have steadily increased since 2008 to reach pre-crisis levels of about $75 billion in 2013.

Among the asset-backed security segments, the non-agency RMBS segment has experienced a significant decline in the number of issuers with twenty-two issuers arranging non-agency RMBS (and only one issuer arranging non-agency registered RMBS) as of the end of 2013, compared to fifty-eight issuers in 2004. In the RMBS market, issuers arranging non-agency RMBS encounter competitive pressure from government-sponsored enterprises that arrange RMBS that are guaranteed [82] and exempt from registration and reporting requirements.[83] As non-agency RMBS issuance has declined, issuance of agency RMBS has increased. Issuances of RMBS arranged by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association were $1.4 trillion in 2004 and grew to $1.9 trillion in 2013.[84]

Table 7 shows the number of unique underwriters of non-agency asset-backed securities. As of the end of 2013, it is a highly concentrated industry with ninety underwriters (if international securitizations are included in the data) and fifty underwriters (if international securitizations are excluded), with the top ten underwriters by volume underwriting about 70% of the securitizations.[85]

TABLE 7—NUMBER OF UNIQUE ASSET-BACKED SECURITY UNDERWRITERS

Year	Regist'd	144A	Private	Total excluding internat'l	Internat'l	Total including internat'l
2002	22	40	15	47	86	107
2003	29	41	3	47	87	109
2004	29	46	2	56	99	123
2005	29	45	3	50	101	118
2006	28	57	1	59	114	137
2007	27	59	1	61	109	132
2008	19	42	0	44	95	113
2009	14	26	0	28	58	72
2010	15	45	1	46	76	90
2011	18	44	5	45	62	79
2012	20	46	0	48	63	81
2013	22	47	0	50	72	90

Note: Statistics are calculated by DERA staff using the Asset-Backed Alert and Commercial Mortgage Alert databases. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. The number of unique underwriters of asset-backed securities is divided into categories by type of offering (registered, 144A, private, or international). The total number in the last column may not be the sum of numbers in the columns labeled "Public", "144A", "Private," and "Internat'l" because some underwriters may market offerings in several categories. Only non-agency asset-backed security offerings and underwriters of such deals are counted.

Finally, providers of third-party due diligence services with respect to asset-backed securities are significantly affected by the amendments and new rules being adopted today. The Commission has little information about these firms and the characteristics of the industry. The Commission estimates that there are approximately fifteen providers of third-party due diligence services.[86] Because there are very few publicly traded firms specializing in due diligence, little is known about these service providers in terms of loan review volume, market share, and revenue.[87]

Asset-backed security issuers and underwriters may use third-party due diligence services to identify issues with loans, to negotiate better prices on pools of loans they are considering for

[82] *See* N. Eric Weiss, *GSEs and the Government's Role in Housing Finance: Issues for the 113th Congress,* Congressional Research Service Report for Congress (2013).

[83] Mortgage-backed securities issued by government-sponsored enterprises and the Government National Mortgage Association have been and continue to be exempt from registration under the Securities Act and most provisions of the federal securities laws. For example, the mortgage-backed securities issued by the Government National Mortgage Association are exempt securities under section 3(a)(2) of the Securities Act (15 U.S.C. 77c(a)(2)) and section 3(a)(12) of the Exchange Act (15 U.S.C. 78c(a)(12)). The chartering legislation for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation contain exemptions with respect to the mortgage-backed securities issued by these entities. *See* 12 U.S.C. 1723c; 12 U.S.C. 1455g.

[84] *See* Securities Industry Financial Market Association ("SIFMA"), *U.S. Mortgage-Related Issuance and Outstanding Data from 1996 to May 2014 (issuance), 2002 to 2014 Q1 (outstanding)* (June 3, 2014 update).

[85] The market share attributed to an asset-backed security underwriter is calculated by DERA staff using Asset-Backed Alert and Commercial Mortgage Alert databases.

[86] This number comes from combining the names of third-party due diligence firms cited by Vicki Beal, Senior Vice President of Clayton Holdings, in her testimony before the Financial Crisis Inquiry Commission, and the names of third-party due diligence firms that S&P reviews as a part of its U.S. RMBS rating process. *See* Testimony of Vicki Beal, Senior Vice President of Clayton Holdings before the Financial Crisis Inquiry Commission, (Sept. 23, 2010), *available at http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Beal.pdf* ("Clayton Testimony"). S&P's updated list of third-party due diligence firms reviewed for U.S. RMBS is available at *https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1246530&SctArtId=208825&from=CM&nsl_code=LIME.* The Commission does not know whether the estimate of fifteen providers of third-party due diligence services captures all of the primary participants in this business but believes that, based on available information, this is a reasonable estimate for purposes of this economic analysis.

[87] *See* Clayton Testimony, p. 1 (describing the market for due diligence services as "highly fragmented, highly competitive and rapidly changing").

purchase, and to negotiate expanded representations and warranties in purchase and sale agreements from sellers.[88] The reviews of third-party due diligence providers are performed on an adverse or random sample of loans consistent with the guidelines of clients. Compensation is likely not contingent on due diligence findings or the ultimate performance of the loans reviewed. Instead, third-party due diligence providers may be paid a standard service fee for each loan reviewed.[89]

c. Industry Practices

The Commission staff conducts annual examinations of each NRSRO and publishes a report summarizing the essential findings of the examinations, as required by section 15E(p)(3) of the Exchange Act.[90] The staff's 2013 report noted improvements, relative to prior examinations, among the NRSROs in five general areas that are related to the amendments and new rules being adopted today: Enhanced documentation, disclosure, and board of director oversight of criteria and methodologies; investment in software or computer systems for electronic recordkeeping and monitoring employee securities trading; increased prominence of the role of the designated compliance officer within NRSROs; implementation or enhancement of internal controls over the rating process (for example, use of audits and other testing to verify compliance with federal securities laws, and employee training on compliance matters); and adherence to internal policies and procedures.[91] The report also discussed certain weaknesses or concerns in a number of review areas: Adherence to policies, procedures, and methodologies; [92] management of conflicts of interest; [93] implementation of ethics policies; [94] internal supervisory controls; [95] governance; [96] the activities of the designated compliance officer; [97] the processing of complaints; [98] and the policies governing post-employment activities of former staff of the NRSRO.[99] These essential findings were related to several areas of NRSRO operations and were not limited to activities relating to rating asset-backed securities.

3. Broad Economic Considerations

In this section, the Commission describes the primary economic impacts that may derive from the amendments and new rules being adopted today, relative to the baseline discussed above. A detailed analysis of the particular economic effects—including the costs and benefits and the impact on efficiency, competition, and capital formation—that may result from the amendments and rules is presented in the focused economic analyses in section II of this release.[100]

Section 3(f) of the Exchange Act requires the Commission, when engaging in rulemaking that requires the Commission to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.[101] Further, section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.[102] The Commission's analysis of the economic effects, including the likely costs and benefits and the likely impact on efficiency, competition, and capital formation of the amendments and new rules, include those attributable to the rulemaking that the Commission is mandated to undertake in accordance with the Dodd-Frank Act and those attributable to the exercise of the Commission's discretionary authority.

In the proposing release, the Commission solicited comments on all aspects of the costs and benefits associated with the proposed rules. In addition to comments on the economic effects of specific provisions, which will be discussed in section II of this release, the Commission received comments on the overall economic effects of the proposed amendments and new rules. Generally, commenters expressed concerns that the potential cumulative burden and costs associated with the proposed amendments and new rules could be so onerous that they would have negative effects on competition by imposing an excessive burden on smaller NRSROs and raising barriers to entry for credit rating agencies that seek to register as NRSROs.[103] In particular, one commenter suggested that ''fostering competition among rating agencies was a primary goal of both the Rating Agency Act of 2006 and the Dodd-Frank Act'' but that ''the proposed rules will be so costly to implement that additional credit rating agencies are unlikely to register as NRSROs and the existing pool of registrants may contract.'' [104]

As discussed in section II of this release, the Commission has considered these comments and has modified the amendments and new rules being adopted today from the proposals in a number of ways that are designed to reduce the cumulative burden and costs associated with complying with the new requirements. 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.[105] The amendments and rules also impose burdens on issuers and underwriters of asset-backed securities and providers of third-party due diligence services with respect to asset-backed securities. As discussed throughout the economic analysis, the Commission believes that

[88] *See id.* at 2.

[89] *See id.* at 3.

[90] Section 923(a)(8) of the Dodd-Frank Act struck the existing text in paragraph (p) of section 15E of the Exchange Act, which related to the date of applicability of the Rating Agency Act of 2006, and added new text. *See* Public Law 111–203, 932(a)(8). Section 15E(p)(3) of the Exchange Act requires, among other things, the Commission staff to conduct an examination of each NRSRO at least annually. *See* 15 U.S.C. 78o–7(p)(3). Annual inspection reports for 2011, 2012, and 2013 are available at *http://www.sec.gov/divisions/marketreg/ratingagency.htm.*

[91] *See* Commission staff, *2013 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization* (Dec. 2013) (''2013 Annual Staff Inspection Report''), pp. 7–9.

[92] *See* 2013 Annual Staff Inspection Report, pp. 9–11.

[93] *Id.* at 11–13.

[94] *Id.* at 13–14.

[95] *Id.* at 14–19.

[96] *Id.* at 19–20.

[97] *Id.* at 20–21.

[98] *Id.* at 21–22.

[99] *Id.* at 22–23.

[100] *See* sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

[101] *See* 15 U.S.C. 78c(f).

[102] *See* 15 U.S.C. 78w(a)(2); *see also* Current Guidance on Economic Analysis in SEC Rulemakings (available at: *http://insider.sec.gov/divisions_offices/hqo/dera/rsfi-guidance-econ_analysis-rulemaking.pdf*)

[103] *See A.M. Best Letter; DBRS Letter; EJR Letter; Kroll Letter; Morningstar Letter; S&P Letter; TradeMetrics Letter.*

[104] *See DBRS Letter.* This commenter also stated that a ''contradiction lies in the fact that, while directing the Commission to impose costly and onerous new obligations on rating agencies who choose to register as NRSROs, the Dodd-Frank Act also directs the Commission to remove all references to credit ratings from the federal securities regulations.'' *See DBRS Letter. See also* Public Law 111–203, 939A.

[105] Some NRSROs may be subject to rules in foreign jurisdictions under which certain of their policies and procedures or other practices are affected by requirements of these foreign jurisdictions that may be similar to some of the requirements imposed by the amendments and new rules. While the requirements of foreign jurisdictions are not analyzed here in detail, they may impact the incremental costs and benefits of the amendments and new rules.

the new requirements should result in substantial benefits and should not impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

In particular, the amendments and new rules being adopted today are designed to implement Title IX, Subtitle C of the Dodd-Frank Act, which, in turn, was designed to address the causes of certain market failures (that is, the principal-agent problem,[106] including conflicts of interest, and asymmetric information) that may impair the integrity and transparency of NRSRO credit ratings and the procedures and methodologies NRSROs use to determine credit ratings. Some of the amendments and new rules are primarily designed to enhance the integrity of how NRSROs determine credit ratings by improving internal governance of NRSROs, managing potential principal-agent problems and conflicts of interest in the credit rating process, and promoting adherence to the procedures and methodologies for determining credit ratings and compliance with laws and regulations.[107] For example, provisions in the amendments and new rules require an NRSRO, among other things, to: (1) Assess and report on the effectiveness of internal controls; (2) address conflicts of interest relating to sales and marketing activities and employment of former analysts; (3) have policies and procedures relating to their procedures and methodologies for determining credit ratings; (4) have standards of training, experience and competence for their credit analysts; and (5) have policies and procedures to promote the consistent use of credit rating symbols.[108]

Other provisions in the amendments and new rules being adopted today are designed mainly to enhance the transparency of NRSRO credit ratings by increasing disclosure and reducing information asymmetries that may adversely affect users of credit ratings. This should facilitate external scrutiny of NRSRO activities. More specifically, provisions in the amendments and new rules require an NRSRO, among other things, to disclose: (1) Standardized performance statistics; (2) increased information about credit rating histories; (3) information about material changes and significant errors in the procedures and methodologies used to determine credit ratings; and (4) information about a specific rating action.[109] The main objective of these requirements is to improve the information provided to users of credit ratings, including investors. The enhanced disclosure may reduce information asymmetries between the NRSRO and the users of its credit ratings, enabling the users to make more informed investment and credit related decisions and allowing them to compare the performance of credit ratings by different NRSROs. Additionally, there are requirements in the amendments and new rules that are designed to reduce information asymmetries among issuers and underwriters of asset-backed securities, NRSROs rating asset-backed securities, and the users of credit ratings for asset-backed securities.[110] These requirements may benefit NRSROs and users of credit ratings, including investors in these securities.

a. Amendments and Rules Enhancing NRSRO Governance and Integrity of Credit Ratings

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 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. For example, an NRSRO is required to file an annual report containing an assessment by management of the effectiveness during the fiscal year of the internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.[111] Similarly, an NRSRO is required to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.[112] The board's oversight may prevent situations in which an NRSRO seeks to implement a procedure or methodology to determine credit ratings that is designed to inappropriately issue favorable credit ratings for existing and prospective clients in order to retain or gain market share.[113]

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.[114] These requirements may facilitate the alignment of incentives at both the NRSRO and individual NRSRO employee level to ultimately promote the production of unbiased credit ratings. At the NRSRO level, for example, sales and marketing considerations may influence the NRSRO's production of credit ratings. Consequently, there is a new requirement that prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[115] This absolute prohibition should result in internal policies, procedures, and organizational solutions that isolate the analytical function from sales and marketing considerations within the NRSRO. To the extent that the absolute prohibition prevents credit analysts that participate in the determination of

[106] A principal–agent problem occurs when one person (the ''agent'') is able to act in the person's own best interest rather than in the interest of another person (the ''principal''). The problem arises when the parties have different interests and the agent has more information than the principal so that the principal cannot ensure that the agent is always acting in the principal's best interests, especially where activities that are useful to the principal are costly to the agent and where monitoring of the agent's activities is costly to the principal. For example, a principal-agent problem may arise if an NRSRO produces credit ratings that, as a result of conflicts of interest, are not informative to the users of credit ratings.

[107] These requirements are discussed below in sections II.A., II.B., II.C., II.D., II.F., II.I., II.J., and II.K. of this release.

[108] These requirements are discussed below in sections II.A., II.B., II.C., II.F., II.I., and II.J. of this release.

[109] These requirements are discussed below in sections II.E., II.F., II.G., and II.L. of this release.

[110] These requirements are discussed below in sections II.E., II.G., and II.H of this release.

[111] This requirement is discussed below in section II.A.3. of this release.

[112] This requirement is discussed below in section II.F.1. of this release.

[113] *See* Griffin and Tang, *Did Subjectivity Play a Role in CDO Credit Ratings?*

[114] These requirements are discussed below in sections II.B. and II.C. of this release.

[115] This requirement is discussed below in section II.B.1. of this release.

credit ratings from being influenced by sales and marketing considerations, this should curb potential conflicts of interest related to ''rating catering'' practices that have been suggested by anecdotal evidence [116] and academic literature.[117] Isolating the production of credit ratings and the development of procedures and methodologies for determining credit ratings from sales and marketing considerations should promote the integrity and quality of credit ratings to the benefit of their users.

At the individual level, an analyst's incentives may be distorted by the prospect of future employment at an issuer or underwriter, which could influence the analyst in determining a credit rating for that issuer or underwriter. Consequently, there is a new requirement that an NRSRO must have policies and procedures that address instances in which this conflict of interest influenced a credit rating that are reasonably designed to ensure that the NRSRO promptly determines whether the current credit rating must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings and to promptly publish a revised credit rating, an affirmation of the credit rating, or potentially place the credit rating on watch or review and in each case include certain disclosures about the existence of the conflict.[118] This provision is designed to require the NRSRO to promptly address a conflicted credit rating, and it will likely limit the potential risk that users of credit ratings may make investment decisions using biased or inaccurate information. The disclosures also should provide information to investors and other users of credit ratings that they can use to scrutinize an NRSRO, thereby promoting accountability to the market for failing to appropriately manage this conflict of interest.

In terms of accountability, the Commission is finalizing a rule amendment pursuant to which an NRSRO could have its registration suspended or revoked for violating a rule governing conflicts of interest.[119] In addition, the Commission is amending Form NRSRO to provide notice to an NRSRO or a credit rating agency applying for registration as an NRSRO that an NRSRO is subject to applicable fines, penalties, and other sanctions under the Exchange Act.[120] This may serve as a reminder to the NRSRO or applicant of the potential consequences of failing to comply with federal laws and regulations. Taken together, these accountability measures may have incremental effects on the integrity of an NRSRO's activities and credit ratings by promoting compliance with the Commission's rules.

There are new requirements applicable to NRSROs pursuant to which they must establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that: (1) The procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are developed and modified in accordance with the policies and procedures of the NRSRO; and (2) material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, that the NRSRO uses to determine credit ratings are applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply and, to the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.[121] To the extent that these policies and procedures are effectively implemented and enforced, their application may enhance the integrity of how NRSROs determine credit ratings.

There are new requirements applicable to NRSROs pursuant to which they must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals they employ to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered. At a minimum, these standards must include: (1) A requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings; and (2) a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating.[122] These requirements may increase the level of competence and experience of the credit analysts employed by the NRSRO to participate in the production of credit ratings with possible positive effects on the integrity and quality of credit ratings.[123]

There are new requirements applicable to NRSROs pursuant to which they must have reasonably designed policies and procedures relating to: (1) Assessing the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or money market instrument; (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO; and (3) applying any symbol,

[116] *See* Coffee Testimony I, pp. 2–3.

[117] *See* John M. Griffin, Jordan Nickerson, Dragon Yongjun Tang, *Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Credit Ratings,* Rev. Fin. St. 2270–2310 (2013). The authors draw a distinction between rating shopping and rating catering. ''Rating shopping'' refers to a situation in which issuers solicit ratings from multiple credit rating agencies and then hire the credit rating agencies that will issue the most favorable credit ratings (Skreta and Veldkamp, 2009). Even though rating agencies adhere to their rating procedures and methodologies and issue unbiased ratings, credit rating inflation is a natural consequence of the rating shopping process and is not driven by the rating agencies. ''Rating catering'' refers to a situation in which issuers solicit credit ratings from multiple credit rating agencies and the credit rating agencies may not strictly adhere to their procedures and methodologies for determining credit ratings in order to issue more favorable credit ratings. The authors argue that under pressure from investment banks, the credit rating agency with a more stringent procedure or methodology for determining credit ratings stretches the procedure or methodology to match more lenient competitors (Bolton, Freixas, and Shapiro, 2012).

[118] This requirement is discussed below in section II.C.1. of this release.

[119] This requirement is discussed below in section II.B.3. of this release.

[120] This requirement is discussed below in section II.D.1. of this release.

[121] This requirement is discussed below in section II.F.1. of this release.

[122] *See* section II.I.1. of this release (providing a more detailed discussion of the requirements of this paragraph).

[123] *See* Cesare Fracassi, Stefan Petry, and Geoffrey Tate, *Are Credit Ratings Subjective? The Role of Credit Analysts in Determining Ratings* (2014), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2230915.* The authors find that the identity of the credit analysts covering a firm significantly affects the firm's credit rating, comparing credit ratings for the same firm at the same time across credit rating agencies. Analyst effects account for 30% of the variation within credit ratings. In addition, the quality of credit ratings varies with observable analyst characteristics.

number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[124] Compliance with these policies and procedures may increase the likelihood that NRSROs apply rating symbols, numbers, or scores consistently across classes of credit ratings to the benefit of the users of credit ratings and obligors and issuers that are subject to credit ratings.

Finally, there are new requirements applicable to NRSROs pursuant to which they must retain records of certain internal controls, policies, procedures and standards they are required to document.[125] These record retention requirements should facilitate Commission oversight of NRSROs to the benefit of users of credit ratings. Similarly, the Exchange Act requires an annual report of the NRSRO's designated compliance officer to be filed on a confidential basis with the Commission.[126] The new requirement should facilitate Commission oversight as well.

There will be costs associated with the amendments and new rules being adopted today related to governance of NRSROs.[127] These costs will be primarily incurred by NRSROs.[128] Initial and ongoing direct costs, including compliance costs, may vary among the NRSROs depending on the size and complexity of their business activities (for example, number of credit ratings outstanding, number of analysts, or number of classes of credit ratings). Among other costs, NRSROs also may incur training costs in order to make their personnel aware of the changes in internal controls, policies, and procedures required by the amendments and new rules. These costs are difficult to quantify because they depend significantly on how the required changes differ from the internal policies and procedures currently in place within each NRSRO. In addition, they depend on factors such as the NRSRO's size and business complexity. For example, an NRSRO may need to train its credit analysts and sales and marketing staff in the updated policies and procedures related to the sales and marketing conflict requirements. Among other factors, this cost will likely vary significantly with the degree of the existing separation between the functions of analytical staff and sales and marketing personnel.[129]

Keeping all other factors constant, the costs associated with establishing, maintaining, enforcing, and documenting internal policies and procedures may be higher for structured finance products because the inherent conflict of interest that credit rating agencies face in rating these products is more acute than it is with respect to rating other types of securities.[130] In addition, keeping all other factors constant, NRSROs operating under a business model that combines the issuer-pay and subscriber-pay models may face greater direct costs, given that the two models may entail different internal policies and procedures to prevent different sources of potential conflicts of interest. A component of these costs may also be fixed, which may have a disproportionate impact on smaller NRSROs that may find it more difficult to bear the costs. If NRSROs are not able to readily pass the overall additional costs to clients, there may be adverse effects, particularly on smaller NRSROs.

As a result of the amendments and new rules being adopted today, the number of credit rating agencies registered with the Commission as NRSROs may decline if current registrants believe that the cost of being registered and being subject to these new requirements outweighs the benefit of registration. The barriers to entry for credit rating agencies to register as NRSROs may rise, discouraging credit rating agencies from registering as NRSROs. Further, historically, successful new entrants have established themselves by first specializing in a particular industry, creating a track record in a particular rating class, and building the necessary reputational capital to achieve marketplace acceptance of their credit ratings.[131] Compliance costs may reduce the incentive for an NRSRO to expand its rating business into new classes of credit ratings, with adverse effects on competition in certain market segments. Also, if compliance costs significantly erode profit margins for NRSROs, the barriers to exit from being registered as an NRSRO in certain or all classes of credit ratings may lower. The risk for deregistration may likely be higher for smaller NRSROs. As mentioned earlier, these costs also should depend on the complexity of operations within the NRSRO. Further, given that the conflict of interest in rating structured finance products is more acute, the competitive effects could be greater within the markets for rating these products. These potential consequences could reduce competition among NRSROs.

An amendment being adopted today provides a mechanism for a small NRSRO to seek an exemption from the sales and marketing prohibition.[132] The exemption based on size may decrease the burden on small NRSROs. However, this amendment could create adverse effects on competition as exempted NRSROs may be able to draw business through rating catering. In particular, exempted NRSROs may be able to more readily produce conflicted and inflated ratings [133] or generate a greater stream of revenue from selling rating and ancillary services than non-exempted NRSROs. Reputation, which is an important disciplinary mechanism in this industry, may mitigate this risk to a certain extent.[134]

A number of credit rating agencies located in the United States have not registered as NRSROs.[135] As U.S. regulatory agencies continue to remove references to NRSRO credit ratings from the regulations they administer, market

[124] These requirements are discussed below in section II.J. of this release.

[125] These requirements are discussed below in sections II.A.2., II.C.2., II.F.2., II.I.2., and II.J.2. of this release.

[126] This requirement is discussed below in section II.K. of this release.

[127] A detailed analysis of the economic costs, including compliance costs that can potentially result from each amendment and/or rule is presented in the focused economic analyses in section II of this release. *See* sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

[128] NRSROs may be able to pass some of the incremental costs to their clients.

[129] This requirement is discussed below in section II.B.4. of this release.

[130] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63844. (''In the case of structured finance products, the Commission believes this 'issuer/underwriter-pay' conflict is particularly acute because certain arrangers of structured finance products repeatedly bring ratings business to the NRSROs. As sources of frequent, repeated deal-based revenue, some arrangers have the potential to exert greater undue influence on an NRSRO than, for example, a corporate issuer that may bring far less ratings business to the NRSRO.'') (footnotes omitted).

[131] *See* Commission, *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets* (Jan. 2003), p. 24.

[132] This provision is discussed below in section II.B.3. of this release.

[133] *See* Griffin, Nickerson, and Tang, *Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Credit Ratings.*

[134] *See* Jerome Mathis, James McAndrews, and Jean-Charles Rochet, *Rating the Raters: Are Reputation Concerns Powerful Enough to Discipline Rating Agencies?,* J. of Monetary Economics 657–674 (July 2009).

[135] *See, e.g.,* James H. Gellert, Chairman and CEO, Rapid Ratings International, Inc., *Testimony Concerning: Oversight of the Credit Rating Agencies Post Dodd-Frank* (July 27, 2011) (testimony before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Oversight and Investigations), *available at http://www.rapidratings.com/images/custom/gellert_testimony_to_house_cfs_oversight_and_investigations_july_27_2011_final_w_bio.pdf.*

participants subject to these regulations may choose to use unregistered credit rating agencies thereby diminishing the incentive to register as an NRSRO.[136] On the other hand, users of credit ratings may choose to use NRSROs over unregistered credit rating agencies because of the NRSRO registration and oversight program, which is being enhanced by the amendments and new rules being adopted today.

To the extent that these amendments and new rules improve the quality of credit-related information, they may have effects related to allocative efficiency and capital formation. As a result of these amendments and new rules, users of credit ratings could make more efficient investment decisions based on higher-quality information. Market efficiency also may improve if credit ratings become more informative and the additional information is reflected in asset prices. To the extent that the amendments and rules will be effective in enhancing the integrity and quality of NRSRO credit ratings, users of these credit ratings may benefit from an enhanced confidence in the quality of the creditworthiness assessments reflected in the credit ratings, which may have positive effects on the willingness of investors to participate in the securities markets and thereby enhance capital formation, as capital efficiently flows to more productive uses. The benefits in terms of efficiency and capital formation arising from the rules enhancing governance and the integrity of credit ratings are likely to be greater for asset-backed securities, where the inherent conflict of interest in the issuer-pay model is more acute, and, as a result of the amendments and new rules, investors may become less reluctant to invest in asset-backed securities.

b. Amendments and Rules Enhancing Disclosure and Transparency of Credit Ratings

The requirements in the amendments and new rules being adopted today that are primarily designed to enhance disclosure should have economic benefits, relative to the baseline that existed before the amendments and rules were adopted, in terms of promoting the transparency of credit ratings and NRSRO activities and, therefore, NRSRO accountability. This should benefit users of credit ratings, including investors. The amendments and rules also should enhance disclosure requirements with respect to asset-backed securities for the benefit of users of credit ratings, including investors in these securities.

The amendments significantly enhance the existing requirements for NRSROs to produce and disclose performance statistics to make the disclosures more comparable across NRSROs and easier for users of credit ratings and others to understand.[137] Similarly, the existing requirements for NRSROs to disclose rating histories are being enhanced to make the histories more complete in terms of the scope of credit ratings that must be included in the histories and more robust in terms of the information that must be disclosed with each rating action.[138] To the extent that the new disclosures facilitate the evaluation of the performance of an NRSRO's credit ratings and the comparison of rating performance across all NRSROs—including direct comparisons of the rating history of the same obligor or instrument across two or more NRSROs—the rules may benefit users of credit ratings, including investors. In particular, the enhanced disclosure may allow them to better assess the reliability of credit ratings from different NRSROs and, in the case of issuer-paid credit ratings or subscriber-paid credit ratings, make more informed decisions regarding whether to hire, or subscribe to the credit ratings of, a particular NRSRO.

There are new requirements applicable to NRSROs pursuant to which they must publish on their Internet Web sites: (1) Material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings; and (2) notice of the existence of a significant error identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change to current credit ratings.[139] These requirements may benefit users of NRSRO credit ratings in terms of their ability to evaluate the procedures and methodologies used by an NRSRO to determine credit ratings. In this way, they also may promote the NRSROs' accountability to the market and the issuance of quality credit ratings.

There are new requirements applicable to NRSROs pursuant to which they must publish two items when taking a rating action: (1) A form containing certain quantitative and qualitative information about the credit rating that is the result or subject of the rating action; and (2) any certification of a third-party due diligence provider relating to the credit rating.[140] The required disclosures may be used by investors and other users of credit ratings to better understand credit ratings issued by NRSROs. Specifically, the forms and certifications will provide incremental information about how a credit rating was produced (for example, disclosure about assumptions, limitations, information relied on, version of the procedure or methodology used, potential conflicts of interest) and the information content of the credit rating. The information disclosed in the form, including information about the limitations of the credit rating and information regarding due diligence, may discourage undue reliance on credit ratings by investors and other users of credit ratings in making investment and other credit-based decisions.

There is a new requirement applicable to issuers and underwriters of asset-backed securities pursuant to which they must disclose the findings and conclusions of any third-party due diligence report they obtain.[141] The rule applies to both registered and unregistered offerings of asset-backed securities. Additionally, there is a new requirement applicable to providers of third-party due diligence services with respect to asset-backed securities pursuant to which they must provide a written certification to any NRSRO that is producing a credit rating with respect to the asset-backed security.[142] The certification must disclose information about the due diligence performed, including a summary of the findings and conclusions of the third party, and identification of any relevant NRSRO due diligence criteria that the third party intended to meet in performing the due diligence.

As discussed above, the amendments and new rules are intended to reduce asymmetric information in the asset-backed security market. NRSROs producing credit ratings for asset-backed securities may benefit from receiving the information in the certification. The certification also will be signed by an individual who is duly authorized by the third-party due diligence provider to

[136] *See* Public Law 111–203, 939A.

[137] These amendments are discussed below in section II.E.1. of this release.

[138] These amendments are discussed below in section II.E.3. of this release.

[139] These amendments are discussed below in section II.F.1. of this release.

[140] These amendments are discussed below in section II.G. of this release.

[141] These amendments are discussed below in section II.H.1. of this release.

[142] These amendments are discussed below in sections II.H.2. and II.H.3. of this release.

make such a certification, promoting confidence in the accuracy of the information disclosed. Importantly, issuers and underwriters can no longer select what part of this information to provide to NRSROs, reducing the possibility of less favorable information being withheld from NRSROs and reducing the risk that the credit ratings will be based on imperfect or incomplete information (to the extent the NRSROs use information about due diligence in producing their credit ratings). Further, making this information available to all NRSROs (rather than just the NRSROs hired to rate the asset-backed security) could promote the issuance of more credit ratings for a given asset-backed security, including credit ratings that provide a more diverse range of views on the creditworthiness of the security. Users of credit ratings, including investors and other participants in the asset-backed securities markets, may benefit both directly and indirectly from the disclosures made by issuers, underwriters, and providers of third-party due diligence services. To the extent that findings and conclusions of all third-party due diligence reports were not previously disclosed to these persons, the amendments and new rules should enhance information available to the public.

Finally, there are new requirements pursuant to which NRSROs must use the Commission's Electronic Data Gathering, Analysis, and Retrieval (''EDGAR'') system to electronically submit Form NRSRO and required exhibits to the form to the Commission.[143] Having all information available in an electronic format in EDGAR will provide a centralized location and should make the information and the history of that information more easily accessible, comparable, and searchable to users of credit ratings, including investors.

There will be costs associated with the amendments and new rules being adopted today that are related to enhanced disclosure and transparency.[144] These costs will be primarily incurred by NRSROs,[145] issuers and underwriters of asset-backed securities, and third-party due diligence providers. Initial and ongoing direct costs, including compliance costs, may vary among the affected parties depending on their size and the complexity of their business activities (for example, number of credit ratings outstanding, number of analysts, number of classes of credit ratings, number of years issuing credit ratings, and number of historical credit ratings). Keeping all other factors constant, NRSROs operating according to a subscriber-pay model may face greater losses in revenue from the sale of access to historical ratings data, as more of this data becomes publicly available, since they are likely to be more dependent on this source of revenue than NRSROs operating according to the issuer-pay model. A component of these costs may also be fixed, affecting more significantly smaller NRSROs that may find it more difficult to bear the costs. If NRSROs are not able to readily pass the overall additional costs to clients, there may be adverse effects, especially on smaller NRSROs.

Similar to the amendments and new rules relating to governance, the amendments and new rules relating to disclosure and transparency could reduce the number of credit rating agencies registered with the Commission as NRSROs to the extent that current registrants believe the cost of being registered and subject to these new requirements outweighs the benefit of registration. In addition, the barriers to entry for credit rating agencies to register as NRSROs may rise, especially for smaller credit rating agencies. NRSROs may have a reduced incentive to register for a new class of credit ratings with adverse effects on competition in certain market segments. Barriers to exit from registration as an NRSRO may lower due to the possible erosion of profit margins, though an NRSRO's decision to deregister from certain or all classes of credit ratings may depend on whether users of credit ratings will favor NRSROs because of the NRSRO registration and oversight program, which is being enhanced by the amendments and new rules being adopted today. The risk for deregistration will likely be higher for smaller NRSROs, given the fixed component of some compliance costs and the greater difficulty to pass the increase in costs to their clients.

Also, the amendments and new rules may impact competition among third-party due diligence providers. Although the Commission knows little about the characteristics of the market for the services they provide, the certification requirement may increase the liability risk for these providers, particularly for those who do not already bear expert liability under Rule 193.[146] If third-party due diligence providers are not able to charge more for performing the asset review to account for the heightened risk of liability, some providers may exit the market or some entities that otherwise would have entered the market may decide against doing so.

The amendments and new rules also may have positive effects on competition, efficiency and capital formation. The enhanced standardization of the information content may facilitate comparing performance statistics and rating histories across NRSROs. Clients of NRSROs (for example, issuers, subscribers, and others) may use the performance statistics to inform their hiring or subscribing decisions, increasingly promoting competition among NRSROs on the basis of the quality of their credit ratings and the procedures and methodologies used to determine credit ratings. To the extent that the adopted rules facilitate the external monitoring and comparative analysis of NRSROs, they may allow users of credit ratings to develop more refined views of NRSRO performance and thereby indirectly increase accountability and encourage integrity in the production of credit ratings. This, in turn, may facilitate the ability of NRSROs to establish and maintain reputations for issuing quality credit ratings to remain competitive. More comparable performance data may also help relatively smaller and newer NRSROs, including subscriber-paid NRSROs, to attract attention to their rating performance, enhancing their ability to develop a reputation for producing quality credit ratings. This may allow them to better compete with more established competitors. Also, the ability of non-hired NRSROs to obtain the information disclosed in the third-party due diligence certification may provide them with an advantage in producing informative unsolicited credit ratings, relative to unregistered

[143] *See* section II.L. of this release (providing a more detailed discussion of the amendments).

[144] A detailed analysis of the economic costs, including compliance costs that can potentially result from each rule is presented in the focused economic analyses in section II of this release. *See* sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

[145] NRSROs may be able to pass some of the incremental costs to their clients.

[146] *See* 17 CFR 230.193; 17 CFR 229.1111. Under Rule 193 and Item 1111 of Regulation AB, an issuer of a registered asset-backed security is required to perform a review of the assets underlying the asset-backed security and disclose the nature of the review. In meeting this requirement, an issuer may engage a third party to perform the required review of the underlying assets. If the third party's findings and conclusions are to be attributed to it, the third-party must consent to being named in the issuer's registration statement as an ''expert,'' thus subjecting the third party to so-called ''expert liability'' under the Securities Act. If third-party diligence providers are not subject to legal liability as experts, the issuer itself remains legally accountable for the accuracy of the disclosures it makes to investors.

credit rating agencies that cannot obtain this information.

The new disclosure requirements in the form and certifications that accompany a rating action may reduce information asymmetries about how a credit rating was determined by providing additional information about the rating process, such as assumptions, limitations, version of the procedures or methodologies used, and, in the case of an asset-backed security, a description of the findings and conclusions of a third-party due diligence provider, if such services were employed. To the extent that the required disclosure does not diminish the content and timeliness of the information conveyed with the rating actions, the enhanced information may increase the ability of users of credit ratings to accurately interpret the information, potentially resulting in more efficient investment decisions and higher overall market efficiency to the benefit of those investors that use credit ratings. This, in turn, may increase investors' participation in the securities markets with positive effects on capital formation. Because of the higher degree of information asymmetry in the asset-backed security market, the benefits in efficiency and capital formation resulting from the enhanced disclosure and transparency of credit ratings are likely to be greater for these securities, with the result that investors may become more willing to participate in this market.

II. Final Rules and Rule Amendments

As discussed in detail below, the Commission is adopting new rules and amendments to existing rules to implement Title IX, Subtitle C of the Dodd-Frank Act and to enhance the NRSRO registration and oversight program administered by the Commission. In designing rules to implement Title IX, Subtitle C of the Dodd-Frank Act, the Commission has taken into account section 15E(c)(2) of the Exchange Act.[147] This section provides, in pertinent part, that neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.[148] One way the Commission has sought to reconcile the rulemaking mandated by the Exchange Act, as amended by the Dodd-Frank Act, with the limitation in section 15E(c)(2) is to model rule text closely on statutory text.

A. Internal Control Structure

Section 932(a)(2)(B) of the Dodd-Frank Act added paragraph (3) to section 15E(c) of the Exchange Act.[149] Section 15E(c)(3)(A) requires an NRSRO to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings (''internal control structure''), taking into consideration such factors as the Commission may prescribe, by rule.[150] While section 15E(c)(3)(A) provides that the Commission ''may'' prescribe factors an NRSRO would need to take into consideration when establishing, maintaining, enforcing, and documenting the internal control structure, the requirement that an NRSRO ''establish, maintain, enforce, and document an effective internal control structure'' is self-executing.[151] Consequently, an NRSRO must adhere to this provision irrespective of whether the Commission prescribes factors pursuant to section 15E(c)(3)(A).

Section 15E(c)(3)(B) of the Exchange Act provides that the Commission ''shall prescribe'' rules requiring each NRSRO to submit an annual internal controls report to the Commission, which shall contain: (1) A description of the responsibility of the management of the NRSRO in establishing and maintaining an effective internal control structure; (2) an assessment of the effectiveness of the internal control structure; and (3) the attestation of the chief executive officer (''CEO''), or equivalent individual, of the NRSRO.[152]

In the proposing release, the Commission: (1) Deferred prescribing factors the NRSRO must take into consideration in establishing, maintaining, enforcing, and documenting an effective internal control structure; (2) proposed amending the NRSRO recordkeeping rule (Rule 17g–2) to require that the documentation of the internal control structure be subject to the rule's record retention requirements; and (3) proposed amending the NRSRO annual reporting rule (Rule 17g–3) to require an NRSRO to file an unaudited annual internal controls report with the Commission.[153]

1. Prescribing Factors

In the proposing release, the Commission stated that it was deferring prescribing factors an NRSRO must take into consideration when establishing, maintaining, enforcing, and documenting an effective internal control structure to provide the Commission with an opportunity—through the NRSRO examination process and the submission of annual reports by the NRSROs on the effectiveness of their internal control structures—to review how NRSROs have complied with the self-executing requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure.[154] However, the Commission sought comment on whether it would be appropriate as part of this rulemaking to prescribe factors and on potential factors the Commission could prescribe.[155] In particular, the Commission identified factors relating to: (1) The establishment of an internal control structure; (2) the maintenance of an internal control structure; and (3) the enforcement of an internal control structure.[156]

In terms of establishing an internal control structure, the Commission requested comment on the following factors:

- Controls reasonably designed to ensure that a newly developed methodology or proposed update to an in-use methodology for determining credit ratings is subject to an appropriate review process (for example, by persons who are independent from the persons that developed the methodology or methodology update) and to management approval prior to the new or updated methodology being employed by the NRSRO to determine credit ratings;[157]
- Controls reasonably designed to ensure that a newly developed methodology or update to an in-use methodology for determining credit ratings is disclosed to the public for consultation prior to the new or updated

[147] 15 U.S.C. 78o–7(c)(2).

[148] *See* 15 U.S.C. 78o–7(c)(2).

[149] *See* Public Law 111–203, 932(a)(2)(B); 15 U.S.C. 78o–7(c)(3)(A).

[150] *See* 15 U.S.C. 78o–7(c)(3)(A).

[151] *See id.*

[152] *See* 15 U.S.C. 78o–7(c)(3)(B)(i) through (iii).

[153] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33421–33425.

[154] *Id.* at 33421–33423.

[155] *Id.*

[156] *Id.* at 33422–33423.

[157] Section 15E(t)(3)(A) of the Exchange Act contains a self-executing provision requiring that the board of directors of the NRSRO shall ''oversee'' the ''establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.'' *See* 15 U.S.C. 78o–7(t)(3)(A). At the same time, section 15E(r) of the Exchange Act requires the Commission to adopt rules ''to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models'' that are approved by the board of the NRSRO. *See* 15 U.S.C. 78o–7(r)(1)(A).

methodology being employed by the NRSRO to determine credit ratings, that the NRSRO makes comments received as part of the consultation publicly available, and that the NRSRO considers the comments before implementing the methodology;

• Controls reasonably designed to ensure that in-use methodologies for determining credit ratings are periodically reviewed (for example, by persons who are independent from the persons who developed and/or use the methodology) in order to analyze whether the methodology should be updated;

• Controls reasonably designed to ensure that market participants have an opportunity to provide comment on whether in-use methodologies for determining credit ratings should be updated, that the NRSRO makes any such comments received publicly available, and that the NRSRO considers the comments;

• Controls reasonably designed to ensure that newly developed or updated quantitative models proposed to be incorporated into a credit rating methodology are evaluated and validated prior to being put into use;

• Controls reasonably designed to ensure that quantitative models incorporated into in-use credit rating methodologies are periodically reviewed and back-tested;

• Controls reasonably designed to ensure that an NRSRO engages in analysis before commencing the rating of a class of obligors, securities, or money market instruments the NRSRO has not previously rated to determine whether the NRSRO has sufficient competency, access to necessary information, and resources to rate the type of obligor, security, or money market instrument;

• Controls reasonably designed to ensure that an NRSRO engages in analysis before commencing the rating of an ''exotic'' or ''bespoke'' type of obligor, security, or money market instrument to review the feasibility of determining a credit rating;

• Controls reasonably designed to ensure that measures (for example, statistics) are used to evaluate the performance of credit ratings as part of the review of in-use methodologies for determining credit ratings to analyze whether the methodologies should be updated or the work of the analysts employing the methodologies should be reviewed;

• Controls reasonably designed to ensure that, with respect to determining credit ratings, the work and conclusions of the lead credit analyst developing an initial credit rating or conducting surveillance on an existing credit rating is reviewed by other analysts, supervisors, or senior managers before a rating action is formally taken (for example, having the work reviewed through a rating committee process);

• Controls reasonably designed to ensure that a credit analyst documents the steps taken in developing an initial credit rating or conducting surveillance on an existing credit rating with sufficient detail to permit an after-the-fact review or internal audit of the rating file to analyze whether the analyst adhered to the NRSRO's procedures and methodologies for determining credit ratings; and

• Controls reasonably designed to ensure that the NRSRO conducts periodic reviews or internal audits of rating files to analyze whether analysts adhere to the NRSRO's procedures and methodologies for determining credit ratings.[158]

In terms of maintaining an internal control structure, the Commission requested comment on the following factors:

• Controls reasonably designed to ensure that the NRSRO conducts periodic reviews of whether it has devoted sufficient resources to implement and operate the documented internal control structure as designed;

• Controls reasonably designed to ensure that the NRSRO conducts periodic reviews or ongoing monitoring to evaluate the effectiveness of the internal control structure and whether it should be updated; and

• Controls designed to ensure that any identified deficiencies in the internal control structure are assessed and addressed on a timely basis.[159]

In terms of enforcing an internal control structure, the Commission requested comment on the following factors:

• Controls designed to ensure that additional training is provided or discipline taken with respect to employees who fail to adhere to requirements imposed by the internal control structure; and

• Controls designed to ensure that a process is in place for employees to report failures to adhere to the internal control structure.[160]

In terms of documenting the internal control structure, the Commission asked for comment on whether there should be a factor relating to the level of written detail about the internal control structure that should be documented.[161]

A number of commenters addressed whether the Commission should prescribe factors as part of this rulemaking and, if so, the type of factors the Commission should prescribe.[162] NRSROs urged the Commission to defer rulemaking and stated that the Commission should not prescribe factors.[163] For example, one NRSRO stated that the Commission should defer rulemaking until it has the opportunity to determine through the examination process and its review of the NRSROs' annual reports the ''best practices utilized'' by NRSROs to comply with the self-executing requirement in section 15E(c)(3)(A) and that the Commission's ''examination feedback regarding best practices related to internal controls will be an important element for the adequate design and monitoring of internal controls.'' [164] Another NRSRO stated that it ''strongly agrees'' with the Commission's proposal to defer rulemaking but that, if the Commission proceeds with rulemaking, it should ''exercise caution'' because attempting to create a ''one-size fits all'' rule in ''such a short timeframe could result in the creation of an anti-competitive environment and the attendant unintended consequences.'' [165] A third NRSRO stated that ''NRSROs should have the flexibility to implement whatever control structure suits their size and particular business operations.'' [166]

In contrast, several other commenters stated that the Commission should not defer rulemaking.[167] For example, one commenter stated that the Commission ''already has significant information about the weak internal controls at the NRSROs and has already identified a number of factors critical to an effective internal control system'' and that ''[p]ostponing the issuance of any standards will result in the NRSROs developing different internal control

[158] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33422.

[159] *Id.*

[160] *Id.* at 33422–33423.

[161] *Id.*

[162] *See AFSCME Letter; A.M. Best Letter; Better Markets Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter; DBRS Letter; Kroll Letter; Levin Letter; Morningstar Letter; S&P Letter; TradeMetrics Letter.*

[163] *See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter; S&P Letter.*

[164] *See Morningstar Letter.*

[165] *See A.M. Best Letter* (''prescribing specific factors implies that all NRSROs are the same, which they are not. NRSROs vary in size, ownership, business plans, and management. 'Specific factors' would undoubtedly be designed to apply to the largest NRSROs—this scenario would create a disproportionate impact on smaller NRSROs, whose internal control structure would be best served by designing and implementing policies and procedures that apply the law to the specific characteristics of the NRSRO.'').

[166] *See DBRS Letter.*

[167] *See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; Levin Letter.*

structures, making oversight and the implementation of minimum standards more difficult, time consuming, and expensive down the line.'' [168] Another commenter stated that the proposed approach ''will be ineffective in reforming credit rating agency practices and will leave the Commission with little if any ability to hold ratings agencies accountable if they adopt weak and ineffective controls.'' [169] These commenters and others recommended that the Commission prescribe factors,[170] and one of the commenters recommended that the Commission re-propose the rule to prescribe factors.[171]

One commenter discussed factors that the commenter believed should be included in ''a set of mandatory minimum standards for an effective internal control system for credit ratings.'' [172] Another commenter stated that ''the criteria on which the Commission seeks comment are precisely the sort of controls that ought to be in place if the system is operating effectively.'' [173] A third commenter agreed that the rule should ''incorporate all of these factors [as described in the proposing release].'' [174] Two commenters pointed to the internal control framework developed by the Committee of Sponsoring Organizations of the Treadway Commission in 1992 as a model.[175] Two commenters stated that the rule should require that the documentation of the internal control structure include specific elements, such as how the board of directors conducted its oversight of the internal control structure.[176]

The Commission believes it is critically important to investors and other users of credit ratings that, as required by section 15E(c)(3)(A) of the Exchange Act, NRSROs establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their policies, procedures, and methodologies for determining credit ratings.[177] The Commission agrees that the requirements established by the NRSROs to address the internal control structure should ''provide the companies' management the ability to effectively administer their internal compliance measures, and instill confidence in their investors and the public that the companies in fact are achieving the objectives of their internal control rules and, in so doing, promoting ratings that are high-quality, objective, independent, reliable, and free from influence by any conflicts of interest.'' [178] This is one of the reasons that the Commission previously has expressed concerns about—and has taken action to address—the integrity of policies, procedures, and methodologies for determining credit ratings used by certain NRSROs in light of the role these NRSROs played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages.[179]

Moreover, the Commission staff conducts annual examinations of each NRSRO and publishes a report summarizing the essential findings of the examinations, as required by section 15E(p)(3) of the Exchange Act.[180] The annual report attributes the essential findings, as applicable, to the ''smaller'' NRSROs or ''larger'' NRSROs, and describes for the public the nature and extent of the deficiencies cited. The Commission staff, as part of the annual examination of each NRSRO, reviews whether the internal control structure of the NRSRO is effective as required by section 15E(c)(3)(A) of the Exchange Act.[181]

For example, in the annual report published in December 2013, the Commission staff noted that all NRSROs had ''added or improved internal controls over the rating process'' since the examinations began in 2010 and generally improved adherence to their rating policies and procedures, which ''appear[ed] to be attributable, in part, to improvements in the internal control structure at NRSROs.'' [182] However, in several instances the staff found that an NRSRO did not follow its policies and procedures and the staff recommended that the NRSRO improve its internal controls to ensure compliance with the policies and procedures.[183] In particular, the Commission staff cited section 15E(c)(3)(A) of the Exchange Act in its report and stated that many NRSROs relied on a testing or internal audit program as an internal supervisory control.[184] The staff then described certain weaknesses it found in those controls, and recommended that those NRSROs improve and better document their testing and audit programs.[185]

Deficiencies in the internal control structure found by the examination staff are brought to the attention of the NRSRO, and the staff monitors whether and how those deficiencies are addressed. If warranted, the examination staff also can refer an NRSRO to the enforcement staff for potential violations of section 15E(c)(3)(A).

Given the importance of the NRSROs' internal control structures, the Commission believes that an NRSRO should be required to consider the factors identified in the proposing release when establishing, maintaining, enforcing, and documenting an effective internal control structure. The exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement. This should improve the overall effectiveness of the internal control structures of the NRSROs.

Consequently, the Commission is adding paragraph (d) to new Rule 17g–8 to provide that an NRSRO must consider certain factors when establishing, maintaining, enforcing, or documenting an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Act.[186] The factors identified in this paragraph are

[168] *See Levin Letter.*

[169] *See CFA/AFR Letter. See also CFA II Letter.*

[170] *See AFGI Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; Harrington Letter; Levin Letter; TradeMetrics Letter.*

[171] *See CFA II Letter*

[172] *See Levin Letter.*

[173] *See CFA/AFR Letter.*

[174] *See Better Markets Letter.*

[175] *See CFA/AFR Letter; AFSCME Letter.*

[176] *See AFSCME Letter* (stating that the NRSRO should be required to document: the control environment; risk assessment; control activities; and information and communication within the NRSRO); *CFA/AFR Letter* (stating that the NRSRO should be required to document: The design of the system of internal controls; the evidence obtained and conclusions reached during testing of the effectiveness of the internal controls; material weaknesses identified and how they were remediated; how the board of directors conducted its oversight; significant matters that arose in the design, operation, or monitoring of internal controls and how they were resolved; and the basis for reports to the Commission on the effectiveness of the internal control structure).

[177] *See* 15 U.S.C. 78o–7(c)(3)(A).

[178] *See* CFA II Letter.

[179] *See, e.g., Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 73 FR 36212; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR 63832; 2008 Staff Inspection Report.

[180] *See* 15 U.S.C. 78o–7(p)(3).

[181] *See* 15 U.S.C. 78o–7(c)(3)(A). *See also* 15 U.S.C. 78o–7(p)(3)(B) (requiring the Commission to review, among other things, whether the NRSRO conducts business in accordance with the policies, procedures, and rating methodologies of the NRSRO, the internal supervisory controls of the NRSRO, and the governance of the NRSRO).

[182] *See* 2013 Annual Staff Inspection Report, p. 8.

[183] *See, e.g.,* 2013 Annual Staff Inspection Report, p. 10 (discussing Commission staff finding that an NRSRO did not consistently follow its policies and procedures for rating criteria development).

[184] *See* 2013 Annual Staff Inspection Report, p. 18.

[185] *See id.*

[186] *See* paragraph (d) of Rule 17g–8.

the same factors the Commission identified in the proposing release.[187] Paragraph (d)(1) identifies the factors relating to establishing an effective internal control structure, paragraph (d)(2) identifies the factors relating to maintaining an effective internal control structure, and paragraph (d)(3) identifies the factors relating to enforcing an effective internal control structure.[188]

In considering a given factor, an NRSRO should determine whether it would be appropriate for the firm's internal control structure. Moreover, paragraphs (d)(1), (d)(2), and (d)(3) contain a ''catchall'' provision that provides that the NRSRO must consider any other controls necessary to establish, maintain, or enforce an effective internal control structure taking into consideration the nature of the business of the NRSRO, including its size, activities, organizational structure, and business model. The Commission is including the catchall provisions because the factors identified in paragraph (d) of Rule 17g–8 may not be comprehensive or sufficient for the circumstances of a particular NRSRO. An NRSRO should not treat them as a checklist or ''safe harbor'' that allows the firm to conclude that it has established, maintained, enforced, and documented an effective internal control structure.

Paragraph (d)(4) of Rule 17g–8 addresses the documentation of the internal control structure.[189] In the proposing release, the Commission did not identify a factor relating to this provision of the statute.[190] Consequently, paragraph (d)(4) does not identify a specific factor.[191] Instead, the paragraph provides—consistent with the catchall provisions in paragraphs (d)(1) through (d)(3)—that an NRSRO must take into consideration any controls necessary to document an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.[192]

Finally, in adopting the final rule, the Commission has taken into account comments from NRSROs that it should not prescribe factors or ''exercise caution'' in doing so because ''NRSROs should have the flexibility to implement whatever control structure suits their size and particular business operations'' [193] and attempting to create a ''one-size fits all'' rule in ''could result in the creation of an anti-competitive environment and the attendant unintended consequences.'' [194] In particular, the Commission notes that, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a specific factor be implemented. Consequently, while NRSROs must consider the factors identified by the Commission, they can tailor their internal control structures to their particular circumstances.

2. Amendment to Rule 17g–2

Section 15E(c)(3)(A) of the Exchange Act contains a self-executing provision that requires an NRSRO, among other things, to document its internal control structure.[195] However, the statute does not prescribe how an NRSRO must maintain this record. For example, the statute does not prescribe how long the record must be retained or the manner in which it must be maintained. Consequently, the Commission proposed adding paragraph (b)(12) to Rule 17g–2 to identify the internal control structure an NRSRO must document pursuant to 15E(c)(3)(A) of the Exchange Act as a record that must be retained.[196] As a result, the various retention and production requirements of paragraphs (c), (d), (e), and (f) of Rule 17g–2 would apply to the record documenting the internal control structure.[197]

Two commenters expressed support for the proposal,[198] whereas three other commenters raised concerns which are discussed below.[199] The Commission is adding paragraph (b)(12) to Rule 17g–2 as proposed.[200] Retention of the record will provide a means for the Commission to monitor the NRSROs' compliance with 15E(c)(3)(A) of the Exchange Act.

In addition, the Commission is amending paragraph (c) of Rule 17g–2. Prior to today's amendments, this paragraph provided that the records required to be retained under paragraphs (a) and (b) of Rule 17g–2 must be retained for three years after the date the record is made or received. The modification clarifies that the records documenting the internal control structure, the policies and procedures discussed in sections II.C., II.F., and II.J. of this release, and the standards discussed in section II.I. of this release must all be retained until three years after the record is replaced with an updated record (that is, when a control, policy, procedure, or standard documented in one of these records is replaced with a new control, policy, procedure, or standard).[201]

The reason for this clarifying amendment is that the text of paragraph (c) of Rule 17g–2 prior to today's amendment was intended to address records that generally contain historical information. For example, the rule requires the retention of records reflecting entries to and balances in all general ledger accounts, records indicating the identity of any credit analyst(s) that participated in determining a credit rating, credit analysis reports, credit assessment reports, and private credit rating reports.[202] The intent of the three-year record retention requirement is to preserve these records documenting historical information for three years after the fact in order to allow Commission examiners the opportunity to review the past activities of the NRSRO as reflected in these records. It also provides the NRSRO with records that can be used in connection with internal or third-party audits and for tracking past activities.

The Commission intended the three-year record retention provision in paragraph (c) of Rule 17g–2 as applied to the documentation of the internal control structure, the policies and

[187] *See id. See also Nationally Recognized Statistical Rating Organizations,* 76 FR at 33422–33423.

[188] *See* paragraphs (d)(1) through (3) of Rule 17g–8.

[189] *See* paragraph (d)(4) of Rule 17g–8.

[190] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33421–33423.

[191] *See* paragraph (d)(4) of Rule 17g–8.

[192] *Id.*

[193] *See DBRS Letter.*

[194] *See A.M. Best Letter* (''prescribing specific factors implies that all NRSROs are the same, which they are not. NRSROs vary in size, ownership, business plans, and management. 'Specific factors' would undoubtedly be designed to apply to the largest NRSROs—this scenario would create a disproportionate impact on smaller NRSROs, whose internal control structure would be best served by designing and implementing policies and procedures that apply the law to the specific characteristics of the NRSRO.'').

[195] *See* 15 U.S.C. 78o–7(c)(3)(A).

[196] *See* proposed paragraph (b)(12) of Rule 17g–2; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33423, 33539.

[197] *See* 17 CFR 240.17g–2(c) through (f).

[198] *See DBRS Letter; S&P Letter.*

[199] *See AFSCME Letter; A.M.Best Letter; Lambert Letter.*

[200] *See* paragraph (b)(12) of Rule 17g–2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[201] *See* paragraph (c) of Rule 17g–2 (providing that the records required to be retained pursuant to paragraphs (a) and (b) of the rule must be retained for three years after the date the record is made or received, except that a record identified in paragraph (a)(9), (b)(12), (b)(13), (b)(14), or (b)(15) of the rule must be retained until three years after the date the record is replaced with an updated record).

[202] *See, e.g.,* 17 CFR 240.17g–2(a)(1), (a)(2)(i), and (b)(3).

procedures, and the standards to also preserve historical information for three years after the fact to facilitate Commission examinations and NRSRO internal or third party audits of past activities. However, the record reflects current rather than historical information until there is an update of the internal control structure, policies and procedures, or standards documented in the record (that is, the record reflects the internal controls, policies and procedures, or standards, as applicable, that govern the NRSRO's conduct now and in the future). Consequently, because paragraph (c) of Rule 17g–2—prior to today's amendments—required a record ''to be retained for three years after the date the record is made or received,'' this provision as applied to the documentation of the internal control structure, policies and procedures, and standards would be ambiguous as to whether the record must be retained for three years after the information reflected in the record is no longer current.

For example, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to document its internal control structure.[203] This means that at all times the NRSRO must document the internal control structure that is in effect and, consequently, if a given version of an internal control structure is in effect for more than three years, the NRSRO must continue to maintain the record documenting the internal control structure even though three years have elapsed since the record was made. The clarifying text being added to paragraph (c) of Rule 17g–2 addresses an ambiguity in the rule text. This ambiguity could be read to establish a three-year retention period that is largely meaningless and is inconsistent with the Commission's intent that these records be retained for three years after the information in the record is no longer current.[204] Specifically, without the clarifying amendment, paragraph (c) of Rule 17g–2 could be read to provide that the three-year retention period begins to run at the time the internal control structure was first documented. Under this reading, the rule would be redundant because it would prescribe a retention period that is already addressed by the self-executing requirement in section 15E(c)(3)(A) of the Exchange Act (that an NRSRO must document its internal control structure). In other words, the statutory requirement to document the internal control structure acts as a retention requirement for as long as the current version of the internal control structure is in effect. Further, under this reading of the rule, if an internal control structure was in effect for three or more years, an NRSRO could discard the record documenting the previous internal control structure as soon as it is replaced with an updated record documenting the revised internal control structure (as it would have retained the previous record of the internal control structure for three or more years). This could prevent the Commission from reviewing whether the NRSRO adhered to its previous internal control structure, as examinations generally review past activities. The appropriate and intended retention period is until three years after the internal control structure is updated. As a result, the documentation recording the current internal control structure and the documentation recording any prior versions of the internal control structure that were updated within three years will be available to Commission examiners. This will create an audit trail between prior versions of the internal control structure and the existing internal control structure. For these reasons, the Commission is amending paragraph (c) of Rule 17g–2 to make clear that the records documenting the internal control structure, the policies and procedures, and the standards must be retained until three years after the date the record is replaced with an updated record.[205]

One commenter stated that a three-year retention period is ''insufficient,'' since ''the effects of a credit rating decision may not arise until after that retention period expires.'' [206] The Commission believes the three year retention period is sufficient. First, as noted above, an NRSRO must maintain a record documenting its existing internal control structure for as long as the internal control structure is in effect and for an additional three years after the record is replaced with an updated record documenting the internal control structure. Second, the Commission staff performs an annual examination of each NRSRO. Consequently, the record documenting an internal control structure that is no longer in effect will be available for several exam cycles.

Another commenter suggested requiring that documentation be made available to the Commission ''regardless of where the credit rating is produced.'' [207] The Commission notes that under the rules, regardless of where a credit rating is produced, an NRSRO must document its internal control structure and produce to Commission staff the records documenting both its current internal control structure and any prior versions of the internal control structure that are within the three-year retention period.[208]

A third commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, and argued that documenting policies and procedures ''naturally coincide with the establishment of a properly functioning internal controls structure,'' which the NRSRO should be allowed to establish on its own, and the commenter urged the Commission to exclude ''extensive or overly-inclusive documentation requirements'' should it adopt new paragraph (b)(12) of Rule 17g–2.[209] In response, the Commission notes that section 15E(c)(3)(A)—not Rule 17g–2—requires an NRSRO to document its internal control structure.[210] The amendment to Rule 17g–2 establishes retention requirements for this documentation.

3. Amendments to Rule 17g–3

Section 15E(c)(3)(B) of the Exchange Act provides that the Commission shall prescribe rules requiring an NRSRO to submit an annual internal controls report to the Commission, which must contain: (1) A description of the responsibility of management in establishing and maintaining an effective internal control structure; (2) an assessment of the effectiveness of the internal control structure; and (3) the attestation of the CEO or equivalent individual.[211]

The Commission proposed amending Rule 17g–3 to implement the rulemaking mandated by section 15E(c)(3)(B) of the Exchange Act.[212]

[203] *See* 15 U.S.C. 78o–7(c)(3)(A).

[204] *See* paragraph (c) of Rule 17g–2 (providing that the records must be retained until three years after the date the record is replaced with an updated record).

[205] *See* sections II.C.2., II.F.2., II.I.2., and II.J.2. (discussion the amendments to Rule 17g–2 to establish record retention requirements for the records documenting policies and procedures or standards).

[206] *See Lambert Letter.* This commenter also suggested that the final amendments mandate record retention requirements of seven years, ''similar to section 802 of the Sarbanes-Oxley Act.''

[207] *See AFSCME Letter.*

[208] *See* 15 U.S.C. 78o–7(c)(3)(A). *See also* paragraph (d) of Rule 17g–2, which requires, among other things, that an NRSRO maintain each record identified in paragraphs (a) and (b) in a manner that makes the original record or copy easily accessible to the principal office of the NRSRO. 17 CFR 240.17g–2(d).

[209] *See A.M. Best Letter.*

[210] *See* 15 U.S.C. 78o–7(c)(3)(A).

[211] *See* 15 U.S.C. 78o–7(c)(3)(B)(i) through (iii).

[212] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33423–33425; 15 U.S.C.

Rule 17g–3 requires an NRSRO to furnish annual reports to the Commission.[213] In particular, before today's amendments, paragraph (a) of Rule 17g–3 required an NRSRO to furnish five or, in some cases, six separate reports within ninety days after the end of the NRSRO's fiscal year and identified the reports that must be furnished.[214] The first report containing the NRSRO's financial statements must be audited; the remaining reports on revenues and other matters may be unaudited.[215] Before today's amendments, paragraph (b) of Rule 17g–3 provided that the NRSRO must attach to the reports a signed statement by a duly authorized person that the person has responsibility for the reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the information contained in the reports.[216]

The proposed amendments would add paragraph (a)(7) to Rule 17g–3 to require an NRSRO to file an additional report—which would be unaudited—with its annual submission of reports pursuant to Rule 17g–3.[217] The proposed rule text describing the report that would need to be filed closely mirrored the statutory text.[218] In particular, proposed paragraph (a)(7) would have required that the internal controls report contain: (1) A description of the responsibility of management in establishing and maintaining an effective internal control structure; and (2) an assessment by management of the effectiveness of the internal control structure.[219]

Section 15E(c)(3)(B)(iii) of the Exchange Act provides that the annual internal controls report must contain an attestation of the NRSRO's CEO or equivalent individual.[220] Accordingly, the Commission proposed amending paragraph (b) of Rule 17g–3 to require that the NRSRO attach to the report a signed statement by the CEO or, if the firm does not have a CEO, an individual performing similar functions.[221]

The Commission is adding paragraphs (a)(7) and (b)(2) to Rule 17g–3 with modifications from the proposal in response to comments.[222] As discussed below, the modifications to the text of paragraph (a)(7) are designed to provide more guidance to NRSROs on the information that must be included in the report compared to the proposed rule text, which—as noted above—closely mirrored the statutory text.

Paragraph (a)(7)—as proposed and adopted—requires an NRSRO to include in the report a description of the responsibility of management in establishing and maintaining an effective internal control structure.[223] This rule text largely mirrors the statutory text.[224] A number of commenters addressed the level of management that should have primary responsibility for establishing and maintaining an effective internal control structure and for assessing its effectiveness.[225] An NRSRO stated that the CEO (or equivalent) and other management, supervisory, and compliance personnel affiliated with the NRSRO should be responsible for designing the structure, and that the board of directors should oversee the structure.[226] Two other commenters stated that the board of directors should oversee the structure.[227] An NRSRO stated that the wording in the proposed rule was reasonable, but that the Commission should refrain from specifying which level of management should be responsible for establishing and maintaining the system and that this determination ''is best left to each NRSRO based upon its business needs and organization.'' [228] Similarly, another NRSRO stated that management and board oversight of the internal control structure will vary greatly between each NRSRO and, therefore, such determinations should be left to each NRSRO.[229] On the other hand, a commenter suggested that management should have no part in the establishment or maintenance of an internal control structure, and that a committee of analysts should assess the effectiveness of the NRSRO's internal control structure.[230]

In response to these comments, the Commission notes that section 15E(t)(3)(C) of the Exchange Act prescribes a self-executing requirement that the board of directors of the NRSRO shall ''oversee'' the ''effectiveness of the internal control system with respect to the policies and procedures for determining credit ratings. '' [231] Moreover, as discussed above, the self-executing provision in section 15E(c)(3)(A) requires an NRSRO to establish, maintain, enforce, and document an effective internal control structure.[232] Further, section 15E(c)(3)(B) of the Exchange Act refers, in pertinent part, to ''a description of the responsibility of the management of the [NRSRO] in establishing and maintaining an effective internal control

78o–7(c)(3)(B)(i) through (iii). In addition, as a technical amendment, the Commission proposed to amend the title of Rule 17g–3 to replace the words ''financial reports'' with the words ''financial and other reports.'' *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33424, n.25. The Commission stated that the report identified in paragraph (a)(6) of Rule 17g–3, the proposed internal control report that would be required under paragraph (a)(7), and the compliance report that would be required under paragraph (a)(8) (which is discussed below in section II.K. of this release) are not financial in nature. *Id.* The Commission also proposed adding the word ''filed'' in the title of Rule 17g–3 to conform to amendments the Dodd-Frank Act made to section 15E of the Exchange Act. *See* Public Law 111–203, 932(a).

[213] *See* 17 CFR 240.17g–3.

[214] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33423.

[215] *See id.*

[216] *See id.*

[217] *See* paragraph (a)(7) of Rule 17g–3, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. As discussed below, while the report will not be audited, it will be reviewed by Commission examination staff.

[218] *Compare* paragraph (a)(7) of Rule 17g–3, as proposed, *with* 15 U.S.C. 78o–7(c)(3)(B)(i) through (ii).

[219] *See* paragraph (a)(7) of Rule 17g–3, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539.

[220] *See* 15 U.S.C. 78o–7(c)(3)(B)(iii).

[221] *See* paragraph (b) of Rule 17g–3, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. In particular, the Commission proposed re-organizing paragraph (b) of Rule 17g–3 into paragraphs (b)(1) and (b)(2). As proposed, paragraph (b)(1) would contain the current requirement that the NRSRO must attach to each of the annual reports required pursuant to paragraphs (a)(1) through (6) a signed statement by a duly authorized person associated with the NRSRO stating that the person has responsibility for the financial reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the information required to be contained in the reports. As proposed, paragraph (b)(2) of Rule 17g–3 would require that the NRSRO attach to the report filed pursuant to paragraph (a)(7) a signed statement by the CEO of the NRSRO or, if the NRSRO does not have a CEO, an individual performing similar functions, stating that the CEO or individual has responsibility for the report and, to the best knowledge of the CEO or other individual, the report fairly presents, in all material respects, a description of the responsibility of management in establishing and maintaining an effective internal control structure and an assessment of the effectiveness of the internal control structure.

[222] *See* paragraph (a)(7) of Rule 17g–3. The amendments to Rule 17g–3 also replace the phrase ''financial reports'' with the phrase ''financial and other reports'' and replace the phrase ''to be furnished'' with the phrase ''to be filed or furnished.'' These amendments are being adopted as proposed.

[223] *See* paragraph (a)(7)(i)(A) of Rule 17g–3.

[224] *Compare* paragraph (a)(7)(i)(A) of Rule 17g–3, with 15 U.S.C. 78o–7(c)(3)(B)(i).

[225] *See AFSCME Letter; CFA/AFR Letter; Harrington Letter; Kroll Letter; Morningstar Letter; S&P Letter.*

[226] *See Morningstar Letter.*

[227] *See AFSCME Letter; CFA/AFR Letter.*

[228] *See S&P Letter.*

[229] *See Kroll Letter.*

[230] *See Harrington Letter* (suggesting the formation of a ''Committee Assessment Function'' that would be ''devoted solely to evaluating the committee performance over the course of a year of all members regardless of title'' and would ''bypass management entirely and report directly to a board member tasked with sole responsibility for this function'').

[231] *See* 15 U.S.C. 78o–7(t)(3)(A).

[232] *See* 15 U.S.C. 78o–7(c)(3)(A).

structure.'' [233] Moreover, this section of the statute also provides that the annual internal controls report—which must include an assessment of the effectiveness of the internal control structure—must contain an attestation of the NRSRO's CEO or equivalent individual.[234] Consequently, a reasonable interpretation of these statutory provisions is that they allocate responsibility to the NRSRO's board to ''oversee'' the effectiveness of the internal control structure and responsibility to the NRSRO's management to establish, maintain, enforce, and document the internal control structure and to report annually on its effectiveness. This interpretation also is consistent with the Commission's understanding of how the responsibilities of a firm's board and management generally are allocated.

While it is the responsibility of management to establish, maintain, enforce, and document the internal control structure, in carrying out this responsibility management could, as a matter of good practice, consider the extent to which other persons within the NRSRO should be involved.[235] For example, management could seek input from persons within the NRSRO that carry out the day-to-day functions related to governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. This could include input from persons responsible for determining credit ratings, developing rating methodologies, and reviewing and monitoring the NRSRO's compliance with its policies, procedures, and methodologies. In addition, establishing a mechanism for persons within the NRSRO to report, on a confidential basis if they choose, directly to the board of directors any material weaknesses in the NRSRO's internal control structure could be a useful check on management's annual assessment of the effectiveness of the internal control structure and could assist the board in its responsibility to oversee the effectiveness of the internal control structure. Finally, an NRSRO could consider developing procedures to identify and address internal conflicts of interest that potentially could prevent an independent, impartial, and unbiased assessment of the effectiveness of the internal control structure. This could promote more accurate reporting by the NRSRO on the internal control structure.

In addition to the description of the responsibility of management in establishing and maintaining an effective internal control structure, the proposal required that the internal controls report include ''an assessment by management of the effectiveness of the internal control structure.'' [236] As discussed in more detail below, several commenters stated that the Commission should strengthen the reporting requirement in the rule relating to the assessment of the effectiveness of the internal control structure.[237]

The Commission is persuaded that the proposal should be modified to provide more clarity on the information that must be reported in the internal controls report. In particular, paragraph (a)(7) of Rule 17g–3, as adopted, requires that the internal controls report include (in addition to a description of the responsibility of management in establishing and maintaining an effective internal control structure): (1) A description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and (2) a statement as to whether the internal control structure was effective as of the end of the fiscal year.[238] Consequently, the final amendment provides more specificity as to the information that must be included in the internal controls report in terms of assessing the effectiveness of the NRSRO's internal control structure.[239]

Further, in response to comments that the rule should specify that the assessment covers the entire year, the Commission has made several modifications to the proposal.[240] Specifically, the prefatory text of paragraph (a)(7)(i) of Rule 17g–3, as amended, provides that the internal controls report must contain an assessment by management of the effectiveness *during the fiscal year* of the internal control structure.[241] The amendment further requires that the report must include a description of each material weakness in the internal control structure identified *during the fiscal year,* if any, and a description, if applicable, of how each identified material weakness was addressed.[242] Consequently, the reporting relating to material weaknesses must cover the entire fiscal year. The amendment also requires that the internal controls report contain a statement as to whether the internal control structure was effective *as of the end of the fiscal year.*[243] Thus, this statement in the report relates to a point in time: The fiscal year end. However, the assessment of whether the internal control structure is effective as of the fiscal year end will depend on how the NRSRO addressed any material weaknesses identified during the fiscal year.[244]

Commenters also addressed how to assess the internal control structure. One commenter pointed to the internal control framework developed by the Committee of Sponsoring Organizations (''COSO'') of the Treadway Commission in 1992 as a model.[245] Another commenter stated that the Commission should establish a framework against which the internal controls of an NRSRO can be measured that would identify the objectives of the controls, set forth mandatory minimum components, and specify how a material weakness would be handled.[246] Some commenters suggested that the Commission clarify how an NRSRO should assess whether its internal

[233] *See* 15 U.S.C. 78o–7(c)(3)(B)(i).

[234] *See* 15 U.S.C. 78o–7(c)(3)(B)(ii) and (iii).

[235] *See Harrington Letter; Morningstar Letter.*

[236] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. This provision of the proposed amendment largely mirrored the statutory text. *See* 15 U.S.C. 78o–7(c)(3)(B)(ii).

[237] *See AFSCME Letter; CFA/AFR Letter.* These two commenters stated that the rule should require reporting on: (1) The period of time to which management's assessment relates, which should be the entire year; (2) the benchmark or framework used in assessing internal controls, as well as the definition of internal control used; (3) the statement that the board of directors is responsible for overseeing the system of internal controls; (4) if a material weakness was detected during the year, a description of that material weakness and whether it has been remediated (and how) as of the end of that year; and (5) non-compliance with applicable laws and regulations that have been identified, consistent with the Yellow Books standard of the General Accounting Office (''GAO'').

[238] *See* paragraph (a)(7)(i) of Rule 17g–3.

[239] *See* paragraphs (a)(7)(i)(B) and (C) of Rule 17g–3. As discussed above, the proposal would have required the report to include an ''assessment by management of the effectiveness of the internal control report.'' *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. This more general description of what must be contained in the internal controls report is being moved to the prefatory text of paragraph (a)(7)(i) of Rule 17g–3.

[240] *See AFSCME Letter; CFA/AFR Letter.*

[241] *See* paragraph (a)(7)(i) of Rule 17g–3 (emphasis added).

[242] *See* paragraph (a)(7)(i)(B) of Rule 17g–3 (emphasis added). The Commission expects the description to include the nature and the duration of the material weakness.

[243] *See* paragraph (a)(7)(i)(C) of Rule 17g–3 (emphasis added).

[244] As discussed below, paragraph (a)(7)(ii) of Rule 17g–3 provides that management is not permitted to conclude that the internal control structure was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.

[245] *See CFA/AFR Letter* (stating that the Commission should use the COSO framework as a basis for evaluating and inspecting the assessment of internal controls and the control structure on which management will report).

[246] *See Levin Letter.*

control structure is effective.[247] One of these commenters suggested the Commission lay out a basic definition of internal control and the objectives the internal controls are designed to achieve but did not provide a suggested definition.[248] An NRSRO suggested that the Commission clarify that ''an 'effective' internal control structure is one that is 'reasonably designed' to achieve its purposes.'' [249] In contrast, another NRSRO stated that the proposed reporting requirement is ''sufficiently explicit'' and that ''additional guidance is not needed.''[250] This commenter added that each NRSRO operates in its own unique way and that prescribing more detailed rules ''may not be appropriate for every NRSRO in every situation.''[251]

The Commission agrees that providing more clarity as to when management of the NRSRO is not permitted to conclude that its internal control structure is effective would strengthen the requirement and provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure.[252] The Commission therefore is modifying the proposal to add a provision specifying when the NRSRO is not permitted to conclude that its internal control structure is effective.[253] In particular, the final amendment provides that management of the NRSRO is not permitted to conclude that the internal control structure of the NRSRO was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.[254]

Commenters suggested several definitions of the term *material weakness.* For example, one commenter suggested that *material weakness* be defined as a ''serious deficiency that would prevent or in fact did prevent the internal controls from achieving their objective.'' [255] Another commenter described a *material weakness* as ''a serious deficiency in an internal control that would prevent it from achieving its objective.'' [256] Similarly, a third commenter stated that a definition of *material weakness* should be one ''which clearly sets out what would be a serious deficiency in internal controls that would prevent the internal controls from achieving their objective.'' [257] An NRSRO requested that the Commission provide guidance as to what constitutes a material weakness and suggested that a *material weakness* be defined as a ''deficiency, or combination of deficiencies, in internal controls where it is more likely than not that the integrity of the rating process will be compromised by the failure to follow the NRSRO's policies, procedures, and methodologies.'' [258] This commenter also stated that it believed that one of the objectives of the internal control structure is to ''provide reasonable assurance regarding the prevention or timely detection of actions that could have a material effect on the integrity of credit ratings.'' [259] On the other hand, another NRSRO stated that the Commission should allow NRSROs to define *material weakness* and other terms.[260]

The Commission is persuaded that including a description of a material weakness in paragraph (a)(7) of Rule 17g–3 will strengthen the reporting requirement and provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure. Consequently, the paragraph, as adopted, includes a description of when a material weakness exists.[261] This description is based, in part, on suggestions by commenters and on recent amendments to the broker-dealer reporting rule.[262] The description of *material weakness* in the rule incorporates the concept of a deficiency in the internal control structure of the NRSRO.[263] Consequently, paragraph (a)(7) of Rule 17g–3 also includes a description of when a deficiency in the internal control structure exists.[264] Under the requirements of the paragraph, the first step is to determine whether there are deficiencies in the internal control structure. If so, the second step is to determine whether a material weakness exists in light of the identified deficiencies.

The description in paragraph (a)(7) of Rule 17g–3 of when a deficiency exists is based on the control objectives set forth in section 15E(c)(3)(A) of the Exchange Act.[265] This self-executing provision specifies that the internal control structure must effectively govern the implementation of and adherence to the NRSRO's policies, procedures, and methodologies for determining credit ratings. In other words, the controls must be designed to achieve the following objectives: (1) That the NRSRO implements policies, procedures, and methodologies for determining credit ratings in accordance with its policies and procedures; and (2) that the NRSRO determines credit ratings in accordance with its policies, procedures, and methodologies for determining credit ratings. Given these control objectives, the paragraph provides that a deficiency in the internal control structure exists when the design or operation of a control does not allow management or employees of the NRSRO, in the normal course of performing their assigned functions, to prevent or detect a failure of the NRSRO to: (1) Implement a policy, procedure, or methodology for determining credit ratings in accordance with its policies and procedures; or (2) adhere to an implemented policy, procedure, or methodology for determining credit ratings.[266]

The existence of a deficiency in the internal control structure, however, does not necessarily mean that a material weakness exists. Even a well-designed internal control structure cannot guarantee that a deficiency will never occur. Therefore, paragraph (a)(7) of Rule 17g–3 provides that a material weakness exists if a deficiency, or a combination of deficiencies, in the design or operation of the internal control structure creates a reasonable possibility that a failure identified in the description of deficiency (that is, a failure of the NRSRO to implement a policy, procedure, or methodology for

[247] *See CFA/AFR Letter; DBRS Letter.*

[248] *See CFA/AFR Letter.*

[249] *See DBRS Letter.*

[250] *See S&P Letter.*

[251] *Id.*

[252] *See, e.g., CFA/AFR Letter; DBRS Letter.* The Commission provided such guidance when it recently adopted a new reporting requirement for broker-dealers pursuant to which certain types of broker-dealers must file a compliance report that contains, among other statements, a statement as to whether the broker-dealer's internal control over compliance with certain rules was effective. *See Broker-Dealer Reports,* Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910, 51916–51920 (Aug. 21, 2013). *See also* 17 CFR 240.17a-5(d)(3). The reporting requirement contains provisions prescribing when a broker-dealer is not permitted to conclude that its internal control over compliance with these rules was effective.

[253] *See* paragraph (a)(7)(ii) of Rule 17g–3.

[254] *Id.*

[255] *See CFA/AFR Letter.*

[256] *See Levin Letter.*

[257] *See COPERA Letter.*

[258] *See Morningstar Letter* (also stating that, ''[t]o the extent the CEO's report requires a discussion of internal control deficiencies, this discussion should be limited to material deficiencies that prevent management from concluding its internal structure is effective, which is consistent with the Commission's requirement for reports related to internal controls over financial reporting.'').

[259] *See Morningstar Letter.*

[260] *See S&P Letter.*

[261] *See* paragraph (a)(7)(iv) of Rule 17g–3.

[262] *See Broker-Dealer Reports,* 78 FR at 51916–51920; 17 CFR 240.17a-5(d)(3).

[263] *See* paragraph (a)(7)(iv) of Rule 17g–3.

[264] *See* paragraph (a)(7)(iii) of Rule 17g–3.

[265] *See* 15 U.S.C. 78–o7(c)(3)(A) (requiring that the internal control structure govern the ''implementation of and adherence to [the NRSRO's] policies, procedures, and methodologies for determining credit ratings'').

[266] *See* paragraph (a)(7)(iii) of Rule 17g–3.

determining credit ratings in accordance with its policies and procedures or to adhere to a policy, procedure, or methodology for determining credit ratings) that is material will not be prevented or detected on a timely basis.[267]

In the proposing release, the Commission asked whether the internal controls report should be made public.[268] One commenter stated that the internal controls report should be made publicly available.[269] The commenter stated that making the report public would enable users of credit ratings ''to evaluate the effectiveness of [the] rating agency's internal control structure and consider what impact, if any, it may have on the quality of the credit ratings the NRSRO produces.'' [270] On the other hand, three commenters—all NRSROs—stated that the report should be kept confidential (as are the other reports submitted to the Commission under Rule 17g–3).[271] One NRSRO stated that publicizing the reports could make them less informative and more defensive in nature, limiting their effectiveness.[272] A second NRSRO stated that ''[m]anagement reports to the board (including an annual report, which would also be filed with the Commission) are likely to be key elements of the board's ability to oversee the effectiveness of the internal control structure'' and ''[s]ince board oversight will be promoted by open and free dialogue with management, the Commission should not impede such communication when imposing requirements that make some or all parts of such management reports publicly available.'' [273] A third NRSRO stated that the reports may contain proprietary or confidential information pertaining to the activities of the NRSRO.[274]

The Commission is adopting the amendment as proposed and, therefore, is not requiring that the internal controls report be made public. The final amendment is intended to assist the Commission in examining and monitoring the effectiveness of the internal control structures of NRSROs and how the structures evolve and improve over time.[275] Making the reports public—as suggested by one commenter—could cause NRSROs to make them less detailed and candid.[276] In appropriate cases, if an NRSRO fails to establish, maintain, enforce, and document an effective internal control structure, the Commission could institute enforcement proceedings, at which point the allegations related to the internal control structure would be a matter of public record.

One commenter suggested the report be subjected to a third-party audit attesting to the report's reliability.[277] As stated above, the final amendment does not require that the internal controls report be made public. Consequently, the report is not a public document that will be relied upon by investors and other users of credit ratings. Rather, it is a non-public report that will be used by Commission examiners as part of their monitoring of NRSROs' compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure. The Commission has taken these factors into consideration in balancing the benefits of having the internal controls report audited by a third party and the costs of such a requirement. The Commission examines each of the ten NRSROs currently registered with the Commission annually. At this time, the Commission believes that the annual examinations by the Commission staff will provide a sufficient means for reviewing the accuracy of the internal controls reports filed by the NRSROs.

In order to implement section 15E(c)(3)(B)(iii) of the Exchange Act, the Commission is adopting the amendment to paragraph (b) of Rule 17g–3 with modifications to correspond to the modifications to paragraph (a)(7) discussed above.[278] Specifically, as proposed, paragraph (b)(2) of Rule 17g–3 would require that the NRSRO attach to the internal controls report filed pursuant to paragraph (a)(7) a signed statement by the CEO of the NRSRO or, if the NRSRO does not have a CEO, an individual performing similar functions, stating, in pertinent part, that the report fairly presents, in all material respects, a description of the responsibility of management in establishing and maintaining an effective internal control structure and an assessment of the effectiveness of the internal control structure.[279] As discussed above, under the final amendments, paragraph (a)(7) of Rule 17g–3 provides that the report must contain a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each material weakness was addressed, and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.[280] Consequently, under the final amendments, paragraph (b)(2) of Rule 17g–3 provides that the CEO or individual performing similar functions must state, in pertinent part, that the internal controls report fairly presents, in all material respects: An assessment by management of the effectiveness of the internal control structure during the fiscal year that includes a description of the responsibility of management in establishing and maintaining an effective internal control structure; a description of each material weakness in the internal control structure identified during the fiscal year, if any; a description, if applicable, of how each identified material weakness was addressed; and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.[281]

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to reporting on internal control structures.[282] The baseline that existed before today's amendments was one in which NRSROs must establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.[283] In

[267] *See* paragraph (a)(7)(iv) of Rule 17g–3.

[268] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33425.

[269] *See CII Letter.*

[270] *Id.*

[271] *See DBRS Letter; Kroll Letter; S&P Letter.*

[272] *See DBRS Letter* (also arguing that nothing in the Dodd-Frank Act suggests the intent of Congress was to make the reports public and that there is no precedent under federal securities laws to force a private company to publicize information of this kind, and that users of credit ratings already have access to much information on NRSROs on which to make informed use of ratings, including how they formulate credit opinions and the historical performance of those opinions).

[273] *See Kroll Letter.*

[274] *See S&P Letter.*

[275] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33513.

[276] *See DBRS Letter.*

[277] *See Levin Letter.*

[278] *See* paragraph (b)(2) of Rule 17g–3. *See also* 15 U.S.C. 78o–7(c)(3)(B)(iii) (providing, in pertinent part, that the Commission shall prescribe rules requiring each NRSRO to submit to the Commission an internal controls report, which shall contain the attestation of the CEO, or equivalent individual, of the NRSRO).

[279] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539.

[280] *See* paragraph (a)(7)(i) of Rule 17g–3.

[281] *See* paragraph (b)(2) of Rule 17g–3.

[282] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[283] *See* 15 U.S.C. 78o–7(c)(3)(A).

addition, section 15E(t)(3)(C) of the Exchange Act requires the board of directors of the NRSRO to ''oversee'' the ''effectiveness of the internal control system with respect to policies and procedures for determining credit ratings.'' [284] However, before today's amendments, there were no requirements addressing: (1) The factors an NRSRO must consider when establishing, maintaining, enforcing, and documenting an internal control structure; and (2) the retention of the records documenting the NRSRO's internal control structure. In addition, there were no requirements to file an annual internal controls report with the Commission attested to by the NRSRO's CEO or equivalent individual describing the responsibility of the management of the NRSRO in establishing and maintaining an effective internal control structure and containing an assessment of the effectiveness of the internal control structure.

Relative to the baseline, paragraph (d) of Rule 17g–8 requiring an NRSRO to consider certain factors when establishing, maintaining, enforcing, and documenting an internal control should result in benefits. As noted above, the exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.[285] This should improve the overall effectiveness of the internal control structures of the NRSROs.

Relative to this baseline, the amendments to Rule 17g–2 requiring an NRSRO to retain a record documenting its internal control structure should result in benefits. Recordkeeping rules such as Rule 17g–2 are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.[286] Rule 17g–2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission's staff in monitoring, through its examination program, whether an NRSRO is complying with applicable securities laws, including the provisions of section 15E of the Exchange Act and the rules adopted under section 15E. The amendments to Rule 17g–2 are designed to assist the Commission staff in monitoring an NRSRO's compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to its policies, procedures, and methodologies for determining credit ratings.

Relative to the baseline, the amendments to Rule 17g–3 requiring NRSROs to file an internal controls report with the Commission should result in benefits. First, the annual report will facilitate the Commission's oversight of NRSROs by assisting the Commission in monitoring an NRSRO's compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. Compliance with the requirement to file the internal controls report may enhance the integrity of credit ratings by increasing the likelihood that NRSROs will adhere to their procedures and methodologies for determining credit ratings.

Second, the requirement that an NRSRO describe in the report any material weaknesses identified during the fiscal year and how any identified material weakness was addressed may incentivize an NRSRO to more closely monitor and make appropriate improvements to its internal control structure, which could improve the integrity and quality of its credit ratings. The requirements also could provide accountability for effective governance by the NRSRO's board and management, which also may improve the integrity of credit ratings.

Third, the requirement that the CEO or a person performing similar functions attest to the report should help to ensure that the report fairly presents the assessment by management of the effectiveness of the internal control structure. It also should promote greater focus within an NRSRO on establishing, maintaining, enforcing, and documenting an effective internal control structure, given the involvement of senior level management in attesting to the reported information. Further, because the person attesting to the report must represent that the person has responsibility for the report, there will be senior level accountability for the accuracy and completeness of the report, which also should promote greater focus within an NRSRO on establishing, maintaining, enforcing, and documenting an effective internal control structure.

Paragraph (d) of Rule 17g–8 and the amendments to Rules 17g–3 and 17g–2 should promote the objective of ensuring that NRSROs comply with section 15E(c)(3)(A) of the Exchange Act (that is, establish, maintain, enforce, and document an effective internal control structure).[287] This should mitigate the risk that an NRSRO may use a rating methodology that has not been implemented in accordance with its policies and procedures or that it issues a credit rating that was not determined in accordance with its policies, procedures, and methodologies for determining credit ratings. Again, the integrity and quality of credit ratings could increase as a result.

With respect to prescribing factors, commenters stated, in response to a question in the proposing release, that the Commission should not prescribe factors for an internal control structure because this would place a heavy burden on small NRSROs.[288] The Commission believes the manner in which it has prescribed factors will address these concerns and, relative to the baseline, paragraph (d) of Rule 17g–8 should not result in costs. NRSROs already are required to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.[289] In doing so, an NRSRO already must consider the types of controls that would be necessary to meet this statutory requirement. Paragraph (d) of Rule 17g–8 provides reference points for engaging in this exercise and may facilitate and focus the process. Moreover, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a specific factor be implemented. Consequently, while NRSROs must consider the factors identified by the Commission, they can tailor and scale their internal control structures to their size and business activities.

Relative to the baseline, the amendments to Rule 17g–2 prescribing retention requirements for the documentation of the internal control structure will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule

[284] *See* 15 U.S.C. 78o–7(t)(3)(C).

[285] *See* 15 U.S.C. 78o–7(c)(3)(A).

[286] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33582.

[287] *See* 15 U.S.C. 78o–7(c)(3)(A).

[288] *See A.M. Best Letter; Kroll Letter.*

[289] *See* 15 U.S.C. 78o–7(c)(3)(A).

17g–2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the Paperwork Reduction Act (''PRA''),[290] the Commission estimates that paragraph (b)(12) of Rule 17g–2 and the amendment to paragraph (c) of Rule 17g–2 will result in total industry-wide one-time costs to NRSROs of approximately $12,000 and total industry-wide annual costs to NRSROs of approximately $3,000.[291]

Relative to the baseline, the amendments to Rule 17g–3 requiring that NRSROs file an annual internal controls report with the Commission will result in costs to NRSROs. An NRSRO will likely incur costs to engage outside counsel to analyze the requirements for the report and to assist in drafting and reviewing the report. These legal costs are expected to be greater for the filing of the first report and are expected to depend on the size and complexity of the operations of the NRSRO. NRSROs also will need to establish and maintain internal processes to gather and retain evidentiary information to support the report. However, NRSROs already have processes and controls for preparing and submitting the annual reports required by Rule 17g–3 before today's amendments. Therefore, the reporting costs of this rule will be incremental to the costs associated with these existing requirements. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a)(7) of Rule 17g–3 and the amendment to paragraph (b) of Rule 17g–3 will result in total industry-wide one-time costs to NRSROs of approximately $400,000 and total industry-wide annual costs to NRSROs of approximately $667,000.[292]

The amendments to Rule 17g–2 and Rule 17g–3 may result in other costs. For example, these requirements may affect the timeliness of credit ratings if they result in an NRSRO implementing internal controls that increase the time required to produce a credit rating. For example, an NRSRO may choose to implement controls which require the work of a lead credit analyst to be reviewed by other analysts. As a result, users of credit ratings may incur costs associated with having credit ratings that are less timely.

Paragraph (d) of Rule 17g–8 and the amendments to Rule 17g–3 and Rule 17g–2 could have a number of effects related to efficiency, competition, and capital formation.[293] As stated above, these amendments could improve the integrity and quality of credit ratings. Consequently, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also 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. Alternatively, the timeliness of credit-related information may be diminished as discussed above. In this case, users of credit ratings may have access to less timely credit-related information which could decrease the efficiency of their investment decisions and the efficiency of markets as it could delay the updating of asset prices to reflect available information. The amendments to Rule 17g–3 and Rule 17g–2 also will impose costs, some of which may have a component that is fixed in magnitude across NRSROs and does not vary with the size of the NRSRO. Therefore, the operating costs per rating of smaller NRSROs may increase relative to that of larger NRSROs, which could create adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as NRSROs might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

There are a number of reasonable alternatives to the amendments. First, the Commission could have deferred prescribing factors to be taken into consideration when establishing, maintaining, enforcing, and documenting an effective internal control structure. As explained above, the exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.[294] This should improve the overall effectiveness of the internal control structures of the NRSROs. Moreover, the ''catchall'' provisions in the rule will mitigate the risk that an NRSRO treats the factors as a checklist or ''safe harbor.'' Moreover, as discussed above, the Commission does not believe that prescribing factors will result in additional costs to NRSROs.

Second, the Commission could require that the annual internal controls report be made public, as suggested by one commenter.[295] This alternative could improve the quality of credit ratings by providing additional information to issuers, subscribers, investors, and other users of credit ratings to assess the quality of an NRSRO's internal control structure and, thereby, promote the NRSROs' accountability to the market and the issuance of quality credit ratings by the NRSRO. However, as stated above, publicly disclosing the internal controls reports could cause NRSROs to be less detailed and candid. This could diminish the utility of the reports as a means for the Commission to monitor compliance with the requirements of section 15E(c)(3)(A) of the Exchange Act and for the boards of the NRSROs to meet their obligations under section 15E(t)(3)(C) of the Exchange Act to ''oversee'' the ''effectiveness of the internal control system with respect to the policies and procedures for determining credit ratings.''

Third, the Commission could require that the internal controls report be audited by a third party, as suggested by a commenter.[296] As stated above, the final amendment does not require that the internal controls report be made public. Consequently, the report is not a public document that will be relied upon by investors and other users of credit ratings. Rather, it is a non-public report that will be used by Commission examiners. The Commission has taken these factors into consideration in balancing the benefits of having the internal controls report audited by a third party and the costs of such a requirement. The Commission examines each of the ten NRSROs currently

[290] 44 U.S.C. 3501 *et seq.*

[291] *See* section V.A. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[292] *See* section V.A. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.4. of this release.

[293] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[294] *See* 15 U.S.C. 78o–7(c)(3)(A).

[295] *See CII Letter.*

[296] *See Levin Letter.*

registered with the Commission annually. At this time, the Commission believes that the annual examinations by the Commission staff will provide a sufficient means for reviewing the accuracy of the internal controls reports filed by the NRSROs.

B. Sales and Marketing Conflict of Interest

Section 932(a)(4) of the Dodd-Frank Act added paragraph (3) to section 15E(h) of the Exchange Act.[297] Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO.[298] Section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission's rules shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.[299] Section 15E(h)(3)(B)(ii) of the Exchange Act requires that the Commission's rules shall provide for the suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that: (1) The NRSRO has committed a violation of a rule issued under section 15E(h) of the Exchange Act; and (2) the violation affected a rating.[300]

The Commission proposed to implement sections 15E(h)(3)(A), 15E(h)(3)(B)(i), and 15E(h)(3)(B)(ii) of the Exchange Act by amending the NRSRO conflict of interest rule (Rule 17g–5).[301] The proposal would amend Rule 17g–5 by: (1) Identifying a new prohibited conflict in paragraph (c) of the rule relating to sales and marketing activities; (2) adding paragraph (f) to the rule to set forth the finding the Commission would need to make in order to grant a small NRSRO an exemption from the prohibition; and (3) adding paragraph (g) to the rule to set forth the standard for suspending or revoking an NRSRO's registration for violating a rule adopted under section 15E(h) of the Exchange Act.[302]

1. New Prohibited Conflict

Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO.[303] The Commission proposed to implement this provision by identifying a new conflict of interest in paragraph (c) of Rule 17g–5.[304] Paragraph (c) prohibits an NRSRO and a person within an NRSRO from having a conflict of interest identified in the paragraph under all circumstances (an ''absolute prohibition'').[305] As proposed, paragraph (c)(8) of Rule 17g–5 would identify an additional absolute prohibition: Issuing or maintaining a credit rating where a person within the NRSRO who participates in sales or marketing of a product or service of the NRSRO or a product or service of a person associated with the NRSRO also participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative or quantitative models.[306] In effect, this would prohibit persons who participate in sales and marketing activities from participating in determining or monitoring credit ratings or developing or approving rating procedures or methodologies.

Several commenters suggested that the requirements in the proposed amendment should be stronger.[307] Commenters raised concerns that the amendment as proposed would not prohibit managers from seeking to inappropriately influence credit analysts and the personnel who develop and approve rating procedures and methodologies.[308] For example, one commenter stated that the proposal could ''be strengthened by barring NRSRO management from taking negative actions against analysts due to client complaints seeking better ratings, more lenient treatment of their products, or relief from providing information about a product being rated'' and that such actions ''inevitably lead to inaccurate and inflated ratings.'' [309] A second commenter stated that the requirement needs to apply ''more broadly to any action by any rating agency employee that has the intent or effect of allowing sales and marketing considerations, including concern over building market share, to inappropriately influence the rating process or undermine ratings accuracy.'' [310] The commenter stated that this was necessary to address practices such as ''basing analysts' performance evaluations or compensation on their success in building market share, allowing investment bankers to influence the selection of analysts involved in rating their deals, and delaying revisions to rating models because of concerns about their impact on market share.'' [311] A third commenter stated that motivations by management to increase profits and market share can lead to top-down policies and practices that emphasize higher credit ratings over improved accuracy and reliability.[312]

Other commenters suggested that the proposed requirement be less restrictive.[313] These commenters recommended, among other things, that the proposed amendment require procedures to manage the conflict,[314] or apply only when sales and marketing considerations ''influenced'' the production of the credit rating.[315]

[297] *See* Public Law 111–203, 932(a)(4); 15 U.S.C. 78o–7(h)(3).

[298] 15 U.S.C. 78o–7(h)(3)(A).

[299] 15 U.S.C. 78o–7(h)(3)(B)(i).

[300] 15 U.S.C. 78o–7(h)(3)(B)(ii).

[301] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33425–33429. *See also* 17 CFR 240.17g–5. The Commission adopted and subsequently amended Rule 17g–5 pursuant, in part, to authority in section 15E(h)(2) of the Exchange Act (15 U.S.C. 78o–7(h)(2)). *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33595–33599 (June 18, 2007); *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6465–6469 (Feb. 9, 2009); *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63842–63850 (Dec. 4, 2009).

[302] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33425–33429.

[303] 15 U.S.C. 78o–7(h)(3)(A).

[304] *See* paragraph (c)(8) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33426.

[305] *See* 17 CFR 240.17g–5(c)(1) through (7). These absolute prohibitions are distinguished from the types of conflicts identified in paragraph (b) of Rule 17g–5, which are prohibited *unless* the NRSRO has taken the steps to address them as set forth in paragraph (a) of Rule 17g–5. *See* 17 CFR 240.17g–5(a) and (b). *See also* 17 CFR 240.17g–5(d) (defining the term *person within an NRSRO* to mean an NRSRO, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the NRSRO or its credit rating affiliates (or any person occupying a similar status or performing similar functions)).

[306] *See* paragraph (c)(8) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[307] *See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Levin Letter. See also CFA II Letter* (stating that the rule should be re-proposed).

[308] *See, e.g., AFR II Letter; CFA II Letter; Levin Letter.*

[309] *See Levin Letter.*

[310] *See CFA/AFR Letter.*

[311] *See CFA/AFR Letter.*

[312] *See CFA II Letter.*

[313] *A.M. Best Letter; S&P Letter; TradeMetrics Letter.*

[314] *See S&P Letter; TradeMetrics Letter.*

[315] *See A.M. Best Letter.* This commenter suggested that if the Commission modified the proposed amendment to require ''influence,'' the Commission could, among other things, require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to prevent sales and marketing considerations of an NRSRO from influencing the production of credit ratings and specify that those procedures contain language providing that any

Continued

After considering these comments, the Commission is revising the rule text to incorporate into the rule language that is both consistent with the statutory language and with the requirement in paragraph (a)(1)(iii) of Rule 17g–7 [316] (discussed in section II.G.4. of the release), which would address sources of influence with respect to sales and marketing considerations in addition to persons involved in sales and marketing activities. Accordingly, the final amendment modifies the proposal to provide that an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[317]

Under the first prong of the final amendment, an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO.[318] As with the proposal, this prong of the absolute prohibition is designed to address situations in which, for example, individuals within the NRSRO who engage in activities to sell products and services (both ratings-related and non-ratings-related) of the NRSRO or its affiliates could seek to influence a specific credit rating to favor an existing or prospective client or the development of a credit rating procedure or methodology to favor a class of existing or prospective clients. In practice, the Commission believes the amendment will require an NRSRO to prohibit personnel that have any role in the determination of credit ratings or the development or modification of rating procedures or methodologies from having any role in sales and marketing activities. It also will require an NRSRO to prohibit personnel that have any role in sales and marketing activities from having any role in the determination of credit ratings or the development or modification of rating procedures or methodologies. Consequently, these functions will need to be separate.

Commenters suggested that the proposed requirement be less restrictive.[319] These commenters recommended, among other things, that the proposed amendment require procedures to manage the conflict,[320] or apply only when sales and marketing considerations ''influenced'' the production of the credit rating.[321] In response, the Commission notes that section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to *prevent* the sales and marketing considerations of an NRSRO from influencing the production of ratings by the NRSRO.[322] Moreover, section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission's rules under section 15E(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the *separation* of the production of credit ratings and sales and marketing activities is not appropriate.[323] The Commission therefore believes that it is a reasonable interpretation of the statute to adopt a rule that requires the separation of the two functions. As stated above, in practice, the final amendment will require an NRSRO to prohibit the personnel that have any role in sales and marketing activities from having any role in the determination of credit ratings or the development or modification of rating procedures and methodologies. In addition, this approach establishes a particularly strong measure to address the sales and marketing conflict because, as discussed above, the final amendment establishes an absolute prohibition. Moreover, depending on the facts and circumstances, it would also violate the first prong of the rule as amended for an individual who participates in sales and marketing activities to seek to influence the determination of a credit rating or the rating procedures and methodologies used to determine a credit rating, even if the individual's conduct did not influence the credit rating or rating procedures or methodologies.

Further, Commission staff found as part of the examination of the activities of the three largest NRSROs in rating RMBS and CDOs linked to subprime mortgages that it appeared ''employees responsible for obtaining ratings business would notify other employees, including those responsible for criteria development, about business concerns they had related to the criteria.'' [324] As the Commission stated in the proposing release, the absolute prohibition was designed to insulate individuals within the NRSRO responsible for the analytic function from such sales and marketing concerns and pressures.[325]

The Commission shares the concerns raised by commenters about the potential inappropriate influence that managers may have over employees involved in the determination of credit ratings or the development or modification of rating procedures and methodologies.[326] In response, the Commission notes that a manager who participates in sales and marketing activities and who seeks to influence a credit rating or the rating procedures and methodologies used to determine the credit rating would be ''participating'' in determining or monitoring the credit rating or in developing or approving the rating procedures or methodologies used to determine the credit rating under paragraph (a)(8) of Rule 17g–5, as adopted.[327] Consequently, depending

communications between sales and marketing personnel and ratings personnel are subject to the broader recordkeeping requirements of Rule 17g–2.

[316] As discussed below in section II.G.4. of this release, paragraph (a)(1)(iii) of Rule 17g–7 provides that an NRSRO must attach to the form to accompany certain credit rating actions a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument. Sales and marketing are subparts of ''business activities'' and including it in paragraph (c)(8) of Rule 17g–5 is a relevant conforming change.

[317] *Id.*

[318] *See* paragraph (c)(8)(i) of Rule 17g–5.

[319] *A.M. Best Letter; S&P Letter; TradeMetrics Letter.*

[320] *See S&P Letter; TradeMetrics Letter.*

[321] *See A.M. Best Letter.*

[322] *See* 15 U.S.C. 78o–7(h)(3)(A) (emphasis added).

[323] *See* 15 U.S.C. 78o–7(h)(3)(B)(i) (emphasis added).

[324] *See Summary Report of Issues Identified in the Commission Staff's Examination of Select Credit Rating Agencies,* pp. 25–26. Commenters pointed to other sources to argue that the proposal should be stronger. *See, e.g., CFA/AFR Letter; CFA II Letter.*

[325] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33426.

[326] *See, e.g.,* CFA II Letter.

[327] One commenter suggested that management ''would not likely fall under the Commission's definition of 'participants' in either sales or marketing activities.'' *See CFA II Letter.* In response, the Commission notes that, as discussed above, a person within an NRSRO—including a manager—would participate in sales and marketing activities if, for example: the individual contacted a company that was about to issue debt and solicited the business of rating the issuance or met with company officials for business development purposes (for example, to ''pitch'' the NRSRO's services); the individual contacted an institutional investor and offered subscriptions to the NRSRO's credit ratings or credit analyses; or the individual

on the facts and circumstances, the rule as amended would be violated if it was established that an NRSRO issued or maintained a credit rating in a case in which managers involved in sales and marketing activities pressured or otherwise offered incentives to analysts working on the credit rating to take commercial concerns into account in determining the credit rating. Similarly, depending on the facts and circumstances, it would violate the rule as amended for an NRSRO to issue or maintain a credit rating that managers involved in sales and marketing activities sought to influence by pressuring or offering incentives to personnel who developed or approved the rating procedures or methodologies used to determine the credit rating to take commercial concerns into account in developing or approving the procedures or methodologies. Moreover, depending on the facts and circumstances, because the rule is an absolute prohibition, this conduct would violate the rule, even if a manager did not successfully influence any credit rating or the rating procedures or methodologies used to determine the credit rating.

Commenters stated that the requirements of proposed paragraph (c)(8) of Rule 17g–5 are ambiguous and requested that the Commission clarify various aspects of the proposal.[328] Five commenters raised concerns as to what it means to participate in sales and marketing activities under the proposed rule.[329] Four of those commenters requested that the Commission provide additional guidance on this question.[330] On the other hand, an NRSRO suggested that the Commission should not provide additional guidance and should allow the NRSRO to define *participate*.[331] Similarly, five commenters (including NRSROs) requested the Commission clarify what constitutes a sales and marketing activity,[332] while an NRSRO suggested that the Commission not provide additional guidance and allow the NRSRO to determine what constitutes a sales and marketing activity.[333] One NRSRO stated that the rule should not contain definitions that ''compel large size'' by mandating, explicitly or implicitly, minimum numbers of employees or layers of management.[334]

In response to these comments requesting clarification of terms used in the amendment, the Commission notes that sales and marketing activities involve efforts by an NRSRO to sell or in any manner market its products and services to prospective customers.[335] Participating in sales and marketing activities would clearly include certain actions. For example, a person within an NRSRO would participate in a sales and marketing activity if: (1) The individual contacted a company that was about to issue debt and solicited the business of rating the issuance or met with company officials for business development purposes (for example, to ''pitch'' the NRSRO's services); (2) the individual contacted an institutional investor and offered subscriptions to the NRSRO's credit ratings or credit analyses; (3) the individual was contacted by an issuer about the cost of rating its issuance or by an institutional investor about the cost of a subscription to the NRSRO's credit ratings or analyses and the individual provided information about these costs.

The Commission recognizes that certain scenarios posed by commenters may not be as clear-cut as these examples in terms of whether the activities would be considered participating in sales and marketing activities; each scenario will have to be evaluated based on the particular facts and circumstances.[336] For example, if rating personnel engage in analytical discussions with persons outside the NRSRO, including with obligors and issuers who purchase credit rating services from the NRSRO or with investors and others who purchase subscriptions to the NRSRO's credit ratings, that would not constitute participating in a sales and marketing activity as long as the discussions do not involve commercial matters related to selling or marketing the NRSRO's services; however, if the discussions with ratings analysts involved such commercial matters, the analysts may be considered to be participating in sales and marketing activities.[337] Similarly, if an issuer agrees to have only one meeting with an NRSRO to discuss both analytical matters relating to, and fees for, obtaining credit ratings for the securities it issues, the NRSRO could bring a team of analysts and a team of sales and marketing personnel to the meeting.[338] If the sales and marketing team does not attend the portion of the meeting in which analytical matters are discussed, they would not have participated in the determination of a credit rating. Similarly, if the analytical team does not attend the portion of the meeting in which commercial matters are discussed, they would not have participated in a sales and marketing activity. Further, an analyst would not necessarily participate in a sales or marketing activity if the analyst gives a presentation at a conference attended by persons who could be prospective purchasers of the NRSRO's services.[339] For example, the analyst would generally not be considered to be participating in a sales or marketing activity if the presentation avoided marketing the services offered by the NRSRO and focused solely on topics involving credit analysis (for example, the analytical process used by the NRSRO to determine credit ratings, an analysis of the creditworthiness of one or more obligors or issuers, or a credit forecast for a particular industry sector).[340] Similarly, the analyst would not participate in a sales or marketing activity if the analyst gave this type of presentation in the context of an interview with a news outlet. In each case, the determination whether the analytical team is participating in sales and marketing activity would turn on the facts and circumstances.

As noted above, the first prong of the absolute prohibition requires an NRSRO to separate its analytical functions from its sales and marketing functions. While

was contacted by an issuer about the cost of rating its issuance or by an institutional investor about the cost of a subscription to the NRSRO's credit ratings or analyses and the individual provided information about these costs.

[328] *See A.M. Best Letter; COPERA Letter; DBRS Letter; Kroll Letter; Moody's Letter; TradeMetrics Letter.*

[329] *See DBRS Letter; Kroll Letter; Kroll II Letter; Moody's Letter; S&P Letter; TradeMetrics Letter.*

[330] *See DBRS Letter; Kroll Letter; Kroll II Letter; Moody's Letter; TradeMetrics Letter.*

[331] *See S&P Letter.*

[332] *See A.M. Best Letter; COPERA Letter; Kroll Letter; Moody's Letter; TradeMetrics Letter.* For example, commenters argued that that, without clarification of these terms, the scope of the amendment could be applied too broadly. *See A.M. Best Letter; Kroll Letter.*

[333] *See S&P Letter.*

[334] *See Kroll Letter.*

[335] The examples of what it means to *participate* in *sales and marketing* activities discussed in this section of the release are intended to assist NRSROs in understanding those terms as they are used in paragraph (c)(8) of Rule 17g–5.

[336] *See A.M. Best Letter; DBRS Letter; Moody's Letter.*

[337] *See Moody's Letter.*

[338] *See DBRS Letter.*

[339] *See A.M. Best Letter.*

[340] As discussed throughout this release, one of the objectives of the amendments and new rules being adopted today is to increase the transparency of the credit rating activities of NRSROs to promote competition among NRSROs on the basis of the quality of the credit ratings they produce and the procedures and methodologies they use to determine credit ratings. The persons within an NRSRO responsible for determining credit ratings and developing the procedures and methodologies used to determine credit ratings can promote this transparency, given their responsibilities and expertise. Consequently, the Commission does not intend the new absolute prohibition in paragraph (c)(8) of Rule 17g–5 to constrain them from helping market participants better understand the quality of an NRSRO's credit ratings and procedures and methodologies an NRSRO uses to determine credit ratings.

this is a strong measure to address the sales and marketing conflict, the Commission also believes that it is appropriate to revise the rule text to incorporate language about persons participating in production of a credit rating being ''influenced'' by sales and marketing considerations.[341] Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from *influencing* the production of credit ratings by the NRSRO.[342] Given the concerns raised by commenters, this statutory language, the language in section 15E(q)(2)(F) of the Exchange Act,[343] and Rule 17 g–7, the Commission is modifying the proposal to add a second prong to the absolute prohibition. Under the second prong, an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also is influenced by sales or marketing considerations.[344] Thus, this prong of the absolute prohibition is consistent with the provision of Rule 17g–7 that specifically requires a statement that no part of the rating was ''influenced'' by business activities.

In connection with making the evaluation necessary for the second prong of the absolute prohibition, the Commission believes there are a number of possible channels of influence that should be considered, such as compensation arrangements that may incentivize analysts to produce inflated credit ratings to increase or retain the NRSRO's market share, performance evaluation systems that reward analysts who produce inflated credit ratings to increase or retain the NRSRO's market share, compliance personnel who unduly influence credit analysts to inflate credit ratings in response to complaints by clients, clients such as rated entities who pressure analysts to produce inflated credit ratings to retain their business, or managers who are not involved in sales and marketing activities but may seek to pressure analysts to produce inflated credit ratings to increase or retain the NRSRO's market share.

In addition, the Commission notes that the sales and marketing prohibition is being added to a comprehensive set of existing requirements that address NRSRO conflicts and, as discussed below, the Commission is adopting additional measures to address conflicts.[345] Consequently, the sales and marketing prohibition should not be viewed in isolation but rather as part of a set of requirements (both statutory and regulatory) pursuant to which NRSROs must disclose and manage conflicts of interest and, in some cases, avoid them altogether. For example, paragraph (b)(1) of Rule 17g–5 identifies the conflict of being paid by issuers or underwriters to determine credit ratings (the issuer-pay conflict), and under paragraph (a)(2) of Rule 17g–5 and section 15E(h)(1) of the Exchange Act, an NRSRO with this conflict must establish, maintain and enforce written policies and procedures reasonably designed to address and manage the conflict.[346] An NRSRO that permits a corporate culture in which managers seek to inappropriately influence analysts and the personnel who develop and approve rating procedures and methodologies could not be viewed as having or enforcing policies and procedures reasonably designed to address the issuer-pay conflict and, consequently, this type of conduct would violate section 15E(h)(1) of the Exchange Act and Rule 17g–5.

Further, as discussed below in section II.G.4. of this release, the Commission is adopting a requirement that an NRSRO must attach to the form to accompany certain credit rating actions a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) No part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.[347] If any of these requirements are not satisfied, such person would not be able to truthfully make this attestation.

The Commission made another modification to the proposal in response to a comment suggesting that the text of the amendment be revised to reference the ''products or services of the NRSRO's affiliated entities'' in place of the proposed reference to a ''product or service of a person associated with the [NRSRO].''[348] A ''person associated'' with the NRSRO includes natural persons.[349] The commenter stated that, as proposed, the amendment could preclude a natural person from participating in the credit rating process ''if he or she operates a completely different business (such as a photography studio on the side).''[350] This would be an overly broad application of the amendment, as it is designed to prevent sales and marketing of products and services of the NRSRO or its affiliated companies from influencing the credit rating process. Consequently, the final amendment has been modified from the proposal to apply to products and services of the affiliates of the NRSRO (rather than persons associated with the NRSRO).[351] However, the Commission notes that outside businesses of employees can raise potential conflicts.[352] Consequently, pursuant to section 15E(h)(1) of the Exchange Act and Rule 17g–5, an NRSRO must have policies, procedures, and controls to address employees engaging in outside businesses if the NRSRO permits employees to operate outside businesses.[353]

Two commenters stated that paragraph (c)(8) of Rule 17g–5 may be redundant, given the existing absolute prohibition in paragraph (c)(6) of Rule 17g–5.[354] In response, the Commission

[341] *See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Levin Letter. See also CFA II Letter* (stating that the rule should be re-proposed).

[342] 15 U.S.C. 78o–7(h)(3)(A) (emphasis added). *See also* section 15E(q)(2)(F).

[343] Section 15(E)(q)(2)(F) provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was *influenced* by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument). ''Sales'' and ''marketing'' are a subparts of ''business activities.''

[344] *See* paragraph (c)(8)(ii) of Rule 17g–5.

[345] *See* 15 U.S.C. 78o–7(h); 17 CFR 240.17g–5.

[346] *See* 15 U.S.C. 78o–7(h); 17 CFR 240.17g–5.

[347] *See* paragraph (a)(1)(iii) of Rule 17g–7.

[348] *See DBRS Letter.*

[349] *See* 15 U.S.C. 78c(a)(63).

[350] *See DBRS Letter.*

[351] *See* paragraph (c)(8) of Rule 17g–5.

[352] For example, an analyst operating an outside business could seek to solicit business from persons employed by an obligor that the analyst rates or an issuer of securities the analyst rates.

[353] *See* 15 U.S.C. 78o–7(h)(1) (requiring each NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of the NRSRO and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business); 17 CFR 240.17g–5 (prohibiting NRSROs from having conflicts of interest unless they disclose and manage the conflicts or, in some cases, absolutely prohibiting the conflict).

[354] *See DBRS Letter; Kroll Letter.* Under paragraph (c)(6) of Rule 17g–5, an NRSRO is prohibited from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving

believes it is appropriate to retain paragraph (c)(6) because it complements paragraph (c)(8) of Rule 17g–5, as adopted. In particular, paragraph (c)(6) of Rule 17g–5 addresses the conflict that arises when persons within an NRSRO involved in determining credit ratings or developing or approving rating methodologies also negotiate, discuss, or arrange the fees paid for determining credit ratings.[355] Thus, it focuses on preventing persons within the NRSRO responsible for credit analysis from being influenced by business considerations (for example, issuing ratings favorable to a client with whom they negotiated a substantial fee). Paragraph (c)(8) of Rule 17g–5, as adopted, addresses the conflict that arises when persons within an NRSRO involved in sales and marketing activities also participate in determining credit ratings or developing or approving rating procedures and methodologies. Thus, it focuses on preventing the persons within the NRSRO responsible for generating business for the NRSRO from influencing the work of the persons responsible for credit analysis (for example, pressuring them to develop rating procedures and methodologies that favor the NRSRO's clients or prospective clients).

Finally, several commenters stated that the proposed amendment would negatively impact smaller NRSROs.[356] As discussed below, the final amendments to Rule 17g–5 provide a mechanism for small NRSROs to apply for an exemption from the absolute prohibition.[357] Under the final amendment, the Commission may grant an exemption if it finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[358]

For all of the reasons discussed above, the Commission is adopting the amendment with the modifications discussed above. Moreover, for those reasons, the Commission is not persuaded that it is necessary to re-propose the rule as suggested by one commenter.[359] However, the Commission may consider further rulemaking to address conflicts of interest inherent in the NRSRO industry as appropriate and as circumstances warrant.

2. Exemption for ''Small'' NRSROs

Section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission's rules under section 15E(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.[360] To implement this provision, the Commission proposed to amend Rule 17g–5 by adding paragraph (f).[361] As proposed, paragraph (f) would provide a mechanism for a small NRSRO to apply in writing for an exemption from the absolute prohibition that would be established by adding paragraph (c)(8) to Rule 17g–5.[362] In particular, the proposed amendment provided that upon written application by an NRSRO, the Commission may exempt, either conditionally or unconditionally or on specified terms and conditions, such NRSRO from the provisions of paragraph (c)(8) of Rule 17g–5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[363]

The Commission stated in the proposing release that in some cases the small size of an NRSRO could make a complete separation of the sales and marketing function from the credit rating analytical function inappropriate.[364] For example, the NRSRO may not have enough staff (or the resources to hire additional staff) to establish separate functions.[365] In this case, the Commission stated that it would entertain requests for relief, although it may impose conditions designed to preserve as much of the separation between these two functions as possible.[366]

The Commission is adding paragraph (f) to Rule 17g–5 substantially as proposed, but with a technical modification to the rule text in response to comments.[367] In particular, the final amendment provides that, upon written application by an NRSRO, the Commission may exempt, either unconditionally or on specified terms and conditions, such NRSRO from the provisions of paragraph (c)(8) of Rule 17g–5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[368]

Several commenters expressed support for the objective of the proposed amendment.[369] Supporters argued that it could be difficult for smaller NRSROs to maintain the strict separation of sales and marketing activities from the production of credit ratings, as would be required under paragraph (c)(8) of Rule 17g–5, as proposed.[370] In contrast, several commenters expressed concerns with the proposed amendment, generally arguing that the proposed amendment should be narrowed or eliminated altogether because the size of an NRSRO does not affect whether the potential conflict could influence a

procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.

[355] *See Summary Report of Issues Identified in the Commission Staff's Examination of Select Credit Rating Agencies,* p. 25 (''there were indications that analysts were involved in fee discussions with employees of the rating agency's billing department'').

[356] *See A.M. Best Letter; Kroll Letter.*

[357] *See* paragraph (f) of Rule 17g–5.

[358] *Id.*

[359] *See CFA II Letter* (recommending that the Commission re-propose the rule).

[360] *See* 15 U.S.C. 78o–7(h)(3)(B)(i).

[361] *See* paragraph (f) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33426–33427.

[362] *See* paragraph (f) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540. Section 36 of the Exchange Act provides that the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. 17 U.S.C. 78mm. Consequently, an NRSRO could request to be exempt from the sales and marketing prohibition pursuant to this more general authority in section 36. The Commission has established rules providing mechanisms for registrants—such as broker-dealers—to request an exemption from specific rule requirements. *See, e.g.,* 17 CFR 240.15c3–1(b)(3); 17 CFR 240.15c3–3(k)(3); 17 CFR 240.17a–5(m)(3). The proposed amendment was modeled after these provisions. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[363] *See* paragraph (f) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[364] *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33427.

[365] *Id.*

[366] *Id.*

[367] *See* paragraph (f) of Rule 17g–5. The Commission is modifying the proposal to remove redundant text, as suggested by a commenter. *See DBRS Letter.* The Commission originally proposed that ''[u]pon written application by a [NRSRO], the Commission may exempt, either conditionally or unconditionally or on specified terms and conditions, such [NRSRO] from the provisions of paragraph (c)(8) of [Rule 17g–5].'' The modification removes the phrase ''conditionally or'' as it is redundant of the phrase ''on specified terms and conditions.'' *See* paragraph (f) of Rule 17g–5.

[368] *See* paragraph (f) of Rule 17g–5.

[369] *See A.M. Best Letter; CFA/AFR Letter; DBRS Letter; Kroll Letter; Morningstar Letter; TradeMetrics Letter.*

[370] *See CFA/AFR Letter; TradeMetrics Letter.*

credit rating.[371] For example, one of these commenters stated that ''if a credit rating agency is too small to separate its rating process from its marketing process, it should not qualify as an NRSRO.''[372]

In response to concerns about providing for exemptions for small NRSROs, the Commission notes that section 15E(h)(3)(B)(i) of the Exchange Act provides that the Commission's rules issued under section 15E(h)(3)(A) *shall* provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.[373] The final amendment implements this statutory requirement but in a manner that will require the Commission to make a specific finding before granting an exemption; namely, that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[374]

The Commission considered the concerns expressed by commenters about granting any relief to small NRSROs in considering whether to adopt a self-executing exemption, which was suggested by a commenter.[375] Under the final amendment, exemptions will be granted on a case-by-case basis, after analyzing the facts and circumstances the applying NRSRO presents in its request for relief and any other relevant facts and circumstances. Any exemptive relief granted can be tailored to the specific circumstances of the NRSRO and can include specific terms and conditions designed to mitigate the sales and marketing conflict and help ensure that any relief that may be provided to a small NRSRO does not undermine the overarching purpose of section of 15E(h)(3)(A) of the Exchange Act. The ability to tailor exemptive relief on a case-by-case basis will allow the Commission the flexibility to specify conditions that address the conflict in a way that takes into account the specific circumstances of the NRSRO requesting the relief (including its size, business model, and the steps it has taken to mitigate sales and marketing conflicts). For these reasons, the Commission does not believe it would be appropriate to establish a self-executing exemption.

Commenters addressed various aspects of potential exemption orders the Commission might grant under the proposed amendment. For example, several NRSROs commented on how the Commission should determine ''small'' for purposes of granting exemptions.[376] Two commenters stated that all NRSROs that are smaller than the three largest NRSROs should be considered small.[377] Three commenters suggested that annual revenue should be the metric for determining if an NRSRO is small.[378] Two commenters stated that the Commission should make the size determination on a case-by-case basis,[379] while one commenter suggested a self-executing exemption under which an NRSRO would be automatically exempt if its total revenue falls below a certain threshold.[380] On the other hand, one opponent of the proposal stated that revenue is not an appropriate measure for granting an exemption and suggested, if the Commission proceeds with an exemption, that it be based on other metrics.[381]

Commenters also addressed the duration of an exemption.[382] One supporter of granting exemptions under the proposal suggested that the Commission periodically re-evaluate whether the NRSRO continued to be small and provide it with a transition period in the event the Commission determines it is no longer small.[383] Another commenter, opposing the proposal, suggested that if the Commission does grant an exemption, it should be very limited, and that if the Commission later determines the NRSRO is not small, it should have only a short transition period.[384] This commenter added that an exempted NRSRO should have to publicly disclose the rules from which it is exempt.[385]

Several commenters addressed the conditions that should be part of an exemption order under the proposal.[386] Some stated that even if an NRSRO is exempt, the amendments to Rule 17g–5 should make clear that NRSROs remain subject to the overarching prohibition against allowing sales and marketing considerations to influence credit ratings.[387] Two commenters suggested that any exemption should be contingent upon the NRSRO adhering to certain requirements.[388] Another commenter suggested that any NRSRO that is granted an exemption under the proposal should be required to indicate on the homepage of its Web site that it is a recipient of the exemption.[389] One commenter that opposed the proposed exemption identified additional conditions the Commission should consider if it adopts the proposal.[390]

In making its finding for purposes of determining whether to grant an exemption, the Commission will evaluate the particular facts and circumstances of the application. In addition, the Commission may specify conditions designed to mitigate the sales and marketing conflict without imposing an absolute prohibition. Although the Commission is not modifying the exemption process from the proposal, suggestions by commenters may be helpful to the Commission in undertaking the analysis of whether a particular NRSRO should be considered ''small'' and in considering how to tailor the exemptive relief to mitigate the sales and marketing conflict.

3. Suspending or Revoking a Registration

Section 15E(h)(3)(B)(ii) of the Exchange Act provides that the Commission's rules under section 15E(h) of the Exchange Act shall provide for suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that the NRSRO has committed a violation of ''a rule issued under this

[371] *See AFSCME Letter; Barnard Letter; Better Markets Letter; Levin Letter; S&P Letter.*

[372] *See Levin Letter.*

[373] *See* 15 U.S.C. 78o–7(h)(3)(B)(i) (emphasis added).

[374] *See* paragraph (f) of Rule 17g–5.

[375] *See Kroll Letter.*

[376] *See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter; S&P Letter.*

[377] *See A.M. Best Letter; Morningstar Letter* (requesting that the Commission consider defining smaller NRSROs as it did in the proposing release for purposes of the Regulatory Flexibility Act).

[378] *See A.M. Best Letter* (suggesting a $250 million revenue threshold); *Kroll Letter* (suggesting a $100 million revenue threshold); *Morningstar Letter.*

[379] *See A.M. Best Letter; DBRS Letter.*

[380] *See Kroll Letter.*

[381] *See S&P Letter* (''Other metrics, such as the number of personnel, or number of ratings issued in a practice area, may provide a more meaningful metric for the granting of any exemption'').

[382] *See Morningstar Letter; S&P Letter.*

[383] *See Morningstar Letter.*

[384] *See S&P Letter.*

[385] *Id.*

[386] *See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Fitch Letter; S&P Letter.*

[387] *See Better Markets Letter; CFA/AFR Letter.*

[388] *See AFSCME Letter* (suggesting that the NRSRO should submit a detailed explanation of why it should be exempt and ''concrete evidence, not just assertions'' to support its claims that it cannot function under the requirement); *CFA/AFR Letter* (suggesting that the application should include a section on what steps the NRSRO is taking to ensure sales and marketing considerations do not influence rating decisions).

[389] *See Fitch Letter.*

[390] *See S&P Letter* (suggesting that the Commission should ''specify the terms of the activities permitted and require that the NRSRO have policies to address the potential conflict, that the policies be transparent, and that compliance of the policies be well documented.'').

subsection'' and the violation of the rule affected a credit rating.[391] While section 15E(h)(3)(A) relates only to the conflict arising from sales and marketing activities, section 15E(h)(3)(B)(ii)—by using the term ''subsection''—has a broader scope in that it refers to all rules issued under section 15E(h) of the Exchange Act. Consequently, the proposed amendment implementing section 15E(h)(3)(B)(ii) addressed violations of any rule adopted under section 15E(h). Section 15E(h)(3)(B)(ii) does not require that the violation of the rule under section 15E(h) be ''willful.''

Currently, the Commission can seek to suspend or revoke the registration of an NRSRO, in addition to other potential sanctions, under section 15E(d) of the Exchange Act.[392] In particular, section 15E(d) provides that the Commission shall, by order, censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of an NRSRO if the Commission finds, ''on the record after notice and opportunity for a hearing,'' that such sanction is ''necessary for the protection of investors and in the public interest'' and the NRSRO, or a person associated with the NRSRO (whether prior to or subsequent to becoming so associated), has engaged in one or more of six categories of conduct specified in sections 15E(d)(1)(A) through (F) of the Exchange Act.[393] Section 15E(d)(1)(A) specifies the first category of conduct: That the NRSRO or an associated person has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Exchange Act; has been convicted of any offense identified in section 15(b)(4)(B) of the Exchange Act; or has been enjoined from any action, conduct, or practice identified in section 15(b)(4)(C) of the Exchange Act.[394] The acts enumerated in section 15(b)(4)(D) of the Exchange Act include that the person has willfully violated any provision of the Exchange Act or the rules or regulations under the Exchange Act.[395] Therefore, the Commission has the authority, if it makes the finding under section 15E(d)(1)(A), to suspend or revoke the registration of an NRSRO for a willful violation of Rule 17g–5, but does not have the authority to do so under section 15E(d)(1)(A) for violations of Rule 17g–5 that are not willful.[396]

In addition to proceedings under section 15E(d)(1) of the Exchange Act, the Commission can take action under section 15E(d)(2).[397] This section provides that the Commission may temporarily suspend or permanently revoke the registration of an NRSRO with respect to a particular class or subclass of securities, if the Commission finds, on the record after notice and opportunity for a hearing, that the NRSRO does not have adequate financial and managerial resources to consistently produce credit ratings with integrity.[398] Furthermore, section 21C of the Exchange Act provides the Commission with authority, among other things, to enter an order requiring, among other things, that a person cease and desist from continuing to violate, or future violations of, a provision of the Exchange Act or any rule or regulation thereunder.[399]

In the proposing release, the Commission stated its preliminary belief that a rule implementing section 15E(h)(3)(B)(ii) of the Exchange Act should work in conjunction with sections 15E(d) and 21C of the Exchange Act.[400] Consequently, the Commission proposed adding paragraph (g) to Rule 17g–5.[401] This paragraph provided that in a proceeding pursuant to section 15E(d) or section 21C of the Exchange Act, the Commission shall suspend or revoke the registration of an NRSRO if the Commission finds in such proceeding that the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act, the violation affected a credit rating, and that suspension or revocation is necessary for the protection of investors and in the public interest.[402] This provision was proposed to be placed in Rule 17g–5, given that it is the predominant rule issued under section 15E(h) of the Exchange Act.[403]

The first two findings in the proposed amendment mirrored the text of section 15E(h)(3)(B)(ii) of the Exchange Act.[404] The final finding—that the suspension or revocation is necessary for the protection of investors and in the public interest—is a common finding that the Commission must make to take disciplinary action against a registered person or entity.[405] It is not, however, a finding that the Commission must make in a proceeding under section 21C.[406] Further, unlike section 15E(d) of the Exchange Act, the Commission can take action under section 21C for violations of the securities laws even if the violations are not willful.[407] Moreover, section 15E(h)(3)(B)(ii) of the Exchange Act does not prescribe the maximum amount of time for which an NRSRO could be suspended, whereas section 15E(d) provides that a suspension shall not exceed twelve

[391] *See* 15 U.S.C. 78o–7(h)(3)(B)(ii).

[392] *See* 15 U.S.C. 78o–7(d).

[393] *See* 15 U.S.C. 78o–7(d)(1)(A) through (F).

[394] *See* 15 U.S.C. 78o–7(d)(1)(A); *see also* 15 U.S.C. 78o(b)(4)(A), (B), (C), (D), (E), (G), and (H). Section 15E(d)(1)(B) specifies the second category of conduct: that the NRSRO or an associated person has been convicted during the ten-year period preceding the date on which an application for registration is filed with the Commission, or at any time thereafter, of: (1) Any crime that is punishable by imprisonment for one or more years, and that is not described in section 15(b)(4)(B); or (2) a substantially equivalent crime by a foreign court of competent jurisdiction. *See* 15 U.S.C. 78o–7(d)(1)(B). Section 15E(d)(1)(C) specifies the third category of conduct: That the NRSRO or an associated person is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. *See* 15 U.S.C. 78o–7(d)(1)(C). Section 15E(d)(1)(D) specifies the fourth category of conduct: That the NRSRO or an associated person fails to file the annual certification required under section 15E(b)(2) of the Exchange Act. *See* 15 U.S.C. 78o–7(d)(1)(D). Section 15E(d)(1)(E) specifies the fifth category of conduct: That the NRSRO or an associated person fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity. *See* 15 U.S.C. 78o–7(d)(1)(E). Finally, section 15E(d)(1)(F) specifies the sixth category of conduct: That the NRSRO or an associated person has failed reasonably to supervise, with a view to preventing a violation of the securities laws, an individual who commits such a violation, if the individual is subject to the supervision of that person. *See* 15 U.S.C. 78o–7(d)(1)(F).

[395] *See* 15 U.S.C. 78o(b)(4)(D).

[396] *See* 15 U.S.C. 78o–7(d)(1)(A); 15 U.S.C. 78o(b)(4)(D).

[397] *See* 15 U.S.C. 78o–7(d)(2).

[398] *See* 15 U.S.C. 78o–7(d)(2)(A). Section 15E(d)(2)(B) provides that, in making any determination under section 15E(d)(2)(A), the Commission shall consider whether the NRSRO has failed over a sustained period of time, as determined by the Commission, to produce ratings that are accurate for that class or subclass of securities and such other factors as the Commission may determine. *See* 15 U.S.C. 78o–7(d)(2)(B).

[399] *See* 15 U.S.C. 78u–3.

[400] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33428. *See also* 15 U.S.C. 78o–7(d); 15 U.S.C. 78u–3.

[401] *See* paragraph (g) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33427–33428.

[402] *See* paragraph (g) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540. *See also* 15 U.S.C. 78o–7(d); 15 U.S.C. 78o–7(h); 15 U.S.C. 78u–3.

[403] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33428. *See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33595–33599; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6465–6469; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63842–63850.

[404] *See* paragraph (g) of Rule17g–5, as proposed; 15 U.S.C. 78o–7(h)(3)(B)(ii)(I) and (II).

[405] *See* paragraph (g) of Rule 17g–5, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540. For example, the Commission must make this finding to take action under section 15E(d) of the Exchange Act. *See* 15 U.S.C. 78o–7(d).

[406] *See* 15 U.S.C. 78u–3.

[407] *Compare* 15 U.S.C. 78o–7(d), *with* 15 U.S.C. 78u–3.

months.[408] Consequently, a proceeding pursuant to paragraph (g) of Rule 17g–5 brought under section 21C could result in a suspension that exceeds twelve months. Given that section 21C of the Exchange Act has a lower threshold for intent to establish a violation, and given the substantial consequences of suspending or revoking a registration, the Commission stated a preliminarily belief in the proposing release that the public interest finding would be an appropriate predicate to a suspension or revocation of an NRSRO's registration under section 21C of the Exchange Act.[409]

Two commenters addressed whether the Commission should adopt, pursuant to section 15E(h)(3)(B)(ii) of the Exchange Act, an independent and alternative process for suspending or revoking an NRSRO's registration beyond the processes set forth in sections 15E(d) and 21C of the Exchange Act.[410] Both commenters agreed with the Commission's proposal that the processes for suspension or revocation currently available under the Exchange Act are sufficient.[411] One commenter stated that section 15E(h)(3)(B)(iii) of the Exchange Act should work in conjunction with proceedings already available under sections 15E(d) and 21C of the Exchange Act.[412] Similarly, a second commenter stated that proceedings currently available under the Exchange Act are adequate and that no alternative process is necessary, but stated that if the Commission does implement a separate process, there should be certain prerequisites to its decision to suspend or revoke a registration.[413]

The Commission is persuaded that it is appropriate to adopt an amendment to Rule 17g–5 that incorporates the statutory provisions governing the suspension or revocation of an NRSRO's registration (rather than a stand-alone rule). Consequently, the Commission is incorporating the statutory provisions into paragraph (g) of Rule 17g–5, as proposed, but with modifications from the proposal.[414] Two commenters stated that the proposed rule should incorporate only section 15E(d) of the Exchange Act in response to the Commission's requests for comment on whether the amendment should incorporate section 15E(d) and section 21C.[415] One of these commenters added that the section 21C standard is ''too low and its consequences too high'' and is therefore inappropriate to use in considering suspension or revocation of an NRSRO's registration.[416] The other commenter stated that authority under section 15E(d) is ''adequate,'' making it unnecessary for the Commission to incorporate section 21C into the rule, and that not all of the provisions of section 21C are applicable to NRSROs.[417]

The Commission believes that it is not necessary to incorporate section 21C of the Exchange Act into the provision governing the suspension or revocation of an NRSRO's registration for violating a rule issued under section 15E(h) of the Exchange Act, but not for the reasons stated by the commenters. The Commission believes the rule can be modified in a way that achieves one objective of the proposal—providing for the suspension or revocation of the registration of an NRSRO for violations that are not willful—without incorporating section 21C. Instead, the rule can be modified from the proposal so that it includes a finding that the Commission must make in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F) of the Exchange Act. As discussed above, the finding specified in section 15E(d)(1)(A) is that the NRSRO or an associated person committed or omitted any act, or has been subject to an order or finding, enumerated in section 15(b)(4)(D) of the Exchange Act, among other sections.[418] The acts enumerated in section 15(b)(4)(D) of the Exchange Act include that the person has willfully violated any provision of the Exchange Act or the rules or regulations under the Exchange Act.[419] Therefore, the Commission has the authority, if it makes a finding under section 15E(d)(1)(A) of the Exchange Act, to suspend or revoke the registration of an NRSRO for a violation of Rule 17g–5, but only if the violation is willful.[420] The alternative finding does not require a finding that the violation was willful, and the Commission can therefore suspend or revoke the registration of an NRSRO using this alternative without a finding of willfulness and without the need to institute the proceeding under section 21C.

For these reasons, the Commission is modifying the rule from the proposal to establish a finding that must be made in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F).[421] In particular, paragraph (g) of Rule 17g–5, as adopted, provides that in a proceeding pursuant to section 15E(d)(1) of the Exchange Act, the Commission shall suspend or revoke the registration of an NRSRO if the Commission finds, in lieu of a finding required under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F) of the Exchange Act, that the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act (for example, Rule 17g–5) and that the violation affected a credit rating.[422]

The alternative finding includes the first two prongs of the proposed finding: (1) That the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act; and (2) that the violation affected a credit rating. As discussed above and in the proposing release, these two prongs of the finding mirror the text of section 15E(h)(3)(B)(ii) of the Exchange Act.[423] In addition, the alternative finding must be made in the context of a proceeding under section 15E(d)(1). Consequently, the Commission must find, ''on the record after notice and opportunity for a hearing,'' that suspension or revocation is ''necessary for the protection of investors and in the public interest.''[424] In this way, the alternative finding also incorporates the public interest finding that was part of the proposed finding, which the Commission continues to

[408] *Compare* 15 U.S.C. 78o–7(h)(3)(B)(ii), *with* 15 U.S.C. 78o–7(d).

[409] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33428.

[410] *See Morningstar Letter; S&P Letter.*

[411] *See Morningstar Letter; S&P Letter.*

[412] *See Morningstar Letter.*

[413] *See S&P Letter.*

[414] The Commission is making one technical modification to the proposal by adding the word ''credit'' before the word ''rating.'' *See* paragraph (g) of Rule 17g–5.

[415] *See A.M. Best Letter; S&P Letter.*

[416] *See A.M. Best Letter* (stating that the process under section 21C is inappropriate because it has no requirement of a public interest finding and provides no suspension limits).

[417] *See S&P Letter* (stating that certain provisions of section 21C are applicable to brokers, dealers, and investment advisors, among others, but not to NRSROs).

[418] *See* 15 U.S.C. 78o–7(d)(1)(A). *See also* 15 U.S.C. 78o(b)(4)(A), (B), (C), (D), (E), (G), and (H).

[419] *See* 15 U.S.C. 78o(b)(4)(D).

[420] *See* 15 U.S.C. 78o–7(d)(1)(A); 15 U.S.C. 78o(b)(4)(D).

[421] The Commission does not intend the final amendment to affect in any manner the Commission's ability to suspend or revoke the registration of an NRSRO under section 15E(d)(1) of the Exchange Act based upon a finding specified under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F).

[422] *See* paragraph (g) of Rule 17g–5.

[423] 15 U.S.C. 78o–7(h)(3)(B)(ii) (providing that the Commission's rules under section 15E(h) of the Exchange Act shall provide for suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that the NRSRO has committed a violation of ''a rule issued under this subsection'' and the violation of the rule affected a credit rating).

[424] 15 U.S. C. 78o–7(d).

believe is appropriate given the severity of the sanction of suspending or revoking an NRSRO's registration.[425]

The final amendment—because it incorporates section 15E(d) only—is different from the proposed amendment in that the Commission is limited to suspending a registration for a period not exceeding twelve months.[426] The Commission does not view this as a significant difference. To the extent the Commission believes a credit rating agency should stop operating as an NRSRO for a period longer than twelve months, the Commission can seek to revoke its registration.[427]

Finally, three commenters addressed the factual predicate necessary to support a finding that the violation affected a credit rating.[428] The commenters generally stated that a finding that a rule violation affected a credit rating is only part of the appropriate analysis and is not, by itself, enough to suspend or revoke an NRSRO's registration.[429] One commenter added that any suspension or revocation proceeding must ''take into account all relevant factors of the particular circumstance at issue.'' [430] The other two commenters recommended additional findings that should be considered in making a determination that a violation of a rule affected a credit rating.[431] In response, the Commission notes that to suspend or revoke an NRSRO's registration under section 15E(d)(1) of the Exchange Act the Commission must find, among other things, that doing so is necessary for the protection of investors and in the public interest.[432] This will entail consideration of the particular facts and circumstances of each case in crafting an appropriate remedy.

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments relating to the sales and marketing conflict of interest.[433] The baseline that existed before today's amendments was one in which an NRSRO was not explicitly prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations. However, section 15E(h)(1) of the Exchange Act and Rule 17g–5, thereunder, require NRSROs to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage any conflicts of interest that can arise from the business of the NRSRO.[434] In addition, paragraph (c)(6) of Rule 17g–5 prohibits an NRSRO from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models. Rule 17g–6 prohibits an NRSRO from engaging in certain unfair, coercive, or abusive practices such as conditioning the issuance of a credit rating on the purchase of other services or products of the NRSRO.[435]

Relative to this baseline, paragraph (c)(8) of Rule 17g–5, as amended, should result in benefits. For example, the amendment should decrease the probability that undue influences on credit analysts based on sales and marketing considerations could impact the objectivity of an NRSRO's credit rating process.[436] Certain academic studies suggest that NRSROs may have engaged in ''ratings catering'' in which an NRSRO will deliberately inflate a

[425] A number of commenters addressed whether the Commission should be required to make a public interest finding to suspend or revoke an NRSRO's registration in a proceeding under proposed paragraph (g) of Rule 17g–5 pursuant to section 21C of the Exchange Act. *See AFSCME Letter; A.M. Best Letter; Better Markets Letter; FSR Letter; Morningstar Letter; S&P Letter.* Four commenters supported the requirement. *See A.M. Best Letter; FSR Letter; Morningstar Letter; S&P Letter.* One commenter that supported this aspect of the proposal stated that a public interest finding is necessary ''to consider whether, in fact, a violation had any impact on the public.'' *See A.M. Best Letter.* A second commenter added that a public interest finding is appropriate because a sanction of suspension or revocation is significant and that NRSROs play an important role in the financial markets. *See S&P Letter.* In contrast, two commenters opposed the proposed required public interest finding. *See AFSCME Letter; Better Markets Letter.* One of these commenters stated that the finding could make it more difficult for the Commission to sanction an NRSRO, and that it provides NRSROs with additional defenses to potential sanctions. *See Better Markets Letter.* The other commenter suggested that the standard be changed from ''necessary for the protection of investors and in the public interest'' to ''consistent with the public interest'' to give the Commission more flexibility in the enforcement remedy. *See AFSCME Letter.* Both commenters suggested the increased threshold in the proposal to suspend or revoke an NRSRO's registration was not the intent of Congress. *See AFSCME Letter; Better Markets Letter.* In response to these comments, the Commission believes—as indicated above—that the public interest finding is appropriate given the severity of the sanctions. In response to the commenter that suggested the standard be changed from ''necessary for the protection of investors and in the public interest'' to ''consistent with the public interest'' to give the Commission more flexibility in the enforcement remedy, the Commission notes that the standard ''necessary for the protection of investors and in the public interest'' is a standard used consistently throughout the Commission's rules and the Exchange Act. The Commission is not persuaded it is necessary to use a different standard in this instance. Consequently, because the finding required under the final amendment must be made in the context of a proceeding under section 15E(d) of the Exchange Act, the final amendment incorporates the public interest finding in that section.

[426] 15 U.S.C. 78o–7(d)(1).

[427] Commenters addressed whether the rule should limit the length of a suspension under section 21C of the Exchange Act. *See A.M. Best Letter; Morningstar Letter; S&P Letter.* Two commented that the ability to suspend the registration of an NRSRO for up to twelve months under section 15E(d) was sufficient and, therefore, a suspension proceeding under section 21C is unnecessary. *See A.M. Best Letter; S&P Letter.* One commenter stated that there should be a time limit for a suspension under section 21C and, while stating that the twelve month limit under section 15E(d) is sufficient, suggested an alternative approach based on the time horizon of the associated credit rating. *See Morningstar Letter* (suggesting, as an alternative, that the Commission ''could use a multiple of the intended time horizon associated with the rating'' as a maximum suspension). As discussed above, the finding required under the final amendment must be made in a proceeding under section 15E(d)(1), which limits suspensions to a period not to exceed twelve months. *See* 15 U.S.C. 78o–7(d)(1).

[428] *See A.M. Best Letter; Morningstar Letter; S&P Letter.*

[429] *See A.M. Best Letter; Morningstar Letter; S&P Letter.*

[430] *See A.M. Best Letter.*

[431] *See Morningstar Letter* (stating that the findings should be ''supported by Commission evidence that the undue influence . . . resulted in the NRSRO issuing a credit rating without conforming to its documented procedures and methodologies and that investors who relied on those ratings were harmed.''); *S&P Letter* (stating that the following factors should be a factual predicate to support the finding that the violation affected a rating: ''(i) there was an appropriate attempt to influence the rating decision; (ii) the NRSRO did not adhere in material respects to its applicable policies and procedures; and (iii) the rating decision was not honestly held by the rating committee analysts who voted for it at the time it was issued.'').

[432] *See* 15 U.S.C. 78o–7(d)(1).

[433] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[434] *See* 15 U.S.C. 78o–7(h)(1); 17 CFR 240.17g–5.

[435] *See* 17 CFR 240.17g–5(c)(6); 17 CFR 240.17g–6(a)(1).

[436] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33598–33599, 33613 (discussing objectives and benefits of paragraph (c) of Rule 17g–5 when it was adopted); *see also Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6465–6469, 6474–6475 (discussing objectives and benefits of paragraph (c) of Rule 17g–5 when it was amended).

credit rating in order to induce the purchase of the credit rating by the issuer, sponsor, or underwriter of the rated security.[437] Involving credit analysts in sales and marketing activities (which are designed to obtain business) could potentially influence them to inappropriately take business considerations into account when determining credit ratings. Such influence may also arise from other channels, such as compensation arrangements that may incentivize analysts to produce inflated credit ratings to increase or retain the NRSRO's market share, performance evaluation systems that reward analysts who produce inflated credit ratings to increase or retain the NRSRO's market share, clients such as rated entities who pressure analysts to produce inflated credit ratings to retain their business, or managers that are not involved in sales and marketing activities but may seek to pressure analysts to produce inflated credit ratings to increase or retain the NRSRO's market share. The two-pronged absolute prohibition is designed to insulate credit analysts from sales and marketing concerns and pressures that may arise through any channel. This could enhance the integrity and quality of credit ratings.

Relative to the baseline, paragraph (c)(8) of Rule 17g–5 will result in costs to NRSROs. For example, some NRSROs may incur costs for hiring additional personnel, given the need to separate the analytical and sales and marketing functions. Commenters did not provide data for this specific cost. However, some NRSROs may choose to reallocate responsibilities among existing staff in order to meet the requirement. This cost of hiring additional personnel will likely vary significantly with the size of the NRSRO and the degree of existing separation between analytical staff and sales and marketing personnel.[438] NRSROs may also incur costs to make other operational changes, such as changes to communication policies, to ensure that credit analysts are not influenced by sales or marketing considerations from other channels. These incremental costs may vary based on the current operational structure of NRSROs. It is also possible that NRSROs may incur costs related to changes in the compensation arrangements of credit analysts.[439]

An NRSRO also will incur costs for updating its written policies and procedures to address and manage conflicts of interest required under section 15E(h) of the Exchange Act and Rule 17g–5 and to file with the Commission an update of its registration on Form NRSRO to account for the updated policies and procedures. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (c)(8) of Rule 17g–5 will result in total industry-wide one-time costs to NRSROs of approximately $354,000.[440]

Relative to the baseline, paragraph (f) of Rule 17g–5 will result in costs to NRSROs to the extent they expend resources to draft and submit a written request for an exemption under paragraph (f) of Rule 17g–5. The Commission believes that an NRSRO would likely engage outside counsel to assist in drafting the request. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (f) of Rule 17g–5 will result in costs to NRSROs of approximately $62,000 per request.[441] However, if a small NRSRO is granted an exemption from the absolute prohibition, it could avoid having to hire additional personnel to undertake sales and marketing activities that were otherwise undertaken by individuals involved in the production of credit ratings.

Relative to the baseline, paragraph (g) of Rule 17g–5 should not result in additional costs to NRSROs. NRSROs already are subject to the remedy of suspension or revocation under section 15E(d) the Exchange Act.

The amendments to Rule 17g–5 also may result in other costs. For example, prohibiting persons within an NRSRO who participate in determining or monitoring the credit ratings, or developing or approving rating procedures or methodologies from participating in sales and marketing activities may diminish the effectiveness of an NRSRO's sales and marketing efforts. For example, the revenues of an NRSRO may decrease if existing sales and marketing staff lack the expertise to communicate technical information about the NRSRO's rating procedures and methodologies to clients and potential clients. However, as discussed above, the final amendment does not preclude credit analysts from having these discussions with clients as long as the analysts do not discuss commercial matters and are not influenced by, for example, any pressure imposed by clients to produce inflated credit ratings.

The amendments to Rule 17g–5 should have a number of effects related to efficiency, competition, and capital formation.[442] First, these amendments could improve the quality of credit-related information. As a result, users of credit ratings could make more efficient investment decisions based on this better-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. These amendments also provide for an exemption based on size, which may decrease the burden of these requirements on small NRSROs. However, these amendments could still create adverse effects on competition as exempted NRSROs potentially may be more prone to engage in ''ratings catering'' and, thereby, obtain more business as a result.[443] More specifically, exempted NRSROs may be more likely to produce credit ratings that favor their clients as a result of allowing persons involved in sales and marketing activities to participate in analytical processes.

As explained above, commenters suggested a number of alternatives to

[437] *See* Griffin, Nickerson, and Tang, *Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Ratings,* Bolton, Freixas, and Shapiro, *The Credit Ratings Game.*

[438] The Commission estimates the cost of hiring an additional credit analyst to be $55,600 on a one-time basis and $591,000 per year thereafter (2080 work hours per year × $284 for a fixed income research analyst (intermediate) = $591,000; 200 hours × $278 for a senior human resources representative = $55,600). The Commission estimates the cost of hiring an additional sales and marketing staff member to be $55,600 on a one-time basis and $528,000 per year thereafter (2080 work hours per year × $254 for a marketing manager = $528,000; 200 hours × $278 for a senior human resources representative = $55,600). The salary figures provided in this release are from SIFMA's *Management & Professional Earnings in the Securities Industry 2013,* modified by Commission staff to account for a 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[439] The cost of changes to operational and compensation arrangements have been reflected in the PRA burdens discussed in section IV.D.5. and section IV.D.6. of this release.

[440] *See* section V.B. of this release (discussing implementation and annual compliance considerations). The one-time costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

[441] *See* section V.B. of this release (discussing implementation and annual compliance considerations). The cost per request is determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

[442] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[443] As part of its 2012–2013 NRSRO examinations, Commission staff found that four smaller NRSROs did not have sufficient procedures and controls for separating business and analytical functions or for preventing rating analysts from being involved in fee discussions and from having access to rating fee information. *See* 2013 Annual Staff Inspection Report, pp. 11–12.

the proposed amendments to Rule 17g–5. Several commenters suggested that the amendments be less restrictive. One reasonable alternative suggested by commenters would be for the Commission not to adopt an absolute prohibition but rather to require an NRSRO to disclose and have procedures to manage the conflict.[444] This alternative might reduce costs for NRSROs related to, for example, hiring additional personnel. However, as explained above, the absolute prohibition was designed to insulate individuals within the NRSRO responsible for the analytic function from any sales and marketing concerns and pressures. Another less restrictive alternative would be, as proposed, to adopt only the first prong of the prohibition. This alternative may reduce the scope of policies and procedures that an NRSRO may need to revise to ensure compliance with the amendments. However, as discussed above, there are several potential channels through which sales and marketing considerations could influence credit analysts that would not be addressed by the first prong of the prohibition. Any less restrictive alternative may reduce the benefit of improved credit ratings quality if this alternative fails to mitigate conflicts of interest as effectively as the requirements of the final amendment.

One commenter suggested a self-executing exemption where an NRSRO would be automatically exempt if its total revenue falls below a certain threshold.[445] This alternative would eliminate the need and associated cost for certain NRSROs to apply to the Commission for exemptive relief. However, this alternative would eliminate the flexibility of the Commission to tailor exemptive relief. Under the final amendment, exemptions will be granted on a case-by-case basis, after analyzing the facts and circumstances concerning the NRSRO seeking the relief. Any exemptive relief granted can be tailored to the specific circumstances of the NRSRO requesting the relief and include specific terms and conditions designed to mitigate the sales and marketing conflict. The ability to tailor exemptive relief on a case-by-case basis will allow the Commission the flexibility to specify conditions that address the conflict in a way that takes into account the specific circumstances of the NRSRO requesting the relief (including its size and business model). For this reason, the Commission does not believe it would be appropriate to establish an automatic self-executing exemption.

Commenters also suggested that the rule not require that the Commission make a public interest finding to suspend or revoke an NRSRO's registration for violating a rule issued under section 15E(h) of the Exchange Act, as this would weaken the enforcement remedy.[446] 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. In addition, as stated above, among other things, the Commission believes that the public interest finding is appropriate given the severity of the sanctions.

C. ''Look-Back'' Review

Section 932(a)(4) of the Dodd-Frank Act amended section 15E(h) of the Exchange Act to add a paragraph (4).[447] Section 15E(h)(4)(A) provides that an NRSRO must establish, maintain, and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the NRSRO, or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken with respect to the credit rating, the NRSRO shall: (1) Conduct a review (a ''look-back review'') to determine whether any conflicts of interest of the employee influenced the credit rating[448]; and (2) take action to revise the credit rating, if appropriate, in accordance with such rules as the Commission shall prescribe.[449]

Section 15E(h)(4)(A) of the Exchange Act contains a self-executing provision requiring an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO will conduct look-back reviews.[450] The Commission proposed paragraph (c) of new Rule 17g–8 and proposed adding paragraph (a)(9) to Rule 17g–2 to implement rulemaking required in section 15E(h)(4)(A)(ii) of the Exchange Act.[451] The Commission is adopting paragraph (c) of Rule 17g–8, with modifications, and adding paragraph (a)(9) to Rule 17g–2 as proposed.[452]

1. Paragraph (c) of New Rule 17g–8

As proposed, paragraph (c) of Rule 17g–8 provided that the policies and procedures an NRSRO establishes, maintains, and enforces pursuant to section 15E(h)(4)(A) of the Exchange Act must address instances in which a look-back review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or money market instrument.[453]

Specifically, paragraph (c)(1) of Rule 17g–8, as proposed, provided that an NRSRO must have procedures reasonably designed to ensure that, upon the NRSRO's discovery that a former employee's conflict influenced a credit rating, it immediately publishes a rating action placing the applicable credit ratings of the obligor, security, or money market instrument on credit watch or review.[454] Proposed paragraph (c)(1) also provided that the policies and procedures must be reasonably designed to ensure the NRSRO includes the information required by proposed paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7 in the form to accompany a credit rating with the publication of the rating action placing the credit rating on credit watch.[455] Specifically, paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7, as proposed, would have required the NRSRO to provide in the form published with the rating action an

[444] *See S&P Letter; TradeMetrics Letter.*

[445] *See Kroll Letter.*

[446] *See AFSCME Letter; Better Markets Letter.*

[447] *See* Public Law 111–203, 932(a)(4); 15 U.S.C. 78o–7(h)(4).

[448] *See* 15 U.S.C. 78o–7(h)(4)(A)(i).

[449] *See* 15 U.S.C. 78o–7(h)(4)(A)(ii).

[450] *See* 15 U.S.C. 78o–7(h)(4)(A)(i).

[451] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33429–33432.

[452] *See* paragraph (c) of Rule 17g–8, and paragraph (a)(9) of Rule 17g–2. In addition, Rule 17g–8 consolidates requirements that NRSROs have policies and procedures in a number of areas. As discussed in section II.F.1. of this release, paragraph (a) of Rule 17g–8 requires an NRSRO to establish policies and procedures with respect to credit rating procedures and methodologies. *See* paragraph (a) of Rule 17g–8. Further, as discussed in section II.J.1. of this release, paragraph (b) of Rule 17g–8 requires an NRSRO to establish policies and procedures with respect to the use of credit rating symbols, numbers, and scores. *See* paragraph (b) of Rule 17g–8.

[453] *See* paragraph (c) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[454] *See* paragraph (c)(1) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[455] *See* paragraph (c)(1) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest and the date and associated credit rating of each prior rating action the NRSRO currently has determined was influenced by the conflict.[456]

Paragraph (c)(2) of Rule 17g–8, as proposed, provided that the NRSRO must have procedures reasonably designed to ensure that it promptly determines whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.[457] The proposed approach was intended to ensure that, as soon as possible, the assigned credit rating will become solely a product of the NRSRO's procedures and methodologies for determining credit ratings (that is, no longer influenced by the conflict).[458]

Paragraph (c)(3) of Rule 17g–8, as proposed, provided that the NRSRO must have procedures reasonably designed to ensure it promptly publishes a revised credit rating, if appropriate, or an affirmation of the credit rating, if appropriate, based on the determination of whether the current credit rating assigned to the obligor, security, or money market instrument must be revised.[459] Paragraph (c)(3), as proposed, also provided that the NRSRO's procedures must be reasonably designed to ensure that information required pursuant to paragraphs (a)(1)(ii)(J)(*3*)(*ii*) and (*iii*) of Rule 17g–7, as proposed, is included in the form to accompany the publication of a revised credit rating or a credit rating affirmation.[460] In the case of a revised credit rating, paragraph (a)(1)(ii)(J)(*3*)(*ii*) of Rule 17g–7, as proposed, would require the NRSRO to provide in the form an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and an estimate of the impact the conflict had on each such prior rating action.[461] Similarly, in the case of an affirmed credit rating, paragraph (a)(1)(ii)(J)(*3*)(*iii*) of Rule 17g–7, as proposed, would require the NRSRO to provide an explanation of why no rating action was taken to revise the credit rating notwithstanding the conflict, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and an estimate of the impact the conflict had on each such prior rating action.[462]

As discussed in more detail below, the Commission is adopting paragraph (c) of Rule 17g–8, with modifications from the proposal in response to comments.[463] The modifications eliminate the requirement to *immediately* place the credit rating on credit watch or review and make certain technical changes. The Commission is adopting paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7 with modifications from the proposal in response to comments.[464] The modifications eliminate the required disclosure that would have accompanied the placement of the credit rating on credit watch, revise the disclosure requirement with respect to estimating the impact of the conflict, and make certain technical changes.[465]

The Commission is adopting the prefatory language to paragraph (c) of Rule 17g–8 as proposed.[466] Consequently, the final rule provides, in pertinent part, that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act must address instances in which a review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or money market instrument by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO will take the steps discussed below.[467]

Two commenters stated that the Commission should define what it means for a conflict of interest to *influence* a credit rating.[468] One of these commenters stated that any definition should not require ''proof of subjective intent or motivation on the part of the NRSRO employee'' since it would be difficult to discern.[469] On the other hand, two NRSROs stated that the Commission should not provide a definition.[470] One stated that a finding of influence should only be required ''where the NRSRO determines that, absent the conflict, the NRSRO would have issued a different rating'' because this is the only ''influence'' that has ''practical consequences for the users of the affected credit rating.''[471] The other NRSRO stated that any definition should ''include situations where a primary analyst or voting member of a credit rating committee succeeded in persuading other committee members to agree to a ratings determination that was inconsistent with the NRSRO's ratings criteria, procedures and methodologies.''[472]

The Commission does not believe it is necessary at this time to define in the rule what it means to influence a credit rating because the provisions of the rule provide sufficient guidance in this respect. In particular, the rule provides that the NRSRO must determine whether a conflicted credit rating must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.[473] Thus, the rule contains a standard that can be used for purposes of making the influence determination required by section 15E(h)(4)(A) of the Exchange Act: Namely, whether the credit rating is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings. As one commenter stated, a finding of influence should only be required ''where the NRSRO determines that, absent the conflict, the NRSRO would have issued a different rating.''[474] The Commission believes that this is an appropriate framework for assessing whether a conflict influenced a credit rating under

[456] *See* paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[457] *See* paragraph (c)(2) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[458] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33430.

[459] *See* paragraphs (c)(3)(i) and (ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[460] *See* paragraphs (c)(3)(i) and (ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543. *See also* paragraphs (a)(1)(ii)(J)(3)(ii) and (iii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[461] *See* paragraph (a)(1)(ii)(J)(*3*)(*ii*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[462] *See* paragraph (a)(1)(ii)(J)(*3*)(*iii*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[463] *See* paragraph (c) of Rule 17g–8.

[464] *See* paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7.

[465] As discussed below in section II.G.1. of this release, the form to accompany a rating action need not be published when a credit rating is put on watch or review.

[466] *See* prefatory paragraph (c) of Rule 17g–8.

[467] *See* paragraph (c) of Rule 17g–8.

[468] *See AFSCME Letter; Harrington Letter.*

[469] *See AFSCME Letter.*

[470] *See DBRS Letter; S&P Letter.*

[471] *See DBRS Letter.*

[472] *See S&P Letter.*

[473] *See* paragraph (c)(1) of Rule 17g–8.

[474] *See DBRS Letter.*

section 15E(h)(4)(A). Moreover, it is consistent with the standard to be used in paragraph (c) of Rule 17g–8, as adopted, for determining whether the credit rating must be revised.[475]

One commenter stated that the rule should require the NRSRO to review whether a conflict influenced the determination of its rating methodologies or procedures.[476] This suggestion is outside the scope of the proposal. However, section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such NRSRO and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business.[477] Further, Rule 17g–5, among other things, prohibits an NRSRO from having conflicts of interest unless they are disclosed and managed through policies and procedures.[478] Thus, the statute and rule cover the conflict that arises when the prospective employment of an NRSRO's employee influenced a credit rating methodology (as opposed to a credit rating). For these reasons, an NRSRO would need to address the conflict pursuant to section 15E(h)(1) and Rule 17g–5 if it concluded in connection with a look-back review conducted pursuant to section 15E(h)(4)(A) of the Exchange Act that the prospect of future employment inappropriately influenced a credit rating procedure or methodology of the NRSRO.

One commenter stated that the Commission should specify minimum steps that the NRSRO must follow to determine if a former employee's conflict of interest influenced a credit rating because an ''NRSRO's initial review'' to determine whether a conflict influenced a rating is ''at least as important as the process for revising a rating.'' [479] One NRSRO stated that the NRSRO should review credit ratings ''upon a discovery that they may have been influenced by a conflict'' but that convening a new rating committee each time a potential conflict is discovered should not be required because it could impact the timeliness of ratings determinations.[480]

These comments address the self-executing provisions of section 15E(h)(4)(A)(i) of the Exchange Act.[481] The Commission did not propose rules to implement this part of the statute as the statute itself directly prescribes specific requirements for NRSROs.[482] However, the Commission notes that the statute requires the look-back review policies and procedures to be reasonably designed. Consequently, while the Commission is not prescribing by rule how an NRSRO must conduct a look-back review, an NRSRO must establish, maintain, and enforce policies and procedures that are reasonably designed to achieve the objectives set forth in the statute.

A number of commenters addressed proposed paragraph (c)(1) of Rule 17g–8, which would have required NRSROs to immediately publish a rating action placing applicable credit ratings on credit watch or review based on the discovery that a former employee's conflict influenced a credit rating.[483] Several commenters, including NRSROs, stated that the proposed requirements may cause volatility, confusion, or disruption in the market,[484] and one NRSRO stated that the placement of credit ratings on credit watch may force investment managers to sell securities, pursuant to investment guidelines.[485] Two NRSROs stated that the NRSRO should be allowed to determine whether and when to place a credit rating on credit watch, in accordance with its analytical criteria and procedures.[486] One of these NRSROs stated that mandating that the NRSRO place a credit rating on credit watch may impact the timeliness of credit rating determinations and may constitute regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in violation of section 15E(c)(2) of the Exchange Act.[487] Another NRSRO suggested that the Commission ''provide a timeframe for the NRSRO to revise and affirm the rating when a conflict arises'' before requiring it to place the credit rating on credit watch.[488] Several commenters stated that a credit rating should be placed on credit watch only after the NRSRO determines that a conflict of interest has influenced the credit rating.[489]

The Commission is persuaded that the proposed requirement to immediately place the credit rating on watch or review could lead to potential market disruption and confusion, possibly harming investors and issuers, at a time when it is not clear that the credit rating will be changed. However, the Commission also believes that investors and other users of an NRSRO's credit ratings should be notified that a prior credit rating was influenced by a conflict of interest within a reasonable period of time. As discussed below, an NRSRO must promptly determine whether the credit rating must be revised or affirmed and promptly revise or affirm the credit rating and include with the publication of the rating action revising or affirming the credit rating information about the existence of the conflict. In most cases, this process should provide investors and other users of the NRSRO's credit ratings with notice of the existence of the conflict in a timely manner.

However, if there is a delay in publishing the revised or affirmed credit rating, the Commission believes the NRSRO should provide notice of the existence of the conflict of interest through another means. Accordingly, paragraph (c) of Rule 17g–8, as adopted, has been modified to eliminate the requirement to immediately place credit ratings on credit watch or review based on the discovery of the conflict.[490] Instead, the rule provides that the NRSRO must place the credit rating on

[475] *See* paragraph (c)(1) of Rule 17g–8.

[476] *See CFA/AFR Letter.*

[477] *See* 15 U.S.C. 78o–7(h)(1).

[478] *See also* 17 CFR 240.17g–5.

[479] *See Better Markets Letter.*

[480] *See S&P Letter.*

[481] *See* 15 U.S.C. 78o–7(h)(4)(A)(i) (requiring an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the NRSRO or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken with respect to the credit rating, the NRSRO shall conduct a look-back review to determine whether any conflicts of interest of the employee influenced the credit rating).

[482] As discussed throughout this section, the Commission is implementing the part of the statute that addresses the steps to be taken if the look-back review determines that a conflict of interest of the employee influenced the credit rating. *See* 15 U.S.C. 78o–7(h)(4)(A)(ii) (providing that the NRSRO must take action to revise the credit rating, if appropriate, in accordance with such rules as the Commission shall prescribe).

[483] *See A.M. Best Letter; AFSCME Letter; DBRS Letter; FSR Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[484] *See A.M. Best Letter; DBRS Letter; FSR Letter; Morningstar Letter; S&P Letter.*

[485] *See S&P Letter.*

[486] *See DBRS Letter; S&P Letter.*

[487] *See S&P Letter.*

[488] *See Morningstar Letter.*

[489] *See A.M. Best Letter; AFSCME Letter; DBRS Letter; FSR Letter; Moody's Letter; S&P Letter.* The rule, as proposed, required the NRSRO to place the credit rating on watch only after the NRSRO determined based on a look-back review that the credit rating was influenced by the conflict of interest.

[490] The rule, as adopted, does not preclude an NRSRO from immediately placing credit ratings on credit watch or review based on the discovery of a conflict if such action is in accordance with the NRSRO's policies and procedures.

watch or review if the credit rating is not revised or affirmed in accordance with the rule within fifteen calendar days of the date of the discovery that the credit rating was influenced by a conflict of interest.[491] This is designed to provide notice to users of the NRSRO's credit ratings of the existence of the conflict in a case where the NRSRO delays publishing a revision or affirmation of the credit rating. However, by prescribing a deadline of fifteen calendar days, the Commission is not suggesting that an NRSRO can meet its obligation to promptly revise or affirm a credit rating by waiting fifteen calendar days. As discussed below, an NRSRO must promptly revise or affirm the credit rating. The question of whether an NRSRO has met this standard will depend on the facts and circumstances.

Consistent with modifications to Rule 17g–7 discussed below in section II.G.1. of this release, the Commission is eliminating the related disclosure requirement in proposed paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7 that would need to have been made when the credit rating is put on watch or review.[492] Instead, paragraph (c)(2)(ii) of Rule 17g–8 provides that, if an NRSRO is required to place the credit rating on watch or review because it did not revise or affirm the credit rating within fifteen calendar days, the NRSRO must include with the publication an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest.

The Commission is adopting the requirement in proposed paragraph (c)(2) of Rule 17g–8 substantially as proposed, but is redesignating it as paragraph (c)(1) of Rule 17g–8.[493] As adopted, the final rule requires that the NRSRO's policies and procedures under section 15E(h)(4)(A) of the Exchange Act be reasonably designed to ensure that the NRSRO will promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it is no longer influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.[494]

In the proposing release, the Commission asked whether the rule should be more prescriptive in terms of how an NRSRO would be required to determine whether to revise a credit rating by, for example, requiring an NRSRO to apply a *de novo* review of the rated obligor, security, or money market instrument using its rating procedures and methodologies.[495] Three NRSROs stated that the Commission should not prescribe more requirements for how NRSROs must determine whether a rating must be revised.[496] Two of these NRSROs stated that doing so may constitute regulating the substance of the credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act,[497] and one of these NRSROs stated that the NRSRO ''should retain the flexibility to conduct whatever analysis a particular situation calls for.'' [498] On the other hand, one commenter stated that the Commission should be ''more prescriptive in this area'' and ''require the NRSRO to apply *de novo* its procedures and methodologies'' to determine whether a credit rating must be revised.[499] Another commenter stated that it is ''essential'' to require the NRSRO to ''conduct a *de novo* analysis of the credit rating using its methodologies and procedures.'' [500] In implementing section 15E(h)(4)(A)(i) of the Exchange Act through Rules 17g–8 and 17g–7, the Commission has sought to strike an appropriate balance between adopting a measure designed to address the employment conflict with the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.[501] To strike this balance, the Commission believes that the rule should provide flexibility for the NRSRO to make this determination by applying procedures and methodologies that it designs to ensure that the credit rating is no longer influenced by the conflict of interest. Such procedures and methodologies could but may not necessarily require a *de novo* review of the rated obligor or obligation.

Two NRSROs stated that a conflict of interest may impact a number of other credit ratings, which would need to be revised and published.[502] Accordingly, one of these NRSROs suggested that the words ''immediately'' and ''promptly'' in the proposed requirements be replaced with ''as soon as practicable'' given that certain procedures may have to be followed.[503] The other NRSRO suggested that paragraph (c)(2) of proposed Rule 17g–8 include a ''reasonableness standard'' for the term ''promptly.'' [504] A third NRSRO suggested that a ''reasonable amount of time'' be given to the NRSRO to ''investigate the conflict and determine whether the rating must be revised.'' [505]

In response, the Commission believes it is important that the NRSRO not delay completing the process that it will use to determine whether the credit rating must be revised to ensure that it is solely a product of the NRSRO's procedures and methodologies for determining credit ratings (that is, not influenced by the conflict of interest). The longer the determination takes the longer that investors and other users of credit ratings will remain unaware of the important fact that the credit rating was influenced by a conflict. Consequently, the final rule retains the requirement that the NRSRO must ''promptly determine'' whether a credit rating must be revised.[506] The Commission recognizes that the amount of time necessary to complete the determination will depend on facts and circumstances, including the number of credit ratings impacted, the degree to which the conflict influenced the credit ratings, and the complexity of the rating procedures and methodologies used to determine the credit ratings.[507] However, the Commission expects that in each instance, the NRSRO will complete the process promptly in order to satisfy the ''promptly determine'' requirement and that the process, in many cases, will be expedited by the fact that much of the work to determine the impact, if any, and, if necessary, revise the credit rating would already be accomplished at the time an NRSRO determines that the credit rating was in

[491] *See* paragraph (c)(2)(ii) of Rule 17g–8. *See also Morningstar Letter* (suggesting that the Commission ''provide a timeframe for the NRSRO to revise and affirm the rating when a conflict arises'' before requiring it to place the credit rating on credit watch).

[492] As discussed below in section II.G.1. of this release, the Commission is eliminating the requirement to publish the form containing the required information about the rating action when an NRSRO places a credit rating on watch or review.

[493] *See* paragraph (c)(1) of Rule 17g–8. The final rule modifies the proposal by re-designating paragraph (c)(2) as paragraph (c)(1) because the requirement to place a credit rating on credit watch, which would have been codified in paragraph (c)(1) under the proposal, is being eliminated.

[494] *See* paragraph (c)(1) of Rule 17g–8.

[495] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33432.

[496] *See DBRS Letter; Moody's Letter; S&P Letter.*

[497] *See Moody's Letter; S&P Letter.*

[498] *See DBRS Letter.*

[499] *See AFSCME Letter.*

[500] *See Better Markets Letter.*

[501] *See* 15 U.S.C. 78o–7(c)(2).

[502] *See Moody's Letter; S&P Letter.*

[503] *See Moody's Letter.*

[504] *See S&P Letter.*

[505] *See Morningstar Letter.*

[506] *See* paragraph (c)(1) of Rule 17g–8.

[507] *See Moody's Letter; Morningstar Letter; S&P Letter.*

fact influenced by a conflict. In such cases, the Commission would expect the revision or affirmation, as appropriate, to be issued promptly after the existence of the conflict was determined. The Commission notes that, as part of the annual examinations of each NRSRO, Commission staff reviews the policies of the NRSRO governing the post-employment activities of former staff of the NRSRO.

The Commission is adopting the requirements in proposed paragraph (c)(3) of Rule 17g–8 substantially as proposed, with technical modifications, and is redesignating it as paragraph (c)(2)(i) of Rule 17g–8.[508] As adopted, the final rule provides that the NRSRO must promptly publish, based on the determination of whether a current credit rating referred to in paragraph (c)(1) of Rule 17g–8 must be revised: (1) A revised credit rating, if appropriate, and include with the publication of the revised credit rating the information required by paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7; or (2) an affirmation of the credit rating, if appropriate, and include with the publication of the affirmation the information required by paragraph (a)(1)(ii)(J)(*3*)(*ii*) of Rule 17g–7.[509] As discussed below, the Commission also is adopting the corresponding disclosure requirements to accompany the publication of a revised credit rating and an affirmation of a credit rating in paragraphs (a)(1)(ii)(J)(*3*)(*i*) and (*ii*) of Rule 17g–7, respectively, with modifications in response to comments.

One commenter stated that the NRSRO should publish a revised credit rating or affirmation, as appropriate, ''as soon as practicable'' instead of ''promptly.'' [510] As discussed above, paragraph (c)(1) of Rule 17g–8, as adopted, requires the NRSRO to promptly determine whether a credit rating discovered through a look-back review to have been influenced by a conflict of interest must be revised so that it is no longer influenced by the conflict and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings. Having made the determination, paragraph (c)(2) of Rule 17g–8, as adopted, sets forth the next steps the NRSRO must take: Promptly publish a revised credit rating or an affirmation of the credit rating and provide users of the NRSRO's credit ratings information about the reasons for taking either action. These steps are an important component of the look-back review process. They are designed to ensure that the NRSRO promptly addresses any impact the conflict had on the credit rating and alerts the users of its credit ratings about the existence of the conflict and its resolution. As stated above, failing to act when a conflict has influenced a credit rating creates the risk that investors and other users of credit ratings will use a conflicted credit rating when making an investment or other credit-related decision. Thus, paragraph (c)(2) of Rule 17g–8, as adopted, retains the requirement that the NRSRO must act promptly.

Commenters addressed whether the NRSRO should be required to publish a rating affirmation,[511] including whether such a requirement would constitute regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act.[512] The Commission does not expect (and the final rule does not require) an NRSRO to revise a credit rating in every circumstance in which an earlier rating action was influenced by a conflict of interest. Section 15E(h)(4)(A)(ii) of the Exchange Act provides that the NRSRO's policies and procedures shall be reasonably designed to, among other things, ensure that the NRSRO takes action to revise the credit rating ''if appropriate.'' [513] It is possible, for example, that in the period since the NRSRO published the conflicted credit rating, events unrelated to the conflict occurred that, when taken into account by the NRSRO's procedures and methodologies for determining credit ratings, would produce a credit rating at the same notch in the rating scale of the NRSRO as the credit rating that was influenced by the conflict.[514] A requirement that the NRSRO nonetheless revise the credit rating could interfere with the NRSRO's procedures and methodologies for determining credit ratings in that it would force the NRSRO to change the credit rating assigned to the obligor, security, or money market instrument to a different notch in the rating scale than would be the case if the credit rating were solely a product of the NRSRO's procedures and methodologies. Consequently, a mandatory revision requirement could, in effect, require the NRSRO to publish a credit rating that was not consistent with those procedures and methodologies. Accordingly, the final rule permits the NRSRO to publish an affirmation of the credit rating as an alternative to revising the credit rating, if appropriate. As discussed below, the Commission is requiring that an NRSRO publish an affirmation if the credit rating is not going to be revised because this will be the mechanism for disclosing the fact that a conflict at one time influenced the credit rating.

Commenters suggested that if the credit rating is not going to be revised there should not be a requirement to publish an affirmation.[515] One commenter stated that such a requirement constitutes regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act.[516] The Commission is not persuaded that the rule should require only the publication of a revised credit rating. If the rule did not require publication of an affirmation, the users of the NRSRO's credit ratings would not learn of the existence of the conflict. One of the goals of the registration and oversight program for NRSROs is to increase the transparency of their activities so that users of credit ratings can understand how they operate and can compare NRSROs. Disclosing the

[508] *See* paragraph (c)(2)(i) of Rule 17g–8. The final rule modifies the proposal by re-designating paragraph (c)(3) as paragraph (c)(2)(i) because, as discussed above, the requirement in paragraph (c)(1) of Rule 17g–8, as proposed, is being eliminated. In addition, the final rule modifies the proposal by revising the text to specifically reference the credit rating ''in paragraph (c)(1)''.

[509] *See* paragraph (c)(2) of Rule 17g–8.

[510] *See Moody's Letter.*

[511] *See DBRS Letter; S&P Letter.*

[512] *See Moody's Letter. See also* 15 U.S.C. 78o–7(c)(2).

[513] 15 U.S.C. 78o–7(h)(4)(A)(ii).

[514] For example, assume that nine months ago an analyst upgraded the credit rating assigned to an issuer's securities from the BBB to AA. The analyst leaves the NRSRO to work for the issuer. The analyst's new employment triggers a look-back review of the rating action upgrading the credit rating from BBB to AA pursuant to section 15E(h)(4)(A)(i) of the Exchange Act. The look-back review determines the credit rating should not have been upgraded from BBB to AA at that point in time and the analyst's action in upgrading the credit rating was influenced by the prospect of employment with the issuer. The NRSRO performs a *de novo* review of the credit rating assigned to the issuer by applying its procedures and methodologies for determining credit ratings. This review—as required by the procedures and methodologies—takes into consideration favorable financial results the issuer reported three months ago. Consequently, the process of re-rating the issuer's securities determines that the current credit rating should remain AA.

[515] *See, e.g., DBRS Letter* (supporting the proposed requirement that NRSROs ''promptly publish'' a revised rating, but stating that an affirmation of a credit rating that was influenced by a conflict of interest should be published ''only where the NRSRO has determined . . . to place the existing rating on credit watch''); *S&P Letter* (''we also support elimination of proposed Rule 17g–8(c)(3), to the extent that it would require NRSROs to publish ratings affirmations or other actions following a CreditWatch action required by proposed Rule 17g–8(c)(1).'').

[516] *See Moody's Letter.*

existence of the conflict with the publication of the revised credit rating or affirmation of the credit rating will provide users of the NRSRO's credit ratings with information to assess the adequacy of the NRSRO's policies, procedures, and controls designed to manage conflicts of interest and, more generally, the integrity of the NRSRO's credit rating process. Moreover, the required disclosures could be useful to users of the NRSRO's credit ratings in considering the potential risk of using the NRSRO's credit ratings to make investment or other credit-based decisions. Furthermore, in light of the prohibition against regulating the substance of credit ratings and rating procedures and methodologies in section 15E(c)(2) of the Exchange Act, the final rule has been carefully tailored to avoid interfering with the NRSRO's analytical process.[517] It is the NRSRO that will determine—using its own procedures and methodologies—whether the credit rating should be revised or affirmed. For these reasons, the Commission is adopting the requirement to publish an affirmation of the credit rating if the credit rating does not need to be revised.

The Commission is adopting the disclosure requirements in proposed paragraphs (a)(1)(ii)(J)(*3*)(*ii*) and (*iii*) of Rule 17g–7 with modifications and is redesignating them as paragraphs (a)(1)(ii)(J)(*3*)(*i*) and (*ii*).[518] Commenters raised concerns about the proposed requirement to disclose an estimate of the impact of the conflict on each applicable prior credit rating.[519] One commenter stated that estimating the impact of a conflict on a credit rating may ''create inefficiencies.'' [520] A second NRSRO stated that it may be ''unduly burdensome,'' delaying publication of a corrective rating.[521] A third NRSRO stated that it would be ''practically impossible'' to estimate the impact of a conflict on a prior rating and that the Commission should not require disclosure of the reasons for revising or affirming a credit rating.[522]

The Commission is persuaded by commenters that precisely quantifying the impact of the conflict could be difficult and that a more narrative disclosure would be appropriate. Consequently, the final amendments to Rule 17g–7 require the NRSRO to provide a description of the impact the conflict had on the prior rating action or actions.[523] The Commission expects the description to be sufficient to provide investors and users of credit ratings with insight into the nature of the impact the conflict had on the credit rating. The Commission recognizes that this may entail a degree of judgment on the part of the NRSRO in terms of estimating the degree of the impact.

In addition, the text of paragraph (a)(1)(ii)(J)(*3*)(*iii*) of Rule 17g–7, as proposed, has been modified to reflect that the requirement to place the credit rating on watch and make a corresponding disclosure has been eliminated.[524] As proposed, this paragraph would govern the disclosure to be made with an affirmation of the credit rating. The disclosure requirement was intended to follow the initial disclosure that would have been made when the credit rating was placed on watch. The initial disclosure would have included an explanation that the credit rating was placed on watch because of the discovery that the credit rating was influenced by a conflict of interest. Because this disclosure will not be required, the disclosure that accompanies an affirmation of a credit rating will need to include an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest.[525] This will provide context for why the NRSRO is issuing the affirmation.[526]

One commenter stated that the rule should require disclosure about the nature of the conflict.[527] In response, the Commission notes that the rule requires the NRSRO to include with a revised credit rating an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest.[528] Similarly, the rule requires an NRSRO to include with an affirmation of a credit rating an explanation that the credit rating was influenced by a conflict of interest.[529] The Commission agrees with the commenter that the disclosure should provide some context for these explanations. Consequently, the Commission is modifying the rule text from the proposal to provide that the explanation of the conflict to be made with a revision of a credit rating or an affirmation of a credit rating must include a description of the nature of the conflict.[530] For example, the description could disclose that a former employee was unduly influenced by the prospect of working for the issuer of the rated security and, as a consequence, did not adhere to the NRSRO's rating methodology in order to make the credit rating more favorable to the issuer.

Finally, two commenters stated that information regarding a credit rating influenced by a conflict of interest should be provided to former subscribers.[531] As discussed above, the disclosures are required to be made in the form to accompany a rating action under paragraph (a) of Rule 17g–7, as amended.[532] This form—as discussed below in section II.G.1. of this release—must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.[533] This provision thereby accommodates both the issuer-pay business model in which rating actions generally are made publicly available and the subscriber-pay business model in which rating actions generally are made available to current subscribers only.[534] Consequently, if the NRSRO makes its rating actions available only to current subscribers, former subscribers will not have access to the form and the

[517] *See* 15 U.S.C. 78o–7(c)(2).

[518] *See* paragraphs (a)(1)(ii)(J)(*3*)(*i*) and (*ii*) of Rule 17g–7. Because the disclosure requirement with respect to placing a conflicted credit rating on credit watch is being eliminated, the final amendments modify the proposed rule text by re-designating paragraph (a)(1)(ii)(J)(*3*)(*ii*) as paragraph (a)(1)(ii)(J)(*3*)(*i*), and re-designating paragraph (a)(1)(ii)(J)(*3*)(*iii*) as paragraph (a)(1)(ii)(J)(*3*)(*ii*). Further, because paragraph (c)(3) of Rule 17g–8, as proposed, is being re-designated as paragraph (c)(2), the final amendments modify the references in paragraphs (a)(1)(ii)(J)(*3*)(*ii*) and (*iii*) of Rule 17g–7, as proposed, to refer to paragraph (c)(2) of Rule 17g–8. The final amendments modify the proposed rule text to make other minor changes to improve readability.

[519] *See DBRS Letter; Moody's Letter; S&P Letter.*

[520] *See S&P Letter.*

[521] *See DBRS Letter.*

[522] *See Moody's Letter.*

[523] *See* paragraphs (a)(1)(ii)(J)(*3*)(i) and (*ii*) of Rule 17g–7.

[524] *Id.*

[525] *Id.*

[526] A similar modification is not necessary for the disclosure that must accompany a revised credit rating because, as proposed, that disclosure would have needed to include an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest, thus providing the necessary context. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541. The final amendments retain this disclosure requirement. *See* paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7.

[527] *See Better Markets Letter.*

[528] *See* paragraph (a)(1)(ii)(J)(*3*)(*i*) of Rule 17g–7.

[529] *See* paragraph (a)(1)(ii)(J)(*3*)(*ii*) of Rule 17g–7.

[530] *See* paragraphs (a)(1)(ii)(J)(*3*)(*i*) and (*ii*) of Rule 17g–7.

[531] *See AFSCME Letter; DBRS Letter.*

[532] *See* paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7.

[533] *See* paragraph (a) of Rule 17g–7.

[534] *See* 15 U.S.C 78c(a)(61) (defining a *credit rating agency,* in pertinent part, as any person engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or a reasonable fee).

disclosure it contains about the conflict of interest. In considering the comments about disclosing the information to former subscribers, the Commission balanced the interest in providing users of credit ratings with information about a given NRSRO's credit ratings with the interest in promulgating rules that accommodate and integrate with the two predominant NRSRO business models. For example, since the final amendments to Rule 17g–7 require the disclosure to be made in the same manner as the disclosure of the credit rating that is the result or subject of the rating action, a requirement that the disclosure must be made to former subscribers (who normally would not have access to a rating action that was published after their subscription expired) would necessarily require a different process for the disclosure. For example, the disclosure could be made through publication on the NRSRO's Web site, but this method of disclosure may not be effective if former subscribers no longer view the Web site. Alternatively, the NRSRO could send the disclosure to former subscribers, but this could be burdensome and present practical difficulties. Because former subscribers are no longer using the NRSRO's credit ratings, the Commission believes at this time that it is not necessary to add a requirement that an NRSRO operating under the subscriber-pay model must make this disclosure to former subscribers.

2. Amendment to Rule 17g–2

The Commission proposed adding paragraph (a)(9) to Rule 17g–2 to require NRSROs to make and retain a record documenting the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of proposed Rule 17g–8.[535] As a result, the policies and procedures would need to be documented and the record documenting them would be subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g–2.[536] One NRSRO stated that it ''supports the Commission's proposal to include look-back policies and procedures as records that an NRSRO must retain under Rule 17g–2(a)(9).'' [537] The Commission is adding paragraph (a)(9) to Rule 17g–2 as proposed.[538] This will provide a means for the Commission to monitor the NRSROs' compliance with section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g–8. The record must be retained until three years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g–2 discussed above in section II.A.2. of this release.[539]

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule with respect to look-back reviews.[540] The baseline that existed before today's amendments and new rule was one in which section 15E(h)(4)(A)(i) of the Exchange Act, added by the Dodd-Frank Act, required NRSROs to establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO conducts look-back reviews in any case in which an employee of a person subject to a credit rating of the NRSRO or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the one-year period preceding the date an action was taken with respect to the credit rating.[541] The Commission staff found during its 2013 examinations of NRSROs that all NRSROs had established written policies and procedures to address the look-back requirement.[542] However, the staff found that two larger and six smaller NRSROs did not consistently, in the staff's view, conduct adequate look-back searches or did not have adequate policies governing the searches.[543]

Section 15E(h)(4)(A)(ii) provides that an NRSRO must establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO will take action to revise the credit rating if appropriate, in accordance with such rules as the Commission shall prescribe.[544] Before today's amendments and new rule, if the NRSRO found, after conducting the look-back review, that the credit rating was influenced by a conflict, the NRSRO would have needed to ensure that the credit rating was determined in accordance with the procedures and methodologies the NRSRO uses to determine credit ratings. However, the NRSRO was not required to ''promptly'' determine whether the current credit rating must be revised or ''promptly'' publish a revised credit rating or an affirmation of the credit rating, as appropriate. Further, there was no requirement that the NRSRO disclose information about the existence of the conflict with the publication of a revised credit rating, affirmation of the existing credit rating, or placement of the credit rating on watch or review if the credit rating is not revised or affirmed within fifteen calendar days of the discovery that the credit rating was influenced by a conflict. Finally, an NRSRO was not required to make and retain a record documenting the policies and procedures required under section 15E(h)(4)(A).

The baseline that existed before today's amendments and new rule was one in which, pursuant to paragraph (c)(4) of Rule 17g–5, an NRSRO is prohibited from issuing or maintaining a credit rating where a credit analyst who participated in determining the credit rating is an officer or director of the person that is subject to the credit rating.[545] Also, section 15E(h)(1) of the Exchange Act and Rule 17g–5 require NRSROs to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage any conflicts of interest that can arise from the business of the NRSRO.[546]

In addition, section 15E(h)(5)(A) of the Exchange Act requires NRSROs to report to the Commission any case in which a person associated with the NRSRO within the previous five years obtains employment with a rated entity or the issuer, underwriter, or sponsor of a rated instrument for which the NRSRO issued a credit rating during the twelve-month period prior to the employment if the employee was a senior officer of the NRSRO or participated, or supervised an employee that participated, in determining credit

[535] *See* section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[536] *See* 17 CFR 240.17g–2(c) through (f).

[537] *See DBRS Letter.*

[538] *See* paragraph (a)(9) of Rule 17g–2.

[539] *See* paragraphs (a)(9) and (c) of Rule 17g–2.

[540] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[541] *See* 15 U.S.C. 78o–7(h)(4)(A)(i).

[542] *See* 2013 Annual Staff Inspection Report, p. 22. The 2013 examinations generally focused on NRSRO activities for the period October 1, 2011 through December 31, 2012.

[543] *See* 2013 Annual Staff Inspection Report, pp. 22–23.

[544] *See* 15 U.S.C. 78o–7(h)(4)(A)(ii).

[545] *See* 17 CFR 240.17g–5(c)(4).

[546] *See* 15 U.S.C. 78o–7(h)(1).

ratings for the new employer.[547] Section 15E(h)(5)(B) requires that the Commission make the reports publicly available.[548] The Commission received 244 of these reports between January 24, 2006 and December 31, 2013.[549] One academic study examined these transition reports for three NRSROs (Fitch, Moody's, and S&P), which submitted 167 of these reports during that period.[550] The study suggests that the credit ratings assigned to the future employer by the NRSRO employing the transitioning employee were more likely to be upgraded and less likely to be downgraded than the ratings assigned to that future employer by other NRSROs in the year prior to the transition.[551]

Relative to this baseline, the amendments and new rule should result in benefits. They are designed to require the NRSRO to evaluate whether a credit rating has been influenced by a conflict of interest and, if so, promptly address the conflicted credit rating. This could limit the potential risk that users of credit ratings might make investment or other credit-based decisions using incomplete, biased, or inaccurate information. As stated above, the disclosures also will increase transparency and provide users of NRSRO credit ratings with information to assess an NRSRO's ability to address conflicts and to compare NRSROs with respect to their ability to manage the conflicts. Further, the amendments and new rule—because they are designed to integrate with an NRSRO's existing policies and procedures for taking rating actions—could mitigate potential inefficiencies associated with the requirements. For example, the amendments and new rule are designed to work within the existing framework of an NRSRO's policies and procedures for taking rating actions but not to regulate the substance of the credit rating or the procedures and methodologies for determining credit ratings.

The records NRSROs must make and keep under the amendment to Rule 17g-2 will be used by Commission examiners to assess whether a given NRSRO's policies and procedures are reasonably designed and whether it appears that the NRSRO is complying with them. Recordkeeping requirements are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.[552] Compliance by an NRSRO with its policies and procedures for look-back reviews and the oversight exercised by the Commission may benefit users of credit ratings by mitigating conflicts of interest, which may increase the integrity and quality of credit ratings.

Relative to the baseline, the amendments and new rule relating to look-back reviews will result in costs for NRSROs. NRSROs will need to expend resources to establish, make a record of, enforce, and periodically review and update (if necessary) the procedures they establish pursuant to section 15E(h)(4)(A) of the Exchange Act to ensure they comply with paragraph (c) of Rule 17g–8. They also will need to develop and periodically modify processes and systems for ensuring that, if the look-back review determines that a conflict of interest influenced the credit rating, a revised credit rating or an affirmation of the credit rating is promptly published (as appropriate) along with the corresponding disclosures required under paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7, or that the credit rating is placed on watch or review if the credit rating is not revised or affirmed within fifteen calendar days of the discovery that the credit rating was influenced by a conflict of interest. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (c) of Rule 17g–8 will result in total industry-wide one-time costs to NRSROs of approximately $295,000 and total industry-wide annual costs to NRSROs of approximately $71,000.[553]

Relative to the baseline, the amendments to Rule 17g–2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g–2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a)(9) of Rule 17g–2 and the amendment to paragraph (c) of Rule 17g–2 will result in total industry-wide one-time costs to NRSROs of approximately $12,000 and total industry-wide annual costs to NRSROs of approximately $3,000.[554]

The amendments and new rule by increasing the scrutiny of the work of former analysts could potentially decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process can improve the quality of ratings. In particular, an NRSRO may establish credit rating methodologies that diminish the ability of analysts to exercise subjective judgment in order to minimize the chance that in exercising judgment an analyst may be influenced by this conflict, which, in turn, will trigger the requirements in the amendments and new rule, including the requirement to disclose the existence of the conflict. If the ability to apply subjective analysis is diminished, the credit ratings issued by an NRSRO may not benefit fully from the expertise of the analysts.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.[555] First, they could improve the quality of credit-related information. As a result, users of credit ratings may 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. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the efficiency of investment decisions, market efficiency,

[547] *See* 15 U.S.C. 78o–7(h)(5)(A).

[548] *See* 15 U.S.C. 78o–7(h)(5)(B).

[549] The reports are available at *http://www.sec.gov/divisions/marketreg/nrsro_etr.htm.*

[550] *See* Jess Cornaggia, Kimberly J. Cornaggia, and Han Xia, *Revolving Doors on Wall Street* (2014), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2150998.*

[551] These authors state that ''the difference between the ratings awarded by transitioning analysts and their benchmarks changes by an average of 0.23 notches during the last five quarters leading up to a transition.'' *Id.*

[552] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33582.

[553] *See* section V.C. of this release (discussing implementation and annual compliance considerations). These costs are derived by monetizing internal hour burdens identified in the PRA analysis in section IV.D.7. of this release. The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

[554] *See* section V.C. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[555] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

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. These amendments also will result in costs, some of which may have a component that is fixed in magnitude across NRSROs and does not vary with the size of the NRSRO. Therefore, the operating costs per rating of smaller NRSROs may increase relative to that of larger NRSROs, which could create adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as NRSROs might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

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. 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. In addition, a number of academic studies indicate that both stock and bond prices of an issuer react adversely when credit ratings are placed on negative credit watch.[556] Therefore, this alternative might also create mispricing and confusion in the market. In particular, a placement of a credit rating on credit watch creates uncertainty in the credit rating that is resolved when the credit rating is either revised or affirmed. As a result of unfamiliarity, users of credit ratings might not react rationally in the short term to the uncertainty introduced by placements of credit ratings on credit watch resulting from look-back reviews. Consequently, this alternative might result in costs for issuers and on market participants who may make non-optimal investment decisions as a result of mispricing and confusion. Several comment letters discussed these potential adverse consequences.[557] However, these costs could arise if the NRSRO is required to place the credit rating on credit watch or review because it does not revise or affirm the credit rating within fifteen calendar days of the discovery of the conflict.

Other alternatives include those that would apply standards other than acting ''promptly'' with respect to the required timing of review and rating actions after a rating is determined to have been conflicted in a look-back review. For example, an NRSRO could be required to take these actions ''as soon as practicable'' rather than ''promptly,'' as suggested by one commenter.[558] However, the Commission believes it is important that the NRSRO not delay completing the process that it will use to determine whether the credit rating must be revised to ensure that it is solely a product of the NRSRO's procedures and methodologies for determining credit ratings and to publish a revised credit rating or an affirmation of the credit rating with the required disclosure of information about the existence of the conflict. The longer the NRSRO takes to complete these steps the greater the risk that investors and other users of credit ratings will rely on a conflicted credit rating when making an investment or credit-related decision. Consequently, the final amendment retains the requirement that the NRSRO must ''promptly determine'' whether a credit rating must be revised. At the same time, the Commission recognizes that the amount of time necessary to complete the determination will depend on the facts and circumstances, including the number of credit ratings impacted, the degree to which the conflict influenced the credit ratings, and the complexity of the rating methodologies used to determine the credit ratings.[559]

There are a number of other alternatives that would impose additional requirements for addressing a credit rating that is found through a look-back review to be influenced by a conflict of interest. One alternative suggested by commenters would be to require a *de novo* review of a credit rating that was determined through a look-back review to have been influenced by a conflict of interest.[560] This alternative could produce higher-quality credit ratings because a *de novo* review may provide a higher level of assurance that the credit rating is no longer influenced by the conflict as the entire rating process would be undertaken (this time without the conflicted analyst participating). In other words, *de novo* reviews may be more likely to result in credit ratings that are in accordance with the NRSRO's procedures and methodologies for determining credit ratings.

On the other hand, this alternative might impose further costs as NRSROs may be able to conduct a sufficient review without taking all the steps necessary to perform a *de novo* review (for example, some of the prior work could have been undertaken by a credit analyst that was not influenced by the conflict). Requiring a *de novo* review also may implicate the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.[561] Further, this alternative might decrease the quality of credit ratings in certain circumstances if it caused NRSROs to eliminate or reduce the use of subjective judgment in rating procedures or methodologies as

[556] *See* Kee H. Chung, Carol Ann Frost, and Myungsun Kim, *Characteristics and Information Value of Credit Watches,* Financial Management 119–158 (2012); Sugato Chakravarty, Chiraphol N. Chiyachantana, & Yen Teik Lee, *On the Informativeness of Credit Watch Placements* (2009), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1252542;* Christina E. Bannier and Christian W. Hirsch, *The Economic Function of Credit Rating Agencies—What Does the Watchlist Tell Us?,* J. of Banking and Finance 3037–3049 (2010); John R.M. Hand, Robert W. Holthausen, Richard W. Leftwich, *The Effect of Bond Rating Agency Announcements on Bond and Stock Prices, J. of Finance* 733–752 (1992); Robert W. Holthausen and Richard W. Leftwich, *The Effect of Bond Rating Changes on Common Stock Prices,* J. of Fin. Economics 57–89 (1986).

[557] *See A.M. Best Letter; DBRS Letter; FSR Letter; Morningstar Letter; S&P Letter.*

[558] *See Moody's Letter.*

[559] *See Moody's Letter; Morningstar Letter; S&P Letter.*

[560] *See AFSCME Letter; Better Markets Letter.*

[561] *See* 15 U.S.C. 78o-7(c)(2).

discussed earlier. In addition, the amendments and new rule provide flexibility for the NRSRO to make this determination by applying procedures and methodologies that it designs to ensure that the credit rating is no longer influenced by the conflict of interest, which could include procedures and methodologies that require a *de novo* review of the rated obligor or obligation in all or certain cases.

Commenters also proposed alternatives which would make the amendments and new rule less restrictive. One alternative suggested by commenters would be to not require publication of an affirmation after a credit rating has been determined to have been conflicted in a look-back review if, for example, in the period since the NRSRO published the credit rating, events unrelated to the conflict occurred that, when taken into account by the NRSRO's procedures and methodologies for determining credit ratings, would produce a credit rating at the same notch in the rating scale as the credit rating that was influenced by the conflict.[562] This alternative could benefit NRSROs by reducing the potential costs associated with publishing affirmations such as the cost of composing text to appear in the NRSRO's publications and press releases. This alternative also might increase the quality of credit ratings in certain circumstances if not having to disclose the existence of the conflict caused NRSROs to allow greater use of subjective judgment in rating methodologies as discussed earlier.

However, as discussed above, if the rule did not require publication of an affirmation, it would result in costs as users of the NRSRO's credit ratings would not learn of the existence of the conflict. Disclosing the existence of the conflict with the publication of the revised credit rating or affirmation of the credit rating will provide users of the NRSRO's credit ratings with information to assess the adequacy of the NRSRO's policies, procedures, and controls designed to manage conflicts of interest and, more generally, the integrity of the NRSRO's credit rating process. Moreover, the required disclosures could be useful to users of the NRSRO's credit ratings in considering the potential risk of using the NRSRO's credit ratings to make investment or other credit-based decisions in comparison to other NRSROs.

[562] *See DBRS Letter; S&P Letter.*

D. Fines and Other Penalties

1. Final Rule

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add subsection (p), which contains four paragraphs: (1), (2), (3), and (4).[563] Section 15E(p)(4)(A) provides that the Commission shall establish, by rule, fines and other penalties applicable to any NRSRO that violates the requirements of section 15E of the Exchange Act and the rules under the Exchange Act.[564]

The Exchange Act already provides a wide range of fines, penalties, and other sanctions applicable to NRSROs for violations of any section of the Exchange Act (including section 15E) and the rules under the Exchange Act (including the rules under section 15E).[565] For example, section 15E(d)(1) of the Exchange Act provides that the Commission shall censure an NRSRO, place limitations on the activities, functions, or operations of an NRSRO, suspend an NRSRO for a period not exceeding twelve months, or revoke the registration of an NRSRO if, among other reasons, the NRSRO violates section 15E of the Exchange Act or the Commission's rules under the Exchange Act.[566] In addition, section 932(a)(3) of the Dodd-Frank Act amended section 15E(d) to explicitly provide additional potential sanctions.[567] First, it provided the Commission with the authority to seek sanctions against persons associated with, or seeking to become associated with, an NRSRO.[568] The Commission can censure such persons, place limitations on the activities or functions of such persons, suspend such persons for a period not exceeding one year, or bar such persons from being associated with an NRSRO.[569] Second, section 932(a)(3) of Dodd-Frank Act amended section 15E(d) to provide the Commission with explicit authority to temporarily suspend or permanently revoke the registration of an NRSRO in a particular class or subclass of credit ratings if the NRSRO does not have adequate financial and managerial resources to consistently produce credit ratings with integrity.[570] Furthermore, sections 21, 21A, 21B, 21C, and 32 of the Exchange Act provide additional sanctions if an NRSRO violates the Exchange Act, including the self-executing provisions in section 15E of the Exchange Act, or rules under the Exchange Act.[571]

In the proposing release, the Commission stated its preliminarily belief that these provisions of the Exchange Act, as amended by the Dodd-Frank Act, provide a sufficiently broad range of means to impose fines, penalties, and other sanctions on an NRSRO for violations of section 15E of the Exchange Act and the rules under the Exchange Act.[572] For example, the fines, penalties, and sanctions applicable to NRSROs are similar in scope to the fines, penalties, and sanctions applicable to other registrants under the Exchange Act, such as broker-dealers. Moreover, since enactment of the Rating Agency Act of 2006, the Commission has not identified a specific need for a fine or penalty applicable to NRSROs not otherwise provided for in the Exchange Act. Consequently, in the proposing release, the Commission stated its preliminary belief that it would be appropriate at that time to defer establishing new fines or penalties in addition to those provided for in the Exchange Act.[573] However, the Commission stated that, in the future, it may use the authority in section 15E(p)(4)(A) of the Exchange Act if a specific need to do so is identified.[574]

For the foregoing reasons, to implement section 15E(p)(4)(A) of the Exchange Act, the Commission proposed to amend the instructions to Form NRSRO by adding Instruction

[563] *See* Public Law 111–203, 932(a)(8); 15 U.S.C. 78o–7(p)(1) through (4).

[564] *See* 15 U.S.C. 78o–7(p)(4)(A).

[565] *See* 15 U.S.C. 78o–7(d); 15 U.S.C. 78u; 15 U.S.C. 78u; 15 U.S.C. 78u–2; 15 U.S.C. 78u–3; 15 U.S.C. 78ff.

[566] *See* section 15E(d)(1)(A) through (F) of the Exchange Act (15 U.S.C. 78o–7(d)(1)(A) through (F)), as amended by the Dodd-Frank Act.

[567] *See* Public Law 111–203, 932(a)(3); 15 U.S.C. 78o–7(d).

[568] 15 U.S.C. 78o–7(d)(1).

[569] *Id.*

[570] *See* Public Law 111–203, 932(a)(3); 15 U.S.C. 78o–7(d)(2). Prior to this amendment, the Commission had the authority to suspend or revoke the registration of an NRSRO if it failed to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity. *See* section 15E(d)(5) of the Exchange Act (15 U.S.C 78o–7(d)(5)) before being amended by the Dodd-Frank Act, which re-designated paragraph (d)(5) of section 15E as paragraph (d)(1)(E) (15 U.S.C 78o–7(d)(1)(E)). Section 15E(d)(2) of the Exchange Act, however, provides explicit authority to target a suspension or registration revocation to a specific class or subclass of security. *See* 15 U.S.C. 78o–7(d)(2).

[571] *See* 15 U.S.C. 78o–7; 15 U.S.C. 78u; 15 U.S.C. 78u–1; 15 U.S.C. 78u–2; 15 U.S.C. 78u–3; 15 U.S.C. 78ff. In fact, the Dodd-Frank Act amended section 21B of the Exchange Act (15 U.S.C. 78u–2) to provide the Commission with the authority to assess money penalties in cease-and-desist proceedings under section 21C (15 U.S.C. 78u–3). *See* section 929P(a)(2) of the Dodd-Frank Act.

[572] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33433.

[573] *Id.*

[574] *Id.*

A.10.[575] This instruction would provide notice to credit rating agencies applying for registration as an NRSRO and to NRSROs that an NRSRO is subject to applicable fines, penalties, and other available sanctions set forth in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act (15 U.S.C. 78o–7, 78u, 78u–1, 78u–2, 78u–3, and 78ff, respectively) for violations of the securities laws.[576]

Several comment letters addressed the proposal.[577] Most commenters generally supported the Commission's proposal to defer establishing new fines or penalties in addition to those currently provided for in the Exchange Act,[578] with one commenter specifically noting that it supports the Commission's proposal to add the new instruction to Form NRSRO.[579] Commenters stated that the fines, penalties, and other sanctions currently applicable to NRSROs under the Exchange Act are ''sufficient,'' [580] and that no other additional fines or penalties are necessary or warranted.[581] However, one commenter suggested that, while other sections of the Exchange Act provide for appropriate penalties and sanctions, it is not appropriate to consider suspension or revocation of an NRSRO's registration under section 21C of the Exchange Act.[582]

The Commission is adopting Instruction A.10 to Form NRSRO [583] as proposed. As stated above, certain commenters agreed that the fines, penalties, and other sanctions currently applicable to NRSROs under the Exchange Act are sufficient and that additional fines, penalties, or other sanctions are not necessary or appropriate. Consequently, commenters supported the Commission's proposal to add Instruction A.10 to Form NRSRO. While the Commission is adopting Instruction A.10 to Form NRSRO, it is deferring establishing new fines or penalties in addition to those provided for in the Exchange Act. The Commission may choose to use the authority to establish new fines or penalties in the future.[584]

2. Economic Analysis

The final amendments should not create any costs for NRSROs and may provide some benefits. It could benefit credit rating agencies applying for registration as NRSROs and NRSROs because it should notify them of the potential consequences of violating provisions of the Exchange Act and Commission rules.

E. Disclosure of Information About the Performance of Credit Ratings

Section 932(a)(8) of the Dodd-Frank Act added subsection (q) to section 15E of the Exchange Act.[585] Section 15E(q)(1) provides that the Commission shall, by rule, require NRSROs to publicly disclose information on the initial credit ratings determined by the NRSRO for each type of obligor, security, and money market instrument, and any subsequent changes to such credit ratings, for the purpose of allowing users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different NRSROs.[586] Section 15E(q)(2) provides that the Commission's rules shall require, at a minimum, disclosures that:

- are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs; [587]
- are clear and informative for investors having a wide range of sophistication who use or might use credit ratings; [588]
- include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the NRSRO; [589]
- are published and made freely available by the NRSRO, on an easily accessible portion of its Web site, and in writing, when requested; [590]
- are appropriate to the business model of an NRSRO; [591] and
- require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the credit rating was influenced by any other business activities, that the credit rating was based solely on the merits of the instruments being rated, and that such credit rating was an independent evaluation of the risks and merits of the instrument.[592]

The rules in existence before today's amendments require NRSROs to publish two types of information about the performance of their credit ratings: (1) Performance statistics [593] and (2) rating histories.[594] The Commission proposed to implement the rulemaking mandated in section 15E(q) of the Exchange Act, in substantial part, by significantly enhancing the requirements for generating and disclosing this information by amending the instructions to Form NRSRO as they relate to Exhibit 1 and the disclosure of transition and default statistics, and by amending Rule 17g–1, Rule 17g–2, and Rule 17g–7 with respect to the disclosure of rating histories.[595] The Commission is adopting the amendments substantially as proposed, with modifications, in part, in response to comments received.

[575] *Id.* at 33552.

[576] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33552.

[577] *See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.*

[578] *See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.*

[579] *See DBRS Letter.*

[580] *See Morningstar Letter.*

[581] *See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.*

[582] *See A.M. Best Letter.* As discussed above in section II.B.3. of this release, the Commission has modified the final amendments relating to suspending or revoking an NRSRO's registration from the proposal so that it no longer incorporates section 21C of the Exchange Act.

[583] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33552.

[584] One commenter recommended the Commission re-propose the rules and, in doing so, invoke its authority under section 15E(p)(4) of the Exchange Act to seek fines and the disgorgement of profits when an NRSRO persistently ''issues non-standardized'' credit ratings. *See CFA II Letter.*

[585] *See* Public Law 111–203, 932(a)(8); 15 U.S.C. 78o–7(q).

[586] *See* 15 U.S.C. 78o–7(q)(1).

[587] *See* 15 U.S.C. 78o–7(q)(2)(A).

[588] *See* 15 U.S.C. 78o–7(q)(2)(B).

[589] *See* 15 U.S.C. 78o–7(q)(2)(C).

[590] *See* 15 U.S.C. 78o–7(q)(2)(D).

[591] *See* 15 U.S.C. 78o–7(q)(2)(E).

[592] *See* 15 U.S.C. 78o–7(q)(2)(F). As discussed in section II.G.4. of this release, the Commission is including this attestation requirement in the rule the Commission is adopting to implement section 15E(s) of the Exchange Act, which requires, among other things, that the Commission adopt rules requiring an NRSRO to generate a form to be included with the publication of a credit rating. *See* 15 U.S.C. 78o–7(s); paragraph (a)(1)(iii) of Rule 17g–7.

[593] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33434. This type of disclosure shows the performance of an NRSRO's credit ratings in the aggregate through statistics. Specifically, it provides the percent of credit ratings assigned to obligors, securities, and money market instruments in each category of credit rating in a rating scale (for example, AAA, AA, A, BBB, BB, B, CCC, CC, and C) that over a given time period were downgraded or upgraded to another credit rating category (''transition rates'') or classified as a default (''default rates''). The goal is to provide a mechanism for users of credit ratings to compare the performance statistics of credit ratings in each category across NRSROs.

[594] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33434. This type of disclosure shows the credit rating history of a given rated obligor, security, or money market instrument. Specifically, it shows the initial credit rating and all subsequent modifications to the credit rating (such as upgrades and downgrades) and the dates of such actions. The goal is to allow users of credit ratings to compare how different NRSROs rated an individual obligor, security, or money market instrument and how and when those ratings were changed over time. The disclosure of rating histories also is designed to provide ''raw data'' that can be used by third parties to generate independent performance statistics such as transition and default rates.

[595] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33433–33452.

1. Amendments to Instructions for Exhibit 1 to Form NRSRO

a. Proposal

Exhibit 1 is part of the registration application a credit rating agency seeking to be registered as an NRSRO must submit to the Commission and that an NRSRO must file with the Commission, keep up-to–date, and publicly disclose.[596] Section 15E(a)(1)(B)(i) of the Exchange Act requires that an application f or registration as an NRSRO include performance measurement statistics over short-term, mid-term, and long–term periods (as applicable).[597] The Commission implemented this requirement, in large part, through Exhibit 1 to Form NRSRO and the instructions for Exhibit 1.[598] Section 15E(b)(1)(A) of the Exchange Act provides that the performance measurement statistics must be updated annually in the annual certification required by section 15E(b)(2).[599] Paragraph (i) of Rule 17g–1 provides, among other things, that the NRSRO must make the annual certification publicly available within ten business days of furnishing the annual certification to the Commission.[600]

Before today's amendments, the instructions for Exhibit 1 required the applicant or NRSRO to provide performance statistics for the credit ratings of the applicant or NRSRO, including performance statistics for each class of credit ratings for which the applicant is seeking registration or the NRSRO is registered.[601] The classes of credit ratings for which an NRSRO can be registered are enumerated in the definition of *nationally recognized statistical rating organization* in section 3(a)(62) of the Exchange Act: (1) Financial institutions, brokers, or dealers;[602] (2) insurance companies;[603] (3) corporate issuers;[604] (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, ''as in effect on the date of enactment of this paragraph'');[605] and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.[606]

In addition, the instructions required that the performance statistics ''must at a minimum show the performance of credit ratings in each class over 1-year, 3-year, and 10-year periods (as applicable) through the most recent calendar year-end, including, as applicable: Historical ratings transition and default rates within each of the credit rating categories,[607] notches, grades, or rankings used by the applicant or NRSRO as an indicator of the assessment of the creditworthiness of an obligor, security, or money market instrument in each class of credit rating.''

Before today's amendments, the instructions for Exhibit 1 did not prescribe the methodology an applicant or NRSRO must use to calculate the performance statistics or the format by which they must be disclosed; nor did the instructions limit the type of information that can be disclosed in Exhibit 1.[608] Consequently, as stated in

[596] In particular, section 15E(a)(1)(A) of the Exchange Act requires an applicant to furnish an application for registration to the Commission, in such form as the Commission shall require, by rule or regulation. *See* 15 U.S.C. 78o–7(a)(1)(A). Section 15E(a)(1)(B) of the Exchange Act identifies information that must be included in the application for registration. *See* 15 U.S.C. 78o–7(a)(1)(B)(i) through (x). The Commission implemented sections 15E(a)(1)(A) and (B) of the Exchange Act by adopting Form NRSRO. *See* Form NRSRO *available at http://www.sec.gov/about/forms/formnrsro.pdf; see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33569–33582. Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, shall require an NRSRO, upon being granted registration, to make the information and documents in its completed application for registration, or in any amendment to its application, publicly available on its Web site, or through another comparable, readily accessible means, except for certain information that is submitted on a confidential basis. *See* 15 U.S.C. 78o–7(a)(3). The Commission implemented this provision by adopting paragraph (i) of Rule 17g–1. *See* 17 CFR 240.17g–1(i); *see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33569. Section 15E(b)(1) requires an NRSRO to promptly amend its application for registration if any information or document provided therein becomes materially inaccurate; however, (as discussed below) certain information does not have to be updated and other information must be updated only on an annual basis. *See* 15 U.S.C. 78o–7(b)(1); 15 U.S.C. 78o–7(b)(1); 15 U.S.C. 78o–7(a)(1)(B)(ix). The Commission implemented this provision by adopting Form NRSRO and paragraph (e) of Rule 17g–1. *See* Form NRSRO; 17 CFR 240.17g–1(e). *See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33567, 33569–33582.

[597] *See* 15 U.S.C. 78o–7(a)(1)(B)(i).

[598] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33628, 33634.

[599] *See* 15 U.S.C. 78o–7(b)(1) and (2). In particular, section 15E(b) of the Exchange Act provides that not later than ninety days after the end of each calendar year, an NRSRO shall file with the Commission an amendment to its registration application, in such form as the Commission, by rule, may prescribe: (1) Certifying that the information and documents in the application for registration continue to be accurate; (2) listing any material change that occurred to such information and documents during the previous calendar year; and (3) updating its credit ratings performance measurement statistics. *See* 15 U.S.C. 78o–7(b). The Commission implemented these provisions by adopting Form NRSRO and paragraph (f) of Rule 17g–1. *See* Instruction F to Form NRSRO; 17 CFR 240.17g–1(f). *See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33567, 33569–33582.

[600] *See* 17 CFR.240.17g–1(i).

[601] As used throughout this release, the term category of a credit rating scale refers to a distinct level in a rating scale represented by a unique symbol, number, or score. For example, if a rating scale consists of symbols (for example, AAA, AA, A, BBB, BB, B, CCC, CC, and C), each unique symbol would represent a category in the rating scale. Similarly, if a rating scale consists of numbers (for example, 1, 2, 3, 4, 5, 6, 7, 8, and 9), each number would represent a category in the rating scale. Each category also represents a notch in the rating scale. In addition, some NRSRO rating scales attach additional symbols or numbers to the symbols representing categories in order to denote gradations within a category. For example, a rating scale may indicate gradations within a category by attaching a plus or a minus or a number to a rating symbol. For example, AA+, AA, and AA- or AA1, AA2, and AA3 would be three gradations within the AA category. If a rating scale has gradations within a category, each category and gradation within a category would constitute a notch in the rating scale. For example, the following symbols would each represent a notch in the rating scale in descending order: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, CCC+, CCC, CCC-, CC, C, and D. Furthermore, for the purposes of this release, changing a credit rating (for example, upgrading or downgrading the credit rating) means assigning a credit rating at a different notch in the rating scale (for example, downgrading an obligor assigned an AA rating to an AA- rating or an A+ rating).

[602] *See* 15 U.S.C. 78c(a)(62)(A)(i).

[603] *See* 15 U.S.C. 78c(a)(62)(A)(ii).

[604] *See* 15 U.S.C. 78c(a)(62)(A)(iii).

[605] *See* 15 U.S.C. 78c(a)(62)(A)(iv). The instructions for Exhibit 1 in existence before today's amendments broadened this class of credit rating to include a credit rating of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. The intent of the instruction was to include in the class (and, therefore, in the performance statistics for the class) credit ratings for structured finance products that are outside the scope of the definition referenced in section 3(a)(62)(A)(iv) of the Exchange Act. *See* 15 U.S.C. 78c(a)(62)(A)(iv); *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6458. As discussed below, the final amendments to the instructions for Exhibit 1 continue to use this broadened definition.

[606] *See* 15 U.S.C. 78c(a)(62)(A)(v). With respect to this class of credit ratings, the instructions for Exhibit 1 in existence before today's amendments required the applicant or NRSRO to provide performance measurement statistics for the following three subclasses (as opposed to the class as a whole): Sovereigns, U.S. public finance, and international public finance. As discussed below, the final amendments to the instructions for Exhibit 1 continue to require performance statistics for these subclasses.

[607] The transition rate is the percent of credit ratings at a given rating notch that transition to another specified rating notch over a given time period. Only credit ratings that were outstanding at the beginning of the time period are used in the calculation of the transition rate. Transition rates are generally used to measure the stability of credit ratings. The default rate is the percent of credit ratings at a given rating notch that have defaulted over a given time period. Only the credit ratings that were outstanding at the beginning of the time period are used in the calculation.

[608] When adopting Form NRSRO, the Commission explained that the instructions would not prescribe how NRSROs must calculate transition rates and default rates, noting that commenters had opposed a standard approach because NRSROs use different

a 2010 report of the GAO, NRSROs at that time used different techniques to produce performance statistics, which limited the ability of investors and other users of credit ratings to compare the performance of credit ratings across NRSROs.[609] In addition, several NRSROs included substantial amounts of information in Exhibit 1 about performance statistics, in addition to transition and default rates.

As noted above, NRSROs have produced and presented performance statistics in various ways. For example, for the calendar year 2009 performance statistics published by the NRSROs, some NRSROs used a ''single cohort approach'' to determine transition rates for their credit ratings.[610] Under this approach, an NRSRO would calculate transition rates for the most recent 1-year, 3-year, or 10-year period. For example, for its 2009 3-year transition rates for corporate issuers using the single cohort approach, an NRSRO would calculate transition rates for the class of corporate issuers for the period December 31, 2006 through December 31, 2009. Other NRSROs used an ''average cohort approach.'' [611] Under this approach, an NRSRO would calculate transition rates for multiple 1-year, 3-year, or 10-year periods and then average them. For example, for its 2009 3-year transition rates for corporate issuers using the average cohort approach, an NRSRO would calculate 3-year transition rates for the class of corporate issuers for multiple 3-year periods (for example, 3-year periods from 1981 to 2009) and then average them. Two NRSROs also published ''Lorenz curves,'' which are ''visual tools for assessing the accuracy of the rank ordering of creditworthiness that a set of ratings provides.'' [612] The GAO found that the variability in how NRSROs produce performance statistics limited the ability of investors and other users of credit ratings to compare the performance of credit ratings across NRSROs.[613]

As described by the GAO, the single cohort approach uses information from the most recent time periods, while the average cohort approach uses information from multiple time periods. The GAO stated that the single cohort approach may be useful to predict the performance of credit ratings under similar circumstances, while the average cohort approach may be useful to predict future transition rates under different economic and other conditions.[614] The GAO also found that ''[b]oth approaches are valid, depending on the needs of the user, but they do not yield comparable information.'' [615]

As indicated above, before today's amendments, the instructions for Exhibit 1 permitted NRSROs to use differing methods to calculate performance statistics and to include additional information in Exhibit 1. This created the potential that the presentation of information in the exhibits would be inconsistent across NRSROs. To address this issue and to implement section 15E(q) of the Exchange Act, the Commission proposed significant amendments to the instructions for Exhibit 1.[616] The proposed amendments would standardize the calculation of the performance statistics by requiring the applicant or NRSRO to calculate 1-year, 3-year, and 10-year transition and default rates for each applicable class and subclass of credit rating using a single cohort approach.[617] Further, the results would need to be presented in tabular form using a standardized format (a ''Transition/Default Matrix'').[618] Finally, the proposed amendments would specify that an applicant or NRSRO must not disclose information in the Exhibit that is not required to be disclosed.[619]

Under the proposal, the ''issuers of asset-backed securities'' class of credit ratings would be divided into the following subclasses: RMBS; CMBS; collateralized loan obligations (''CLOs''); CDOs; asset-backed commercial paper (''ABCP''); other asset-backed securities (''other ABS''); and other structured finance products (''other SFPs'').[620]

As stated above, under the proposal the applicant or NRSRO would be required to use the single cohort approach to calculate transition and default rates in order to determine the percent of credit ratings at each notch in the rating scale for a given class or subclass and for the applicable time period (one, three, or ten years) that were rated at the same notch or transitioned to another notch as of the end of the period, and the percent of credit ratings at each notch that were classified as a default or paid off, or had been withdrawn for reasons other than being classified as a default or paid off during the period.[621] For example, a matrix containing 3-year transition and default rates for the class of corporate issuers would disclose the number of credit ratings of corporate issuers the applicant or NRSRO had outstanding as of the period start date that is three years prior to the most recent calendar year end at each notch in the rating scale used by the applicant or NRSRO, the percent of those credit ratings that were rated at the same notch and the percent that transitioned to each other notch in the rating scale as of the end of the 3-year period, and the percent that were classified as a default or paid off, or had been withdrawn at any time during the 3-year period.[622]

The Commission proposed that an applicant or NRSRO must classify the credit rating assigned to an obligor, security, or money market instrument as a *default* if, during the applicable period, either: (1) The obligor failed to timely pay principal or interest due according to the terms of an obligation or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument; or (2) the applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own

methodologies to determine credit ratings. *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33574. The Commission stated that it intended to continue to consider the issue ''to determine the feasibility, as well as the potential benefits and limitations, of devising measurements that would allow reliable comparisons of performance between NRSROs.'' *Id.* The Commission took an incremental step toward standardizing the disclosure requirements in Exhibit 1 by amending the Form in 2009 to require an NRSRO to disclose transition and default rates for each class of credit rating for which it was registered and for 1-year, 3-year, and 10-year periods. *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations* 74 FR at 6457–6459.

[609] *See, e.g.,* GAO, *Securities and Exchange Commission: Action Needed to Improve Rating Agency Registration Program and Performance Related Disclosures,* Report 10–782 (Sept. 2010) (''GAO Report 10–782''). Section 7 of the Rating Agency Act required the GAO to review the implementation of the Rating Agency Act of 2006. *See* Public Law 109–291, 7. Among other things, the report evaluated the performance-related NRSRO disclosures required by Commission rules under the Exchange Act. *See* GAO Report 10–782, pp. 24–46.

[610] *See* GAO Report 10–782, p. 28.

[611] *Id.*

[612] *Id.* at 25, note 38 (''[Lorenz curves] are considered useful for comparing the relative accuracy of different rating systems or the relative accuracy of a single rating system measured at different points of time for different cohorts.'').

[613] *Id.* at 27–37.

[614] *Id.* at 27.

[615] *Id.* at 27.

[616] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33434–33444. *See also* 15 U.S.C. 78o–7(q)(2)(A) (requiring that the Commission's rules require disclosures that are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs).

[617] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33556–33558.

[618] *See id.* at 33557.

[619] *See id.* at 33556–33557.

[620] *See id.* at 33556.

[621] *See id.* at 33556–33558.

[622] *See id.* at 33556–33558.

definition of default.[623] The applicant or NRSRO would need to classify an obligor, security, or money market instrument as having gone into default even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of default or withdrew the credit rating on or after the event of default.[624]

As proposed, an applicant or NRSRO would classify a credit rating assigned to an obligor, security, or money market instrument as *paid off* if, during the applicable period: (1) An obligor extinguished the obligation by paying in full all outstanding principal and interest due on the obligation according to the terms of the obligation (for example, because the obligation matured, was called, or was prepaid) and the applicant or NRSRO withdrew the credit rating because the obligation was extinguished; or (2) the issuer of a security or money market instrument extinguished its obligation with respect to the security or money market instrument by paying in full all outstanding principal and interest due according to the terms of the security or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid) and the applicant or NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.[625]

The proposal would require the applicant or NRSRO to determine and disclose the number of obligors, securities, and money market instruments assigned a credit rating as of the period start date for which the applicant or NRSRO withdrew a credit rating at any time during the applicable time period for a reason other than that the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid-off.[626] The applicant or NRSRO would have to classify the credit rating assigned to the obligor, security, or money market instrument as withdrawn even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing the credit rating.[627]

Finally, the performance statistics would need to be presented in a ''Transition/Default Matrix'' in a format specified in the instructions, which included a sample matrix.[628]

b. Final Rule

Paragraph (1) of the instructions for Exhibit 1. The Commission is adopting paragraph (1) of the instructions for Exhibit 1 with two technical modifications from the proposal.[629] This paragraph requires the applicant or NRSRO to provide performance statistics for each class of credit ratings for which the applicant is seeking registration as an NRSRO or the NRSRO is registered and for the applicable subclasses of credit ratings listed in the paragraph.[630] Specifically, it requires the applicant or NRSRO to provide transition and default rates for 1-year, 3-year, and 10-year periods for each applicable class or subclass of credit rating.[631] It further requires the applicant or NRSRO to produce and present three separate transition and default statistics for each applicable class or subclass of credit rating; namely, for 1-year, 3-year, and 10-year time periods through the most recent calendar year end. In addition, the applicant or NRSRO must present the transition and default rates for each time period together in tabular form using a standard format (a ''Transition/Default Matrix'').[632]

Paragraph (1) of the instructions for Exhibit 1 specifies the classes and subclasses of credit ratings for which the applicant or NRSRO must produce Transition/Default Matrices, as applicable.[633] The identified classes reference the classes of credit ratings for which an NRSRO can be registered as enumerated in the definition of *nationally recognized statistical rating organization* in section 3(a)(62)(A) of the Exchange Act.[634] As was the case prior to today's amendments, the class of credit ratings enumerated in section 3(a)(62)(A)(iv) of the Exchange Act (issuers of certain asset-backed securities) is expanded to include a broader range of structured finance products than are within the scope of the definition in section 3(a)(62)(A)(iv).[635] Moreover, this class has been divided into the following subclasses: RMBS;[636] CMBS;[637] CLOs;[638] CDOs;[639] ABCP;[640] other

[623] *See id.* at 33557–33558.

[624] *See id.* at 33441–33442, 33557–33558.

[625] *See id.* at 33557–33558.

[626] *See* 15 U.S.C. 78o–7(q)(2)(C) (requiring that the disclosures include information for credit ratings withdrawn by the NRSRO).

[627] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33557–33558.

[628] *See id.* at 33557.

[629] *See* paragraph (1) of the instructions for Exhibit 1. One commenter stated that the phrase ''up-to-date Exhibit 1'' as used in proposed paragraph (1) of the instructions for Exhibit 1 was ambiguous. *See Moody's Letter.* Specifically, as proposed, paragraph (1) of the instructions for Exhibit 1 would provide that the performance measurement statistics must be updated yearly in the NRSRO's annual certification in accordance with section 15E(b)(1)(A) of the Exchange Act and paragraph (f) of Rule 17g–1 (in particular, a Form NRSRO with updated performance measurement statistics—the annual certification—must be filed with the Commission no later than ninety days after the end of the calendar year). The proposed instructions also would remind an NRSRO that, pursuant to paragraph (i) of Rule 17g–1, the annual certification with the updated performance measurement statistics must be made publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet Web site within ten business days after the filing and that the NRSRO must make its ''up-to-date'' Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit. The Commission agrees with the comment and is replacing the phrase ''up-to-date Exhibit 1'' with the phrase ''most recently filed Exhibit 1'' as suggested by the commenter. Further, as proposed, the instructions referenced the ''classes and subclasses'' for which an applicant is seeking registration or for which an NRSRO is registered. As discussed in section II.I.1. of this release, a commenter noted that applicants and NRSROs do not register in ''subclasses'' of credit ratings. *See DBRS Letter.* Paragraph (1) of the instructions for Exhibit 1 has therefore been modified to make this clear. *See* paragraph (1) of the Instructions for Exhibit 1.

[630] *See* paragraph (1) of the instructions for Exhibit 1.

[631] *See id.*

[632] *See id.*

[633] *See id.*

[634] *Compare* 15 U.S.C. 78c(a)(62)(A)(i) through (v), *with* paragraphs (1)(A) through (E) of the instructions for Exhibit 1. As was the case prior to today's amendments, paragraph (1) of the instructions for Exhibit 1 divides the class of credit ratings enumerated in section 3(a)(62)(A)(v) of the Exchange Act (issuers of government securities, municipal securities, or securities issued by a foreign government) into three subclasses: Sovereign issuers; U.S. public finance; and international public finance. *See* paragraph (1) of the instructions for Exhibit 1.

[635] *See* paragraph (1) of the instructions for Exhibit 1; 15 U.S.C. 78c(a)(62)(A)(iv). As was the case before today's amendments, the instructions for Exhibit 1 broaden this class of credit rating to include a credit rating of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.

[636] The instructions provide that *RMBS* means a securitization of primarily residential mortgages. *See* paragraph (1)(D)(i) of the instructions for Exhibit 1.

[637] The instructions provide that *CMBS* means a securitization of primarily commercial mortgages. *See* paragraph (1)(D)(ii) of the instructions for Exhibit 1.

[638] The instructions provide that *CLO* means a securitization of primarily commercial loans. *See* paragraph (1)(D)(iii) of the Instructions for Exhibit 1.

[639] The instructions provide that *CDO* means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other ABS, and corporate bonds. *See* paragraph (1)(D)(iv) of the instructions for Exhibit 1.

[640] The instructions provide that *ABCP* means short term notes issued by a structure that securitizes a variety of financial assets (for example, trade receivables, credit card receivables), which secure the notes. *See* paragraph (1)(D)(v) of the instructions for Exhibit 1.

ABS;[641] and other structured finance products.[642]

Regarding the proposed seven subclasses of asset-backed securities, one commenter stated that the proposed degree of granularity ''would lead to the creation of sparse Transition/Default Matrices because many NRSROs do not have enough ratings for each proposed subclass to produce statistically significant results'' and that the class of ABS ratings should be divided into three classes: RMBS, CMBS, and ''Other ABS.''[643] Another NRSRO stated that dividing the class of credit ratings for structured finance products as proposed ''would tend to further increase market transparency'' and that the proposed subclasses are ''suitable,'' but that ''greater stratification may in some cases produce subclasses that are too small to generate meaningful statistics.''[644]

In response, the Commission notes that the reason for dividing the broad class of structured finance products into these subclasses is to provide investors and other users of credit ratings with more useful information about the performance of an NRSRO's structured finance credit ratings.[645] Each subclass has characteristics that distinguish it from the other subclasses. Consequently, the separation of performance statistics into these subclasses will provide users of credit ratings with additional information and allow them to compare the performance of the credit ratings in each subclass among the NRSROs. Further, the NRSRO must disclose the number of credit ratings outstanding in each subclass at the beginning of the period, so users of credit ratings will be aware of the number of credit ratings the statistics are based upon.

Paragraph (2) of the instructions for Exhibit 1. The Commission is adopting paragraph (2) of the instructions for Exhibit 1 with modifications.[646] This paragraph prescribes how the applicant or NRSRO must present the performance statistics and other required information in the Exhibit.[647] Specifically, it requires that the Transition/Default Matrices for each applicable class and subclass of credit ratings be presented in the order that the classes and subclasses are identified in paragraphs (1)(A) through (E) of the instructions for Exhibit 1.[648] In addition, the order of the Transition/Default Matrices for a given class or subclass must be: The 1-year matrix, the 3-year matrix, and then the 10-year matrix.[649] Further, if the applicant or NRSRO did not issue credit ratings in a particular class or subclass for the length of time necessary to produce a Transition/Default Matrix for a 1-year, 3-year, or 10-year period, it must explain that fact in the location where the Transition/Default Matrix would have been presented in the Exhibit.[650]

The instructions require the applicant or NRSRO to clearly define in Exhibit 1, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the applicant or NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit.[651] The instructions also require the applicant or NRSRO to clearly explain the conditions under which it classifies obligors, securities, or money market instruments as being in default.[652] Further, the instructions require that the applicant or NRSRO provide in Exhibit 1 the uniform resource locator (''URL'') of its corporate Internet Web site where the credit rating histories required to be disclosed pursuant to paragraph (b) of Rule 17g-7 would be located (in the case of an applicant) or are located (in the case of an NRSRO).[653]

Finally, as proposed, the instructions provided that the Exhibit must contain no performance statistics or information other than as described in, and required by, the instructions for Exhibit 1; except that the applicant or NRSRO would be permitted to provide, after the presentation of all required Transition/Default Matrices and other required disclosures, Internet Web site URLs where other information relating to performance statistics of the applicant or NRSRO is located.[654] This provision was intended to address the fact that some NRSROs included substantial amounts of information in Exhibit 1 about performance statistics, in addition to transition and default rates.[655] As discussed in more detail below, some commenters stated that there are advantages and limitations to using the single cohort approach as compared to the average cohort approach to calculate the performance statistics.[656] While the instructions for Exhibit 1 mandate the use of the single cohort approach, the Commission believes that, if an NRSRO also calculates performance statistics using the average cohort approach, it would be appropriate to disclose that fact in Exhibit 1 and provide an Internet URL where the performance statistics are located. This will provide additional information to evaluate the performance of the NRSRO's credit ratings. For these reasons, paragraph (2) of the instructions for Exhibit 1 has been modified to provide that Exhibit 1 must contain no performance measurement statistics or information other than as described in, and required by, the Instructions for Exhibit 1; except that

[641] The instructions provide that *other ABS* means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, equipment loans, or equipment leases. *See* paragraph (1)(D)(vi) of the instructions for Exhibit 1.

[642] The instructions provide that *other structured finance product* means a structured finance product that does not fit into any of the other subclasses of structured products. *See* paragraph (1)(D)(vii) of the instructions for Exhibit 1.

[643] *See DBRS Letter.*

[644] *See S&P Letter.*

[645] *See, e.g.,* GAO Report 10–782, p. 36 (observing that the various structured finance sectors have risk characteristics that vary significantly and, therefore, presenting performance statistics for the class as a whole ''may not be useful.''). During the recent crisis, NRSROs assigned credit ratings to RMBS and CDOs that performed far differently than credit ratings of some other types of securitizations. *See, e.g.,* S&P, *A Global Cross-Asset Report Card of Ratings Performance in Times of Stress* (June 8, 2010).

[646] *See* paragraph (2) of the instructions for Exhibit 1.

[647] *See id.*

[648] *See id.*

[649] *See id.*

[650] *See id.* For example, if an NRSRO is registered in the corporate issuer class but has been issuing credit ratings for only seven years in that class, it could not produce a 10-year Transition/Default Matrix for the class. Instead, the NRSRO must provide an explanation in the location where a 10-year Transition/Default Matrix would have been located (namely, after the 3-year matrix) that it had not been issuing credit ratings in that class for a sufficient amount of time to produce a 10-year Transition/Default Matrix.

[651] *See* paragraph (2) of the instructions for Exhibit 1. As discussed in section II.J.2. of this release, the Commission is implementing section 938(a)(2) of the Dodd-Frank Act through paragraph (b)(2) of Rule 17g-8, which requires an NRSRO to have policies and procedures reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class of credit ratings for which the NRSRO is registered, including in Exhibit 1 to Form NRSRO. *See* Public Law 111–203, 938(a)(2); paragraph (b)(2) of Rule 17g–8.

[652] *See* paragraph (2) of the instructions for Exhibit 1.

[653] *See id.* As discussed below in section II.E.3. of this release, the Commission is amending Rule 17g–2 and Rule 17g–7 to enhance the rating histories disclosure requirements currently codified in Rule 17g–2. Among other things, the amendments relocate the credit rating history disclosure requirements from Rule 17g–2 to Rule 17g–7.

[654] *See* paragraph (2) of the instructions for Exhibit 1. To the extent that an NRSRO wishes to include other information that it believes is relevant for the purposes of drawing comparisons among credit ratings, the NRSRO could use an Internet Web site URL as a channel to provide the reader with additional information the NRSRO believes to be relevant.

[655] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33437.

[656] The advantages and limitations of the single cohort approach as compared to the average cohort approach are also discussed in section II.E.4. of this release.

the NRSRO may provide after the presentation of all required Transition/Default Matrices and other disclosures:

- A short statement describing the required method of calculating the performance measurement statistics in Exhibit 1 (the single cohort approach) and any advantages or limitations to the single cohort approach the NRSRO believes would be appropriate to disclose;
- A short statement that the NRSRO has calculated and published on an Internet Web site performance measurement statistics using the average cohort approach (if applicable), a description of the differences between the single cohort approach and the average cohort approach used to calculate the performance measurement statistics, and the Internet Web site URL where the performance measurements statistics calculated using the average cohort approach are located; and
- The Internet Web site URLs where any other information relating to performance measurement statistics of the NRSRO is located.[657]

Paragraph (3) of the instructions for Exhibit 1. The Commission is adopting paragraph (3) of the instructions for Exhibit 1 with modifications to make the disclosures more understandable to users of credit ratings.[658] This paragraph prescribes the format for a Transition/Default Matrix and includes a sample matrix.[659] Specifically, the prescribed format is designed to allow the applicant or NRSRO to show in the matrix the number of outstanding credit ratings in the class or subclass at each notch in the applicable rating scale at the period start-date, and the percent of those credit ratings that were rated at the same notch at the end of the period, the percent of those credit ratings that were rated at each different notch in the rating scale at the end of the period, and the percent of those credit ratings that were classified as a default or paid off or were withdrawn at any time during the period.[660] The prescribed format also is designed so that this information will be displayed in Exhibit 1 in a standard manner across the NRSROs to make it easier for users of NRSRO credit ratings and others to understand and compare the statistics.

One commenter suggested adding the heading ''Status of those ratings at the end of the time period'' to the Transition/Default Matrix because ''less sophisticated investors'' may not understand the term ''transition,'' and also suggested that it may be useful to highlight the box on the chart that corresponds with the credit rating being at the same notch at the end of the period as it was at the beginning.[661] The Commission agrees that these types of modifications could assist users to better understand the information disclosed in the Transition/Default Matrices. Consequently, the narrative instructions in paragraph (3) and the illustration of the sample Transition/Default Matrix have been modified to require highlighting of the cell in the matrix that corresponds with the credit rating being at the same notch at the end of the period as it was at the beginning and to require that the legends at the top of the matrix reflect that the first two columns represent the status of the credit ratings as of the period start date, the subsequent rating category columns represent the status of the credit ratings as of the period end date, and the *Default, Paid Off,* and *Withdrawn (other)* columns represent other outcomes that occurred during the period.[662]

As adopted, the sample Transition/Default Matrix in Figure 2 is the sample matrix provided in the instructions that the applicant or NRSRO must use as a model for its Transition/Default Matrices.

Figure 2
Corporate Issuers – 10-Year Transition and Default Rates
(December 31, 2000 through December 31, 2010)

Credit Ratings as of 12/31/2000		Credit Ratings as of 12/31/2010 (Percent)									Other Outcomes During 12/31/2000-12/31/2010 (Percent)		
Credit Rating	Number of Ratings Outstanding	AAA	AA	A	BBB	BB	B	CCC	CC	C	Default	Paid Off	Withdrawn (other)
AAA	10	50%	10%									40%	
AA	2000	1%	39%	12%	10%	8%	5%	4%			1%	19%	1%
A	4000		6%	34%	15%	10%	6%	4%	3%		2%	18%	2%
BBB	3600		2%	9%	28%	15%	10%	6%	5%	1%	4%	17%	3%
BB	1000			2%	4%	20%	14%	5%			2%	16%	37%
B	500			1%	3%	6%	20%	20%	15%		15%	15%	5%
CCC	300					4%	6%	15%	25%	20%	20%	4%	6%
CC	200						2%	8%	10%	38%	30%	2%	10%
C	160							2%	8%	10%	67%	1%	12%
Total	11,770												

Paragraph (4) of the instructions for Exhibit 1. The Commission is adopting paragraph (4) of the instructions for Exhibit 1 with the modifications discussed below.[663] This paragraph prescribes how the applicant or NRSRO must calculate the performance statistics and enter information into the Transition/Default Matrices.[664]

[657] *See* paragraph (2) of the instructions for Exhibit 1.

[658] *See* paragraph (3) of the instructions for Exhibit 1.

[659] *See id.*

[660] *See id.*

[661] *See CFA/AFR Letter.* One commenter also suggested that the Commission re-propose the rules and, in doing so, require NRSROs to present their performance statistics in a way that allows the public to compare and cross-reference different assets with the same credit rating. *See CFA II Letter.* The Commission believes the amendments being adopted today—by simplifying the presentation of the transition and default statistics and enhancing the rating history disclosures—will make it much easier for this kind of comparison to be made.

[662] *See* paragraph (3) of the instructions for Exhibit 1.

[663] *See* paragraph (4) of the instructions for Exhibit 1.

[664] *See id.*

Determining Start Date Cohorts

The final amendments (as was proposed) require the applicant or NRSRO to use the single cohort approach to calculate the transition and default rates.[665] One NRSRO stated that the single cohort approach is a ''reasonable approach'' and ''is the best approach as it is, in our opinion, the clearest way to calculate a meaningful default rate.'' [666] Another NRSRO requested that the Commission provide ''fuller background'' on decisions such as the determination to use the single cohort approach rather than an average cohort approach, with a description of potential benefits and limitations of those decisions.[667] Some commenters suggested that the Commission use an average cohort approach in lieu of or in addition to the single cohort approach.[668]

The Commission recognizes that different methods of measuring the performance of credit ratings may have unique advantages in terms of the information provided. As the GAO noted in comparing the single cohort approach and the average cohort approach, ''[b]oth approaches are valid, depending on the needs of the user, but they do not yield comparable information.'' [669] For example, the average cohort approach may provide better information about how credit ratings perform on average across a wider variety of economic conditions when compared to the single cohort approach.[670] However, the single cohort approach, because it does not average out performance over multiple cohorts, may more readily highlight how a given NRSRO's credit ratings have performed in more recent economic cycles.

Moreover, the single cohort approach is a simpler approach than the other methods noted by the GAO and, therefore, it may be easier for less sophisticated investors and other users of credit ratings to understand how the performance statistics were produced. As stated above, section (q)(2)(B) of the Exchange Act provides that the Commission's rules shall require that the performance measurement disclosures be clear and informative for investors having a wide range of sophistication.[671] The Commission notes that one commenter stated that the single cohort approach ''is the clearest way to calculate a meaningful default rate.'' [672] In addition, it will be easier for NRSROs to produce performance statistics using this approach as it requires simpler calculations and, consequently, will be less burdensome than the other approaches.

One commenter stated that the single cohort approach could lead to results that are ''significantly more volatile within the shorter time period, which will make interpreting those results more difficult.'' [673] This commenter stated further that ''the volatility impact will be amplified for NRSROs with fewer ratings, which could lead to bias against smaller NRSROs.'' [674] The Commission has balanced this concern with the need to prescribe an easy to understand method for calculating the performance statistics. As discussed below, the requirements in the instructions for Exhibit 1 provide for very transparent disclosures about the number of credit ratings in the start date cohort and in the cohort for each notch in the credit rating scale of a given class or subclass.[675] This transparency will provide persons reviewing the performance statistics with information to assess how the small number of credit ratings in a given cohort may have impacted the results.[676] Moreover, as discussed above, the Commission has modified paragraph (2) of the instructions for Exhibit 1 to permit an NRSRO to include a statement about any advantages or limitations to the single cohort approach the firm believes would be appropriate to disclose and, if applicable, a statement disclosing that the NRSRO has calculated performance statistics using the average cohort approach and identifying the Internet Web site URL where those statistics are located.

One commenter suggested that NRSROs should be required to calculate performance statistics using both the single cohort approach and the average cohort approach.[677] One of the objectives of the amendments is to make the disclosures in Exhibit 1 to Form NRSRO shorter and easier to understand. Mandating two sets of 1-year, 3-year, and 10-year performance statistics (one based on the single cohort approach and one based on the average cohort approach) for each class or subclass of credit ratings would substantially increase the length and complexity of the disclosure in Exhibit 1. In addition, it would increase the compliance burden. However, as discussed above, NRSROs that also calculate performance statistics using the average cohort approach can disclose that fact in Exhibit 1.

Finally, one commenter stated that NRSROs should be required to use the single cohort approach for credit ratings of corporate and sovereign debt and a ''static pool approach'' for credit ratings of structured finance products.[678] The Commission believes that doing so would make the disclosure unnecessarily complex and undermine the objective of making the performance statistics clear and informative for investors having a wide range of sophistication.[679]

For all the reasons discussed above, the final amendments require NRSROs to produce the performance statistics using the single cohort approach.[680] However, in response to comments, the Commission is modifying the requirement with respect to identifying the credit ratings that must be included in a start-date cohort. Several commenters addressed the proposed requirement that a start-date cohort consist of the obligors, securities, and money market instruments in the applicable class or subclass of credit ratings that were assigned a credit rating as of the beginning of the period. One NRSRO stated that ''mixing units of study,'' consisting of obligors, securities, and money-market instruments ''can create mismatched data and potentially double counting.'' [681] Similarly, another NRSRO recommended that, except for the structured finance class of credit

[665] *See id.*

[666] *See S&P Letter.* This commenter also stated that a better way to measure the performance of rating systems ''that do not define their ratings in terms of target default and transition rates'' is ''a measure of rank-ordering power, such as the Gini coefficient.''

[667] *See Kroll Letter.*

[668] *See DBRS Letter* (advocating use of the average cohort approach); *CFA/AFR Letter* (advocating using both approaches).

[669] *See, e.g.,* GAO Report 10–782, p. 28.

[670] *See* section II.E.4. of this release (discussing in more detail the relative advantages of the single and average cohort approaches).

[671] *See* 15 U.S.C. 78o–7(q)(2)(B).

[672] *See S&P Letter.*

[673] *See DBRS Letter.*

[674] *See id.*

[675] *See* paragraph (4)(A) of the instructions for Exhibit 1 (requiring the applicant or NRSRO to enter into the second column of the Transition/Default Matrix the number of credit ratings in the start-date cohort for each notch in the rating scale). This disclosure is illustrated in the first and second columns of the Sample Transition/Default Matrix in Figure 2 (above).

[676] For example, if the outcome for a notch with ten credit ratings is that five were classified as a default during the period, the default rate reflected on the Transition/Default Matrix for that notch would be 50%. Similarly, if the outcome of a notch with 5,000 credit ratings is that 2,500 were classified as a default during the period, the default rate for that notch would be 50% as well. Investors and other users of credit ratings might conclude that 2,500 credit ratings being classified as defaulting during the period reflects significantly worse performance than five credit ratings being classified as defaulting during the period.

[677] *See CFA/AFR Letter.*

[678] *See TradeMetrics Letter.*

[679] *See* 15 U.S.C. 78o–7(q)(2)(B).

[680] *See* paragraph (4) of the instructions for Exhibit 1.

[681] *See Kroll Letter.*

ratings, the rule should require calculating a senior credit rating for a given issuer and using that rating in the construction of the cohort, as a single issuer can have many issuances, and including each one in the cohort may skew the performance statistics.[682] A third NRSRO stated that for the structured finance category of credit ratings, ''the obligations/issues should be included in the start-date cohorts'' because ''those transactions do not have obligors in a traditional sense . . .''[683] A fourth NRSRO agreed, stating that ''the start-date cohorts should be comprised of obligors for corporate ratings and securities lines for the various subclasses of structured finance ratings.''[684]

The Commission agrees with these comments and has modified the instructions. The final amendments provide that, to determine the number of credit ratings outstanding as of the period start date for all classes of credit ratings other than the class of issuers of asset-backed securities, the applicant or NRSRO must: (1) Identify each obligor that the applicant or NRSRO assigned a credit rating to as an entity where the credit rating was outstanding as of the period start date; (2) identify each additional obligor that issued securities or money market instruments that the applicant or NRSRO assigned credit ratings to where the credit ratings were outstanding as of the period start date; and (3) include in the start-date cohort only credit ratings assigned to an obligor as an entity, or, if the obligor is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt.[685] All other credit ratings outstanding as of the period start date assigned to securities or money market instruments issued by the obligor must be excluded from the start-date cohort.[686] For the class of issuers of asset-backed securities, the start-date cohort (as was proposed) must consist of credit ratings that the applicant or NRSRO assigned to all securities or money market instruments in the class where the credit ratings were outstanding as of the period start date, excluding expected or preliminary credit ratings.[687]

Finally, as proposed, the start date cohort for all classes of credit ratings must exclude credit ratings that the applicant or NRSRO classified as in default (using its own definition of *default*) as of the period start-date (and, as discussed above, expected or preliminary credit ratings).[688] As explained in the proposing release, the Transition/Default Matrices should not include credit ratings of obligors, securities, and money market instruments the applicant or NRSRO has classified as in default because the firm is no longer assessing the relative likelihood that the obligor, security, or money market will continue to meet its obligations to make timely payments of principal and interest as they come due (that is, not default on its obligations).[689] Consequently, as long as the obligor, security, or money market instrument continues to be classified as in default there is no credit rating performance to measure. However, if the credit rating is upgraded from the default category because, for example, the obligor emerges from a bankruptcy proceeding, the obligor's credit rating will need to be included in a Transition/Default Matrix that has a start date after the upgrade.[690]

After determining the credit ratings in the start-date cohort, the applicant or NRSRO must determine the number of credit ratings in the start-date cohort for each notch in the rating scale used for the class or subclass as of the period start date.[691] The final step is to enter

[682] *See Moody's Letter.*

[683] *See S&P Letter.*

[684] *See DBRS Letter.*

[685] *See* paragraph (4)(A) of the instructions for Exhibit 1.

[686] *See id.* For example, assume an obligor is assigned a credit rating of AA as an entity, and also has outstanding senior unsecured debt that is also rated AA and subordinated debt that is rated BBB, meaning there are a total of three credit ratings associated with the obligor. Under the final amendments, the obligor's credit rating as an entity must be included in the start-date cohort, and the credit ratings of the obligor's senior unsecured debt and subordinated debt must be excluded. Alternatively, if the obligor in the above example is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt must be included in the start-date cohort and the credit rating of the obligor's subordinated debt must be excluded.

[687] *See* paragraph (4)(A) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33438. For example, assume a structured finance issuer has ten tranches of securities and the NRSRO has assigned credit ratings to six of the tranches. All six credit ratings must be included in the start-date cohort. As stated, ''expected'' or ''preliminary'' credit ratings must be excluded from the start-date cohort. These types of credit ratings most commonly are issued by an NRSRO with respect to a structured finance product at the time the issuer commences the offering and typically are included in pre-sale reports. Expected or preliminary credit ratings may include a range of credit ratings, or any other indications of a credit rating prior to the assignment of an initial credit rating for a new issuance. Consequently, they should be excluded from the start date cohort since the issuance of the initial credit rating is the first formal expression of the NRSRO's view of the relative creditworthiness of the obligor, security, or money market instrument.

[688] *See* paragraph (4)(A) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33438–33439. The determination of whether the credit rating of the obligor, security, or money market instrument should be excluded from the start-date cohort would be based on the definition of *default* used by the applicant or NRSRO. As discussed below, in determining the outcome of a credit rating assigned to an obligor, security, and money market instrument during the applicable time period covered by a Transition/Default Matrix, the applicant or NRSRO will need to use the standard definition of *default* in paragraph (4)(B)(iii) of the instructions for Exhibit 1 (as opposed to its own definition). The use of a standard definition of *default* to determine the outcome of a credit rating during the applicable time period could result in a credit rating of an obligor, security, or money market instrument being included in the start-date cohort that, as of the start date, would be classified as in default under the standard definition of *default* in paragraph (4)(B)(iii). This is because the applicant or NRSRO may not have classified the obligor, security, or money market instrument as in default as of the start date if it uses a definition of *default* that is narrower than the standard definition in paragraph (4)(B)(iii). In this case, the credit rating of the obligor, security, or money market instrument should be included in the start-date cohort since the applicant or NRSRO, as of the start date, had assigned it a credit rating representing a relative assessment of the likelihood of default (rather than a classification of default) on the start date. Thus, the performance of the applicant or NRSRO in rating that obligor, security, or money market instrument should be incorporated into the default rate shown on the Transition/Default Matrix.

[689] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33438–33439. This does not mean that the obligor, security, or money market instrument will never be reflected in default rates. For example, assume that as of the date ten years prior to the most recently ended calendar year-end an obligor in the corporate issuer class was assigned a credit rating of BBB. This credit rating will be included in the start-date cohort for the 10-year Transition/Default Matrix and grouped with the other BBB credit ratings. Further, assume that during the first seven years of the 10-year period, the credit rating of the obligor was downgraded from BBB to BB (in year two), from BB to B (in year five) and from B to CCC (in year seven). Having an outstanding credit rating of CCC in year seven, the obligor's credit rating will be included in the start-date cohort for the 3-year Transition/Default Matrix and grouped with the other CCC credit ratings. Finally assume the obligor defaults in year 8. For the purposes of the 10-year and 3-year Transition/Default Matrices, the obligor's credit rating will need to be classified as having defaulted and be included in the default rates calculated for those matrices. However, because the obligor will be in default as of the period start date for the 1-year Transition/Default Matrix, it will not be included in the start-date cohort for that matrix.

[690] *See* paragraph (4)(A) of the instructions for Exhibit 1. For example, assume an obligor was classified as in default by the NRSRO as of the start date for the 10-year Transition/Default Matrix. The obligor's credit rating would be excluded from the start-date cohort for the matrix. Assume further that two years later the obligor emerged from a bankruptcy proceeding after a restructuring. At that point in time, the NRSRO upgraded the obligor from the default category by assigning it a credit rating of BBB. Assume that three years later the NRSRO upgraded the obligor's credit rating from BBB to A– and that it retained that rating for the next five years. In this case, the obligor must be included in the start-date cohorts for the 1-year and 3-year Transition/Default Matrices.

[691] *See* paragraph (4)(A) of the instructions for Exhibit 1. For the class of credit ratings in the Sample Transition/Default Matrix in Figure 2, this would mean determining how many credit ratings in the start-date cohort were assigned a credit rating of AAA, AA, A, BBB, BB, B, CCC, CC, and C as of

these amounts, as well as the total number of credit ratings in the start-date cohort, in the second column of the Transition/Default Matrix.[692]

Calculating Transition and Default Statistics

Paragraph (4)(B) of the instructions for Exhibit 1 prescribes how the applicant or NRSRO must calculate the performance statistics and enter the results into the Transition/Default Matrices.[693] More specifically, the instructions provide that each row representing a credit rating notch in the Transition/Default Matrix must contain percentages indicating the credit rating outcomes as of the period end date for all the credit ratings in the start-date cohort at that notch as of the period start date.[694] The instructions also provide that the percentages in a row must add up to 100%.[695] The final amendments (as was proposed) identify five potential outcomes for a credit rating in the start-date cohort: (1) It is assigned the same credit rating as of the period end date; (2) it is assigned a different credit rating as of the period end date; (3) it was classified as a default at any time during the period; (4) it was classified as paid off at any time during the period; or (5) the applicant or NRSRO withdrew the credit rating at any time during the period for a reason other than that the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid off.[696] Because the percentages in a row must add up to 100%, each credit rating in a start-date cohort must be assigned one and only one outcome.[697]

The final amendments (as was proposed) require the applicant or NRSRO to determine the number of credit ratings in a given notch as of the period start date that were assigned the same credit rating as of the period end date.[698] The instructions require that: (1) This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date; (2) the percent must be entered in the column representing the same notch; and (3) the cell must be highlighted.[699] An obligor, security, or money market instrument could have the same credit rating as of the period end date because the credit rating did not change between the start date and the end date or the credit rating transitioned to one or more other notches in the rating scale during the relevant period but transitioned back to the start-date notch where it remained as of the period end date. Consequently, the instructions provide that, to determine this number, the applicant or NRSRO must use the credit rating at the notch assigned to the obligor, security, or money market instrument as of the period end date and not a credit rating at any other notch assigned to the obligor, security, or money market instrument between the period start date and the period end date.[700]

The final amendments (as was proposed) require the applicant or NRSRO to determine the number of credit ratings in a given notch at the period start date that were assigned a credit rating at each other notch in the rating scale as of the period end date.[701] The instructions require that: (1) These numbers must be expressed as percentages of the total number of credit ratings at that notch as of the period start date; and (2) the percentages must be entered in the columns representing each notch.[702] The instructions in the paragraph clarify that, to determine these numbers, the applicant or NRSRO would need to use the credit rating at the notch assigned to the obligor, security, or money market instrument as of the period end date and not a credit rating at any other notch assigned to the obligor, security, or money market instrument between the period start date and the period end date.[703]

The final amendments (as was proposed) require the applicant or NRSRO to determine the total number of credit ratings in a given notch at the period start date that were classified as a default at any time during the applicable time period.[704] The instructions require that: (1) This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date;

the start date. For example, the Sample Transition/Default Matrix in Figure 2 shows a total start-date cohort of 11,770 credit ratings. Within this cohort and as of the December 31, 2000 start date, ten were AAA credit ratings, 2000 were AA credit ratings, 4000 were A credit ratings, 3600 were BBB credit ratings, 1000 were BB credit ratings, 500 were B credit ratings, 300 were CCC credit ratings, 200 were CC credit ratings, and 160 were C credit ratings.

[692] *See* paragraph (4)(A) of the instructions for Exhibit 1.

[693] *See* paragraph (4)(B) of the instructions for Exhibit 1.

[694] *See id.* For example, in the Sample Transition/Default Matrix in Figure 2, cumulative outcomes would need to be calculated for: The cohort of ten credit ratings at the AAA notch; the cohort of 2000 credit ratings at the AA notch; the cohort of 4000 credit ratings at the A notch; the cohort of 3600 credit ratings at the BBB notch; the cohort of 1000 credit ratings at the BB notch; the cohort of 300 credit ratings at the CCC notch; the cohort of 200 credit ratings at the CC notch; and the cohort of 160 credit ratings at the C notch.

[695] *See* paragraph (4)(B) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, the outcomes for the ten credit ratings in the AAA category are: 50% remained at the AAA category, 10% transitioned to the AA category, and 40% were paid off during the period.

[696] *See* paragraphs (4)(B)(i) through (v) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33557–33558.

[697] *See* paragraph (4)(B) of the instructions for Exhibit 1.

[698] *See* paragraph (4)(B)(i) of the instructions for Exhibit 1.

[699] For example, in the Sample Transition/Default Matrix in Figure 2, there were ten credit ratings in the AAA cohort as of the December 31, 2000 start date. Of these ten, five (or 50%) were assigned a credit rating of AAA as of the December 31, 2010 end date. Accordingly, 50% is entered in the AAA column.

[700] *See* paragraph (4)(B)(i) of the instructions for Exhibit 1. For example, assume an obligor was assigned a credit rating of BBB as of the start date of a 10-year Transition/Default Matrix. Assume further that three years after the start date, the credit rating was upgraded to AA but then eight years after the start date the credit rating was downgraded to A, and nine years after the start date the credit rating was downgraded to BBB where it remained as of the period end date. For the purpose of the 10-year Transition/Default Matrix, the outcome assigned to this obligor would be that it had the same credit rating as of the period end date. However, the transitions that occurred in years eight and nine would be reflected, respectively, in the 3-year and 1-year Transition/Default Matrices for the class or subclass of credit ratings. In other words, the credit rating history for this obligor would reflect volatility over the short term but stability over the long term.

[701] *See* paragraph (4)(B)(ii) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33557–33558.

[702] *See* paragraph (4)(B)(ii) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, there were 2000 credit ratings in the AA cohort as of the December 31, 2000 start date. Of these 2000 credit ratings, as of the period end date: Twenty (or 1%) transitioned to the AAA notch; 780 (or 39%) were at the AA notch as of the period end date; 240 (or 12%) transitioned to the A notch; 200 (or 10%) transitioned to the BBB notch; 160 (or 8%) transitioned to the BB notch; 100 (or 5%) transitioned to the B notch; and eighty (or 4%) transitioned to the CCC notch. Accordingly, 1% is entered into the AAA column, 39% is entered into the AA column, 12% is entered into the A column, 10% is entered into the BBB column, 8% is entered into the BB column, 5% is entered into the B column, and 4% is entered into the CCC column.

[703] *See* paragraph (4)(B)(ii) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33557–33558. As explained above, the applicant or NRSRO must reflect in the transition rate for a given notch the credit ratings at that notch as of the period end date (rather than any other credit ratings during the period). For example, in the Sample Transition/Default Matrix in Figure 2, there were 2000 credit ratings at the AA notch as of December 31, 2000. As of December 31, 2010, 4% (or 80) of the credit ratings were at the CCC notch. The path by which these credit ratings arrived at the CCC notch as of the period end date could have been through a series of rating actions that occurred during the ten year period (*e.g.,* being downgraded to A, then BBB, then BB, then B, and then CCC). The credit ratings during the period, other than the CCC rating as of the period end, must not be reflected in the transition rate for the AA notch.

[704] *See* paragraph (4)(B)(iii) of the instructions for Exhibit 1; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33557–33558.

and (2) the percent must be entered in the *Default* column.[705]

As indicated, the applicant or NRSRO must treat the credit rating as a default if the credit rating was classified as a default at any time during the applicable period.[706] This is different from the calculations of the percent of credit ratings that stayed at the same notch or transitioned to a different notch in the rating scale that are based on the end-date status of the credit rating.[707] This period-long approach is designed to address concerns that an applicant or NRSRO might withdraw a credit rating that was classified as a default during the period in order to improve the default rates presented in the matrix.[708]

The Commission proposed a standard definition of *default* to be used to classify credit ratings as defaults for the purposes of calculating the default rates.[709] The Commission's goal in proposing a standard definition was to make the default rates calculated and disclosed by the NRSROs more readily comparable.[710] The Commission was concerned that if applicants or NRSROs use their own definitions of *default,* differences in those definitions could result in applicants and NRSROs inconsistently classifying credit ratings as in default.[711]

A number of commenters addressed the proposed standardized definition of *default.* One NRSRO stated that it agreed ''in principle that there may be value in having'' a standard definition ''so long as allowance is made for ratings that use a term such as 'default' in a non-standard way.'' [712] Another NRSRO stated that the proposed definition of *default* would fail to classify as defaults non-payment events on all instruments that legally constitute equity, including all securitization instruments that use ''pass-through'' trusts.[713] One NRSRO stated that requiring an NRSRO to classify a security as having gone into default when the NRSRO would not choose that classification under its definition ''comes dangerously close to the prohibition against regulating the substance of credit ratings.'' [714] This NRSRO also suggested that the proposed language be modified to clarify that the ''terms of an obligation'' include any grace periods within which an obligor or issuer might cure the default. Another commenter objected to the proposed definition of *default,* because by incorporating the definition used by the NRSRO it ''defeats the aim of promoting uniformity in the performance data for credit ratings.'' [715]

The Commission is adopting a standard definition of *default* with a modification from the proposal to broaden the definition to capture certain events identified by one commenter. As adopted, the final amendments provide that the applicant or NRSRO must classify a credit rating as a *default* if any of the following conditions are met:

- The obligor failed to timely pay principal or interest due according to the terms of an obligation during the applicable period or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument during the applicable period;
- The security or money market instrument was subject to a write-down, applied loss, or other realized deficiency of the outstanding principal amount during the applicable period; or
- The applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of *default* during the applicable period.[716]

The first and second prongs of the definition comprise the standard definition of *default* that must be used by the applicant or NRSRO.[717] The second prong was added to the definition in response to a comment that the standard definition of *default* did not incorporate certain events generally viewed as defaults but that do not involve failure to timely pay principal or interest, such as events relating to securitization instruments that use pass-through trusts.[718] The legal terms of securitizations using pass-through trusts generally do not entitle the certificate holders to receive a greater amount than is collected by the trust. Therefore, failure to make payments to certificate holders in excess of the amounts collected would not constitute a payment default as contemplated under the first prong of the definition.

The second prong is meant to capture events—such as principal write-downs—that are generally viewed to be defaults on this type of security even though such events do not involve failure to timely pay principal or interest. For example, a securitization that uses a pass through trust may experience a write-down of its principal due to losses on underlying collateral backing the security, if those losses cause the security to become under-collateralized (*i.e.,* the principal balance of the collateral is less than the principal balance owed to the holders of the security). Such a write-down results in an immediate loss to the certificate holders since the principal balance against which interest is calculated has been reduced. This is usually considered a situation of default for this type of security. The second prong would also capture distressed exchanges of preferred stock and other hybrid instruments where the principal amount due to preferred security holders is reduced, resulting in a loss to the security holders.

In response to the comment questioning whether the Commission should prescribe a standard definition of *default,*[719] the Commission notes that one objective of a standard definition is

[705] *See* paragraph (4)(B)(iii) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, there were 500 credit ratings in the B cohort as of the December 31, 2000 start date. Of these 500 credit ratings, seventy-five (or 15%) were classified as having gone into default during the period (December 31, 2000 through December 31, 2010). Accordingly, 15% is entered in the *Default* column.

[706] *See* paragraph (4)(B)(iii) of the instructions for Exhibit 1.

[707] *See* paragraphs (4)(B)(i) and (ii) of the instructions for Exhibit 1.

[708] *See* 15 U.S.C. 78o–7(q)(2)(C) (providing that the disclosures include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the NRSRO). The following provides an example of how withdrawals can be used to impact a default rate. In the Sample Transition/Default Matrix in Figure 2, the default rate over the 10-year period for the 3600 credit ratings at the BBB notch is 4%. This means that 144 credit ratings in this cohort were classified as a default during the period (144/3600 = 4%). If the default rate was determined by the credit rating assigned to these 144 obligors as of the period end date, the NRSRO could withdraw, for example, 100 of these credit ratings after default. Consequently, only forty-four of the credit ratings would be classified as a default as of the period end-date and, therefore, the default rate for the BBB notch would be approximately 1.2% instead of 4% (44/3600 = approximately 1.2%).

[709] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33440–33442, 33557–33558.

[710] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33441. *See also* 15 U.S.C. 78o–7(q)(2)(A) (providing that the Commission's rules shall require disclosures that are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs).

[711] *See, e.g.,* GAO Report 10–782, p. 38 (''NRSROs can differ in how they define default. Therefore, some agencies may have higher default rates than others as a result of a broader set of criteria for determining that a default has occurred.'').

[712] *See Kroll Letter.*

[713] *See S&P Letter.*

[714] *See DBRS Letter.*

[715] *See Better Markets Letter.*

[716] *See* paragraphs (4)(B)(iii)(a) through (c) of the instructions for Exhibit 1.

[717] *See* paragraphs (4)(B)(iii)(a) and (b) of the instructions for Exhibit 1.

[718] *See S&P Letter. See also Nationally Recognized Statistical Rating Organizations,* 76 FR at 33444 (soliciting comment on whether the proposed standard definition of *default* was sufficiently broad to apply to most, if not all, events commonly understood as constituting a default).

[719] *See DBRS Letter.*

to avoid a situation in which NRSROs use differing definitions of *default,* which, as stated above, could result in some NRSROs using materially narrower definitions in order to produce more favorable default rates. Moreover, consistent with paragraph (q)(2)(A) of section 15E of the Exchange Act, the Commission sought to establish a rule that requires disclosures that are comparable among NRSROs and allows users of credit ratings to compare the performance of credit ratings across NRSROs.[720] Further, the final amendments do not require that NRSROs use the standard definition of *default* in determining and monitoring credit ratings. The amendments only require that the standard definition be used in calculating credit rating default statistics. Consequently, the amendments do not regulate the substance of credit ratings or the procedures or methodologies an NRSRO uses to determine credit ratings.[721]

The third prong of the definition applies if the applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of *default.*[722] In response to the comment questioning whether the rule should incorporate the applicant's or NRSRO's internal definition,[723] the objective is to supplement the standard definition to address a situation in which the applicant's or NRSRO's definition of *default* is broader than the standard definition. In this case, the NRSRO potentially could classify a rated obligor, security, or money market instrument as having gone into default during the time period even though, under the standard definition, the applicant or NRSRO would not need to make a default classification. As stated above, each credit rating in the start date cohort must be assigned one of five potential outcomes: (1) It is assigned the same credit rating as of the period end date; (2) it is assigned a different credit rating as of the period end date; (3) it was classified as a default at any time during the period; (4) it was classified as paid off at any time during the period; or (5) the applicant or NRSRO withdrew the credit rating at any time during the period for a reason other than the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid off. If the NRSRO has classified the credit rating as a default, there is no other outcome other than default that would be appropriate. It would make the Transition/Default Matrices unnecessarily complex to specify a sixth outcome: That the NRSRO has classified the credit rating as a default but the standard definition did not. The standard definition is broad (particularly with the modification discussed above) and should apply to most cases commonly understood as a default. Consequently, it should rarely happen that an applicant or NRSRO classifies a credit rating as a default and the standard definition does not.[724] For these reasons, the definition incorporates the applicant's or NRSRO's definition of default.

The Commission agrees with the comment suggesting that the ''terms of an obligation'' as used in the standard definition of *default* would include any grace period provided in those terms within which an obligor or issuer may cure the default.[725] Consequently, an applicant or NRSRO need not classify a credit rating as a default under the standard definition if the obligor is within a grace period specifically provided for under the terms and conditions of the obligation and subsequently ''cures the default.''

Finally, as proposed, the final amendments provide that a credit rating must be classified as a default even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of default or withdrew the credit rating on or after the event of default.[726] This is designed to make clear that the requirement that a credit rating classified as a default at any time during the period covered by the Transition/Default Matrix must be included in the default rate irrespective of any post-default rating actions taken by the NRSRO.

As discussed above, the Transition/Default Matrix must provide statistics on the number of credit ratings in the start-date cohort at a given rating notch that were classified as paid off at any time during the relevant period.[727] The instructions require that: (1) This amount be expressed as a percent of the total number of a credit ratings in the start date cohort as of the period start date; and (2) the percent be entered in the *Paid Off* column.[728] This classification must be made if the credit rating is classified as paid off at any time during the period.[729]

The proposed rule prescribed a standard definition of *paid off* with two prongs: (1) One applicable to obligors; and (2) one applicable to securities and money market instruments.[730] One commenter stated that the paid off classification as applied to obligors ''is not practicable'' because some obligors do not have rated debt outstanding and it would be difficult to track whether all obligations of an obligor are paid off.[731] Further, as discussed above, the determination of the start-date cohorts for classes of credit ratings other than the issuer of asset-backed securities class will require—under the modifications to the proposal—that the applicant or NRSRO use the credit ratings of obligors as entities and exclude the credit ratings of securities issued by the obligor unless the obligor does not have an entity credit rating (in which case only the credit rating of the obligor's senior unsecured debt must be included). A credit rating of an obligor as an entity does not relate to a single obligation with a maturity date but rather to the obligor's overall ability to meet any obligations as they come due. Therefore, an obligor credit rating normally cannot be classified as paid off since it does not reference a specific obligation that will mature.

For these reasons, the Commission has modified the standard definition of *paid off* to eliminate the prong that applied to entity ratings of obligors. The final amendments provide that the applicant or NRSRO must classify the credit rating as paid off only if the issuer of the security or money market instrument extinguished its obligation with respect to the security or money market instrument during the applicable time period by paying in full all outstanding principal and interest due

[720] *See* 15 U.S.C. 78o–7(q)(2)(A).

[721] *See* 15 U.S.C. 78o–7(c)(2); *DBRS Letter.*

[722] *See* paragraph (4)(B)(iii)(c) of the instructions for Exhibit 1.

[723] *See Better Markets Letter.*

[724] The Commission recognizes that supplementing the standard definition of *default* with the definition used by the applicant or NRSRO creates the potential for inconsistent classifications. However, any such impact will increase the number of defaults for purposes of calculating the performance statistics (that is, the definition used by the applicant or NRSRO cannot narrow the standard definition). The Commission believes that the incremental increase in the number of credit ratings classified as default using the internal definition would be minimal given the broad scope of the standard definition and, therefore, would not have a material impact on the overall default rates.

[725] *See DBRS Letter.*

[726] *See* paragraph (4)(B)(iv) of the instructions for Exhibit 1.

[727] *See* paragraph (4)(B)(iv) of the instructions for Exhibit 1.

[728] *Id.* For example, in the Sample Transition/Default Matrix in Figure 2, there were 200 credit ratings in the CC cohort as of the December 31, 2000 start date. Of these 200 credit ratings, four (or 2%) were classified as paid off during the period (December 31, 2000 through December 31, 2010). Accordingly, 2% is entered in the *Paid Off* column.

[729] *See* paragraph (4)(B)(iv) of the instructions for Exhibit 1.

[730] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33442, 33557–33558.

[731] *See S&P Letter.*

according to the terms of the security or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid); and the applicant or NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.[732]

As discussed above, the Transition/Default Matrix must provide statistics on the number of credit ratings in the start-date cohort at a given rating notch that were withdrawn for a reason other than they were classified as a default or paid-off.[733] The instructions require that: (1) This amount be expressed as a percent of the total number of credit ratings at a given notch in the rating scale as of the period start date; and (2) the percent be entered in the *Withdrawn (other)* column.[734] The instructions provide that the applicant or NRSRO must classify the credit rating as withdrawn even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing the credit rating.[735]

There are legitimate reasons to withdraw a credit rating assigned to an obligor, security, or money market instrument. For example, an NRSRO might withdraw a credit rating because the rated obligor or issuer of the rated security or money market instrument stopped paying for the surveillance of the credit rating or because the NRSRO issued and was monitoring the credit rating on an unsolicited basis and no longer wanted to devote resources to monitoring it. However, an applicant or NRSRO could withdraw a credit rating to make its transition or default rates appear more favorable.[736] The Commission believes that the instructions with respect to withdrawn credit ratings permit NRSROs the flexibility to withdraw credit ratings for legitimate reasons, including those stated above, while helping to prevent manipulation that would make their transition or default rates appear more favorable.

The Commission did not propose that NRSROs be required to track obligors, securities, or money market instruments after they had withdrawn credit ratings assigned to them, but the Commission did seek comment on whether this should be required.[737] Two NRSROs stated that NRSROs should not be required to track withdrawn ratings after withdrawal.[738] The amendments, as adopted, do not require NRSROs to track the outcomes of obligors, securities, or money market instruments after the credit ratings assigned to them are withdrawn.

2. Amendments to Rule 17g–1

As discussed above, section 932(a)(8) of the Dodd-Frank Act added subsection (q) to section 15E of the Exchange Act.[739] Section 15E(q)(2)(D) of the Exchange Act provides that the Commission's rules must require an NRSRO to publish the information about the performance of its credit ratings and make it freely available on an easily accessible portion of its Internet Web site, and in writing when requested.[740] The Commission proposed to implement section 15E(q)(2)(D) by amending paragraph (i) of Rule 17g–1.[741]

Before today's amendments, paragraph (i) of Rule 17g–1 required an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 publicly available on its Internet Web site or through another comparable, readily accessible means within ten business days of being granted an initial registration or a registration in an additional class of credit ratings, and within ten business days of furnishing a Form NRSRO to update information on the Form, to provide the annual certification, and to withdraw a registration.[742] These requirements implemented section 15E(a)(3) of the Exchange Act, which provides, among other things, that the Commission shall, by rule, require an NRSRO, upon the granting of a registration, to make the information and documents submitted to the Commission in its completed application for registration, or in any amendment, publicly available on its Internet Web site, or through another comparable, readily accessible means.[743]

Although section 15E(q)(2)(D) addresses the disclosure of information about the performance of credit ratings (which NRSROs disclose in Exhibit 1 to Form NRSRO), the Commission proposed amending paragraph (i) of Rule 17g–1 to require an NRSRO to ''make its current Form NRSRO and Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet Web site'' to avoid having separate requirements for the Exhibit 1 performance statistics and the rest of Form NRSRO and the other public exhibits.[744] In this regard, the Commission stated that it believed that a Form NRSRO would be on an ''easily accessible'' portion of an Internet Web site if it could be accessed through a clearly and prominently labeled hyperlink to the form on the homepage of the NRSRO's corporate Internet Web site.[745]

In addition, to implement section 15E(q)(2)(D) of the Exchange Act, the Commission proposed to amend paragraph (i) to provide that an NRSRO ''must make its up-to-date Exhibit 1 to Form NRSRO freely available in writing to any individual who requests a copy of the Exhibit.''[746]

Because there were references in Form NRSRO and the Instructions for Form NRSRO to make Form NRSRO and information and documents submitted in Exhibits 1 through 9 ''publicly available on [the NRSRO's] Web site or through another comparable, readily accessible means,'' the Commission proposed amending these references to mirror the text of the proposed amendment to paragraph (i).[747]

[732] *See* paragraph (4)(B)(iv)(b) of the instructions for Exhibit 1.

[733] *See* paragraph (4)(B)(v) of the instructions for Exhibit 1.

[734] *Id.* For example, in the Sample Transition/Default Matrix in Figure 2, there were 4000 credit ratings in the A cohort as of the December 31, 2000 start date. Of these 4000 credit ratings, eighty (or 2%) were classified as withdrawn for other reasons during the period (December 31, 2000 through December 31, 2010). Accordingly, 2% is entered in the *Withdrawn (other)* column.

[735] *See* paragraph (4)(B)(v) of the instructions for Exhibit 1.

[736] For example, in the Sample Transition/Default Matrix in Figure 2, there were 3600 credit ratings in the BBB cohort as of the start date. The transition rates from a BBB rating to a lower rating are: 15% (BB), 10% (B), 6% (CCC), 5% (CC), and 1% (C). Taken together, this means that 37% (or 1332) of the credit ratings transitioned to a credit rating as of the end-date that was below BBB (that is, to categories commonly referred to as *non-investment grade* or *speculative*). An NRSRO could make its performance statistics appear better by decreasing the number of ''investment grade'' credit ratings that transition to ''non-investment grade'' credit ratings. For example, the credit ratings for 400 obligors, securities, or money market instruments assigned a BBB credit rating as of the start date could be withdrawn. This would reduce the transition rate of BBB credit ratings to credit ratings below BBB from 37% (1332/3600) to approximately 26% (932/3600).

[737] *See Nationally Recognized Statistical Rating Organizations,* 76 FR 33444–33445.

[738] *See Moody's Letter; S&P Letter.*

[739] *See* 15 U.S.C. 78o–7(q).

[740] *See* 15 U.S.C. 78o–7(q)(2)(D).

[741] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33445–33446.

[742] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33620.

[743] *See* 15 U.S.C. 78o–7(a)(3); *Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33569.

[744] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33538.

[745] *See id.* at 33445.

[746] *See id.* at 33538.

[747] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33445.

Several comment letters addressed the proposal.[748] One NRSRO supported the proposal as long as it does not require the disclosure of confidential information.[749] Three NRSROs stated that, as NRSROs are required to make public disclosures in addition to Form NRSRO, a link on the homepage of their corporate Internet Web site labeled ''Regulatory Disclosures'' (or similar language) to a section of the site that included Form NRSRO would be appropriate and would still provide easy access to Form NRSRO and Exhibits 1 through 9.[750] Two NRSROs stated that there would be costs but no benefits in requiring that Exhibit 1 be made freely available in writing to any individual who requests a copy of the Exhibit, and these NRSROs suggested that NRSROs be able to charge reasonable postage and handling fees.[751]

The Commission is adopting the proposed amendments to paragraph (i) of Rule 17g–1 substantially as proposed. In conformity with the modification (in response to comment) to the proposed instructions for Exhibit 1 to Form NRSRO,[752] the Commission is modifying the proposal to replace the phrase ''up-to-date Exhibit 1'' with the phrase ''most recently filed Exhibit 1.'' The Commission also is replacing the phrase ''Web site'' with the word ''Web site,'' consistent with the usage in other NRSRO rules.

The Commission agrees with the comments suggesting that NRSROs may charge reasonable postage and handling fees for sending a written copy of Exhibit 1 to individuals who request it in written form.[753] This should reduce the costs of the requirement and incentivize individuals to access the information using the NRSRO's Internet Web site, which is a more efficient method of obtaining the information.

The Commission also is making conforming amendments to Form NRSRO and the Instructions to Form NRSRO (as was proposed).[754] Finally, the Commission agrees with commenters[755] that a Form NRSRO and Exhibits 1 through 9 to Form NRSRO would be on an ''easily accessible'' portion of an NRSRO's corporate Internet Web site if it could be accessed through a clearly and prominently labeled hyperlink labeled ''Regulatory Disclosures'' on the homepage of the Web site.

3. Amendments to Rule 17g–2 and Rule 17g–7

a. Proposal

Paragraph (a)(8) of Rule 17g–2 requires an NRSRO to make and retain a record that, ''for each outstanding credit rating, shows all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (''CIK'') number of the rated obligor.''[756] An NRSRO is required to retain this record for three years under paragraph (c) of Rule 17g–2.[757]

Before today's amendments, paragraph (d)(2) of Rule 17g–2 (the ''10% Rule'') required an NRSRO to ''make and keep publicly available on its corporate Internet Web site in an eXtensible Business Reporting Language (''XBRL'') format'' the information required to be documented pursuant to paragraph (a)(8) of Rule 17g–2 for 10% of the outstanding credit ratings, selected on a random basis, in each class of credit rating for which the NRSRO is registered if the credit rating was paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated (''issuer-paid'' credit ratings) and the NRSRO has 500 or more such issuer-paid credit ratings outstanding in that class.[758] Paragraph (d)(2) further provided that any ratings action required to be disclosed need not be made public less than six months from the date the action is taken; that if a credit rating made public pursuant to the rule is withdrawn or the rated instrument matures, the NRSRO must randomly select a new outstanding credit rating from that class of credit ratings in order to maintain the 10% disclosure threshold; and that in making the information available on its corporate Internet Web site, the NRSRO must use the List of XBRL Tags for NRSROs as specified on the Commission's Internet Web site.

Before today's amendments, paragraph (d)(3) of Rule 17g–2 (the ''100% Rule'') required an NRSRO to make publicly available on its corporate Internet Web site information required to be documented pursuant to paragraph (a)(8) of the rule for any credit rating initially determined by the NRSRO on or after June 26, 2007, the effective date of the Rating Agency Act of 2006.[759] The 100% Rule applied to all types of credit ratings (as opposed to the 10% Rule, which was limited to issuer-paid credit ratings). However, the 100% Rule prescribed different grace periods for when an NRSRO must disclose a rating action depending on whether or not it involved an issuer-paid credit rating. For issuer-paid credit ratings, the grace period was twelve months after the date the rating action was taken, and for non-issuer paid credit ratings, the grace period was twenty-four months after the date the rating action was taken. The NRSRO was required to disclose the rating history information on its corporate Internet Web site in an XBRL format using the List of XBRL Tags for NRSROs as published by the Commission on its Internet Web site.[760]

The Commission proposed repealing the 10% Rule, significantly amending the 100% Rule, and codifying the revised 100% Rule in paragraph (b) of Rule 17g–7.[761] As discussed below in section II.E.3.b. of this release, these proposals took into account findings by the GAO.[762] As proposed to be amended, the 100% Rule would incorporate requirements in place before the proposed amendments and, in addition, would require that an NRSRO disclose rating history information on an ''easily accessible'' portion of its Internet Web site, add more rating histories to its disclosures, provide more information about each rating action, and not remove a rating history from the

[748] *See DBRS Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[749] *See S&P Letter.*

[750] *See DBRS Letter; Moody's Letter; Morningstar Letter.*

[751] *See DBRS Letter; S&P Letter.*

[752] *See Moody's Letter.*

[753] *See DBRS Letter; S&P Letter.*

[754] *See* Item 5, the Note to Item 6.C, Item 8, and Item 9 of Form NRSRO; Instruction A.3 and Instruction H to Form NRSRO.

[755] *See DBRS Letter; Moody's Letter; Morningstar Letter.*

[756] 17 CFR 240.17–2(a)(8). A CIK number has ten digits and is assigned to uniquely identify a filer using the Commission's EDGAR system. CUSIP is an acronym for the Committee on Uniform Securities and Identification. A CUSIP number consists of nine characters that uniquely identify a company or issuer and the type of security.

[757] *See* 17 CFR 240.17g–2(c).

[758] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63864.

[759] *Id.*

[760] Information about the List of XBRL Tags is located at the following page on the Commission's Web site: *http://www.sec.gov/spotlight/xbrl/nrsro-implementation-guide.shtml.* The XBRL Tags identified by the Commission include mandatory tags with respect to the information identified in paragraph (a)(8) of Rule 17g–2. The XBRL Tags also identify additional information that could be tagged by the NRSRO.

[761] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33446–33452.

[762] *See id.* (discussing the GAO findings); GAO Report 10–782, pp. 40–46 (discussing, among other things, the limitations of the data fields specified in the original rule). *See also* section II.E.3.b. of this release.

disclosure until twenty years after the NRSRO withdraws the credit rating.[763]

To add more rating histories to the disclosures, the 100% Rule, as proposed, would no longer be limited to the disclosure of histories for credit ratings that were *initially determined on or after* June 26, 2007.[764] Instead, as proposed, the rule would apply to any credit rating that was *outstanding* as of June 26, 2007, but the rating histories disclosed for these credit ratings would not need to include information about actions taken before June 26, 2007. Moreover, in order to immediately include these credit ratings in the disclosure, the proposals would require the NRSRO to disclose the credit rating assigned to the obligor, security, or money market instrument and associated information as of June 26, 2007. The proposals provided that the rating actions that would need to be included in the history are the initial credit rating or the credit rating as of June 26, 2007 (if the initial credit rating was prior to that date) and any subsequent upgrades or downgrades of the credit rating (including a downgrade to, or assignment of, default), any placements of the credit rating on credit watch or review, any affirmation of the credit rating, and a withdrawal of the credit rating.

To provide more information about each rating action in a rating history, the proposals would increase the number and scope of the required data fields.[765] Specifically, the 100% Rule, as proposed, would identify seven categories of data that would need to be disclosed when a credit rating action is published. The categories of information were:

- The identity of the NRSRO disclosing the rating action;
- The date of the rating action;
- If the rating action is taken with respect to a credit rating of an obligor as an entity, the following identifying information about the obligor, as applicable: (1) The CIK number of the rated obligor; and (2) the legal name of the obligor;
- If the rating action is taken with respect to a credit rating of a security or money market instrument, as applicable: (1) CIK number of the issuer of the security or money market instrument; (2) the legal name of the issuer of the security or money market instrument; and (3) the CUSIP of the security or money market instrument;
- A classification of the rating action as either: (1) A disclosure of a credit rating that was outstanding as of June 26, 2007 for purposes of the rule; (2) an initial credit rating; (3) an upgrade of an existing credit rating; (4) a downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable; (5) a placement of an existing credit rating on credit watch or review; (6) an affirmation of an existing credit rating; or (7) a withdrawal of an existing credit rating and, if the classification is withdrawal, the reason for the withdrawal as either a default, the obligation was paid off, or the withdrawal was for other reasons;
- The classification of the class or subclass that applies to the credit rating as either: (1) Financial institutions, brokers, or dealers; (2) insurance companies; (3) corporate issuers; (4) RMBS, CMBS, CLO, CDO, ABCP, other ABS, or another structured finance product (in the issuers of structured finance products class); or (5) sovereign issuer, U.S. public finance, or international public finance (in the issuers of government securities, municipal securities, or securities issued by a foreign government class); and
- The credit rating symbol, number, or score the NRSRO assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the rating action, the credit rating symbol, number, or score the NRSRO assigned to the obligor, security, or money market instrument as of the date of the rating action.[766]

The proposed amendments specified when a rating action and its related data would need to be disclosed by establishing two distinct grace periods: Twelve months and twenty-four months.[767] In particular, a rating action would need to be disclosed: (1) Within twelve months from the date the action is taken, if the credit rating subject to the action was issuer-paid;[768] or (2) within twenty-four months from the date the action is taken, if the credit rating subject to the action was not issuer-paid.[769] These proposed separate grace periods for issuer-paid and non-issuer-paid credit ratings were consistent with the requirements of the 100% Rule prior to today's amendments.[770]

Finally, the proposed amendments provided that an NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument no earlier than twenty years after the date a rating action with respect to the obligor, security, or money market instrument is classified as a withdrawal.[771]

b. Final Rule

As proposed, the Commission is eliminating the 10% Rule.[772] The 10% Rule did not permit comparability across NRSROs because it captured only issuer-paid credit ratings in a class of credit ratings where there are 500 or more such ratings and only if two or more NRSROs randomly select the same rated obligor, issuer, or money instrument to be included in the sample.[773] Moreover, the 10% Rule did not produce sufficient ''raw data'' to allow third parties to generate independent performance statistics.[774] The goal of the rule was to provide some information about how an NRSRO's credit ratings performed, particularly ratings assigned to obligors, securities and money market instruments that had been rated for ten or twenty years. In light of the enhancements to the instructions for Exhibit 1 to Form NRSRO (discussed above in section II.E.1. of this release) and the 100% Rule, retaining the 10% Rule would provide little, if any, incremental benefit to investors and other users of credit ratings in terms of providing information about the performance of a given NRSRO's credit ratings. Several commenters addressed the proposal to eliminate the 10% Rule.[775] All of these commenters supported its elimination.

The Commission is adopting the amendments to the 100% Rule (including moving its provisions from Rule 17g–2 to Rule 17g–7) with

[763] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33446–33452.

[764] *See* paragraph (b)(1) of Rule 17g–7, as proposed (emphasis added); *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541–33542.

[765] *See* paragraph (b)(2) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541–33542.

[766] *See* paragraphs (b)(2)(i) through (vii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541–33542.

[767] *See* paragraph (b)(4) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[768] *See* paragraph (b)(4)(i) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[769] *See* paragraph (b)(4)(ii) of Rule 17g–7; as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[770] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63837–63842 (discussing the 100% Rule and the reasons the Commission adopted distinct twelve and twenty-four month grace periods).

[771] *See* paragraph (b)(5) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[772] *See* paragraph (d) of Rule 17g–2.

[773] *See, e.g.,* GAO Report 10–782, pp. 40–47.

[774] *See id.*

[775] *See CFA/AFR Letter; DBRS Letter; S&P Letter.*

modifications, in part, in response to comments.[776] Two commenters generally supported the proposed amendments to the 100% Rule.[777] On the other hand, one NRSRO objected to the Commission's proposal to expand the 100% Rule ''until a more thorough cost-benefit analysis'' has been conducted.[778] This NRSRO stated that on average only one person per month is accessing its rating history disclosures, but that it incurs substantial costs to make the information available. Further, it stated that constantly updating the database for the 100% Rule ''would impose an unwarranted burden on NRSROs'' and that the Commission has ''substantially underestimated the costs'' of the proposal. Another NRSRO also did not support the proposal, stating that it would impose significant costs on NRSROs, that lost subscription revenue due to the requirement to provide historical data for free will limit NRSROs' ability to innovate, and that industry competition will be undermined, particularly for smaller NRSROs who may be more dependent on subscription fees.[779] Among other benefits, the modification to the proposal—as discussed below—should address some of the practical and burden concerns raised by NRSROs.

The final amendments (as was proposed) require that the NRSRO publicly disclose the rating histories for free on an easily accessible portion of its corporate Internet Web site.[780] It also broadens the scope of credit ratings that will be subject to the disclosure requirements (as was proposed).[781] The objective is to require the disclosure of information about all outstanding credit ratings in each class and subclass of credit ratings for which the NRSRO is registered but within certain prescribed timeframes.

In addition to general burden concerns noted above, commenters raised significant concerns about the proposal to include all credit ratings that were outstanding as of June 26, 2007 and information about credit ratings that is more than three years old (that is, outside the record retention requirements of Rule 17g–2).[782] For example, one NRSRO stated that it may not have, or may find it difficult to obtain, the additional information required by the amendments.[783] A second NRSRO that generally supported the amendments also stated that NRSROs may not be able to provide XBRL information as of June 26, 2007, since those rating actions are beyond the scope of the 3-year record retention requirement.[784] A third NRSRO stated that—because it does not consider affirmations, confirmations, placement of credit ratings on watch or review, and assignment of default status to be credit rating actions and does not subdivide withdrawn ratings into the subcategories of withdrawn due to default, withdrawn because the obligation was paid in full, and withdrawn for ''other'' reasons—it does not capture that information in a format that is readily retrievable.[785] Consequently, the commenter recommended that the amendment exempt an NRSRO from providing historical data to the extent it does not already capture the data in a readily retrievable format.

The Commission is persuaded that the proposal raises legitimate practical concerns (for example, the additional information may not be available) and would impose a substantial burden. Accordingly, the final amendments have been modified from the proposal so that an NRSRO need only retrieve information that is no more than three years old.[786] In particular, under the final amendments, for a class of credit rating in which the NRSRO is registered with the Commission as of the effective date of the rule, the disclosure requirement applies to a credit rating in the class that was outstanding as of, or initially determined on or after, the date three years prior to the effective date of the rule.[787] Further, for a class of credit rating in which the NRSRO is registered with the Commission *after* the effective date of the rule, the disclosure requirement applies to a credit rating in the class that was outstanding as of, or initially determined on or after, the date three years prior to the date the NRSRO is registered in the class.[788] Consequently, an NRSRO that is registered in a particular class of credit ratings as of the rule's effective date will need to begin complying with the rule by disclosing information about all credit ratings in that class that were outstanding as of the date three years prior to the effective date or that were initially determined on or after that date, subject to the grace periods discussed below. After the effective date of the rule, a credit rating agency that becomes registered with the Commission as an NRSRO or an NRSRO that adds a class of credit ratings to its NRSRO registration will need to begin complying with the rule by disclosing information about all credit ratings in the classes for which it is registered that were outstanding as of the date three years prior to the registration date or that were initially determined on or after that date, subject to the grace periods. This aligns the retrieval requirement for all NRSROs regardless of when they are registered in a class of credit ratings.[789] It also substantially reduces the burden of adding past rating actions to the rating histories because the NRSRO will need to provide only

[776] *See* paragraph (b) of Rule 17g–7.

[777] *See CFA/AFR Letter; Levin Letter.*

[778] *See DBRS Letter.*

[779] *See Fitch Letter.*

[780] *See* paragraph (b)(1) of Rule 17g–7. As discussed above, section 15E(q)(2)(D) of the Exchange Act provides that the Commission's rules shall require the information about the performance of credit ratings be published and made freely available by the NRSRO on an easily accessible portion of its Web site and in writing when requested. *See* 15 U.S.C. 78o–7(q)(2)(D). The Commission did not propose that the ''in writing'' requirement apply to the disclosures of rating histories because such a requirement would not be feasible. *See Nationally Recognized Statistical Rating Organizations,* 76 FR 33447, n.264. Consistent with the proposal, the final amendments do not apply the ''in writing'' requirement to the disclosures of rating histories. First, the data file containing the disclosures would need to be updated by the NRSRO as new rating actions are added. Thus, it would not remain static like the Exhibit 1 performance measurement statistics, which are updated annually. Consequently, by the time a party received a written copy of the disclosure, it may not be up to date. Second, the amount of information in the data file would be substantial (particularly for NRSROs that have issued hundreds of thousands of credit ratings) and would increase over time. For these reasons, converting the information in the electronic disclosure to written form and mailing it to the party making the request would be impractical. In terms of utility, as discussed below, the electronic disclosure of the data must be made using an XBRL format. This is a much more efficient and practical medium for accessing and analyzing the information rather than obtaining it in paper form.

[781] *See* paragraphs (b)(1)(i) and (ii) of Rule 17g–7.

[782] *See DBRS Letter; Fitch Letter; Moody's Letter; Morningstar Letter.*

[783] *See S&P Letter.*

[784] *See Morningstar Letter.*

[785] *See Moody's Letter* (also stating that collecting data for past rating actions would require ''tens of thousands of hours of analysis'').

[786] *See* paragraphs (b)(1)(i) and (ii) of Rule 17g–7.

[787] *See* paragraph (b)(1)(i) of Rule 17g–7. Rule 17g–2 requires certain rating history information to be retained for a period of three years. *See, e.g.,* 17 CFR 240.17g–2(a)(8).

[788] *See* paragraph (b)(1)(ii) of Rule 17g–7.

[789] For example, under the proposal, NRSROs registered with the Commission in a class of credit ratings when the rule went effective would need to have retrieved information about the credit ratings in that class covering a period from June 26, 2007 to the effective date of the rule. The span of time between June 26, 2007 and the effective date of the rule would be fixed at that point and all NRSROs registered in one or more classes of securities on the effective date would need to retrieve information spanning the same period of time. However, any NRSRO registered after the effective date, or an NRSRO adding a class of credit ratings to its registration after the effective date, would to need retrieve information spanning a longer period of time and, as time progressed, the retrieval period would increase as would the burden of retrieval.

three years of historical information initially, which should mitigate, to some degree, concerns about having to retrieve information that was not retained by the NRSRO.[790]

Under the proposal, if a credit rating was added to the rating histories disclosure either because it was outstanding as of June 26, 2007 or was initially determined on or after that date, the rating history for the credit rating needed to include every subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), any placements of the credit rating on credit watch or review, any affirmation of the credit rating, and a withdrawal of the credit rating.[791] Several commenters raised concerns about the proposed types of rating actions that would trigger the disclosure requirements, including rating affirmations.[792] One NRSRO suggested that the disclosure rules apply only to initial ratings because subscription-based NRSROs will likely have significantly more rating actions, and the proposed rule may encourage these NRSROs to provide less frequent surveillance.[793] Another commenter stated that a rating affirmation should not be included in rating actions as the required disclosures may make NRSROs less likely to provide confirmations of credit ratings, which may make it impossible to amend transaction documents.[794] An NRSRO stated that including affirmations in rating actions would significantly increase the burden on NRSROs.[795] The commenter recommended that if affirmations were included, the Commission should state that the term *affirmation* refers only to a published announcement, or written communication in the case of a private or confidential credit rating, by an NRSRO that it is maintaining the credit rating at its current level, and that the term should not include any purely internal discussions by an NRSRO about a credit rating.

The Commission is persuaded by the comments that the types of rating actions triggering the disclosure requirement can be reduced and the 100% Rule can still meet the objective of allowing users of credit ratings and others to compare the performance of credit ratings among NRSROs and generate their own performance statistics. Consequently, to focus the disclosure on the rating actions that are most relevant to evaluating performance, the final amendments provide that the history of a credit rating must include, in addition to the initial credit rating or the initial entry of the credit rating into the history, any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default) and a withdrawal of the credit rating.[796] These are the rating actions necessary to calculate transition and default rates. With this modification, the final amendments eliminate the requirement to include placements on watch and affirmations (and the required data associated with those actions) in the rating histories. In addition to reducing the burden of the rule, this may alleviate concerns that requiring NRSROs to disclose rating histories (even with the grace periods) may cause subscribers to stop paying for access to credit ratings or for downloads of credit rating actions and instead to use the disclosures of rating histories as a substitute for these types of subscriptions. For example, information about placements of credit ratings on watch and credit rating affirmations may be information that subscribers value as part of their subscriptions.

The final amendments (as was proposed) increase the information that must be disclosed about a rating action.[797] Specifically, paragraph (b)(2) of Rule 17g–7 specifies seven categories of data that must be disclosed with a rating action.[798] The objective of these enhancements is to make the disclosures more useful in terms of the amount of information provided, the ability to search and sort the information, and the ability to compare historical rating information across NRSROs.[799] As discussed below, the Commission has made some modifications to the required data categories in response to suggestions by commenters and to correspond to the modifications discussed above that change the scope of the credit ratings and rating actions covered by the disclosure requirement.

Paragraphs (b)(2)(i) and (ii) of Rule 17g–7 are being adopted as proposed.[800] Paragraph (b)(2)(i) identifies the first category of data that must be disclosed with each rating action: The identity of the NRSRO disclosing the rating action.[801] Because the NRSRO must assign an XBRL Tag to each item of information, including and tagging the identity of the NRSRO will assist users who download and combine data files of multiple NRSROs to sort credit ratings by a given NRSRO. Paragraph (b)(2)(ii) identifies the second category of data: The date of the rating action.[802] This will allow a person reviewing the credit rating histories of the NRSROs to reach conclusions about their relative capabilities in making appropriate and timely adjustments to their credit ratings.[803]

Paragraph (b)(2)(iii) of Rule 17g–7, as proposed, would identify the third category of data that must be disclosed: (1) The CIK number of the rated obligor; and (2) the name of the obligor.[804] Under the proposal, the information in this category would need to be disclosed only if the rating action is taken with respect to a credit rating of an obligor as an entity (as opposed to a credit rating of a security or money market instrument).[805]

Commenters raised concerns about requiring disclosure of the CIK number.[806] One NRSRO questioned the cost-effectiveness of the requirement and recommended that the requirement to provide CIK numbers be eliminated.[807] Another NRSRO stated that it was ''unnecessarily burdensome'' to require the use of identifiers that may become obsolete, that require NRSROs to pay a fee, or that may not be used outside the United States, as long as NRSROs ''use some kind of identifier

[790] As indicated above, one commenter recommended that the rule exempt an NRSRO from providing historical data to the extent it does not already capture the data in a readily retrievable format. *See Moody's Letter.* While the Commission believes the modifications discussed above will address the commenter's concerns to a large degree, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act. *See* 17 U.S.C. 78mm.

[791] *See* paragraph (b)(1) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[792] *See ABA Letter; Deloitte Letter; Moody's Letter; Morningstar Letter; TradeMetrics Letter.*

[793] *See Morningstar Letter.*

[794] *See ABA Letter.*

[795] *See S&P Letter.*

[796] *See* paragraphs (b)(1)(i) and (ii) of Rule 17g–7.

[797] *See* paragraph (b)(2) of Rule 17g–7.

[798] The Commission will update the List of XBRL Tags to include some of the new data fields. Other fields are covered by existing Tags, including by some of the voluntary Tags.

[799] *See, e.g.,* GAO Report 10–782, p. 41 (''First, SEC [sic] did not specify the data fields the NRSROs were to disclose in the rule, and the data fields provided by the NRSROs were not always sufficient to identify a complete rating history for ratings in each of the seven samples. If users cannot identify the rating history for each rating in the sample, they cannot develop performance measures that track how an issuer's credit rating evolves.'').

[800] *See* paragraphs (b)(2)(i) and (ii) of Rule 17g–7.

[801] *See* paragraph (b)(2)(i) of Rule 17g–7.

[802] *See* paragraph (b)(2)(ii) of Rule 17g–7.

[803] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33448–33449.

[804] *See* paragraph (b)(2)(iii) of Rule 17g–2, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[805] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33449.

[806] *See DBRS Letter; Moody's Letter* (suggesting use of the LEI).

[807] *See DBRS Letter.*

system sufficient to identify the rated obligor and obligation,'' for example, ''an internationally recognized LEI [Legal Entity Identifier] system.'' [808]

The Commission believes that the use of an LEI can promote accuracy and standardization of NRSRO data, and therefore can further the purpose of allowing users of credit ratings to compare the performance of credit ratings by different NRSROs.[809] The effort to standardize a universal LEI has progressed significantly over the last few years, and an international standard was published by the International Organization for Standardization (''ISO'') in June 2012, which set out the elements of a working system.[810]

The Commission is modifying the proposal to require, with respect to a rating action involving a credit rating of an obligor as an entity, the disclosure of the obligor's LEI issued by a utility endorsed or otherwise governed by the Global LEI Regulatory Oversight Committee [811] or the Global LEI Foundation, if available, or, if the LEI is not available, the disclosure of the obligor's CIK, if available.[812] The Commission believes that having some method of identifying the obligor—in addition to its name—is appropriate as it will make the data searchable and comparable across NRSROs. Coded identifiers like the LEI and CIK will add a level of standardization to the credit rating history data, making for easier electronic querying and processing.

An NRSRO recommended not requiring inclusion of the legal name of the issuer because inconsistent use of abbreviations has made this problematic.[813] The Commission believes that the name of the obligor provides a more intuitive means of searching for a specific credit rating history in comparison to the LEI or CIK number. The Commission does not, however, view the LEI or CIK as a replacement for a name. For example, the user of the data can search for the name if the user does not know the LEI or CIK number. The Commission agrees with the commenter that requiring the specific legal name can be problematic. Consequently, the proposal has been modified to require the NRSRO to provide the obligor's ''name'' rather than ''legal name.'' [814] An NRSRO must disclose a name that clearly identifies the obligor and use that name consistently.[815] For these reasons, the final amendments require the disclosure of the obligor's name.[816]

Paragraph (b)(2)(iv) of Rule 17g–7, as proposed, would identify the fourth category of data to be disclosed with a rating action: (1) The CIK number of the issuer of the security or money market instrument; (2) the name of the issuer of the security or money market instrument; and (3) the CUSIP of the security or money market instrument.[817] The information in this category would need to be disclosed when the rating action is taken with respect to a security or money market instrument. The Commission is adopting paragraph (b)(2)(iv) of Rule 17g–7 with modifications from the proposal.

First, the paragraph requires an NRSRO to disclose the LEI of the issuer, if available, or, if an LEI is not available, the CIK number of the issuer, if available.[818] This will make paragraph (b)(2)(iv) consistent with paragraph (b)(2)(iii), which, as discussed above, requires the disclosure of the LEI of the obligor, if available, or, if an LEI is not available, the CIK number of the issuer, if available. Second, as adopted, the paragraph requires the NRSRO to disclose the ''name'' of the issuer, rather than the ''legal name'' as was proposed.[819] This also will make paragraph (b)(2)(iv) consistent with paragraph (b)(2)(iii).

The Commission is adopting the requirement to disclose the CUSIP of the security or money market instrument as was proposed.[820] One NRSRO stated that the cost of adding CUSIP data should be included in the Commission's cost-benefit analysis.[821] In response, the Commission notes that the requirement to disclose the CUSIP of the security or money market instrument was required by the 100% Rule before today's amendments.[822] When adopting the 10% Rule and the 100% Rule, the Commission considered the costs associated with the CUSIP requirement.[823] The Commission recognizes that the continued requirement to disclose the CUSIP number of the security or money market instrument subject to the rating action imposes licensing costs. However, without the CUSIP requirement, the disclosures could be of little utility as there would be no standard identifier with which to search for a specific security or money market instrument. This would make it difficult for users of the rating history disclosures to locate and compare the rating history for a given security or money market instrument. The Commission has balanced the cost of the requirement with the benefit of making the disclosures readily searchable and, therefore, enhancing their utility. For these reasons, the final amendments retain the CUSIP disclosure requirements.[824]

Paragraph (b)(2)(v) of Rule 17g–7, as proposed, would identify the fifth

[808] *See Moody's Letter.* The LEI is a reference code to uniquely identify a legally distinct entity that engages in a financial transaction. Further information about LEI is available at *http://www.treasury.gov/initiatives/wsr/ofr/Documents/LEI_FAQs_August2012_FINAL.pdf.*

[809] The Commission has prescribed the use of an LEI for the purposes of reporting information on Form PF. *See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF,* Investment Adviser Act of 1940 Release No. 3308 (Oct. 31, 2011), 76 FR 71128 (Nov. 16, 2011). Form PF is available at *http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf.* The glossary of terms for the form provides the following definition of *LEI:* ''With respect to any company, the 'legal entity identifier' assigned by or on behalf of an internationally recognized standards setting body and required for reporting purposes by the U.S. Department of the Treasury's Office of Financial Research or a financial regulator. In the case of a financial institution, if a 'legal entity identifier' has not been assigned, then provide the RSSD ID assigned by the National Information Center of the Board of Governors of the Federal Reserve System, if any.''

[810] *See* ISO 17442:2012, Financial services—Legal Entity Identifier (LEI). A copy of the standard can be purchased at *http://www.iso.org/iso/home/store/catalogue_tc/catalogue_detail.htm?csnumber=59771. See also* CFTC, *Amended Order Designating The Provider Of Legal Entity Identifiers To Be Used In Recordkeeping And Swap Data Reporting Pursuant To The Commission's Regulations, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/leiamendedorder.pdf* (order expanding, through mutual acceptance by international regulators, the list of identifiers that can be used by registered entities and swap counterparties in complying with the CFTC's swap data reporting regulations).

[811] *See www.leiroc.org.*

[812] *See* paragraph (b)(2)(iii)(A) of Rule 17g–7. The proposal is modified by separating the LEI and CIK disclosure requirements in paragraph (b)(2)(iii)(A) and the legal name disclosure requirement in paragraph (b)(2)(iii)(B). *See* paragraphs (b)(2)(iii)(A) and (B) of Rule 17g–7. While the description of the LEI in Rule 17g–7 is different than the description in the glossary of terms for Form PF, it is intended to have the same meaning. The description in Rule 17g–7 is designed to be more generic and, therefore, address future changes in the organizations administering LEIs.

[813] *See S&P Letter.*

[814] *See* paragraph (b)(2)(iii)(B) of Rule 17g–7.

[815] As discussed below in section II.G.3. of this release, the Commission is taking a similar approach to the identification of the obligor's name in the form to accompany a credit rating.

[816] *See* paragraph (b)(2)(iii)(B) of Rule 17g–7.

[817] *See* paragraph (b)(2)(iii) of Rule 17g–2, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[818] *See* paragraph (b)(2)(iv)(A) of Rule 17g–7.

[819] *See* paragraph (b)(2)(iv)(B) of Rule 17g–7.

[820] *See* paragraph (b)(2)(iv)(C) of Rule 17g–7.

[821] *See DBRS Letter.*

[822] *See* 17 CFR 240.17g–2(a)(8) and (d)(3).

[823] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6477 (adopting the 10% Rule); *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63859 (adopting the 100% Rule).

[824] If securities or money market instruments are assigned LEIs, the Commission would consider replacing the CUSIP requirement with an LEI requirement.

category of data to be disclosed with a rating action: A classification of the type of rating action.[825] Under the proposal, the NRSRO would be required to select one of seven classifications to identify the type of rating action.[826] In particular, the seven possible classifications were:

- A disclosure of a credit rating that was outstanding as of June 26, 2007;[827]
- An initial credit rating;[828]
- An upgrade of an existing credit rating;[829]
- A downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable;[830]
- A placement of an existing credit rating on credit watch or review;[831]
- An affirmation of an existing credit rating;[832] or
- A withdrawal of an existing credit rating and, if the classification is withdrawal, the reason for the withdrawal as: (1) The obligor defaulted, or the security or money market instrument went into default; (2) the obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or (3) the credit rating was withdrawn for reasons other than those set forth in items (1) or (2) above.[833]

The Commission is adopting paragraph (b)(2)(v) of Rule 17g–7 with modifications. First, the final amendments eliminate the rating action classifications with respect to placing a credit rating on watch or review and with respect to affirming a credit rating.[834] As discussed above, the amendments do not require the rating histories disclosure to include these types of rating actions.

Second, paragraph (b)(2)(v)(A) of Rule 17g–7 has been modified.[835] As discussed above, this provision was designed to alert a user of the rating histories disclosure that the credit rating and related information about the credit rating was added to the history because of the requirement in the proposal to add all credit ratings outstanding as of June 26, 2007. The final amendments—as discussed above—modify this requirement from the proposal so that an NRSRO must include with each credit rating disclosed under paragraph (b)(1) of Rule 17g–7 a classification of the rating action, if applicable, as an addition to the rating history disclosure: (1) Because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in paragraph (b) of Rule 17g–7; or (2) because the credit rating was outstanding as of the date three years prior to the date the NRSRO became registered in the class of credit ratings.[836] Consequently, paragraph (b)(2)(v)(A) of Rule 17a–7, as adopted, is modified to conform to this change.[837]

Paragraph (b)(2)(v)(E) of Rule 17g–7, as adopted, requires the NRSRO, in the case of a withdrawal, to classify the reason for the withdrawal as either: (1) The obligor defaulted, or the security or money market instrument went into default; (2) the obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or (3) the credit rating was withdrawn for reasons other than those set forth in (1) and (2) above.[838] These sub-classifications parallel, in many respects, the outcomes identified in paragraphs (4)(B)(iii), (iv), and (v) of the instructions for Exhibit 1 to Form NRSRO discussed above in section II.E.1.b. of this release. However, unlike the instructions for Exhibit 1, the final amendments do not prescribe standard definitions of *default* and *paid-off* for the purposes of making these classifications in the rating histories disclosure. The rating histories disclosure requirement is designed to allow investors and other users of credit ratings to compare how each NRSRO treats a commonly rated obligor, security, or money market instrument. In other words, unlike the production of performance statistics where standard definitions are necessary to promote comparability of aggregate statistics, the historical rating information should indicate on a granular level the differences among the NRSROs with respect to the rating actions they take for a commonly rated obligor, security, or money market instrument, including their differing definitions of default. This will allow investors and other users of credit ratings to review, for example, when one NRSRO downgraded an obligor to the default category as compared to another NRSRO or group of NRSROs. Among other things, investors and other users of credit ratings could review the data to identify NRSROs that are either quick or slow to downgrade obligors, securities, or money market instruments to default. In addition, an NRSRO with a very narrow definition of *default* might continue to maintain a security at a notch in its rating scale above the default category when other NRSROs, using broader definitions, had classified the security as having gone into default. Creating a mechanism to identify these types of variances is a goal of the enhancements to the 100% Rule.

The Commission believes a default and the extinguishment of an obligation because it was paid in full are the most frequently occurring reasons for an NRSRO to withdraw a credit rating. As discussed above in section II.E.1. of this release, there are other reasons an NRSRO might withdraw a credit rating, including that the rated obligor or issuer

[825] *See* paragraph (b)(2)(v) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations.*

[826] The required disclosure would need to be the type of rating action and not the credit rating resulting from the rating action. For example, if the rating action was a downgrade, the NRSRO would need to classify it as a ''downgrade'' and not, for example, a change of the current credit rating from the AA notch to the AA- notch or from the C notch to default. This would allow users of the disclosures to sort the information by, for example, initial credit ratings, upgrades, and downgrades.

[827] *See* paragraph (b)(2)(v)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542. As discussed above, under the proposal, all credit ratings outstanding as of June 26, 2007 and associated information as of that date would need to be disclosed to establish the first data point in the rating history of a credit rating that was outstanding as of that date. This would have meant that thousands, if not hundreds of thousands, of rating histories each beginning on June 26, 2007 would be disclosed. The proposed classification was designed to alert users of the disclosures that the proposed rule caused the June 26, 2007 entry in the rating history of the obligor, security, or money market instrument and not because, for example, a credit rating was initially determined for the obligor, security, or money market instrument on that date.

[828] *See* paragraph (b)(2)(v)(B) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542. An NRSRO would select this classification if the rating action was the first credit rating determined by the NRSRO with respect to the obligor, security, or money market instrument.

[829] *See* paragraph (b)(2)(v)(C) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[830] *See* paragraph (b)(2)(v)(D) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[831] *See* paragraph (b)(2)(v)(E) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[832] *See* paragraph (b)(2)(v)(F) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[833] *See* paragraph (b)(2)(v)(G) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[834] *See* paragraph (b)(2)(v) of Rule 17g–7. As a result of these modifications, paragraph (b)(2)(v)(G) of Rule 17g–7, as proposed, is re-designated paragraph (b)(2)(v)(E) of Rule 17g–7.

[835] *See* paragraph (b)(2)(v)(A) of Rule 17g–7.

[836] *See* paragraph (b)(1) of Rule 17g–7.

[837] *See* paragraph (b)(2)(v)(A) of Rule 17g–7. The final amendments identify the classification as an addition to the rating history disclosure because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in the amendments or because the credit rating was outstanding as of the date three years prior to the NRSRO becoming registered in the class of credit ratings. *Id.*

[838] *See* paragraph (b)(2)(v)(G) of Rule 17g–7.

of the rated security or money market instrument stopped paying for the surveillance of the credit rating or the NRSRO decided not to devote resources to continue to perform surveillance on the credit rating on an unsolicited basis. However, the withdrawal of credit ratings could be used to make performance statistics appear more favorable. Consequently, as with the Transition/Default Matrices in Exhibit 1 to Form NRSRO, an NRSRO would be required to identify when a credit rating was withdrawn for reasons other than default or the extinguishment of the obligation upon which the credit rating is based. Similar to the Transition/Default Matrices, persons using the rating history information could analyze how often an NRSRO withdraws a credit rating for other reasons in a class or subclass of credit ratings.

One NRSRO stated that it does not subdivide withdrawn ratings into the subcategories of: (1) Withdrawn due to default; (2) Withdrawn because the obligation paid in full; and (3) withdrawn for ''other'' reasons.[839] This NRSRO also stated that since it does not monitor withdrawn ratings, it could not certify with confidence that its performance statistics include all defaults with respect to withdrawn ratings, and requiring such monitoring might constitute regulation of the substance of an NRSRO's rating procedures. However, section 15E(q)(2)(C) of the Exchange Act requires that the Commission's rules require the disclosure of performance information for a variety of credit ratings, including for credit ratings withdrawn by an NRSRO.[840] As discussed above, the reason an NRSRO withdraws a credit rating is important information in terms of assessing the performance of an NRSRO's credit ratings. For these reasons, the final amendments retain the requirement to classify the reason for the withdrawal. In response to comment,[841] as stated above with respect to the amendments to the instructions for Exhibit 1 to Form NRSRO, the Commission is clarifying that the amendments as adopted do not require NRSROs to monitor withdrawn credit ratings for a period of time after withdrawal. A withdrawn credit rating is categorized at the time of withdrawal. There is no requirement to update the rating history thereafter.

Paragraph (b)(2)(vi) of Rule 17g–7, as proposed, would identify the sixth category of data that must be disclosed with a rating action: A classification of the class or subclass of the credit rating.[842] The Commission is adopting this paragraph as proposed.[843] The classifications for the classes of credit ratings are based on the definition of *nationally recognized statistical rating organization* in section 3(a)(62) of the Exchange Act.[844] Consequently, the first classification is financial institutions, brokers, or dealers.[845] The second classification is insurance companies.[846] The third classification is corporate issuers.[847]

The fourth classification is issuers of structured finance products.[848] If the credit rating falls into this class, the NRSRO must disclose which of the following sub-classifications it falls into: RMBS;[849] CMBS;[850] CLOs;[851] CDOs;[852] ABCP;[853] other asset-backed securities;[854] or other structured finance products.[855] The sub-classifications are the same subclasses for structured finance credit ratings an applicant and NRSRO must use for the purposes of the Transition/Default Matrices to be disclosed in Exhibit 1 to Form NRSRO.[856]

The fifth classification is issuers of government securities, municipal securities, or securities issued by a foreign government.[857] If the credit rating falls into this class, the final amendments require the NRSRO to identify a sub-classification as well.[858] The sub-classifications are the same as the sub-classifications for this class in the instructions for Exhibit 1 to Form NRSRO: (1) Sovereign issuers; (2) U.S. public finance; or (3) international public finance.[859]

Paragraph (b)(2)(vii) of Rule 17g–7, as proposed, would identify the seventh category of data that must be disclosed with a rating action: The credit rating symbol, number, or score in the applicable rating scale of the NRSRO assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the action, the credit rating symbol, number, or score in the applicable rating scale of the NRSRO assigned to the obligor, security, or money market instrument as of the date of the rating action.[860] The NRSRO also would have to indicate whether the credit rating is in a default category. The Commission is adopting this paragraph as proposed.[861] The rating symbol, number, or score is a key component of the data that must be disclosed as it reflects the NRSRO's view of the relative creditworthiness of the obligor, security, or money market instrument subject to the rating as of the date the action is taken.

Paragraph (b)(3) of Rule 17g–7, as proposed, would provide that the information identified in paragraph

[839] *See Moody's Letter.*

[840] *See* 15 U.S.C. 78o–7(q)(2)(C).

[841] *See Moody's Letter; S&P Letter.*

[842] *See* paragraph (b)(2)(vi) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[843] *See* paragraph (b)(2)(vi) of Rule 17g–7.

[844] *See* 15 U.S.C. 78o–7(a)(62). This is consistent with how the classes of credit ratings are identified for the purposes of the performance statistics that must be disclosed in Exhibit 1 to Form NRSRO. *Compare* paragraphs (b)(2)(vi)(A) through (E) of Rule 17g–7, *with* paragraphs (1)(A) through (E) of the instructions for Form NRSRO.

[845] *See* paragraph (b)(2)(vi)(A) of Rule 17g–7; 15 U.S.C. 78o–7(a)(62)(B)(i).

[846] *See* paragraph (b)(2)(vi)(B) of Rule 17g–7; 15 U.S.C. 78o–7(a)(62)(B)(ii).

[847] *See* paragraph (b)(2)(vi)(C) of Rule 17g–7; 15 U.S.C. 78o–7(a)(62)(B)(iii).

[848] *See* paragraph (b)(2)(vi)(D) of Rule 17g–7; 15 U.S.C. 78o–7(a)(62)(B)(iv). Consistent with the instructions for Exhibit 1 to Form NRSRO, this class of credit rating is broader than the class identified in section 15E(a)(62)(B)(iv) of the Exchange Act.

[849] *See* paragraph (b)(2)(vi)(D)(*1*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *RMBS* for the purposes of the rule means a securitization primarily of residential mortgages.

[850] *See* paragraph (b)(2)(vi)(D)(*2*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *CMBS* for the purposes of the rule means a securitization primarily of commercial mortgages.

[851] *See* paragraph (b)(2)(vi)(D)(*3*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *CLO* for the purposes of the rule means a securitization primarily of commercial loans.

[852] *See* paragraph (b)(2)(vi)(D)(*4*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *CDO* for the purposes of the rule means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds.

[853] *See* paragraph (b)(2)(vi)(D)(*5*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *ABCP* for the purposes of the rule means short term notes issued by a structure that securitizes a variety of financial assets (for example, trade receivables or credit card receivables), which secure the notes.

[854] *See* proposed paragraph (b)(2)(vi)(D)(*6*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *other asset backed security* for the purposes of the rule means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, equipment loans, or equipment leases.

[855] *See* proposed paragraph (b)(2)(vi)(D)(*7*) of Rule 17g–7. Consistent with Exhibit 1 to Form NRSRO, the term *other structured finance product* for the purposes of the rule means a structured finance product not identified in the other sub-classifications of structured finance products.

[856] *See* paragraphs (b)(2)(vi)(D)(*1*) through (*7*) of Rule 17g–7; paragraphs (1)(D)(i) through (vii) of the instructions for Exhibit 1 to Form NRSRO.

[857] *See* paragraph (b)(2)(vi)(E) of Rule 17g–7; 15 U.S.C. 78o–7(a)(62)(B)(v).

[858] *See* paragraphs (b)(2)(vi)(E)(*1*) through (*3*) of Rule 17g–7.

[859] *See* paragraphs (b)(2)(vi)(E)(*1*) through (*3*) of Rule 17g–7; paragraphs (1)(E)(i) through (iii) of the instructions for Exhibit 1.

[860] *See* paragraph (b)(2)(vii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[861] *See* paragraph (b)(2)(vii) of Rule 17g–7. Because the final amendments eliminate rating affirmations from the rating histories, this requirement will be triggered only when an NRSRO withdraws a credit rating that had not changed.

(b)(2) of Rule 17g–7 must be disclosed in an interactive data file that uses an XBRL format and the List of XBRL Tags for NRSROs as published on the Internet Web site of the Commission.[862] One commenter stated that constantly updating the database for the 100% Rule ''would impose an unwarranted burden on NRSROs'' and requested that the Commission confirm that it may update the database monthly.[863] The Commission agrees that the rule should prescribe a standard timeframe within which the XBRL data file must be updated and that the standard should take into account the burden of updating the file. Consequently, the final amendments provide that the XBRL data file must be updated no less frequently than monthly consistent with the commenter's proposal.[864]

Paragraph (b)(4) of Rule 17g–7, as proposed, would specify when a rating action would need to be disclosed by establishing two distinct grace periods: Twelve months and twenty-four months.[865] In particular, a rating action would need to be disclosed: (1) Within twelve months from the date the action is taken, if the credit rating subject to the action was paid for by the obligor being rated or by the issuer, underwriter, depositor, or sponsor of the security being rated; [866] or (2) within twenty-four months from the date the action is taken, if the credit rating subject to the action is not a rating described above.[867] These separate grace periods are consistent with the requirements of the 100% Rule before today's amendments.[868] Commenters expressed opposing views on the appropriate length of the grace periods and whether there should be one grace period for all NRSROs.[869] One NRSRO stated that the grace periods are ''appropriate.'' [870] Another NRSRO stated that the Commission should consider a three-year grace period for rating histories of subscriber-paid credit ratings.[871] Two NRSROs were opposed to having two grace periods,[872] and one of these NRSROs stated that there should be an eighteen month grace period for all NRSROs ''if the goal is to foster comparability among NRSROs.'' [873] Another commenter was ''disappointed'' that the Commission was retaining the twelve and twenty-four month grace periods, because ''such delay is excessive and severely diminishes the usefulness of the information.'' [874]

The Commission believes that the twelve and twenty-four month grace periods strike an appropriate balance between the interests of users of credit ratings and the interests of NRSROs with various business models.[875] In particular, the longer grace period for NRSROs operating under the subscriber-paid business model is premised on the fact that the revenues earned by these NRSROs for their credit rating activities are derived largely from subscriptions to access their credit ratings and related analyses. NRSROs operating under the issuer-pay business model earn revenues largely from the fees paid by obligors and issuers to determine credit ratings for the obligor as an entity or for the issuer's securities or money market instruments. These issuer-paid credit ratings typically are publicly disclosed. For these reasons, subscriber-paid NRSROs would be disproportionately impacted if the rating histories disclosure requirement resulted in subscribers canceling subscriptions. Consequently, the Commission continues to believe the longer twenty-four month grace period is appropriate to limit the disproportionate impact on subscriber-paid NRSROs.

Finally, paragraph (b)(5) of Rule 17g–7, as proposed, would provide that an NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument no earlier than twenty years after the date a rating action with respect to the obligor, security, or money market instrument is classified as a withdrawal of the credit rating, provided no subsequent credit ratings are assigned to the obligor, security, or money market instrument after the withdrawal classification.[876] This proposed requirement was designed to ensure that information about credit ratings that are withdrawn for any reason would remain a part of the disclosure for a significant period of time. Two NRSROs commented on this aspect of the proposal.[877] One NRSRO stated that ten years is sufficient, consistent with the Transition/Default Matrices in Exhibit 1 to Form NRSRO, and that the Commission should perform a cost/benefit analysis of the requirement periodically to confirm that the benefits outweigh the costs.[878] The other NRSRO stated that the information would become less useful to investors as the volume of information on withdrawn ratings increases.[879] The Commission agrees at this time that a shorter retention period is appropriate considering the costs and benefits of retaining rating histories with respect to withdrawn ratings. Consequently, the final amendments provide that the NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument if at least fifteen years has elapsed since a rating action classified as a withdrawal of a credit rating pursuant to paragraph (b)(2)(v)(E) of Rule 17g–7 was disclosed in the rating history of the obligor, security, or money market instrument.[880]

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to the disclosure of information about the performance of credit ratings.[881] The baseline that existed before today's amendments was one in which NRSROs were required to make publicly available two types of information about the performance of their credit ratings: (1) Transition and default statistics; and (2) rating histories for certain subsets of the obligors, securities, and money-market instruments that they have rated.[882]

Before today's amendments, the instructions for Exhibit 1 required the applicant or NRSRO to provide performance statistics for the credit ratings of the applicant or NRSRO,

[862] *See* paragraph (b)(3) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[863] *See DBRS Letter.*

[864] *See* paragraph (b)(3) of Rule 17g–7.

[865] *See* paragraph (b)(4) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[866] *See* paragraph (b)(4)(i) of Rule 17g–7, as proposed.

[867] *See* paragraph (b)(4)(ii) of Rule 17g–7, as proposed.

[868] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63837–63842 (discussing the 100% Rule and the reasons the Commission adopted distinct twelve and twenty-four month grace periods).

[869] *See DBRS Letter; ICI Letter; Kroll Letter; Morningstar Letter; S&P Letter.*

[870] *See Morningstar Letter.*

[871] *See Kroll Letter.*

[872] *See DBRS Letter; S&P Letter.*

[873] *See DBRS Letter.*

[874] *See ICI Letter.*

[875] Section 15E(q)(2)(E) of the Exchange Act provides that the Commission's rules must require that the credit rating performance disclosures are appropriate for various business models of NRSROs. *See* 15 U.S.C. 78o–7(q)(2)(E).

[876] *See* paragraph (b)(5) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[877] *See DBRS Letter; S&P Letter.*

[878] *See DBRS Letter.*

[879] *See S&P Letter.*

[880] *See* paragraph (b)(5) of Rule 17g–7.

[881] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[882] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6483; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63864.

including performance statistics for each class of credit ratings for which the applicant is seeking registration or the NRSRO is registered. In addition, the instructions required that the performance statistics must, at a minimum, show the performance of credit ratings in each class over one-year, three-year, and ten-year periods (as applicable) through the most recent calendar year-end, including transition and default rates within each of the credit rating categories, notches, grades, or rankings used by the applicant or NRSRO. Before today's amendments, the instructions for Exhibit 1 did not prescribe the methodology to be used to calculate the performance statistics or the format in which they must be disclosed; nor did the instructions limit the type of information that can be disclosed in the Exhibit. The instructions did, however, require an applicant or NRSRO to define the credit rating categories, notches, grades, or rankings it used and to explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics. Disclosures provided in Exhibit 2, which require a ''general description of the procedures and methodologies used'' by the NRSRO in determining credit ratings, may have provided additional context for comparing the performance statistics of different NRSROs. NRSROs made their most recent Forms NRSRO and Exhibits 1 through 9 to the forms available on their corporate Internet Web sites, though they were also permitted to make the disclosures publicly available through another comparable, readily accessible means. They were not required to provide Exhibit 1 in writing when requested.

NRSROs also voluntarily provided additional performance statistics in Exhibit 1 or elsewhere on their public Internet Web sites, such as transition and default statistics for particular asset sub-classes, geographies, or industries, or alternative analyses such as Lorenz curves. The voluntary disclosures of such statistics have varied, and some NRSROs, particularly larger ones, may have been able to provide more supplementary statistics at a granular level because they had more credit ratings, over a longer historical period, to analyze.[883]

In characterizing the baseline, it is useful to consider the performance statistics disclosed in NRSROs' annual certifications for the 2009 calendar year, as reviewed by the GAO in its 2010 report. While the disclosures from that year may not be representative of current NRSRO practices, they provide insight into NRSRO practices in 2009 under the rules governing the disclosure of performance statistics before today's amendments. Reviewing the 2009 disclosures of the ten NRSROs then registered, the GAO found significant differences across NRSROs in the computation of performance statistics, which limited their comparability.[884] These differences included, among other things: (1) Whether a single cohort approach or an average cohort approach was used; (2) whether or not statistics were adjusted to exclude withdrawn credit ratings; (3) whether default rates were indicated relative to initial credit ratings or credit ratings as of the beginning of a given period, and (4) whether default statistics were adjusted based on the time to default.[885] The GAO found that five NRSROs did not provide the number of credit ratings in each rating category, which made it impossible either to re-calculate more comparable statistics or to judge the reliability of the performance statistics.[886] The GAO also found that the asset-backed security class of credit ratings may have been too broad for performance statistics for this class as a whole to be meaningful.[887] The GAO concluded that ''the disclosure of these statistics has not had the intended effect of increasing transparency for users.'' [888]

Before today's amendments, the requirements for NRSROs to make certain rating histories publicly available (the 10% Rule and the 100% Rule) were contained in paragraphs (d)(2) and (d)(3) of Rule 17g–2, respectively. The 10% Rule applied only to NRSROs operating under the issuer-pays model, and required the disclosure of rating actions for a random 10% sample of outstanding credit ratings in each class in which an NRSRO was registered and for which the NRSRO had more than 500 issuer-paid credit ratings outstanding. The 100% Rule applied to all NRSROs, and required the disclosure of rating actions for any credit ratings initially determined by the NRSRO on or after June 26, 2007. Under both rules, the rating action information required to be disclosed was consistent with the information required to be retained pursuant to paragraph (a)(8) of Rule 17g–2. The rating actions that were required to be included in the histories were initial ratings, upgrades, downgrades, placements on credit watch, and withdrawals, and the information required to be disclosed for each such rating action was the rating action, date of the action, the name of the security or obligor, and, if applicable, the CUSIP of the security or CIK number of the obligor. The 10% Rule included a six-month grace period after ratings actions were taken before disclosure was required, while the 100% Rule included a twelve-month grace period for issuer-paid credit ratings and a twenty-four-month grace period for all other credit ratings. NRSROs made the required rating histories publicly available on their corporate Internet Web sites.

In characterizing the baseline, it is useful to consider, as in the case of performance statistics, the conclusions of the GAO in its 2010 report with respect to the disclosure of rating histories by NRSROs. While the disclosures from that period may not be representative of current NRSRO practices, the GAO study provides insight into NRSRO practices at the time of the report and into the limitations of the 10% Rule and 100% Rule before today's amendments. The GAO stated its view that the rating histories provided at that time could not be used to generate reliable performance statistics because, among other things: (1) The 10% samples were being generated in ways that did not make them representative of the total population of credit ratings produced by the NRSROs; (2) the 100% samples were also unrepresentative, because, for example, they were missing the issuer credit ratings of many major American corporations because these credit ratings were initiated before 2007; (3) the data fields provided were insufficient; and (4) not all NRSROs disclosed defaults in these histories.[889] The GAO also stated,

[883] *See* GAO Report 10–782, p. 25.

[884] *See id.* at 24.

[885] *See id.* at 27–37. *See also id.* at 22–23 (''For the transition rates, they differed by whether they (1) were for a single cohort or averaged over many cohorts, (2) constructed cohorts on an annual basis or monthly basis, (3) were adjusted for entities that have had their ratings withdrawn or unadjusted, and (4) allowed entities to transition to default or not.''); *Id.* at 30–31 (''NRSROs also used different methodologies for calculating default rates. In general, default rates differed by whether they were (1) relative to ratings at the beginning of a given time period or relative to initial ratings, (2) adjusted for entities that had their ratings withdrawn or unadjusted, (3) adjusted for how long entities survived without defaulting or unadjusted, (4) calculated using annual or monthly cohorts, and (5) calculated for a single cohort or averaged over many cohorts.'').

[886] *See* GAO Report 10–782, pp. 28, 36.

[887] *Id.* at 36.

[888] *Id.* at 94.

[889] *See* GAO Report 10–782, p. 40–46 (stating, for example, with respect to the 10% samples, that the GAO ''could not use these samples to generate reliable performance statistics for the NRSROs, as the rule intended, for the following reasons: (1) The data fields the NRSROs included in their disclosures were not always sufficient to identify

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in explaining why the 10% and 100% samples were unrepresentative of the universe of credit ratings, that these samples were not required to include credit ratings that had been withdrawn in prior periods, leading to a sample in which cases of defaults would be underrepresented.[890] The GAO concluded that it was unlikely that the required rating histories could be used to generate performance measures and studies to evaluate and compare NRSRO performance.[891]

Relative to the baseline, the amendments to the instructions for Exhibit 1 to Form NRSRO, Rule 17g–1, Rule 17g–2, and Rule 17g–7 with respect to the disclosure of performance statistics and rating histories should result in benefits for users of credit ratings. The amendments, which implement the provisions of section 15E(q) of the Exchange Act and, as discussed in sections II.E.1. and II.E.3. of this release, took into account findings by the GAO, should result in performance statistics that are more directly comparable across NRSROs and ratings histories that are more useful for performance analyses than those provided under the baseline requirements.[892] To the extent that the new disclosures therefore facilitate the evaluation of the performance of an NRSRO's credit ratings and comparisons of rating performance across NRSROs—including direct comparisons of different NRSROs' treatment of the same obligor or instrument—the amendments may benefit users of credit ratings by allowing them to better assess the reliability and information content of credit ratings from different NRSROs and, in the case of subscriber-paid credit ratings, make more informed decisions regarding whether to subscribe to the credit ratings of particular NRSROs.

Specifically, the amendments to the instructions for Exhibit 1 requiring a standardized calculation of performance statistics—using specified definitions and the single cohort approach—to be presented in a standardized format and specifying that an applicant or NRSRO must not disclose information in the Exhibit that is not required to be disclosed are expected to result in simpler, more standardized disclosures relative to the disclosures produced under the baseline requirements. Moreover, the single cohort approach involves simpler computations than other approaches, so it may be easier for users of credit ratings to understand how the statistics were produced. Also, requiring all NRSROs to use the single cohort approach ensures that the cohorts being analyzed will be aligned across NRSROs, increasing the comparability of the statistics versus other computation methods (such as the average cohort approach). The amendments therefore may allow users of credit ratings, including users with a wide range of sophistication, to more readily compare the performance of credit ratings of different NRSROs than they could previously. The new requirement to divide the class of issuers of asset-backed securities into subclasses and the requirement to separately disclose the number of credit ratings that are withdrawn because the obligation has been paid in full, because the obligor defaulted, and for other reasons, as well as to report the total number of credit ratings in the start-date cohort in each category, should provide users of credit ratings with additional information that may help them better interpret the transition and default rates for the purpose of evaluating and comparing performance.[893]

In addition, the new requirements that expand the scope of credit ratings that must be included in the rating histories should, over time, generate databases that will include a comprehensive sample of rating actions (in contrast to the data disclosed under the baseline requirements). The databases also will include information about cohorts of credit ratings beyond those reflected in the performance statistics disclosed in Exhibit 1. Thus, the enhanced rating histories can be used to generate alternative statistics for evaluating and comparing NRSRO performance, including certain transition and default statistics using average cohort approaches (though, as discussed below, these statistics will likely be based on fewer cohorts than were used by NRSROs that disclosed performance statistics in Exhibit 1 using the average cohort approach before today's amendments). Because the data will be more comprehensive than that disclosed in the baseline, it should also be more likely, relative to the baseline, that rating histories of different NRSROs with respect to the same obligor or instrument will be available. Therefore, users of credit ratings should have more opportunities to directly compare and analyze different NRSROs' treatment of the same obligor or instrument over time. The requirements regarding the enhanced data fields to be included with a rating action should make any analyses using the rating histories more practicable than was the case with the more limited data fields produced under the baseline requirements.[894]

However, the benefits of the amendments in facilitating the evaluation and comparisons of NRSROs may be constrained by limits on the information required by the final rules, which, as discussed in this section, are intended to reduce the burdens on NRSROs resulting from the amendments and, with respect to the performance statistics, make them easier for users of credit ratings to understand how the statistics were produced. For example,

complete ratings histories for the rated entities comprising each sample, (2) the data fields did not always give us enough information to identify specific types of ratings for making comparisons, (3) the data fields did not always give us enough information to identify the beginning of the ratings histories in all of the samples, (4) SEC rules do not require the NRSROs to publish a codebook or any explanation of the variables used in the samples, (5) not all NRSROs are disclosing defaults in the ratings histories provided as part of their 10 percent samples, and (6) SEC guidance to the NRSROs for generating the random samples does not ensure that the methods used will create a sample that is representative of the population of credit ratings produced by each NRSRO.'').

[890] *See* GAO Report 10–782, p. 46.

[891] *See id.* at 95.

[892] While the amendments are designed to facilitate comparisons across NRSROs, differences in the meanings of the credit ratings of different NRSROs and in the procedures and methodologies they use to determine credit ratings will likely influence the ability to make perfect comparisons. For example, there is variability across NRSROs with respect to the information that is reflected in a credit rating. *See, e.g., S&P Letter;* GAO Report 10–782, p. 37–39. Some credit ratings, for example, reflect relative assessments of the likelihood an obligor or issuer will default on the ''first dollar'' owed, whereas other credit ratings also reflect the expected loss in the case of default. In interpreting the performance statistics and rating histories, users of credit ratings may thus need to account for additional contextual information, such as the general description of the procedures and methodologies used by the NRSRO to determine credit ratings required to be disclosed in Exhibit 2, in order to understand the limits to the comparability of the disclosures.

[893] While the standard definition of *default* is intended to facilitate comparisons across NRSROs, there may continue to be differences across NRSROs in the identification of defaults in the performance statistics which may reduce somewhat the comparability of these statistics. When an event occurs that does not meet the standardized definition of *default* in Exhibit 1, it may still be categorized as a default by an NRSRO under its own definition of *default,* which is incorporated into the Exhibit 1 definition. In interpreting the performance statistics, users of credit ratings may thus need to account for additional contextual information such as the new requirement to ''clearly explain'' the usage of the term *default* directly after the performance statistics.

[894] There may be differences across NRSROs in the identification of defaults and paid off obligations in the rating histories which reduce somewhat the comparability of this data across NRSROs, since the amendments do not prescribe definitions of these terms for the purpose of the rating histories. In interpreting the rating histories, users of credit ratings may thus need to account for additional contextual information such as the new requirement to ''clearly explain'' the conditions under which an NRSRO classifies obligors, securities, or money market instruments as being in *default* after the performance statistics presented in Exhibit 1.

while mandating that only single cohort statistics be presented fosters comparability, the resulting disclosures will present the performance of only three particular cohorts of credit ratings (beginning one, three, and ten years prior to the end of the fiscal year). These statistics therefore may be subject to substantial volatility, particularly for NRSROs with fewer credit ratings.[895] The fact that the credit ratings of particular NRSROs may be more heavily weighted towards particular industries, geographies, or other sectors that might experience more defaults or other changes in creditworthiness over a particular measurement period also may exacerbate volatility in their performance statistics and make it difficult to separate differences in NRSRO performance from the effects of recent conditions.[896] NRSROs are only required to provide their current Form NRSRO on their Web sites, so users of credit ratings may not have access to previous Forms NRSRO in order to consider the cohorts analyzed in these other years.[897]

The rating histories may be helpful to users of credit ratings in addressing the limitations of the performance statistics both in that information about many additional cohorts may be available and also through the ability to directly compare NRSRO performance with respect to the same obligor or instrument. Such direct comparisons should not be skewed by the industry or sector focus of a given NRSRO. However, the final rules require only one or two years of history to be disclosed initially, depending on the applicable grace periods, so the benefits of these histories will be delayed until the histories grow to a length suitable for analysis. Also, as discussed below, even as data for additional years becomes available, the ability of NRSROs to remove a rating history from the data file fifteen years after the credit rating is withdrawn will limit the amount of historical information in the data file and, therefore, limit analyses by users of credit ratings that require a representative sample of credit ratings over an extended period of time. On the other hand, users of credit ratings that are interested in comparing NRSRO performance over time with respect to the same obligor or instrument should not face the same limitation and, therefore, should be able to take advantage of the full length of histories provided under the amendments.

A potential consequence of selecting one approach to be used for purposes of the Exhibit 1 disclosures is that it may impact the disclosures NRSROs make using other approaches. For example, even though the amendments require NRSROs to use the single cohort approach, NRSROs may continue on a voluntary basis to provide, not directly in Exhibit 1 but by reference to an Internet Web site address in this exhibit, disclosures of additional performance statistics such as statistics using the average cohort approach. These supplementary statistics may address some of the aforementioned limitations of statistics using the single cohort approach in that they may provide users of credit ratings with information about many more cohorts of credit ratings. However, NRSROs that previously disclosed average cohort statistics to fulfill their Exhibit 1 requirements might not continue to report these statistics voluntarily or might report them in an even less standardized fashion than previously (for example, for performance periods different from the one-year, three-year, and ten-year periods required in Exhibit 1). Importantly, NRSROs might be less likely to voluntarily disclose such additional statistics when they do not compare favorably to the performance of competitors.

The amendments may result in other benefits to users of credit ratings and NRSROs by enhancing accountability, competition, and efficiency. As has been widely documented, the most common NRSRO business model—the issuer-pay revenue model—creates an inherent conflict of interest.[898] Given this conflict, and because the demand for an NRSRO's credit ratings depends on its reputation for producing credit ratings of high quality, reputation is thought to play a particularly important disciplinary role in this industry.[899] To the extent that the amendments facilitate the external monitoring and comparative analysis of NRSROs, they may allow users of credit ratings to develop more refined views of NRSRO performance and thereby indirectly increase accountability and encourage integrity in the production of credit ratings, since NRSROs should have the incentive to maintain reputations for producing credit ratings of high quality in order to remain competitive. More comparable performance data also may help smaller NRSROs and new and recent entrants into the industry, including subscriber-paid NRSROs, to attract attention to their track records of issuing and monitoring credit ratings. If they produce track records comparable or superior to those of other NRSROs, this could enhance their ability to develop a reputation for producing high quality credit ratings. Such a reputation may allow them to better compete with more established competitors. The enhanced ability of users of credit ratings to evaluate the performance of NRSROs also may increase their ability to accurately interpret the information conveyed by credit ratings, potentially resulting in more efficient investment decisions. Market efficiency could also improve if this information is reflected in asset prices.[900]

The amendments to Rule 17g–1 and Rule 17g–7 requiring that these disclosures be published on an ''easily accessible'' portion of the NRSRO's Internet Web site could result in incremental benefits relative to the baseline. As mentioned above, the Commission agrees with commenters

[895] Averages over a smaller sample size are more susceptible to being skewed by individual extreme data points. *See also DBRS Letter* (stating that ''results will be significantly more volatile within the shorter time period, which will make interpreting those results more difficult'' and that ''the volatility impact will be amplified for NRSROs with fewer ratings'').

[896] A particular industry, geography, or other sector of the market may experience a period of poor performance common to all issuers and securities in that group, resulting in high default rates in that period. Economy-wide default rates are likely to be less volatile than the default rates for these individual groups since they reflect an average across many such groups, which may face downturns at different times. Thus, when considering performance over a short period, as in the case of the single cohort approach, the performance of NRSROs that focus on fewer industries, geographies, or other sectors may be skewed by any recent extremes in performance experienced by these sectors, leading to more volatile performance statistics. When such NRSROs are compared to other NRSROs, it may be difficult to interpret whether differences in their single cohort performance statistics may be due to the recent performance of the sectors they focus on or whether they reflect differences in the ability of the NRSROs to produce accurate ratings.

[897] In the future, users of credit ratings will have access to certain previous Forms NRSRO, including Exhibits 1 through 9 to these Forms. As discussed below in section II.L. of this release, the amendments to Rule 101 of Regulation S–T will require an NRSRO to submit Form NRSRO and Exhibits 1 through 9 to the Form electronically through the EDGAR system. Submission through the EDGAR system will maintain the public availability of a Form NRSRO even after updated versions are submitted.

[898] *See, e.g.,* Lawrence White, *Markets: The Credit Rating Agencies,* J. of Economic Perspectives (Spring 2010), Volume 24, Number 2, p. 211–226.

[899] *See, e.g.,* Jerome Mathis, James McAndrews, and Jean-Charles Rochet, *Rating the Raters: Are Reputation Concerns Powerful Enough to Discipline Rating Agencies?,* J. of Monetary Economics (July 2009), p. 657–674; Lawrence White, *Markets: The Credit Rating Agencies, J. of Economic Perspectives* (Spring 2010), Volume 24, Number 2, p. 211–226; Daniel M. Covitz and Paul Harrison, *Testing Conflicts of Interest at Bond Rating Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate,* Federal Reserve Board (Dec. 2003), *available* at *http://www.federalreserve.gov/pubs/feds/2003/200368/200368pap.pdf.*

[900] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

that the disclosures would be on an ''easily accessible'' portion of an NRSRO's Internet Web site if they could be accessed through a clearly and prominently labeled hyperlink labeled ''Regulatory Disclosures'' on the homepage of the Web site. Some NRSROs may already provide Form NRSRO, Exhibits 1 through 9 to the form, and rating histories in such a location. However, to the extent that these amendments result in NRSROs moving the disclosures to a more prominent location on their Internet Web sites to fulfill the requirement that they be ''easily accessible,'' they may incrementally assist users of credit ratings in locating these disclosures. Requiring that Exhibit 1 be made available in writing when requested may benefit any users of credit ratings who do not have access to the Internet.

Relative to the baseline, the amendments with respect to the disclosure of performance statistics and rating histories will impose costs on applicants and NRSROs. In particular, while all NRSROs currently disclose transition and default rates, the content and presentation of these performance statistics differ, to varying degrees, from the information required and the format prescribed by the rules. The revised requirements therefore will require the initial collection and analysis of certain additional historical data (for example, whether issuers or instruments defaulted under the standard definition) as well as changes in systems and procedures to collect and present this information according to the amendments going forward. The Commission's estimates of these costs—which are based on analyses for purposes of the PRA—are provided below.

Two NRSROs have commented that, in some cases, collecting certain historical information would require substantial cost or could be impossible.[901] The historical information required for the transition and default statistics which NRSROs may not have stored (or stored in a readily retrievable format) consists of, over a ten year history, the more detailed categorization of any withdrawn credit ratings and the assignment of credit ratings in the asset-backed securities class into sub-classes. As discussed above, the Commission has modified the amendments to reduce the amount of historical information that may need to be retrieved with respect to withdrawn credit ratings. In particular, the amendments provide that, except in the case of the asset-backed securities class of credit ratings, the transition and default statistics must include only credit ratings assigned to an obligor as an entity or, if there is no such credit rating, the credit rating of the obligor's senior unsecured debt, instead of all credit ratings of securities or money-market instruments in the respective class or subclass. The Commission has also revised the standard definition of *paid off* to eliminate the prong that applied to credit ratings of obligors as entities. Because the Commission has narrowed the scope of the credit ratings that must be included in the performance statistics for four of the five classes of credit ratings, and has revised the standard definition of *paid off* so that it does not apply to entity credit ratings, the cost of categorizing historical withdrawals based on the standard definitions of *default* and *paid off* and withdrawals for other reasons should be substantially reduced. The modifications from the proposal should therefore mitigate concerns to some degree about having to obtain information that was not traditionally retained by the NRSRO because it will significantly narrow the scope of such information that will need to be collected in order to calculate the performance statistics. While the Commission believes that these modifications may substantially reduce the amount of historical data to be collected, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act.

The costs of the compliance efforts described above should vary across NRSROs due to: (1) Differences in the quantity of credit ratings they issue and the number of classes of credit ratings for which they issue credit ratings; (2) differences in terms of how their disclosures under the baseline requirements compare to the disclosures required under the amendments; (3) differences with respect to the historical information they currently store in a readily-retrievable format; (4) differences in the number of past years and number of historical credit ratings for which additional historical information will need to be collected; and (5) differences in the design and flexibility of their information systems. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to Exhibit 1 to Form NRSRO will result in total industry-wide one-time costs to NRSROs of approximately $737,000 and total industry-wide annual costs to NRSROs of approximately $295,000.[902]

Under the amendments to paragraph (i) of Rule 17g–1, NRSROs are required to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet Web site and to provide a paper copy of Exhibit 1 to individuals who request a paper copy. NRSROs may need to re-configure their corporate Internet Web sites to comply with the amendments and will need to establish procedures and protocols for processing requests for a paper copy. Based on analysis for purposes of the PRA, the Commission estimates that the amendments to paragraph (i) of Rule 17g–1 will result in total industry-wide one-time costs to NRSROs of approximately $150,000 and total industry-wide annual costs to NRSROs of approximately $121,000.[903]

The amendments to the instructions for Exhibit 1 also may result in other costs to NRSROs. For some NRSROs, it is possible that using only the single cohort approach to produce the performance statistics in Exhibit 1 may lead users of credit ratings to misinterpret their performance, negatively impacting competition in the industry. Specifically, as discussed above, the single cohort approach will produce statistics about three particular cohorts of credit ratings and may thus be subject to volatility. Further, the statistics may be particularly volatile for certain NRSROs, such as those that have a small number of credit ratings in a given start date cohort or those that focus on particular industries, geographies, or other sectors within a class of credit ratings. The requirements of the final amendments (that is, showing the number of credit ratings in the start date cohort) are designed to provide persons reviewing the statistics with sufficient information to readily assess the impact that a small number of credit ratings can have on the statistics. Also, the disclosure of ratings histories should permit more refined comparisons of performance in cases where differences in performance statistics may reflect differences in the universe of obligors or instruments rated

[901] *See, e.g., Moody's Letter* (stating that collecting certain data for past rating actions would have to be done manually); *S&P Letter* (stating that ''it may not be possible to track'' the distinction between ratings withdrawn for different reasons ''retroactively'').

[902] *See* section V.E. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.2. of this release.

[903] *See* section V.E. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.1. of this release.

by NRSROs. However, some persons reviewing the transition and default rates could inappropriately view the volatility resulting from such factors unfavorably, potentially disadvantaging these NRSROs relative to the baseline to the extent that their reputation for producing quality credit ratings is negatively affected. The competitive position of small NRSROs may be further disadvantaged by the burden associated with establishing systems to produce the statistics, since this cost may not depend on the number of credit ratings in the start-date cohorts and thus may result in a higher relative burden for small NRSROs.[904]

Under the baseline requirements, NRSROs publicly disclosed certain rating histories data to fulfill the requirements of the 10% Rule and the 100% Rule, but the sample of credit ratings subject to the disclosure, the rating actions disclosed, the extent of the histories, and the included data fields differ, to varying degrees, from those required by the amendments. The amendments may thus require NRSROs to add more rating histories to their disclosures because in contrast to the baseline requirements the amendments: (1) Apply to all credit ratings outstanding as of the specified date or initiated thereafter rather than a random sample of credit ratings; (2) do not exclude credit ratings that were outstanding as of the specified date but initiated before June 26, 2007; and (3) require the rating histories of withdrawn ratings to be retained in the file for fifteen years. Also, the amendments will require NRSROs to revise which rating actions are included and to provide more information about each rating action in the rating histories. NRSROs initially will have to collect additional historical data and edit the history files to meet these requirements. Some of the required information which might not have been collected previously—such as the categorization of credit ratings in the asset-backed securities class into sub-classes—will be retrieved in the process of complying with the amended instructions for Exhibit 1 to Form NRSRO discussed above. NRSROs also will have to reprogram existing systems and make changes in procedures to collect and upload the information according to the amendments going forward. NRSROs may have to make changes to their corporate Internet Web sites to disclose the information on an ''easily accessible'' portion of their Web sites, though the incremental changes required beyond the Web site changes to disclose Form NRSRO discussed above may be minimal. On an ongoing basis, the cost of the procedures required to update the rating histories files at least monthly may exceed the annual burden previously imposed by the 10% Rule (which is being repealed) and the 100% Rule before today's amendments, given the comprehensive nature of the data required. The Commission's estimates of these costs—which are based on analyses for purposes of the PRA—are provided below.

One commenter stated that the Commission ''substantially underestimated the costs'' of the proposed amendments to the 100% Rule in the proposing release.[905] Two other commenters raised concerns that retrieving the required historical data would require substantial cost or could be impossible.[906] The Commission acknowledges that the amendments will impose significant costs on NRSROs, and has modified the proposal in a number of ways to mitigate costs. First, the final amendments eliminate the requirement to include information for all credit ratings outstanding on June 26, 2007, and replace it with a standard three-year backward-looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This should significantly reduce the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures. Further, the final amendments eliminate two types of rating actions that would trigger a requirement to add information to a credit rating's history: Placements of the credit rating on watch or review and affirmations of the credit rating. This may further reduce the cost of retrieving the historical information that must be disclosed in the rating histories, since a record of an affirmation of the credit rating may not previously have been stored (or stored in a readily retrievable format) by NRSROs. Consequently, because of these modifications, NRSROs should not need to perform analyses to identify historical affirmations and reconstruct the information that would need to have been disclosed under the proposal in connection with each affirmation of the credit rating (for example, the date of the action). The remaining information that is required to be disclosed, but may not have been systematically stored by NRSROs previously (such as the required categorization of the reason for a withdrawal), generally will need to be collected only once for each rating history rather than for multiple rating actions within a history, as each rating history should, for example, have only one withdrawal (whereas a history could have multiple affirmations of the credit rating). The narrowing of the scope of the types of rating actions that are required to be included in the rating histories also should reduce the burden of updating the XBRL data file with new information in the future. While the Commission believes the modifications discussed above may substantially reduce the costs of retrieving historical data, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act. The amendments also specify a standard for updating the file—no less frequently than monthly. This should mitigate concerns that the file would need to be updated more frequently. Finally, the final amendments modify the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This should reduce the data retention and maintenance costs associated with the amendments compared to the proposal.

The costs of the compliance efforts described above with respect to the amended requirements for disclosing rating histories should vary across NRSROs due to: (1) Differences in the quantity of credit ratings they issue and have issued in the historical years subject to disclosure; (2) differences in the data fields that they currently include in their rating histories; (3) differences with respect to the historical information they currently store in a readily-retrievable format; and (4) differences in the design and flexibility of their information systems. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to Rule 17g–2 and paragraph (b) of Rule 17g–7 will result in total industry-wide one-time costs to NRSROs of approximately $393,000, and total industry-wide annual costs to NRSROs of approximately $131,000.[907]

One commenter stated that the proposed amendments ''may force NRSROs to incur increased licensing

[904] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[905] *See DBRS Letter.*

[906] *See, e.g., Moody's Letter* (stating that collecting certain data for past rating actions would have to be done manually and ''would require tens of thousands of hours of analysis''); *S&P Letter* (stating that ''it may not be possible to track'' the distinction between ratings withdrawn for different reasons ''retroactively'').

[907] *See* section V.F. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.6. of this release.

costs to add new CUSIP data.'' [908] The CUSIP Global Services' license fees may vary based on the level of usage (that is, the number of CUSIPs databased and the licensees' business lines and regions of operation where the data will be used) and the form of usage (such as the internal databasing of CUSIP data or the distribution of CUSIP data).[909] The Commission believes that most NRSROs already have licensing agreements in place for their current usage of CUSIP data, but it is possible that these baseline licensing agreements may need to be expanded given the additional CUSIP data that may have to be stored and disclosed to comply with the amendments. The comment letter that highlighted these potential costs did not provide an estimate of these costs and did not provide data or analysis that would allow the Commission to estimate how NRSROs' CUSIP licenses would need to be changed to account for the new requirements.[910] Without information about the scope of the NRSROs' current licenses and the cost of obtaining updated licenses, it is not feasible for the Commission to develop an estimate of any such costs.[911]

Another potential cost to NRSROs is the potential loss of revenue from the sale of access to historical ratings data, as more of this data becomes publicly available. The Commission understands that revenue from this source may be significant for certain NRSROs, though commenters did not provide data or analysis that would allow the Commission to estimate the amount of revenue that could be lost.[912] The Commission is unable to estimate the revenue attributable to the sale of access to historical ratings data from other sources because the information about NRSRO revenues available to the Commission is not broken down at this level of granularity and, in practice, access to such historical data may be bundled with access to analytical tools and other services. This potential loss of revenue may be mitigated by the grace periods before disclosure, the fact that historical information before the three-year look-back period is not required to be disclosed, the exclusion of placements on credit watch and affirmations from the rating actions that must be disclosed in the public rating histories,[913] and the ability to remove a rating history from the public data file fifteen years after the credit rating is withdrawn. However, it is difficult to predict how subscribers will react to the change in the extent of publicly available data.

Because any such losses in revenue likely would disproportionately affect NRSROs that are more dependent on revenue from selling access to historical ratings data, and particularly NRSROs that operate on the subscriber-pay model, the disclosure requirement may disadvantage these NRSROs to the detriment of competition in the industry. Additional impacts on competition may result from the disproportionate burden on small NRSROs, given that some of the compliance costs are not likely to vary with size, and on NRSROs that have systems and data collection procedures that vary the most from the requirements of the amendments.

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.[914] 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.[915]

The Commission has considered the costs and benefits of reasonable alternatives relative to today's amendments, including certain alternatives that have been raised by commenters and discussed above. One NRSRO requested that the Commission provide ''fuller background'' on decisions such as the determination to require the single cohort approach rather than an average cohort approach for performance statistics, with a description of potential benefits and limitations of those decisions.[916] As an alternative to the single cohort approach, the Commission could have required NRSROs to use the average cohort approach, or to present two sets of statistics using the average and single cohort approaches respectively, as suggested by commenters.[917] Statistics generated using the average cohort approach would provide information to users of credit ratings that is not available from statistics generated using the single cohort approach, specifically with regard to how credit ratings perform on average across a wider variety of economic conditions. Such information may be of use to users of credit ratings in evaluating and comparing the performance of NRSROs. However, variation in the length of histories available at the different NRSROs makes it difficult to produce a standardized methodology for computing average cohort statistics that would be comparable across NRSROs. Also, because the single cohort approach requires simpler calculations, it may be less burdensome for NRSROs to produce such statistics and easier for less sophisticated investors to understand how such performance measurement statistics were produced. As discussed above, NRSROs will continue to be permitted to present alternative statistics on a voluntary basis on their public Web sites, and by reference to a URL in Exhibit 1.

A second alternative with respect to the performance statistics would be to require the disclosure of withdrawn credit ratings, without requiring that this category be separated into credit ratings that were withdrawn because the related obligation was paid off, because the obligor defaulted, or for other reasons. This alternative would be less burdensome than the approach in the amendments, because, as discussed by

[908] *See DBRS Letter* (''Expanding the ratings history universe, may also force NRSROs to incur increased licensing costs to add new CUSIP data. Any such costs should be factored into the Commission's cost-benefit analysis of this proposal.'').

[909] Information about CUSIP licenses is available at *http://www.cusip.com/cusip/cgs-license-fees.htm.*

[910] *See DBRS Letter.*

[911] CUSIP Global Services does provide some information about potential license fees on its public Web site, but explicitly states that the disclosed fee schedule does not apply to ''information providers, whose fees for their own usage and redistribution of CGS data are calculated using a different pricing model.'' The Web site also states that the ''[f]inal determination of fees is at the judgment of CGS and consideration will be given to aspects of a customer's profile.'' *See http://www.cusip.com/cusip/cgs-license-fees.htm.*

[912] *See, e.g., Fitch Letter.*

[913] For example, as discussed below, academic research suggests that placements on credit watch are significant information events, so some users of credit ratings may value information about historical NRSRO usage and timing of placements on credit watch.

[914] *See, e.g.,* Gustavo Manso, *Feedback Effects of Credit Ratings,* J. of Financial Economics (2013), Volume 109, p. 535–548.

[915] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[916] *See Kroll Letter.*

[917] *See CFA/AFR Letter; DBRS Letter.*

two commenters,[918] NRSROs that have not tracked this information historically likely would incur costs to collect the required information retroactively and change their systems to collect and report this information going forward. However, given that an applicant or NRSRO could withdraw a credit rating to make its transition or default rates appear more favorable, information about the reasons for withdrawal is likely to be useful to users of credit ratings in interpreting the performance statistics.

An alternative approach to the amendments regarding rating histories would be to require the inclusion of placements on credit watch in the rating histories, while still excluding ratings affirmations, which would be consistent with the rating actions subject to disclosure in histories under the baseline requirements. Among the three commenters that recommended that the scope of rating actions included in public rating histories be narrowed, two did not raise concerns about the inclusion of placements on credit watch.[919] Academic research has found that credit watch announcements are associated with abnormal stock and bond returns, indicating that placing a rating on credit watch is a significant information event.[920] Including these announcements in rating histories would thus allow persons to, for example, judge which NRSROs have historically been more likely to provide, and more timely at providing, this information to the users of credit ratings, and thus may increase the accountability, time sensitivity, and judiciousness of NRSROs in placing credit ratings on credit watch. However, while making information about placements on credit watch publicly available in the rating histories may benefit users of credit ratings that value this information, the fact that some users of credit ratings may value this information also means that excluding such information from rating histories may make subscribers to NRSRO services that include access to historical ratings data (including placements on credit watch) somewhat less likely to stop subscribing as an increasing amount of historical ratings data becomes publicly available. The Commission therefore believes that excluding placements on credit watch from the rating histories may reduce potential losses in NRSRO revenues from services that include access to their credit ratings and/or rating histories while still permitting users of credit ratings to use the public rating histories to conduct certain analyses (such as calculating alternative transition and default statistics) to evaluate and compare NRSRO performance.

Additional alternatives with respect to rating history disclosure would be to not permit a rating history for a credit rating to be removed from the data file fifteen years after the credit rating is withdrawn, or to shorten the retention period to ten years as suggested by a commenter.[921] Under the first alternative, the retention period could be substantially increased or a history could be required to be retained permanently. In particular, because the amendments allow credit ratings to be removed from the histories fifteen years after they are withdrawn, any data that becomes available for periods over fifteen years in the past will not reflect a representative sample of the credit ratings of the NRSRO, since withdrawn credit ratings, including credit ratings withdrawn because of default, will be underrepresented in the sample of outstanding credit ratings in the rating histories for a period that is more than fifteen years in the past.[922] Thus, the data files disclosed pursuant to the amendments will over time result in no more than fifteen years (and likely no more than thirteen or fourteen years, given the permitted grace periods) of data that is fully comprehensive and can therefore be used to calculate performance statistics or perform other analyses that require a representative sample of credit ratings. The data will, over time, become sufficient to produce, for example, five-year and twelve-year performance statistics using the single cohort approach or, for example, three-year performance statistics using the average cohort approach applied to the eleven annual cohorts beginning thirteen years ago. However, performance statistics using the data from ratings histories will be limited to cohorts of credit ratings over these thirteen or fourteen years of history and thus may not reflect as wide as a variety of economic conditions as may be desired.

Increasing the retention period would therefore benefit users of credit ratings interested in using the rating histories to perform analyses that require a representative sample of the credit ratings of the NRSRO outstanding as of a date or a series of dates that are more than thirteen or fourteen years in the past. However, as in the case of excluding data with respect to placements on credit watch, applying a shorter retention period may reduce potential losses to NRSROs of revenue from selling access to historical ratings data. Also, one NRSRO stated that ''the amount of data storage required'' to comply with a twenty-year retention requirement for the public rating histories ''would be considerable.'' [923] The Commission therefore believes that a fifteen-year retention requirement may reduce the burden on NRSROs, while still permitting users of credit ratings to use the public rating histories to conduct certain analyses (such as transition and default statistics that require up to thirteen or fourteen years of data, or comparisons over longer horizons of NRSRO performance with respect to the same obligor or instrument) to evaluate and compare NRSRO performance.

For these reasons, the Commission also does not believe it would be appropriate to shorten the retention period to ten years as suggested by one commenter.[924] A ten year retention period (rather than a fifteen year retention period) would further limit the utility of the rating histories in terms of being able to use the data to generate performance statistics that are different than the performance statistics that must be disclosed in Exhibit 1 to Form NRSRO.

A further alternative for rating history disclosure would be to increase or decrease the grace periods relative to the twelve- and twenty-four-month grace periods that are permitted for issuer-paid and other credit ratings respectively under the amendments. Longer permitted grace periods likely would reduce potential losses experienced by NRSROs in revenues

[918] *See Moody's Letter* (stating that it does not ''systematically capture data that sub-divides withdrawn credit ratings into the three sub-categories'' and that collecting this data for past rating actions ''would have to be done manually''); *S&P Letter* (''NRSROs may not currently distinguish between ratings on instruments that are paid off and withdrawn. Tracking this distinction going forward, to the extent it is not presently being done, will require significant systems changes. In addition, it may not be possible to track this distinction retroactively.'').

[919] *See ABA Letter; S&P Letter.* Another commenter recommended that the Commission exclude both affirmations and placements on credit watch, as well as assignments of default status, from the definition of *rating action. See Moody's Letter.*

[920] *See, e.g.,* Hand, Holthausen, and Leftwich, *The Effect of Bond Rating Agency Announcements on Bond and Stock Prices;* Chung, Frost, and Kim, *Characteristics and Information Value of Credit Watches.*

[921] *See DBRS Letter.*

[922] *See* GAO Report 10–782, pp. 46, 98. *See also id.* at 98 (stating that ''[t]o the extent that withdrawn ratings are not included in the data, users will not be able to generate withdrawal-adjusted statistics and the data will underrepresent defaulted issuers and issues'' and recommending that ''withdrawn ratings are not removed from these disclosures'').

[923] *See S&P Letter.*

[924] *See DBRS Letter.*

from services that include access to their credit ratings and/or rating histories. However, shorter grace periods would increase the benefits from the disclosure by making more, and more timely, information available to users of credit ratings for the purpose of evaluating and comparing the performance of NRSROs. The Commission believes it has appropriately balanced the costs and benefits of increasing or decreasing the grace periods in setting the grace periods permitted under the amendments.

F. Credit Rating Methodologies

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add subsection (r).[925] Section 15E(r) of the Exchange Act provides that the Commission shall prescribe rules, for the protection of investors and in the public interest, with respect to the procedures and methodologies, including qualitative and quantitative data and models, used by NRSROs that require each NRSRO to ensure that objectives identified in section 15E(r) are met.[926] The Commission proposed to implement section 15E(r) in large part, through paragraph (a) of Rule 17g-8, which would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure it meets the objectives identified in section 15E(r).[927] The intent was to provide flexibility for an NRSRO to establish policies and procedures that can be integrated with its procedures and methodologies for determining credit ratings, which vary across NRSROs.[928] The proposed approach also was sensitive to the limitation in section 15E(c)(2) of the Exchange Act, given that the objectives set forth in section 15E(r) of the Exchange Act relate to the procedures and methodologies an NRSRO uses to determine credit ratings.[929] The Commission also proposed an amendment to Rule 17g-2 to apply the record retention and production requirements of that rule to the documentation of the policies and procedures that would be required under proposed paragraph (a) of Rule 17g-8.[930]

1. Paragraph (a) of New Rule 17g–8

As proposed, paragraph (a) of Rule 17g-8 would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that it achieves the objectives identified in section 15E(r) of the Exchange Act.[931] In particular, the prefatory text of paragraph (a) would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that it meets the objectives identified in paragraphs (a)(1), (2), (3), (4), and (5).[932] The rule text in proposed paragraphs (a)(1), (2), (3), (4), and (5) of Rule 17g–8 largely mirrored the statutory text of section 15E(r) of the Exchange Act.[933]

The Commission is adopting the prefatory text of paragraph (a) of Rule 17g–8 as proposed.[934] The final rule requires an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that it meets the objectives identified in paragraphs (a)(1), (2), (3), (4), and (5) of the rule.

One commenter stated that the proposal appropriately recognizes that procedures and methodologies vary across NRSROs and thus there is a need for flexibility to establish policies and procedures that can be integrated with the NRSRO's existing credit rating methodologies.[935] Some commenters expressed general opposition to the proposal on the basis of cost.[936] One of these commenters stated that certain aspects of the proposals, including those regarding credit rating methodologies, would compound barriers to entry, and that many of the rules would be expensive and burdensome to implement.[937] More specifically, this commenter stated that the Commission should take into account the dominance of very large players and expand exemptions for small NRSROs designed to level the competitive field.[938]

In response, the Commission notes that the final rule is designed to meet the rulemaking mandate of section 15E(r) of the Exchange Act in a manner that provides flexibility to NRSROs to design the required policies and procedures. Consequently, an NRSRO can tailor and scale its policies and procedures to its business model, size, and the scope of its activities as well as to its procedures and methodologies for determining credit ratings, which should mitigate concerns to some degree about the costs of the final rule and its potential to create barriers to entry for small credit rating agencies. The Commission also believes that the policies and procedures required under section 15E(r), as implemented by the Commission in paragraph (a) of Rule 17g–8, will promote the integrity and transparency of the procedures and methodologies NRSROs use to determine credit ratings by, for example,

[925] *See* Public Law 111–203, 932(a)(8); 15 U.S.C. 78o–7(r).

[926] The objectives are: (1) To ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are (A) approved by the board of the NRSRO or a body performing a similar function; and (B) in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies; (2) to ensure that when material changes to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models) are made, that (A) the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply; (B) to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule; and (C) the NRSRO publicly discloses the reason for the change; and (3) to notify users of credit ratings (A) of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating; (B) when a material change is made to a procedure or methodology, including to a qualitative model or quantitative inputs; (C) when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions; and (D) of the likelihood of a material change described in subparagraph (B) resulting in a change in current credit ratings. *See* 15 U.S. C. 78o-7(r)(1) through (3).

[927] *See* paragraph (a) of Rule 17g-8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33452–33465. As discussed below, the Commission proposed to implement section 15E(r)(3)(A) of the Exchange Act (which addresses notice of the version of a procedure or methodology used with respect to a particular credit rating) also through paragraph (a) of Rule 17g-7, as proposed. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459.

[928] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33452.

[929] *See id.* at 33452. *See also* 15 U.S.C. 78o–7(r); 15 U.S.C. 78o–7(c)(2) (providing, in pertinent part, that the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings).

[930] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33456.

[931] *See* proposed paragraph (a) of Rule 17g–8; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[932] *See* proposed prefatory text of paragraph (a) of Rule 17g–8; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[933] *Compare* paragraphs (a)(1), (2), (3), (4), and (5) of Rule 17g–8, as proposed, *with* 15 U.S. C. 78o–7(r)(1) through (3).

[934] *See* prefatory text of paragraph (a) of Rule 17g–8.

[935] *See ICI Letter.*

[936] *See A.M. Best Letter; Kroll Letter.* Alternatively, another commenter expressed the view that rule should, in general, be strengthened by explicitly requiring NRSROs to assign higher risk to products issued by financial institutions with a track record of issuing poor quality assets. *See Levin Letter.* This recommendation is beyond the scope of the proposal and could implicate section 15E(c)(2) of the Exchange Act. *See* 15 U.S. C. 78o-7(c)(2) (which, among other things, prohibits the Commission from regulating the substance of credit ratings and the procedures and methodologies by which any NRSRO determines credit ratings).

[937] *See Kroll Letter.*

[938] *See id.*

promoting board oversight of these procedures and methodologies and requiring disclosure when material changes are made to them. Nonetheless, as discussed below in the economic analysis, the Commission acknowledges that these requirements will result in costs and that those costs could create competitive barriers.

As proposed, paragraph (a)(1) of Rule 17g–8 would implement section 15E(r)(1)(A) of the Exchange Act.[939] This section identifies the objective of ensuring that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board.[940] Paragraph (a)(1), as proposed, would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board.[941] The Commission intended this requirement to operate in conjunction with section 15E(t)(3)(A) of the Exchange Act, which establishes a statutory requirement that the board of an NRSRO ''shall oversee'' the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings.[942]

The Commission is adopting paragraph (a)(1) of Rule 17g–8, as proposed.[943] The final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that the procedures and methodologies it uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.[944] In relation to this requirement in paragraph (a)(1), section 15E(t)(3)(A) of the Exchange Act (as discussed above) contains a self-executing requirement that the board of an NRSRO ''shall oversee'' the ''establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings.'' [945] Consequently, as discussed in the proposing release, the policies and procedures required pursuant to paragraph (a)(1) of Rule 17g–8, as adopted, must be reasonably designed to ensure that the NRSRO's board carries out this statutorily mandated responsibility.[946] In addition, section 15E(t)(5) of the Exchange Act provides that the Commission may permit an NRSRO to delegate responsibilities required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small NRSRO.[947] In this case, the policies and procedures required pursuant to paragraph (a)(1) of Rule 17g–8, as adopted, must be reasonably designed to ensure the NRSRO's committee carries out the responsibility to oversee the establishment, maintenance, and enforcement of the NRSRO's procedures and methodologies for determining credit ratings.[948]

One commenter stated that the proposal appropriately meets the Exchange Act mandate.[949] Another commenter cited the high costs associated with having an independent board and stated that given those high costs the scope of board functions should not be inadvertently expanded.[950] This commenter also stated that it would have been helpful for the final rule to provide greater guidance to confirm that the board is not required to approve or pass judgment on, for example, ''qualitative and quantitative data and models.'' [951] A second commenter stated that a periodic approval process is more consistent with the board of directors' oversight role and provides the board of directors a better opportunity to provide well-planned and meaningful guidance that would be better at creating consistency in best practices across the NRSRO.[952] A third commenter stated that responsibility for the development of ratings criteria, methodologies, and models ''should be in the hands of experienced ratings professionals'' and that the board should be responsible for approving the policies and procedures that are used to develop the NRSROs' criteria, methodologies, and models.[953] The commenter did not interpret the proposal to require the board to approve the criteria, methodologies, or models themselves, stating that any such requirement would not be feasible given the vast amounts of continually developing criteria used by NRSROs.[954]

In response to the comments, the Commission notes that section 15E(t)(3)(A) of the Exchange Act provides that the board of an NRSRO shall oversee the establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.[955] Consequently, the self-executing requirement in the statute governs the responsibility of the board. Paragraph (a)(1) of Rule 17g–8 governs the responsibility of the NRSRO to have policies and procedures reasonably designed to ensure that the board carries out this responsibility. In terms of complying with the statutory requirement to oversee rating policies and procedures, the Commission recognizes that the board cannot be involved in managing the day-to-day affairs of the NRSRO. There must be an appropriate balance between the board's responsibilities as a governing body and the responsibilities of the NRSRO's managers as supervisors of the daily activities of the NRSRO. As a practical matter, an NRSRO will need to appropriately allocate responsibilities to the NRSRO's board and to the NRSRO's managers with respect to the implementation of rating procedures and methodologies, with the board exercising its statutory responsibility to oversee the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings. Consequently, the Commission does not expect board members to undertake the detailed work of developing rating procedures and methodologies.

Further, as discussed above, section 15E(t)(5) of the Exchange Act provides exception authority under which the Commission may permit an NRSRO to delegate responsibilities of the board required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small NRSRO.[956] The ability to request an exception under section 15E(t)(5) provides a means for a small NRSRO to seek relief to delegate

[939] *See* paragraph (a)(1) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[940] *See* 15 U.S.C. 78o–7(r)(1)(A).

[941] *See* paragraph (a)(1) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[942] *See* 15 U.S.C. 78o–7(t)(3)(A); *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[943] *See* paragraph (a)(1) of Rule 17g–8.

[944] *See id.*

[945] *See* 15 U.S.C. 78o–7(t)(3)(A).

[946] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[947] *See* 15 U.S.C. 78o–7(t)(5).

[948] *See* 15 U.S.C. 78o–7(t)(3)(A).

[949] *See S&P Letter.*

[950] *See Kroll Letter.* Section 15E(t)(2) of the Exchange Act prescribes a self-executing requirement that at least one half of the members of an NRSRO's board must be independent. *See* 15 U.S.C 78o–7(t)(2).

[951] *See Kroll Letter.*

[952] *See Morningstar Letter.*

[953] *See S&P Letter.*

[954] *See id.*

[955] *See* 15 U.S.C. 78o–7(t)(3)(A).

[956] *See* 15 U.S.C. 78o–7(t)(5).

responsibilities to a committee if the potential costs and burdens associated with the requirements of section 15E(t) of the Exchange Act—including the requirement that the board oversee the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings—are an unreasonable burden.[957]

Commenters also questioned whether the board of directors would need to have members with expertise in rating methodologies.[958] One of these commenters stated that the rule should require the NRSRO to appoint at least one board member with quantitative financial analysis expertise.[959] Section 15E(t)(3)(A) of the Exchange Act, while mandating that the NRSRO's board must ''oversee'' the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings, does not address whether the board must include a member with specific expertise in this area.[960] Similarly, section 15E(r)(1)(A) of the Exchange also does not address board expertise and, consequently, neither does paragraph (a)(1) of Rule 17g–8.[961] In complying with the statute and rule, an NRSRO and its shareholders will need to strike an appropriate balance between board members who have generalized experience and those who have more specific experience with aspects of the NRSRO's business activities, including with rating methodologies.

Paragraph (a)(2) of Rule 17g–8, as proposed, would implement section 15E(r)(1)(B) of the Exchange Act.[962] This section identifies the objective of ensuring that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies.[963] As proposed, paragraph (a)(2) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the procedures and methodologies, including qualitative and quantitative data and models, that the NRSRO uses to determine credit ratings are developed and modified in accordance with the policies and procedures of the NRSRO.[964]

The Commission is adopting paragraph (a)(2) of Rule 17g–8 as proposed.[965] Section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to ''establish, maintain, enforce, and document an effective internal control structure *governing the implementation of* and adherence to policies, procedures, and methodologies for determining credit ratings.'' [966] Consequently, section 15E(c)(3)(A) establishes a statutory requirement that an NRSRO have an internal control structure that governs the implementation of rating procedures and methodologies.[967] In addition, paragraph (a)(2) of Rule 17g–8 establishes a complementary requirement that an NRSRO have policies and procedures reasonably designed to ensure that rating procedures and methodologies are developed and modified in accordance with the NRSRO's procedures for developing and modifying rating procedures and methodologies.[968]

Two commenters supported the proposal.[969] In contrast, one commenter suggested the Commission take a different approach than was proposed in paragraph (a)(2) of Rule 17g–8.[970] Specifically, this commenter recommended that the rule establish a ''committee assessment function'' devoted to analyzing the performance of rating committees.[971] In response, the Commission notes that the rulemaking mandate in section 15E(r)(1)(B) of the Exchange Act addresses ensuring that the NRSRO uses rating procedures and methodologies that are in accordance with the NRSRO's procedures and methodologies for developing and modifying such procedures and methodologies.[972] In other words, the statute is concerned with ensuring that the NRSRO follows its processes for developing and modifying rating procedures and methodologies. 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.

Paragraph (a)(3)(i) of Rule 17g–8, as proposed, would implement section 15E(r)(2)(A) of the Exchange Act.[973] This section identifies the objective of ensuring that, when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply.[974] As proposed, paragraph (a)(3)(i) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are applied consistently to all credit ratings to which the changed procedures and methodologies apply.[975]

Paragraph (a)(3)(ii) of Rule 17g–8, as proposed, would implement section 15E(r)(2)(B) of the Exchange Act.[976] This section identifies the objective of ensuring that when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule.[977] As proposed, paragraph (a)(3)(ii) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and

[957] The Commission will respond to such requests in a manner similar to requests for relief under section 36 of the Exchange Act. *See* 15 U.S.C. 78mm. Further information about requesting relief under section 36 of the Exchange Act is *available at http://www.sec.gov/rules/exempt.shtml.*

[958] *See, e.g., AFSCME Letter* (expressing concerns that the board may not possess the necessary expertise, particularly in quantitative analysis, to carry out the oversight function specified in paragraph (a)(1) of Rule 17g–8); *COPERA Letter* (expressing similar concerns); *Morningstar Letter.*

[959] *See AFSCME Letter.*

[960] *See* 15 U.S.C. 78o–7(t)(3)(A). The statute does require the NRSRO to have independent board members, some of whom must be users of credit ratings of NRSROs. *See* 15 U.S.C. 78o–7(t)(2)(A).

[961] *See* 15 U.S.C. 78o–7(r)(1)(A).

[962] *See* paragraph (a)(2) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[963] *See* 15 U.S.C. 78o–7(r)(1)(B).

[964] *See* paragraph (a)(2) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542.

[965] *See* paragraph (a)(2) of Rule 17g–8.

[966] *See* 15 U.S.C. 78o–7(c)(3)(A) (emphasis added).

[967] *See id.*

[968] *See* paragraph (a)(2) of Rule 17g–8.

[969] *See ICI Letter; S&P Letter.*

[970] *See Harrington Letter.*

[971] *See id.*

[972] *See* 15 U.S.C. 78o–7(r)(1)(B).

[973] *See* paragraph (a)(3)(i) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[974] *See* 15 U.S.C. 78o–7(r)(2)(A).

[975] *See* paragraph (a)(3)(i) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33542–33543.

[976] *See* paragraph (a)(3)(ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453–33454.

[977] *See* 15 U.S.C. 78o–7(r)(2)(B).

quantitative data and models, the NRSRO uses to determine credit ratings are, to the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to then-current credit ratings within a reasonable period of time taking into consideration the number of ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.[978] The proposed rule text differed from the text of section 15E(r)(2)(B) of the Exchange Act because it provided that the changes must be applied to then-current credit ratings within a reasonable period of time taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.[979]

The Commission is adopting paragraphs (a)(3)(i) and (ii) of Rule 17g–8 with modifications to paragraph (a)(3)(i) to clarify the requirements of the rule in response to comment.[980] Specifically, one commenter stated that the provision appropriately meets the requirements of the Exchange Act but asked the Commission to clarify that paragraph (a)(3)(i) is applicable only to changes to procedures and methodologies that may impact new credit ratings, and that the implementation of changes affecting existing ratings are addressed separately in paragraph (a)(3)(ii).[981] The commenter's interpretation of paragraph (a)(3)(i) is incorrect. The Commission intended this paragraph to address the procedures and methodologies an NRSRO uses to determine new credit ratings and to make adjustments to current credit ratings. Otherwise, the policies and procedures required under paragraph (a)(3)(i) would not address the consistent treatment of current credit ratings. However, to remove any ambiguity, the text of paragraph (a)(3)(i) has been modified to clarify that the paragraph applies to ''current and future credit ratings.'' [982]

Another commenter questioned whether the provision was appropriate given the commenter's view that an NRSRO cannot ensure that changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply because qualitative assessments differ from credit rating committee to credit rating committee.[983] The Commission acknowledges that rating procedures and methodologies commonly incorporate qualitative analysis that introduces a degree of subjectivity to the rating process. The final rule is not intended to interfere with the qualitative process that is part of determining a credit rating. Rather, it is designed to ensure that an NRSRO does not apply different rating procedures and methodologies when determining credit ratings with respect to types of obligors or obligations that are intended to be subject to the same rating procedures and methodologies. If, for example, an NRSRO changes a rating procedure or methodology for determining initial credit ratings for RMBS, the policies and procedures of the NRSRO must be reasonably designed to ensure that the NRSRO does not continue to use the old procedure or methodology to determine initial credit ratings for some RMBS and the new procedure or methodology to determine initial credit ratings for other RMBS.[984]

The Commission is making modifications to paragraph (a)(3)(ii) of Rule 17g–8 from the rule text as proposed.[985] As stated above, one commenter asked the Commission to clarify that paragraph (a)(3)(i) is applicable only to changes to procedures and methodologies that may impact new credit ratings, and that the implementation of changes affecting current ratings are addressed separately in paragraph (a)(3)(ii).[986] As discussed above, the commenter's interpretation of paragraph (a)(3)(i) was not correct and the paragraph has been modified to clarify that it applies to current and future credit ratings. However, the commenter is correct that paragraph (a)(3)(ii) was intended to apply to current credit ratings. Specifically, the Commission intended paragraph (a)(3)(ii) to address the timeframe in which an NRSRO must apply an updated procedure or methodology for performing surveillance or monitoring of credit ratings to current credit ratings to which the changed procedure or methodology applies. For example, if the NRSRO changes the methodology for monitoring credit ratings of RMBS, paragraph (a)(3)(i) of the final rule requires the firm to have policies and procedures that are reasonably designed to ensure that it uses the updated methodology to monitor all RMBS credit ratings going forward.[987] The change in methodology, however, may require the NRSRO to adjust the current credit ratings assigned to RMBS. Paragraph (a)(3)(ii), as proposed, was intended to address the timeframe in which an NRSRO must apply the updated methodology to current credit ratings to determine whether they should be adjusted. The Commission has modified the text of paragraph (a)(3)(ii) to make this more clear. Specifically, the final rule requires an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are, to the extent that the changes are to surveillance or monitoring procedures and methodologies, *applied to current credit ratings to which the changed procedures or methodologies apply* within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.[988]

One commenter asked for clarification as to what time period constitutes a ''reasonable period'' for applying changed surveillance or monitoring procedures and methodologies to current credit ratings.[989] Two commenters supported the decision not to prescribe a timeframe given the variables surrounding such a change (for example, number of impacted credit ratings).[990] Another commenter acknowledged the need for flexibility with respect to the timeframe but expressed the concern that absent any guidance there would continue to be insufficient resources made available for surveillance and monitoring of credit

[978] *See* paragraph (a)(3)(ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[979] *See* paragraph (a)(3)(ii) of Rule 17g–8, as proposed; 15 U.S.C. 78o–7(r)(2)(B). The proposed rule text was designed to implement the rulemaking provision in section 15E(r)(2)(B) that the changes are to be applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453–33454.

[980] *See* paragraph (a)(3)(i) and (ii) of Rule 17g–8.

[981] *See S&P Letter.*

[982] *See* paragraph (a)(3)(i) of Rule 17g–8.

[983] *See Harrington Letter.*

[984] Similarly, if the NRSRO changes a procedure or methodology for monitoring credit ratings of RMBS, the policies and procedures of the NRSRO under paragraph (a)(3)(i) must be reasonably designed to ensure that it does not continue to use the old procedure or methodology to monitor some RMBS and the new procedure or methodology to monitor other RMBS.

[985] *See* paragraph (a)(3)(ii) of Rule 17g–8.

[986] *See S&P Letter.*

[987] *See* paragraph (a)(3)(i) of Rule 17g–8.

[988] *See* paragraph (a)(3)(ii) of Rule 17g–8 (emphasis added to highlight the modification).

[989] *See DBRS Letter.*

[990] *See S&P Letter; DBRS Letter.*

ratings.[991] Two commenters argued that the Commission must establish a firm deadline for the application of revised rating methodologies or surveillance procedures to current credit ratings to ensure NRSROs act promptly.[992] Another commenter, more generally, urged the Commission to require prompt re-testing after the NRSRO makes any such material changes.[993]

In response to the comments that the rule should prescribe a specific timeframe in which the review must take place or prescribe what constitutes a reasonable period of time, the Commission is not persuaded that doing so would be feasible or appropriate. For example, some NRSROs have hundreds of thousands of credit ratings outstanding in certain classes of credit ratings, whereas others have fewer than one thousand.[994] Consequently, if the specified timeframe was too short, an NRSRO with a large number of credit ratings might need to rush to meet the deadline. This could negatively impact the quality of the review of the credit ratings subject to the changed surveillance or monitoring procedures and methodologies and could result in adjustments to those credit ratings that were not the result of thorough analysis. If the specified timeframe was too long, an NRSRO with relatively few credit ratings would have a ''safe harbor'' that allowed the firm to act more slowly to apply the changed surveillance procedures and methodologies to current credit ratings than was necessary.[995] Consequently, the final rule retains the proposed requirement that the updated surveillance or monitoring procedure or methodology must be applied to the current credit ratings to which the changed procedure or methodology applies within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated. The question of whether the NRSRO has acted within a reasonable period of time will depend on factors such as the number of credit ratings an NRSRO has outstanding that would be impacted by the change.

Another commenter stated that the Commission should clarify the manner in which changes in rating procedures and methodologies would apply to current credit ratings.[996] More specifically, the commenter explained that proposed paragraph (a)(3)(i) of Rule 17g–8 did not address whether an NRSRO applying changed procedures or methodologies to outstanding credit ratings must re-rate the transaction based upon the information available at the time of the initial rating or whether the process should include performance information received after that time.[997] The commenter also stated that the NRSRO should not apply changes in procedures or methodologies to current credit ratings without a change in the performance of the credit rating.[998] In response, the Commission notes that the final rule does not require the NRSRO to adjust the outstanding credit ratings impacted by the changed rating procedure or methodology; nor does it specify on what basis an NRSRO should adjust an outstanding credit rating.[999] Rather, it requires the NRSRO to have policies and procedures reasonably designed to ensure that changes to surveillance or monitoring procedures and methodologies are applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable timeframe. The question of whether an outstanding credit rating must be adjusted after the application of the changed procedures or methodologies will depend solely on the NRSRO's procedures and methodologies. Based on those procedures and methodologies, the NRSRO may adjust an existing credit rating because of the change in the procedure or methodology, because of a change in circumstances that impacts the creditworthiness of the obligor or issuer that is subject to the credit rating, or a combination of these factors. This decision, however, will be based solely on the NRSRO's procedures and methodologies.[1000]

Paragraph (a)(4)(i) of Rule 17g–8, as proposed, would implement sections 15E(r)(2)(C), 15E(r)(3)(B), and 15E(r)(3)(D) of the Exchange Act.[1001] Section 15E(r)(2)(C) identifies the objective of ensuring that when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), the NRSRO publicly discloses the reason for the change.[1002] Section 15E(r)(3)(B) identifies the objective of ensuring that an NRSRO notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input.[1003] Section 15E(r)(3)(D) identifies the objective of ensuring that the NRSRO notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input, of the likelihood the change will result in a change in current credit ratings.[1004] The Commission proposed to implement these sections in paragraph (a)(4)(i) of Rule 17g–8, which would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet Web site material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any ''current ratings.'' [1005]

The Commission is adopting paragraph (a)(4)(i) of Rule 17g–8 with a minor modification to make terminology throughout the rule consistent.[1006] As adopted, paragraph (a)(4)(i) requires the NRSRO to have policies and procedures that are reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet Web site material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings.[1007]

Paragraph (a)(4)(ii) of Rule 17g–8, as proposed, would implement section

[991] *See AFSCME Letter.*

[992] *See Better Markets Letter; CFA/AFR Letter.*

[993] *See Levin Letter.*

[994] *See, e.g.,* 2013 Annual Staff Report on NRSROs, p. 8.

[995] *See Harrington Letter* (raising this concern).

[996] *See FSR Letter.*

[997] *See id.*

[998] *See id.*

[999] As discussed above, in implementing section 15E(r) of the Exchange Act, the Commission has been sensitive to the limitation in section 15E(c)(2) of the Exchange Act. *See* 15 U.S.C. 78o–7(c)(2) (which, among other things, prohibits the Commission from regulating the substance of credit ratings and the procedures and methodologies by which any NRSRO determines credit ratings).

[1000] *See* 15 U.S.C. 78o–7(c)(2).

[1001] *See* paragraph (a)(4)(i) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33454.

[1002] *See* 15 U.S.C. 78o–7(r)(2)(C).

[1003] *See* 15 U.S.C. 78o–7(r)(3)(B).

[1004] *See* 15 U.S.C. 78o–7(r)(3)(D).

[1005] *See* paragraph (a)(4)(i) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1006] *See* paragraph (a)(4)(i) of Rule 17g–8. The modification adds the word ''credit'' after the word ''current'' and before the word ''ratings'' to consistently use the term ''credit ratings'' throughout the rule.

[1007] *See* paragraph (a)(4)(i) of Rule 17g–8.

15E(r)(3)(C) of the Exchange Act.[1008] This section provides that the Commission's rules shall require an NRSRO to notify users of credit ratings when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions.[1009] As proposed, paragraph (a)(4)(ii) would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet Web site significant errors identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change in the current ratings.[1010]

The Commission is adopting paragraph (a)(4)(ii) of Rule 17g–8 with a minor modification. As proposed, the rule provided, in pertinent part, that the NRSRO must publish ''significant errors'' identified in a rating procedure or methodology. The proposal was intended to notify users of the NRSRO's credit ratings when a significant error is identified.[1011] One potential reading of the text, however, was that it required publication of the actual error. This was not intended. Further, publication of the error without context—rather than notification that an error was identified—could diminish the value of the disclosure. For example, if the error was in the code of a quantitative model, the disclosure of the code containing the error without identifying that it contained an error likely would not inform users of the NRSRO's credit ratings that there was an error. Consequently, the final rule is modified to provide for the prompt publication of notice of the existence of a significant error. More specifically, the final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet Web site *notice of the existence of a significant error* identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change to current credit ratings.[1012]

A number of commenters addressed paragraph (a)(4) of Rule 17g–8, as proposed.[1013] Some commenters stated that Internet Web site publication would help ensure that NRSROs communicate information pertaining to material changes in procedures and methodologies, as well as significant errors in the procedures and methodologies, to investors and other users of credit ratings in a timely manner.[1014] One commenter opposed the provision in paragraph (a)(4) of Rule 17g–8 requiring NRSROs to publish material changes and significant errors on an easily accessible portion of the NRSRO's corporate Internet Web site.[1015] The commenter argued that the statute requires more direct notification than Internet Web site publication, which could include allowing users to sign up for alerts.[1016] The Commission believes that specifying publication on an easily accessible portion of the NRSRO's Internet Web site is the most direct and cost effective way to provide an opportunity for all potentially interested parties to have access to the required disclosures.[1017] This does not preclude an NRSRO from offering additional disclosure services such as alerts or third parties from offering alert services based on the disclosures an NRSRO publishes.

One NRSRO stated that it would be helpful for the Commission to provide guidance as to when either a material change or significant error would trigger the disclosures.[1018] This commenter stated that significant errors should be disclosed if there is a reasonable likelihood that correction of the error will result in a change to current credit ratings. In contrast, another commenter stated that the Commission should not attempt to define the phrase *significant error* as any imposition of an arbitrary definition could result in situations where an NRSRO must identify errors that are minor and a correction does not result in a rating action.[1019]

The question of whether a change is material or an error is significant will depend on the facts and circumstances and, most importantly, on the impacted rating procedure or methodology (which vary across NRSROs). In general, the Commission believes that a change to a rating procedure or methodology would be material if there is a substantial likelihood that reasonable users of the NRSRO's credit ratings would find notice of the change important information in terms of assessing the rating procedure or methodology.[1020] The Commission believes that an error in a rating procedure or methodology would be significant if there is a substantial likelihood that reasonable users of the NRSRO's credit ratings would find notice of the error important information in terms of assessing the impact the error had on credit ratings determined using the rating procedure or methodology that contained the error.[1021]

Finally, paragraph (a)(5) of Rule 17g–8, as proposed, would implement section 15E(r)(3)(A) of the Exchange Act.[1022] This section provides that the Commission's rules shall require an NRSRO to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.[1023] As proposed, paragraph (a)(5) would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.[1024]

[1008] *See* paragraph (a)(4)(ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33454.

[1009] *See* 15 U.S.C. 78o–7(r)(3)(C).

[1010] *See* paragraph (a)(4)(ii) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1011] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33453.

[1012] *See* paragraph (a)(4)(ii) of Rule 17g–8 (emphasis added to highlight the modification).

[1013] *See Barnard Letter; CFA/AFR Letter; DBRS Letter; Gardner Letter; Harrington Letter; ICI Letter; Levin Letter; S&P Letter.*

[1014] *See DBRS Letter; Harrington Letter; ICI Letter; S&P Letter.*

[1015] *See CFA/AFR Letter.*

[1016] *See id.*

[1017] *See DBRS Letter* (supporting Web site-based disclosure); *Harrington Letter* (same); *ICI Letter* (same).

[1018] *See DBRS Letter.*

[1019] *See S&P Letter.*

[1020] *See DBRS Letter* (suggested that a change to a rating methodology should be considered material if there is a substantial likelihood that a reasonable investor or other user of the credit ratings would consider the change to be important in evaluating the affected credit ratings).

[1021] *See id.* (stating an error should be disclosed if there is a reasonable likelihood that correction of the error will result in a change to current credit ratings).

[1022] *See* paragraph (a)(5) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33454–33455.

[1023] *See* 15 U.S.C. 78o-7(r)(3)(A).

[1024] *See* paragraph (a)(5) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543. In addition, because this would be a rating-by-rating disclosure, the Commission proposed, as discussed below in section II.G.3. of this release, that disclosure of the version of a credit rating procedure or methodology be part of the rule implementing section 15E(s) of the Exchange Act. *See* 15 U.S.C. 78o-7(s). Section 15E(s) specifies, among other things, that the Commission adopt rules requiring an NRSRO to generate a form to be included with the publication of a credit rating. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459–33460 (discussing paragraph (a)(1)(ii)(B) of Rule 17g–7, as proposed).

The Commission is adopting paragraph (a)(5) of Rule 17g–8 as proposed.[1025] Specifically, the final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that it discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.[1026]

One commenter requested clarification that the requirement to publish the version of the criteria used for a particular credit rating applies only when there is an action on the credit rating, such as an upgrade, downgrade, or withdrawal.[1027] A second commenter stated that the rule should require the NRSRO to publicly provide, along with the publication of the credit rating, disclosure about the credit rating and the methodology used to determine it.[1028]

The Commission is implementing section 15E(r)(3)(A) of the Exchange Act through paragraph (a)(5) of Rule 17g–8 and paragraph (a)(1)(ii)(B) of Rule 17g–7. Paragraph (a)(1)(ii)(B) of Rule 17g–7, as discussed below in section II.G.3. of this release, requires that the form to be included with the publication of certain rating actions include a disclosure of the version of the credit rating procedure or methodology used to determine the credit rating.[1029] The policies and procedures required by paragraph (a)(5) of Rule 17g–8 must address the NRSRO's compliance with the disclosure requirement in Rule 17g–7. In response to the comments about when the version of the credit rating procedure or methodology used to determine the credit rating must be disclosed, Rule 17g–7 specifies when the form containing the disclosure of the version of the credit rating procedure or methodology used to determine the credit rating must be published by the NRSRO: Upon the taking of one of the rating actions identified in the rule (for example, an initial credit rating or an upgrade or a downgrade of an outstanding credit rating).[1030]

A third commenter expressed concern that the proposal would provide NRSROs with a defense for developing poor opinions on creditworthiness.[1031] More specifically, the commenter stated that, based on his experience, reference to published methodologies has given at least one NRSRO a defense for having formed poor opinions on CDOs and RMBS.[1032] The commenter also questioned the underlying rationale of the rule insofar as NRSRO methodologies are already freely accessible and transparent.[1033] In response, the Commission notes that the statutory directive is clear: The rule must require each NRSRO to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.[1034] To address the commenter's concern, the Commission would need to do the opposite and prohibit an NRSRO from notifying users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating. This would be inconsistent with the statutory requirement that the rule provide for notification.

2. Amendment to Rule 17g–2

The Commission proposed adding paragraph (b)(13) to Rule 17g–2 to identify the policies and procedures an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g–8 as a record that must be retained.[1035] The one comment letter that addressed the proposal supported it.[1036] The Commission is adding paragraph (b)(13) to Rule 17g–2 as proposed.[1037] This will provide a means for the Commission to monitor the NRSROs' compliance with paragraph (a) of Rule 17g–8. The record must be retained until three years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g–2 discussed above in section II.A.2. of this release.[1038]

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments and new rule relating to credit rating methodologies.[1039] The economic baseline that existed before today's amendments was one in which an NRSRO's board of directors must oversee the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings pursuant to Exchange Act section 15E(t)(3)(A).[1040] The baseline that existed before today's amendments and new rule also was one in which NRSROs must establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.[1041] NRSROs—under the baseline requirements—were not explicitly required to establish, maintain, enforce, document, and retain a record of policies and procedures relating to: (1) Board approval of the procedures and methodologies for determining credit ratings;[1042] (2) the development and modification of the procedures and methodologies for determining credit ratings;[1043] (3) applying material changes to the procedures and methodologies for determining credit ratings;[1044] (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;[1045] and (5) disclosing the version a procedure or methodology for determining credit ratings used with respect to a particular credit rating.[1046]

Relative to this baseline, the Commission believes that the amendments and new rule may result in a number of benefits. For example, implementing policies and procedures designed to ensure that the NRSRO's board of directors (or a body performing a similar function) oversees the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings in accordance with 15E(t)(3)(A) of the Exchange Act should promote the quality and consistency of the

[1025] *See* paragraph (a)(5) of Rule 17g–8.

[1026] *See id.*

[1027] *See S&P Letter.*

[1028] *See Gardner Letter.*

[1029] *See* paragraph (a)(1)(ii)(B) of Rule 17g–7.

[1030] *See id.*

[1031] *See Harrington Letter.*

[1032] *See id.*

[1033] *See id.*

[1034] *See* 15 U.S.C. 78o–7(r)(3)(A).

[1035] *See* paragraph (b)(13) of Rule 17g–2, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. *See also* section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[1036] *See DBRS Letter.*

[1037] *See* paragraph (b)(13) of Rule 17g–2.

[1038] *See* paragraphs (b)(13) and (c) of Rule 17g–2.

[1039] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1040] *See* 15 U.S.C. 78o–7(t)(3)(A).

[1041] *See* 15 U.S.C. 78o–7(c)(3)(A).

[1042] *See* paragraph (a)(1) of Rule 17g–8.

[1043] *See* paragraph (a)(2) of Rule 17g–8. As noted above, an NRSRO must establish, maintain, enforce, and document an effective internal control structure governing the implementation of their methodologies for determining credit ratings. *See* 15 U.S.C. 78o–7(t)(3)(A).

[1044] *See* paragraph (a)(3) of Rule 17g–8.

[1045] *See* paragraph (a)(4) of Rule 17g–8.

[1046] *See* paragraph (a)(5) of Rule 17g–8.

procedures and methodologies. Similarly, taking steps to ensure that the procedures and methodologies for determining credit ratings are developed and modified pursuant to the NRSRO's policies and procedures also should promote the quality and consistency of the procedures and methodologies.

Taking steps to ensure that material changes to the procedures and methodologies the NRSRO uses to determine credit ratings are applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply should help ensure consistent and timely application of such changes and promote the integrity of the credit rating process. This should benefit users of credit ratings. In addition, taking steps to ensure that an NRSRO promptly publishes on an easily accessible portion of its Internet Web site information about material changes to the procedures and methodologies the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings should benefit investors and other users of credit ratings by increasing the transparency of the NRSROs' credit rating activities and providing additional information with which to assess the quality of a given NRSRO's credit rating processes. Similarly, taking steps to ensure that an NRSRO promptly publishes on an easily accessible portion of its corporate Internet Web site notice of the existence of a significant error identified in a procedure or methodology used to determine credit ratings also should benefit investors and other users of credit ratings by increasing the transparency of the NRSROs' credit rating activities and providing additional information with which to assess the quality of a given NRSRO's credit rating processes.

The records NRSROs must keep pursuant to Rule 17g–2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are reasonably designed and the NRSRO is complying with them. Compliance with these policies and procedures may increase the likelihood that NRSROs apply sound procedures and methodologies consistently to all applicable credit ratings and inform investors of these procedures and methodologies.

Relative to the baseline, the Commission anticipates that the final rule will result in costs. NRSROs will need to expend resources to develop, document, enforce, and periodically modify the policies and procedures they establish pursuant to paragraph (a) of Rule 17g–8.

As stated above, some commenters opposed the proposed rule on the basis of cost.[1047] One of these commenters stated that certain aspects of the proposals, including those regarding credit rating methodologies, would compound barriers to entry, and that many of the rules would be expensive and burdensome to implement.[1048] More specifically, this commenter stated that the Commission should take into account the dominance of very large players and expand small NRSRO exemptions designed to level the competitive field.[1049]

In response, the Commission acknowledges that these requirements will result in costs, which could create competitive barriers. However, the Commission reiterates that the final rule is designed to meet the rulemaking mandate in section 15E(r) of the Exchange Act in a manner that provides flexibility to NRSROs in terms of designing the required policies and procedures. Consequently, an NRSRO can tailor its policies and procedures to its business model, size, and the scope of its activities as well as to its methodologies and procedures for determining credit ratings, which, to some degree, may mitigate concerns about the costs of the final rule and its potential to create barriers to entry for small credit rating agencies. These costs would likely be higher for NRSROs with more complex operations in terms of the quantity of credit ratings they issue, the different types of credit ratings they issue, and the number of locations from which they determine and issue credit ratings. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a) of Rule 17g–8 will result in total industry-wide one-time costs to NRSROs of approximately $566,000 and total industry-wide annual costs to NRSROs of approximately $142,000.[1050]

Relative to the baseline, the amendments to Rule 17g–2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g–2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(13) of Rule 17g–2 and the amendment to paragraph (c) of Rule 17g–2 will result in total industry-wide one-time costs to NRSROs of approximately $12,000 and total industry-wide annual costs to NRSROs of approximately $3,000.[1051]

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. This cost will likely vary significantly per occurrence depending on the number of credit ratings and the type of instruments affected by the change as well as the nature and extent of the change. In addition, the Commission believes that an NRSRO will incur costs when promptly publishing on an easily accessible portion of its Internet Web site information about material changes to procedures and methodologies, the likelihood such changes will result in changes to any current ratings, and notice of significant errors identified in a procedure or methodology in accordance with paragraphs (a)(4)(i) and (ii) of Rule 17g–8. Based on analysis for purposes of the PRA, the Commission estimates that paragraphs (a)(4)(i) and (ii) of Rule 17g–8 will result in costs to NRSROs of approximately $5,700 per publication on their Web site.[1052]

A possible additional cost is that the final rule potentially could decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process could improve the quality of ratings. In order to ensure that material changes to ratings procedures and methodologies are applied consistently to all current credit ratings to which the changed procedures or methodologies apply ''within a reasonable timeframe''

[1047] *See A.M. Best Letter; Kroll Letter.*

[1048] *See Kroll Letter.*

[1049] *See Kroll Letter.*

[1050] *See* section V.G. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

[1051] *See* section V.G. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[1052] *See* section V.G. of this release (discussing implementation and annual compliance considerations). The cost per publication is determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

in accordance with the new rule, an NRSRO may establish credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment, which could lengthen the rating process. As a result, the credit ratings may not benefit fully from the expertise of the analysts in the rating process, which could negatively impact the quality of the credit rating. This concern may be mitigated by the fact that the new rule does not require that the policies and procedures specify a specific timeframe to apply the changed procedure or methodology but rather requires that the change to be applied within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.[1053] 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. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the quality of credit ratings may decrease, which could decrease the efficiency of investment decisions made by users of credit ratings. 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. These amendments also will result in costs, some of which may have a component that is fixed in magnitude and does not vary with the size of the NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs. Consequently, the costs associated with these amendments may have a disproportionate impact on smaller NRSROs as suggested by commenters,[1054] creating adverse effects on competition. For example, one commenter suggested that these requirements would require an NRSRO to review credit rating methodologies, which would place an undue burden on smaller NRSROs.[1055] As a result of these amendments, the barriers to entry for credit rating agencies to register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO. As discussed earlier, these costs also will depend on the complexity of operations within the NRSRO.

Commenters have proposed a number of alternatives to the final rule. One alternative would be to require that NRSROs permit users of an NRSRO's credit ratings to sign up for alerts regarding material changes and significant errors in an NRSRO's procedures and methodologies, which, according to the commenter, ''would significantly improve communication.'' [1056] As stated above, the Commission believes that publication on an easily accessible portion of the NRSRO's Internet Web site is the most direct and cost effective way to ensure that all potentially interested parties have access to the required disclosures. Therefore, this alternative without a requirement to also disclose the information on the NRSRO's Internet Web site could potentially have the result that fewer users of credit ratings are informed of changes and errors. For example, certain users of credit ratings may opt not to sign up for email notification in order to avoid receiving unwanted communications.

Another alternative would be for the Commission to establish a firm deadline for the application of revised rating methodologies or surveillance or monitoring procedures to current credit ratings to ensure that NRSROs act promptly, as suggested by commenters.[1057] As stated above, the Commission is not persuaded that prescribing a specific timeframe in which the review must take place is feasible or appropriate. For example, some NRSROs have hundreds of thousands of credit ratings outstanding in certain classes of credit ratings, while others have fewer than one thousand.[1058] In addition, there is variation across NRSROs in the level of resources available to apply these changes. For example, the number of credit analysts employed by each NRSRO ranges from fewer than ten to more than a thousand.[1059] Consequently, mandating a timeframe that is too short could negatively impact the quality of the review of the credit ratings subject to the changed surveillance or monitoring procedures and methodologies and could result in adjustments to those credit ratings that are not the result of thorough analysis. In this case, this alternative could result in costs for users of credit ratings who may make credit-based decisions using incomplete or inaccurate information. In addition, an NRSRO with relatively fewer resources to make the required changes might need to incur costs such as hiring more staff to meet the deadline. If the mandated timeframe were too long, an NRSRO with relatively greater resources could take longer than necessary to apply the changed surveillance procedures and methodologies to impacted credit ratings.[1060] In this case, this alternative could result in costs for users of credit ratings as information would be updated in a less timely fashion than will be the case under the new rule.

G. Form and Certifications to Accompany Credit Ratings

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add paragraphs (q) and (s).[1061] Section 15E(q)(2)(F) of the Exchange Act provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.[1062] Sections 15E(s)(1) through (4), among other things, contain provisions requiring Commission rulemaking with respect to disclosures an NRSRO must make with the publication of a credit rating.[1063] The

[1053] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1054] *See A.M. Best Letter; Kroll Letter.*

[1055] *See A.M. Best Letter.*

[1056] *See CFA/AFR Letter.*

[1057] *See Better Markets Letter; CFA/AFR Letter.*

[1058] *See* Table 2 in section I.B. of this release.

[1059] *See* Table 1 in section I.B. of this release.

[1060] *See Harrington Letter* (raising this concern).

[1061] *See* 15 U.S.C. 78o–7(q) and (s).

[1062] *See* 15 U.S.C. 78o–7(q)(2)(F).

[1063] *See* Public Law 111–203, 932(a)(8); 15 U.S.C. 78o–7(s)(1) through (4). Section 15E(s)(4) of the Exchange Act also establishes requirements and mandates rulemaking with respect to issuers and underwriters of asset-backed securities, NRSROs,

Commission proposed paragraph (a) to Rule 17g–7, in large part, to implement sections 15E(q) and 15E(s) of the Exchange Act.[1064]

Under the proposal, an NRSRO would be required to publish two items when taking a rating action: (1) A form containing information about the credit rating resulting from or subject to the rating action; and (2) any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[1065] The proposal also included provisions prescribing the format of the form; the content of the form; and an attestation requirement for the form.[1066] The Commission is adopting paragraph (a) to Rule 17g–7 with modifications in response to comments.[1067]

1. Paragraph (a) of Rule 17g–7—Prefatory Text

Section 15E(s)(1) of the Exchange Act provides that the Commission shall require, by rule, an NRSRO to prescribe a form to accompany the publication of each credit rating that discloses: (1) Information relating to the assumptions underlying the credit rating procedures and methodologies; the data that was relied on to determine the credit rating; and if applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating; and (2) information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the NRSRO.[1068] Section 15E(s)(2)(C) of the Exchange Act provides that the form shall be made readily available to users of credit ratings, in electronic or paper form, as the Commission may, by rule, determine.[1069] Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO at the time it produces a credit rating to disclose any certifications from providers of third-party due diligence services to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by the third party.[1070]

The Commission proposed to implement sections 15E(s)(1), 15E(s)(2)(C), and 15E(s)(4)(D) of the Exchange Act, in large part, through the prefatory text of proposed paragraph (a) of Rule 17g–7.[1071] As proposed, the prefatory text provided that an NRSRO must publish two items when taking a rating action: (1) A form containing information about the credit rating resulting from or subject to the rating action;[1072] and (2) any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[1073] The first sentence of the prefatory text further provided that an NRSRO must publish the form and certification, as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the NRSRO is registered.[1074] The second sentence of the prefatory text defined the term *rating action* for purposes of the rule to mean any of the following: The publication of an expected or preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); a placement of an existing credit rating on credit watch or review; an affirmation of an existing credit rating; and a withdrawal of an existing credit rating.[1075] The third sentence of the prefatory text provided that the form and any applicable certifications must be published in the same medium and made available to the same persons who can receive or access the credit rating that is the result of the rating action or the subject of rating action.[1076]

The Commission is adopting the first sentence of the prefatory text of paragraph (a) of Rule 17g–7 with a modification in response to comment.[1077] As adopted, this sentence provides that except as provided in paragraph (a)(3), an NRSRO must publish the items described in paragraphs (a)(1) (the form) and (a)(2) (third-party due diligence certifications), as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the NRSRO is registered.[1078]

The Commission is adopting the second sentence of the prefatory text of paragraph (a) of Rule 17g–7 with modifications to narrow the definition of *rating action* in response to comments.[1079] Several commenters stated generally that the proposed definition is overly broad.[1080] One NRSRO stated that a broad definition of *rating action* could limit disclosure by ''creating incentives for NRSROs to publish commentary about their credit ratings less frequently.''[1081] Commenters stated that the proposed definition of *rating action* would make it difficult for NRSROs to release their credit ratings in a timely fashion.[1082] One commenter stated that rating actions involving transaction documents that were finalized before the effective date of the rules should not be subject to the disclosure requirements.[1083] An NRSRO stated that the amount of preparation time needed to comply with the rule will likely delay the issuance of ratings, ''particularly with respect to preliminary ratings.''[1084] In contrast,

and providers of third-party due diligence services with respect to third-party due diligence services relating to asset-backed securities. *See* 15 U.S.C. 78o–7(s)(4)(A) through (D). As discussed in more detail below in section II.H. of this release, the Commission also proposed to implement section 15E(s)(4) of the Exchange Act through: (1) Rule 15Ga–2; (2) amendments to Form ABS–15G; (3) Rule 17g–10; and (4) Form ABS Due Diligence–15E. *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33465–33476.

[1064] *See* paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33456–33465.

[1065] *See* paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33456–33465.

[1066] *See* paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33456–33465.

[1067] *See* paragraph (a) of Rule 17g–7.

[1068] *See* 15 U.S.C. 78o–7(s)(1)(A) and (B).

[1069] *See* 15 U.S.C. 78o–7(s)(2)(C).

[1070] *See* 15 U.S.C. 78o–7(s)(4)(D).

[1071] *See* prefatory text of paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33456–33457. As discussed below, the Commission proposed to implement section 15E(s)(1)(A)(iii) of the Exchange Act—which relates to the use of servicer or remittance reports—in paragraph (a)(1)(ii)(G) of Rule 17g–7, as proposed, because it specifies a particular item of information that would need to be disclosed in the form. *See* 15 U.S.C. 78o–7(a)(1)(i)(G); *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461.

[1072] *See* paragraph (a)(1) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1073] *See* paragraph (a)(2) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541–33542.

[1074] *See* prefatory text to paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1075] *See* prefatory text to paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1076] *See* prefatory text to paragraph (a) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1077] *See Fitch Letter;* prefatory text of paragraph (a) of Rule 17g–7 (first sentence). The modification, as discussed below, refers to an exemption the Commission is adopting from the publication requirement for certain rating actions that relate to a non-U.S. person and transactions that occur overseas. *See* paragraph (a)(3) of Rule 17g–7.

[1078] *See* prefatory text of paragraph (a) of Rule 17g–7 (first sentence).

[1079] *See* prefatory text of paragraph (a) of Rule 17g–7 (second sentence).

[1080] *See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.*

[1081] *See Moody's Letter.*

[1082] *See DBRS Letter; FSR Letter.*

[1083] *See ABA Letter.*

[1084] *See S&P Letter.*

another commenter stated that including preliminary ratings on asset-backed securities ratings will ensure that investors receive the information at a time when it is ''likely to be most useful to them in making an investment decision.'' [1085]

As explained below, commenters urged the Commission to eliminate from the definition of *rating action:* Preliminary credit ratings; placements of credit ratings on watch or review; affirmations and confirmations of credit ratings; and withdrawals of credit ratings.[1086]

One NRSRO commented that placing a credit rating on review should not be considered a rating action because a review is simply an indication of the potential for a future rating action, and is not itself a rating action.[1087] Several commenters stated that some or all rating affirmations should not be included in the definition of a rating action.[1088] One NRSRO stated that including rating affirmations would ''significantly'' increase the reporting burden on NRSROs, and would produce only a record that there was no change to the rating in question.[1089] The NRSRO also suggested that if affirmations are included, they should refer only to a published announcement or written confirmation that the rating is being maintained at its current level. Another commenter stated that affirmations should be excluded unless they represent ''a comprehensive review of a transaction.'' [1090] A different commenter stated that a ''confirmation,'' which is a type of affirmation that simply indicates that a particular action will not change a credit rating, should not constitute a rating action because disclosures associated with confirmations would only cover very minor document changes and add ''little value.''[1091]

Two commenters stated that some or all withdrawals should not be included in the definition of a *rating action.*[1092] One NRSRO stated that publishing the forms for withdrawals that are ''mechanical in nature and not based on a credit assessment or analysis'' could make it more difficult for market participants to locate significant information.[1093]

The Commission is sensitive to the burdens imposed by its rules, and in considering the comments discussed above has sought to balance the need for timely and robust disclosure with concerns about the costs that would result from the proposal. As discussed below, the Commission believes it is appropriate to narrow the definition of *rating action* from the proposed definition to include those actions that are made at a time when there is limited information about the rated obligor, security, or money market instrument and to other rating actions if they are linked to the performance of credit analysis. This will reduce the burden of complying with the rule. Nonetheless, the Commission recognizes that preparing the form in response to those rating actions that trigger the disclosure requirement will take time and that this could impact how quickly an NRSRO is able to publish the credit rating that results from or is the subject of the rating action. However, the Commission has balanced this concern with the directive of the statute (that the Commission adopt a rule requiring the form to be published with a credit rating) and the benefits of the increased transparency the disclosures in the form will provide to users of the NRSRO's credit ratings.[1094] Moreover, an NRSRO should be able to draft significant portions of the form largely in tandem with the credit rating process and, therefore, the form and the final decision on the rating action generally should be completed simultaneously.

In response to the comment to eliminate preliminary credit ratings from the definition of *rating action,* the Commission notes that this type of rating action and certain initial credit ratings (that is, those assigned to a newly formed obligor or newly issued security or money market instrument) are made at a time when there is little information available about the rated obligor, security, or money market instrument. Given the timing of these rating actions, the Commission agrees with comments that it is critical that investors and other users of credit ratings have access to the information that is required to be disclosed in the form and any applicable certifications on Form ABS Due Diligence–15E.[1095] Consequently, the Commission is adopting the requirement that the form and certifications be published when the NRSRO publishes a preliminary or expected credit rating or an initial credit rating.[1096]

Some of the types of rating actions included in the proposed definition are not necessarily linked to the performance of credit analysis. In particular, placements of credit ratings on watch or review, certain types of affirmations of credit ratings, and certain types of withdrawals of credit ratings are not based on the NRSRO applying its rating procedures or methodologies and making a credit rating determination. In the case of a watch or review, the rating action precedes the application of the rating procedure or methodology, which, once completed, may result in an affirmation or an adjustment (upgrade or downgrade) to the credit rating. However, not all credit rating

[1085] *See CFA/AFR Letter.*

[1086] *See, e.g., A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.*

[1087] *See Moody's Letter.*

[1088] *See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.*

[1089] *See S&P Letter.*

[1090] *See ASF Letter.*

[1091] *See FSR Letter.*

[1092] *See Deloitte Letter; Moody's Letter.*

[1093] *See Moody's Letter.*

[1094] *See, e.g., CFA/AFR Letter* (''One reason rating agencies were able to play fast and loose with their own rating methodologies is that the ratings were a sort of 'black box,' with little information made available to the users of those ratings about the assumptions that lay behind them or the data on which they were based. Dodd-Frank includes provisions to address this problem by requiring new disclosures to accompany the publication of a rating.'').

[1095] *See CFA/AFR Letter* (''Importantly, the Commission proposes to include preliminary ratings among the actions that would trigger the required disclosures. We strongly support this approach, which is essential to ensure that investors in ABS get the information at time [sic] when it is likely to be most useful to them in making an investment decision.''). As the Commission explained when adopting Rule 17g–7, the definition of *credit rating* in the note to the rule was designed to address pre-sale reports, which are typically issued by an NRSRO with respect to an asset-backed security at the time the issuer commences the offering and typically include an expected or preliminary rating and a summary of the important features of a transaction. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4503–4505 (Jan. 26, 2011). Consequently, disclosure at the time of issuance of a pre-sale report is particularly important to investors, since such reports provide them with important information prior to the point at which they make an investment decision. *See id.*

[1096] *See* prefatory text of paragraph (a) of Rule 17g–7 (second sentence). The Commission requested comment in the proposing release as to whether the disclosures required by the proposed rule in the context of a new offering should be provided no later than at least five business days in advance of the first sale of securities in the offering. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33457. In response, an NRSRO stated that requiring disclosures in a fixed timeframe is ''unrealistic'' because NRSROs often receive their information after the prospectus is filed and frequently assign ratings well after the actual closing and first sale of a transaction. *S&P Letter.* Another NRSRO and a commenter stated that the five business day requirement could potentially delay many issuances. *See DBRS Letter; FSR Letter.* In contrast, one commenter recommended that the Commission adopt the five business day requirement. *See CFA/AFR Letter.* The Commission believes at this time that the five business day requirement could raise practical issues and, therefore, is not adopting such a requirement. Consequently, the NRSRO must publish the form and any certifications at the same time the NRSRO publishes the result of the rating action.

affirmations are based on the NRSRO applying its rating procedures and methodologies.[1097] Similarly, NRSROs withdraw credit ratings for a number of reasons that are unrelated to the performance of credit analysis, including that the obligation was paid off or the obligor stopped paying to be rated.[1098]

In balancing the concerns of commenters about the burden of the rule against the need for timely and robust disclosure, the Commission, as stated above, believes it is appropriate to focus the disclosure requirement on rating actions that are based on the application of the NRSRO's procedures and methodologies for determining credit ratings. In this regard, much of the information required to be disclosed in the form under section 15E(s)(3) of the Exchange Act relates to the procedures, methodologies, and information used to determine the credit rating.[1099] For these reasons, placements of credit ratings on watch or review have been removed from the definition of *rating action.*[1100] In addition, the definition provides that an affirmation or withdrawal is a *rating action* if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using its procedures and methodologies for determining credit ratings.[1101]

For the foregoing reasons, the amendments have been modified from the proposal to eliminate placements of credit ratings on watch or review from the definition of *rating action* and to eliminate from the definition affirmations and withdrawals that are not based on the NRSRO applying its procedures and methodologies for determining credit ratings. Consequently, the second sentence—as adopted—provides that the term *rating action* ''means any of the following: The publication of an expected or preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); and an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using applicable procedures and methodologies for determining credit ratings.'' [1102]

The Commission is making another modification to the proposed amendments that will reduce the burden of the adopted rule. Specifically, one NRSRO recommended that the temporary conditional exemption for foreign transactions from the requirements in paragraph (a)(3) of Rule 17g–5 be applied to the disclosure requirements in paragraph (a) of Rule 17g–7, as proposed.[1103] The commenter stated that many foreign issuers lack the infrastructure to comply with the level of disclosure required by paragraphs (a)(1) and (a)(2) of Rule 17g–7, as proposed.[1104] The commenter stated further that, without an exemption, ''NRSROs either might be unable to issue a credit rating on non-U.S. securities or must withdraw as an NRSRO in order to continue rating certain non-U.S. securities.'' [1105]

The Commission is persuaded that at this time the disclosure requirement should not apply to rating actions involving credit ratings of obligors or issuers whose securities or money market instruments will be offered or sold in transactions that occur exclusively outside the United States. As noted above, one commenter suggested that local laws could impede the ability of the NRSRO to obtain or disclose information about the issuer in accordance with the requirements of the proposed amendments. To address these types of concerns, the Commission is adding paragraph (a)(3) to Rule 17g–7 to provide an exemption from the requirements of paragraphs (a)(1) and (a)(2) for rating actions in which: (1) The rated obligor or issuer of the rated security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902(k)); [1106] and (2) the NRSRO has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument after issuance, only in transactions that occur outside the United States.[1107] The wording of the exemption is modeled closely on the temporary conditional exemption from the requirements in paragraph (a)(3) of Rule 17g–5 the Commission has granted by order.[1108]

[1097] *See ASF Letter* (stating that a ''rating agency consent'' or ''rating agency confirmation'' simply confirms that a specific contractual change will not result in adverse effect on an existing rating and arguing that these ''statements do not reflect a comprehensive review of a transaction, unlike the type of review that would be undertaken in connection with an affirmation of a rating following on the placement of a rating on watch or review.'').

[1098] *See Moody's Letter* (stating that the requirement to publish a form should not apply in connection with the withdrawals of credit ratings that are mechanical in nature and not based on a credit assessment or analysis).

[1099] *See* 15 U.S.C. 78o–7(s)(3). For example, the required disclosures include: (1) The version of the methodology used to determine the credit rating; and (2) the main assumptions and principles used in constructing the applicable rating procedures and methodologies.

[1100] *See* prefatory text of paragraph (a) of Rule 17g–7 (second sentence).

[1101] *See id.* An affirmation that results from a look-back review under paragraph (c) of Rule 17g–8 would be an affirmation that is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using its procedures and methodologies for determining credit ratings. In particular, the NRSRO would be applying the procedures required by paragraph (c)(1) of Rule 17g–8 to promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.

[1102] *See* prefatory text of paragraph (a) of Rule 17g–7 (second sentence).

[1103] *See Fitch Letter. See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment,* Exchange Act Release No. 62120 (May 19, 2010). *See also Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment,* Exchange Act Release No. 70919 (Nov. 22, 2013) (most recent extension of the exemption).

[1104] *See Fitch Letter.*

[1105] *See id.*

[1106] 17 CFR 230.902(k).

[1107] *See* paragraph (a)(3) of Rule 17g–7. If the rating action involves a credit rating of an obligor as an entity, the NRSRO must have a reasonable basis to conclude that any security or money market instrument of the obligor will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions of the security or money market instrument after issuance, only in transactions that occur outside the United States. For example, if some securities or money market instruments issued by the obligor are sold in transactions that occur in the United States, the exemption does not apply to rating actions involving the credit rating assigned to the obligor as an entity. In contrast, if the rating action involves a security or money market instrument, the NRSRO need only make the required conclusion with respect to the specific issuance.

[1108] *See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment,* Exchange Act Release No. 62120 (May 19, 2010). *See also Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment,* Exchange Act Release No. 70919 (Nov. 22, 2013) (most recent extension of the exemption). In the original order, the Commission provided guidance on how an NRSRO may have a ''reasonable basis'' for the purpose of the second prong of the conditional exemption. *See Order Granting Temporary Conditional Exemption for Nationally*

Continued

As stated above, the Commission is making a corresponding modification to the first sentence of the prefatory text of paragraph (a) of Rule 17g–7, to add that an NRSRO must publish the items described in paragraphs (a)(1) and (a)(2) of Rule 17g–7 ''except as provided in paragraph (a)(3)'' of Rule 17g–7.[1109]

The Commission is adopting the third sentence of the prefatory text of paragraph (a) of Rule 17g–7 with technical modifications to improve its clarity.[1110] This sentence provides that the items described in paragraphs (a)(1) and (a)(2) must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.[1111] In response to comments, the Commission agrees that an NRSRO may satisfy this requirement by publishing the form and any applicable certifications on its public Internet Web site if the credit rating is disseminated through the Web site as well.[1112] In addition, if the NRSRO publishes the credit rating in a press release announcing the relevant rating action in addition to publishing the credit rating on its corporate Internet Web site, the NRSRO may make the form available through a clearly and prominently labeled hyperlink on the press release to the page on its corporate Internet Web site that contains the form and any applicable certifications.[1113]

In addition, the final amendments, as proposed, require that the form and any applicable certifications on Form ABS Due Diligence–15E must be made available to the same persons who can receive or access the credit rating that is the result of the rating action.[1114] Consequently, if the NRSRO publishes credit ratings for free on its corporate Internet Web site, it must make the form and certifications similarly available.[1115] Alternatively, if the NRSRO operates under the subscriber-pay business model, it must make the form and certifications available to its subscribers.[1116]

Finally, one commenter suggested the assessment of financial penalties for each day that NRSROs do not post the form when taking a rating action.[1117] The Commission has authority to take appropriate action against an NRSRO that fails to comply with the requirements of paragraph (a) of Rule 17g–7. Further, as discussed above in section II.D.1. of this release, the Exchange Act provides a wide range of fines, penalties, and other sanctions applicable to NRSROs for violations of any section of the Exchange Act (including section 15E) and the rules under the Exchange Act (including the rules under section 15E).[1118] The Commission therefore does not believe that providing for additional penalties is necessary.

2. Paragraph (a)(1)(i) of Rule 17g–7—Format of the Form

To implement sections 15E(s)(2)(A) and (B) of the Exchange Act, the Commission proposed paragraph (a)(1)(i) of Rule 17g–7, which would describe the required format of the form to accompany the publication of a rating action.[1119] In particular, section 15E(s)(2)(A) of the Exchange Act provides that the form developed by the NRSRO shall be easy to use and helpful for users of credit ratings to understand the information contained in the report.[1120] The Commission proposed paragraph (a)(1)(i)(A) of Rule 17g–7 to implement this section of the statute.[1121] This paragraph—as proposed—mirrored the statutory text by providing that the form generated by the NRSRO would need to be easy to use and helpful for users of credit ratings to understand the information contained in the form.[1122]

Section 15E(s)(2)(B) of the Exchange Act provides that the quantitative content required to be disclosed in the form and identified in section 15E(s)(3)(B) must be directly comparable across types of securities.[1123] As discussed below, section 15E(s)(3) of the Exchange Act identifies qualitative and quantitative information that must be included in the form.[1124] The Commission proposed that the quantitative content specified in section 15E(s)(3)(B) of the Exchange Act must be disclosed in the form pursuant to paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g–7, as proposed.[1125] Consequently, paragraph (a)(1)(i)(B) of Rule 17g–7, as proposed, required the form generated by the NRSRO to be in a format that provides the content described in paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g–7 in a manner that is directly comparable across types of obligors, securities, and money market instruments.[1126]

The Commission is adopting the proposal with modifications in response to comments.[1127] The modifications are

Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 62120 (May 19, 2010) (''The question of whether an NRSRO has a 'reasonable basis' to conclude that the structured finance product will be offered and sold upon issuance, and [that] any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, in transactions that occur outside the United States will depend on the facts and circumstances of a given situation. In order to have a reasonable basis to make these conclusions, the NRSRO should discuss with any arranger linked to the structured finance product (*i.e.,* the sponsor, underwriter, and issuer) how they intend to market and sell the structured finance product and how they intend to engage in any secondary market activities (*i.e.,* re-sales) of the structured finance product. An NRSRO may choose to obtain from the arranger a representation upon which the NRSRO can reasonably rely that sales of the structured finance product will meet this condition. Factors relevant to the analysis of whether such reliance would be reasonable would include, but not be limited to: (1) Ongoing or prior failures by the arranger to adhere to its representations; or (2) a pattern of conduct by the arranger where it fails to promptly correct breaches of its representations.'').

[1109] *See* prefatory text of paragraph (a) of Rule 17g–7 (first sentence).

[1110] *See* prefatory text of paragraph (a) of Rule 17g–7 (third sentence).

[1111] *See id.* As proposed, the sentence provided: ''[t]he items described in paragraphs (a)(1) and (a)(2) of this section must be published in the same medium and made available to the same persons who can receive or access the credit rating that is the result of the rating action or that is the subject of the rating action.'' *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1112] *See S&P Letter.*

[1113] *See DBRS Letter* (''DBRS supports this part of the proposal, but asks the Commission to confirm that an NRSRO that publishes its credit ratings via an electronically disseminated press release can satisfy the disclosure requirement by hyperlinking the disclosure form and any applicable due diligence certifications to that press release.'').

[1114] *See* prefatory text of paragraph (a) of Rule 17g–7 (third sentence).

[1115] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33457.

[1116] *See id.* at 33457.

[1117] *See Gardner Letter.*

[1118] *See* 15 U.S.C. 78o–7(d); 15 U.S.C. 78u; 15 U.S.C. 78u; 15 U.S.C. 78u–2; 15 U.S.C. 78u–3; 15 U.S.C. 78ff.

[1119] *See* paragraph (a)(1) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33458.

[1120] *See* 15 U.S.C. 78o–7(s)(2)(A).

[1121] *See* paragraph (a)(1) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33458.

[1122] *See* paragraph (a)(1)(i)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1123] *See* 15 U.S.C. 78o–7(s)(3)(B).

[1124] *See* 15 U.S.C. 78o–7(s)(3).

[1125] *See* paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33458–33646.

[1126] *See* paragraph (a)(1)(i)(B) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540. While the statutory text refers only to ''securities,'' section 3(a)(60) of the Exchange Act defines the term *credit rating* to mean an ''assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.'' *See* 15 U.S.C. 78c(a)(60). Consequently, proposed paragraph (a)(1)(i)(B) of Rule 17g–7 also referred to ''obligors'' and ''money market instruments'' to ensure that it applies to all types of credit ratings and to be consistent with the Commission's rules for NRSROs, which commonly apply to credit ratings of ''obligors, securities, and money market instruments.'' *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33458, n.411.

[1127] *See* paragraph (a)(1)(i) of Rule 17g–7.

designed to respond to comments recommending that the rule prescribe a standard format for presenting the information in the form.[1128]

In particular, as proposed, the rule would require that the form, among other things, must be in a format that is easy to use and helpful for users of credit ratings to understand.[1129] However, the proposal did not prescribe a form into which NRSROs would input information or provide more specificity as to how the information in the form must be presented. Two commenters recommended that the format of the form should be more standardized.[1130] One commenter stated that standardization would simplify oversight and make the information in the form easier for investors to analyze.[1131] The other commenter suggested standard headings and prescribing an order for the presentation of the information in the form.[1132] The Commission agrees with the commenters that requiring the NRSROs to adhere to a more standardized format will assist users of the form in locating and analyzing items of information disclosed in the form. It also will facilitate the Commission's oversight of the disclosure requirements, as noted by the commenter. Consequently, paragraph (a)(1)(i) of Rule 17g–7 provides that the form must be in a format that organizes the information required to be disclosed into numbered items that are identified by the type of information being disclosed and by a reference to the paragraph in Rule 17g–7 that specifies the information required to be disclosed, and are in the order that the paragraphs specifying the information to be disclosed are codified in Rule 17g–7.[1133] In addition, as adopted, paragraph (a)(1)(i) of Rule 17g–7 contains a note providing details about this requirement—in particular, stating that a given item in the form should be identified by a title that identifies the type of information and references paragraph (a)(1)(ii)(A), (B), (C), (D), (E), (F), (G), (H), (I), (J), (K), (L), (M), (N), or (a)(2) of Rule 17g–7, based on the information being disclosed in the item.[1134] The note provides the example that the item on the form containing the information specified in paragraph (a)(1)(ii)(C) of Rule 17g–7 should be captioned: ''Main Assumptions and Principles Used to Construct the Rating Methodology used to Determine the Credit Rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g–7.'' [1135] The note also explains that the form must organize the items of information in the following order: Items 1 through 14 must contain the information specified in paragraphs (a)(1)(ii)(A) through (N) of Rule 17g–7, respectively, and item 15 must contain the certifications specified in paragraph (a)(2) of Rule 17g–7.[1136]

Several NRSROs stated that a standardized form may discourage NRSROs from providing more transparency.[1137] Another NRSRO stated that if formatted disclosure is ultimately required, ''the Commission should provide sufficient flexibility to allow for disclosure that is meaningful in the context provided.'' [1138] The Commission believes the approach it has taken in prescribing a standardized format for presenting the information in the form without, for example, requiring that a prescribed form be filled out, strikes an appropriate balance in implementing section 15E(s)(2) of the Exchange Act between the comparability of the information provided across NRSROs and the flexibility to allow for meaningful disclosure. For example, the final amendments—while prescribing certain formatting requirements—generally permit an NRSRO to design the form that will be used to make the disclosure. Thus, an NRSRO can tailor the form to specific classes or subclasses of credit ratings to provide more targeted information.

The proposed amendments required that the form must be in a format that is easy to use and helpful for users of credit ratings to understand the information contained in the form.[1139] The proposed rule text closely mirrored section 15E(s)(2)(A) of the Exchange Act.[1140] The modifications discussed above prescribing a standard for presenting the information in the form are specifically designed to achieve the objective set forth in section 15E(s)(2)(A) and the proposed rule. However, the final amendments, as proposed, include the more general requirement that the form must be in a format that is ''easy to use and helpful for users of credit ratings to understand the information contained in the form.'' [1141] Because the presentation of the information has been prescribed, this format-related requirement will be more relevant to the narrative disclosures that are made in the items of the form. In particular, NRSROs must provide narrative disclosures that help users of credit ratings to understand the information. Several commenters stated that the form will result in boilerplate disclosure rather than more transparency.[1142] Pursuant to the final amendments, NRSROs will need to make the disclosures as specific to the particular rating action, and as relevant to investors, as possible, and strike a reasonable balance between standardizing the disclosures and tailoring them to specific rating actions. While the Commission recognizes that some of the information to be disclosed in the form may be standardized for classes or subclasses of credit ratings, NRSROs must disclose information in the form in a manner that promotes greater understanding of how a credit rating was determined. Accordingly, the form must contain plainly worded and succinct disclosures that are easy to understand and not lengthy boilerplate disclaimers.

Finally, paragraph (a)(1)(i)(C) of Rule 17g–7, as proposed, provides that the form must be in a format that provides the content described in paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g–7 in a manner that is directly comparable across types of obligors, securities, and money market instruments.[1143] As discussed below in section II.G.3. of this release, these paragraphs of Rule 17g–7 require the disclosure of certain types of quantitative information as mandated by section 15E(s)(3)(B) of the Exchange

[1128] *See id.*

[1129] *See* paragraph (a)(1)(i)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1130] *See CFA/AFR Letter; Levin Letter.*

[1131] *See Levin Letter.*

[1132] *See CFA/AFR Letter.*

[1133] *See* paragraph (a)(1)(i)(A) of Rule 17g–7, and the accompanying note to the paragraph. This approach, specifying the order in which the information must be presented, is consistent with the amendments to the instructions for Exhibit 1 to Form NRSRO being adopted today, which specify the order in which the Transition/Default Matrices must presented in the Exhibit. *See* paragraph (2) of the instructions for Exhibit 1 to Form NRSRO. *See also* section II.E.1.c. of this release discussing the amendments to the instructions for Exhibit 1 to Form NRSRO.

[1134] *See* note to paragraph (a)(1)(i)(A) of Rule 17g–7. *See also* paragraphs (a)(1)(ii)(A) through (N) and (a)(2) of Rule 17g–7. As discussed below in section II.G.3. of this release, paragraphs (a)(1)(ii)(A) through (N) and (a)(2) of Rule 17g–7 specify the types of information that must be disclosed in the form.

[1135] *See* note to paragraph (a)(1)(i)(A) of Rule 17g–7.

[1136] *See id.*

[1137] *See DBRS Letter; Morningstar Letter; S&P Letter.*

[1138] *See Kroll Letter.*

[1139] *See* paragraph (a)(1)(i)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR 33540.

[1140] *See* 15 U.S.C. 78o–7(s)(2)(A).

[1141] *See* paragraph (a)(1)(i)(B) of Rule 17g–7.

[1142] *See DBRS Letter; Morningstar Letter; S&P Letter.*

[1143] *See* paragraph (a)(1)(i)(C) of Rule 17g–7.

Act.[1144] One commenter stated that it would be difficult, if not impossible, to make this information ''directly comparable'' across all NRSROs.[1145] In response, the Commission notes that the final amendments require certain types of quantitative information to be comparable across types of obligors, securities, and money market instruments rated by the NRSRO (rather than across NRSROs).[1146]

3. Paragraph (a)(1)(ii) of Rule 17g–7—Content of the Form

Section 15E(s)(3) of the Exchange Act provides that the Commission shall require, by rule, that the form accompanying the publication of a credit rating contain specifically identified items of information.[1147] In particular, section 15E(s)(3)(A) identifies eight items of ''qualitative content'' [1148] and section 15E(s)(3)(B) identifies four items of ''quantitative content.'' [1149] Because the statute specified the type of information to be included in the form, the Commission proposed rule text prescribing the required contents of the form that largely mirrored the statutory text.[1150] In particular, the prefatory text of paragraph (a)(1)(ii) of Rule 17g–7, as proposed, provided that the form generated by the NRSRO must contain the information about the credit rating that is identified in paragraphs (a)(1)(ii)(A) through (N) of the rule.[1151] The order of, and information required in, these paragraphs largely mirrored the provisions of section 15E(s)(3) of the Exchange Act.[1152]

The Commission is adopting the prefatory text of paragraph (a)(1)(ii) of Rule 17g–7 without modification.[1153] The paragraph provides that the form generated by the NRSRO must contain information about the credit rating identified in paragraphs (a)(1)(ii)(A) through (N).[1154] Consequently, NRSROs are required to generate a form containing the prescribed information and publish it when taking a rating action (as defined in the prefatory text of paragraph (a) of Rule 17g–7).

Several commenters raised concerns that the proposed rule could require the disclosure of confidential or proprietary information regarding the NRSRO or an issuer.[1155] The Commission does not intend that the rule require an NRSRO to disclose confidential or proprietary information in the form. As discussed above, the format of the form must be easy to use and helpful for users of credit ratings to understand the information contained in the form about the rating action.[1156] NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. An NRSRO must meet this standard through disclosures that are informative but at the same time the Commission does not expect an NRSRO to disclose confidential or proprietary information.

As noted above, commenters suggested expanding the information required to be disclosed in the form. In particular, one commenter stated that the Commission should encourage NRSROs to provide additional information if they deem it appropriate,[1157] another stated that NRSROs should provide further information that would enable investors to understand the significance of the disclosures,[1158] and a third stated that NRSROs should be required to indicate the ''projected time period during which the given rating was expected to be valid.'' [1159] One commenter stated that some disclosure requirements should be expanded to provide in greater detail information that can be used by investors and other users of credit ratings.[1160] Another commenter suggested further rulemaking to require NRSROs to disclose and explain the rationale behind proposed credit ratings to the rated entity prior to publication, provide a rated entity with the right to appeal a proposed credit rating, and give reasonable consideration to an appeal.[1161]

In contrast, other commenters raised burden concerns with respect to the breadth of the information that the proposed rule required to be included in the form. One NRSRO urged the Commission not to extend the rule beyond what the statute requires.[1162] Another NRSRO stated that although the form may be useful to investors, it must not be ''so lengthy and overburdened with detail that it loses its utility,'' and expressed a concern that the level of detail ''far surpasses what most users of credit ratings would find of practical use, while imposing unnecessary burdens on NRSROs.'' [1163] A third NRSRO stated that disclosure should be limited to asset-backed securities ratings, indicating that expanding requirements to other ratings is ''extremely overburdensome'' and provides little information that is not already publicly available.[1164]

The Commission acknowledges that section 15E(s)(3) of the Exchange Act identifies a significant amount of information that the Commission's rule must require to be disclosed in the form.[1165] This information will be helpful in providing transparency as to how an NRSRO determines credit ratings across all classes of credit ratings. This transparency should benefit users of credit ratings and could mitigate the risk of undue reliance on credit ratings by providing information about the limits of credit ratings. Further, because the statute was very specific regarding the information to be disclosed, the Commission has sought to model its rule closely on the statutory text. Accordingly, the Commission does not believe it would be appropriate to limit the disclosure requirements to rating actions involving asset-backed securities. Moreover, given the significant amount of information required to be disclosed, the Commission also does not believe it to be necessary at this time to expand the disclosure requirements as suggested by some commenters.

The Commission also wants to emphasize that the information that must be disclosed in the form must relate to the rating action that is being taken. The NRSRO need not include in the disclosure information about the credit rating that is no longer up-to–date. For example, consistent with the statutory text, the rule text sometimes

[1144] *See* paragraphs (a)(1)(ii)(K) through (M) of Rule 17g–7; 15 U.S.C. 78o–7(s)(3)(B).

[1145] *See S&P Letter.*

[1146] *See* paragraph (a)(1)(i)(C) of Rule 17g–7.

[1147] *See* 15 U.S.C. 78o–7(s)(3).

[1148] *See* 15 U.S.C. 78o–7(s)(3)(A)(i) through (vii). Section (s)(3)(A)(ix) includes a ninth catchall item: Such additional information as the Commission may require. 15 U.S.C. 78o–7(s)(3)(A)(ix).

[1149] *See* 15 U.S.C. 78o–7(s)(3)(B)(i) through (iv).

[1150] *See* paragraph (a)(1)(ii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33458–33463.

[1151] *See* paragraph (a)(1)(ii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1152] *See* paragraphs (a)(1)(ii)(A) through (M) of Rule 17g–7; 15 U.S.C. 78o–7(s)(3)(A)(i) through (vii) and (B)(i) through (iv).

[1153] *See* paragraph (a)(1)(ii) of Rule 17g–7. One NRSRO suggested that the prefatory text be modified to add the phrase ''to the extent applicable''. *See Moody's Letter.* The Commission is not making this modification because the specific disclosure provisions contain such limiters when the information to be disclosed may not be applicable in all cases. *See, e.g.,* paragraphs (a)(1)(ii)(D), (G), (J), (L), (M), (N) of Rule 17g–7.

[1154] *See* paragraph (a)(1)(ii) of Rule 17g–7.

[1155] *See, e.g., Barnard Letter; FSR Letter; Moody's Letter; Siff Letter; S&P Letter.*

[1156] *See* paragraph (a)(1)(i)(B) of Rule 17g–7.

[1157] *See ICI Letter.*

[1158] *See Better Markets Letter.*

[1159] *See Levin Letter.*

[1160] *See Better Markets Letter.*

[1161] *See Andrews Letter.*

[1162] *See DBRS Letter.*

[1163] *See S&P Letter.*

[1164] *See A.M. Best Letter.*

[1165] *See* 15 U.S.C. 78o–7(s)(3).

uses the phrase ''to determine the credit rating.'' The Commission intended this to relate to the credit rating that is determined as a consequence of the rating action that triggers the disclosure requirement (a preliminary credit rating, an initial credit rating, an upgrade or downgrade of the credit rating, or certain affirmations or withdrawals of the credit rating). The objective is to provide investors and other users of credit ratings with helpful information about the rating action being taken with respect to the credit rating of the obligor, security, or money market instrument.

Paragraph (a)(1)(ii)(A). Section 15E(s)(3)(A)(i) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the credit ratings produced by the NRSRO.[1166] The Commission proposed to implement this section in paragraph (a)(1)(ii)(A) of Rule 17g–7.[1167] This paragraph, as proposed, would require the NRSRO to include in the form the symbol, number, or score in the rating scale used by the NRSRO to denote the credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and the identity of the obligor, security, or money market instrument.[1168]

The Commission is adopting paragraph (a)(1)(ii)(A) of Rule 17g–7 with one modification from the proposal.[1169] The paragraph provides that the form must contain the symbol, number, or score in the rating scale used by the NRSRO to denote credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and, as applicable, the identity of the obligor or the identity of the security or money market instrument and, in a modification from the proposal, must also contain, a description of the security or money market instrument.[1170]

The Commission stated in the proposing release that the identity of a security or money market instrument must be the name of the security or money market instrument, if applicable, and a description of the security or money market instrument.[1171] In the proposing release, the Commission provided an example of how an NRSRO could identify a bond: ''senior unsecured debt issued by Company XYZ maturing in 2015.''[1172] Consistent with the discussion in the proposing release, the Commission has modified the rule text from the proposal to add that, in the case of a credit rating of a security or money market instrument, the NRSRO must include in the form ''the identity and a description of the security or money market instrument.''[1173]

Two NRSROs commented on the requirement to identify the relevant obligor.[1174] In the proposing release, the Commission stated its preliminary belief that the obligor's identity would be its legal name and any other name used in its business.[1175] One NRSRO stated that it could be ''enormously burdensome'' for an NRSRO to learn and disclose all the business names that an obligor may use, and the additional information would add ''little benefit'' to those who use the form.''[1176] The other NRSRO stated that entry of legal names in its database has been problematic due to the inconsistent use of abbreviations.[1177] Both NRSROs suggested that NRSROs should be permitted to determine the clearest way to identify obligors.[1178] The Commission agrees with the commenters that an NRSRO should be permitted to determine the clearest way to identify an obligor. An NRSRO must disclose a name that clearly identifies the obligor.[1179]

Paragraph (a)(1)(ii)(B). Section 15E(r)(3)(A) of the Exchange Act provides that the Commission shall prescribe rules with respect to the procedures and methodologies used by NRSROs that require NRSROs to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.[1180] As discussed above in section II.F.1. of this release, the Commission proposed to implement this provision in Rules 17g–8 and 17g–7.[1181] With respect to Rule 17g–7, proposed paragraph (a)(1)(ii)(B) would require an NRSRO to disclose on the form the version of the procedure or methodology used to determine the credit rating.[1182]

The Commission is adopting paragraph (a)(1)(ii)(B) of Rule 17g–7 as proposed.[1183] The paragraph provides that the NRSRO must include in the form the version of the procedure or methodology used to determine the credit rating.[1184]

Two NRSROs commented on paragraph (a)(1)(ii)(B) of Rule 17g–7, as proposed.[1185] One NRSRO stated that disclosing the version of the procedure or methodology used to determine a credit rating could be accomplished by identifying the name of the procedure or methodology, the date the procedure was implemented, and a hyperlink to further information about the procedure or methodology.[1186] The Commission agrees.[1187]

A second NRSRO stated that the actual benefit to investors is slight because the required content can be accessed through the NRSRO's public Internet Web site.[1188] As the Commission stated in the proposing release, section 15E(s)(1)(B) of the Exchange Act provides that the Commission shall require, by rule, each NRSRO to prescribe a form to accompany the publication of a credit rating that discloses information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the NRSRO.[1189]

[1166] *See* 15 U.S.C. 78o–7(s)(3)(A)(i).

[1167] *See* paragraph (a)(1)(ii)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459.

[1168] *See* paragraph (a)(1)(ii)(A) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR 33540.

[1169] *See* paragraph (a)(1)(ii)(A) of Rule 17g–7.

[1170] *Id.*

[1171] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459.

[1172] *Id.*

[1173] *See* paragraph (a)(1)(ii)(A) of Rule 17g–7.

[1174] *See DBRS Letter; S&P Letter.*

[1175] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459.

[1176] *See DBRS Letter.*

[1177] *See S&P Letter.*

[1178] *See DBRS Letter; S&P Letter.*

[1179] As discussed above in section II.G.2. of this release, the format of the form must be easy to use and helpful for users of credit ratings to understand the information contained in the form. *See* paragraph (a)(1)(i) of Rule 17g–7.

[1180] *See* 15 U.S.C. 78o–7(r)(3)(A).

[1181] *See Nationally Recognized Statistical Rating Organizations,* 76 FR 33454–33455, 33459.

[1182] *See* paragraph (a)(1)(ii)(B) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33540.

[1183] *See* paragraph (a)(1)(ii)(B) of Rule 17g–7.

[1184] *Id.*

[1185] *See DBRS Letter; S&P Letter.*

[1186] *See DBRS Letter.*

[1187] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459 (''The Commission preliminarily believes that this disclosure could be made by identifying the name of the procedure or methodology (including any number used to denote the version), the date the procedure was implemented, and an Internet URL where further information about the procedure or methodology can be obtained.''). In the proposing release, the Commission provided an example of the disclosure. *Id.* at 33459 (''For example, a disclosure could resemble: 'RMBS Rating Methodology 3.0, implemented February 12, 2011. For further information go to [insert Web site address].'''). The Commission continues to believe this provides a useful example that NRSROs could use in making the required disclosure.

[1188] *See S&P Letter.*

[1189] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33459; 15 U.S.C. 78o–7(s)(1)(B).

Disclosing in the form the version of the procedure or methodology used to determine the credit rating will promote this goal. For example, credit rating methodologies that are predominantly quantitative may rely on models to produce credit ratings. These models are periodically updated and released as newer or different versions of the previous model. Disclosing in the form the version of a model used to produce a credit rating *with the credit rating* is expected to help investors and other users of credit ratings better understand the credit rating and how the determination of the credit rating may differ from the determination of credit ratings of similar products using an earlier version of the model.

Paragraph (a)(1)(ii)(C). Section 15E(s)(3)(A)(ii) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the main assumptions and principles used in constructing procedures and methodologies, including qualitative methodologies and quantitative inputs and assumptions about the correlation of defaults across underlying assets used in rating structured products.[1190] The Commission proposed to implement this section through paragraph (a)(1)(ii)(C) of Rule 17g–7, which mirrored the statutory text.[1191] The Commission is adopting paragraph (a)(1)(ii)(C) of Rule 17g–7 as proposed.[1192] The paragraph provides that the NRSRO must include in the form the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets.[1193]

Three commenters addressed paragraph (a)(1)(ii)(C) of Rule 17g–7, as proposed.[1194] One NRSRO stated that the Commission should harmonize this requirement with those of similar disclosures required in other jurisdictions, including the European Union.[1195] The commenter, however, did not provide explicit suggestions as to how the rule text could be modified to provide for such harmonization. Consequently, the Commission is not modifying the text on this basis. Two commenters stated that the Commission should not require the disclosure of confidential or proprietary information belonging to either the NRSRO or the issuer, such as non-public financial information of an issuer.[1196] The Commission does not intend that NRSROs will be required to disclose confidential or proprietary information to meet the requirements of paragraph (a)(1)(ii)(C) of Rule 17g–7. As discussed earlier with respect to the format of the form, NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information. Accordingly, the form must contain plainly worded and succinct disclosures. However, the Commission does not expect the disclosures to include confidential or proprietary information.

Paragraph (a)(1)(ii)(D). Section 15E(s)(3)(A)(iii) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the potential limitations of the credit ratings and the types of risks excluded from the credit ratings that the NRSRO does not comment on, including liquidity, market, and other risks.[1197] The Commission proposed to implement this section through paragraph (a)(1)(ii)(D) of Rule 17g–7, which mirrored the statutory text.[1198]

The Commission is adopting paragraph (a)(1)(ii)(D) of Rule 17g–7 as proposed.[1199] The paragraph provides that the NRSRO must include in the form the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks.[1200]

Two commenters addressed paragraph (a)(1)(ii)(D) of Rule 17g–7, as proposed.[1201] One NRSRO supported the rule text as proposed,[1202] and another commenter stated that the disclosure should include more than a listing of the risks that are not assessed as part of the rating.[1203] The Commission agrees with both commenters and notes that the rule as proposed and adopted requires the NRSRO to disclose the potential limitations of the credit rating, *including* the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks. Consequently, the risks excluded from the credit rating are only a part of the required disclosure. For example, the NRSRO also must disclose the limitations of the credit rating with respect to the risks the NRSRO does comment on, including credit risk.

Paragraph (a)(1)(ii)(E). Section 15E(s)(3)(A)(iv) of the Exchange provides that, as required by Commission rule, an NRSRO shall disclose on the form information on the uncertainty of the credit rating, including: (1) Information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and (2) a statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including any limits on the scope of historical data and any limits in accessibility to certain documents or other types of information that would have better informed the credit rating.[1204] The Commission proposed to implement this section through paragraph (a)(1)(ii)(E) of Rule 17g–7, which mirrored the statutory text.[1205]

The Commission is adopting paragraph (a)(1)(ii)(E) of Rule 17g–7 as proposed.[1206] The paragraph provides that the form must contain information on the uncertainty of the credit rating, including: (1) Information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and (2) a statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including any limits on the scope of historical data and any limits on accessibility to certain documents or other types of information that would have better informed the credit rating.[1207]

[1190] *See* 15 U.S.C. 78o–7(s)(3)(A)(ii).

[1191] *See* paragraph (a)(1)(ii)(C) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33460, 33540. This paragraph, as proposed, would require the NRSRO to include in the form the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets.

[1192] *See* paragraph (a)(1)(ii)(C) of Rule 17g–7.

[1193] *Id.*

[1194] *See Barnard Letter; S&P Letter; Siff Letter.*

[1195] *See S&P Letter.*

[1196] *See Barnard Letter; Siff Letter.*

[1197] *See* 15 U.S.C. 78o–7(s)(3)(A)(iii).

[1198] *See* paragraph (a)(1)(ii)(D) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33460, 33540. This paragraph, as proposed, would require the NRSRO to include in the form the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks.

[1199] *See* paragraph (a)(1)(ii)(D) of Rule 17g–7.

[1200] *Id.*

[1201] *See CFA/AFR Letter; S&P Letter.*

[1202] *See S&P Letter.*

[1203] *See CFA/AFR Letter.*

[1204] *See* 15 U.S.C. 78o–7(s)(3)(A)(iv).

[1205] *See* paragraph (a)(1)(ii)(E) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33460, 33540.

[1206] *See* paragraph (a)(1)(ii)(E) of Rule 17g–7.

[1207] *Id.*

Two commenters addressed paragraph (a)(1)(ii)(E) of Rule 17g–7, as proposed.[1208] One commenter stated that the Commission should require an NRSRO to address specifically the heightened uncertainty associated with ratings of offerings that do not have an extensive track record, complex or customized securities, or areas where the credit rating agency has limited data on which to base a rating.[1209] The Commission agrees and believes the rule as proposed and adopted requires disclosure on the matters identified by the commenter in that it requires disclosures regarding limits on the scope of historical data and limits on the accessibility to certain documents or other types of information that would have better informed the credit rating.

One NRSRO stated that requiring NRSROs to provide overly detailed information regarding '''reliability,' 'accuracy' and 'quality''' of data, could result in extremely lengthy disclosures due to the number of types of data.[1210] The NRSRO further stated that the Commission should harmonize this requirement with other jurisdictions' requirements by requiring only a statement about ''(i) whether essential data was available; (ii) whether such data was believed to be reliable; and (iii) any limitations on access to data for that transaction that differed from typical circumstances.'' [1211] As discussed above, NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not unnecessarily detailed. As for the suggestion to harmonize the rule with other jurisdictions' requirements, the text suggested by the commenter generally seems consistent with the proposed rule. Consequently, the Commission is not persuaded that it is necessary to modify the proposed rule in response to this comment.[1212]

Paragraph (a)(1)(ii)(F). Section 15E(s)(3)(A)(v) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form whether and to what extent third-party due diligence services have been used by the NRSRO, a description of the information that such third party reviewed in conducting due diligence services, and a description of the findings or conclusions of such third party.[1213] The Commission proposed to implement this section through paragraph (a)(1)(ii)(F), which largely mirrored the statutory text.[1214]

Several commenters addressed paragraph (a)(1)(ii)(F) of Rule 17g–7, as proposed.[1215] The Commission is adopting paragraph (a)(1)(ii)(F) of Rule 17g–7 with modifications in response to comments.[1216]

Two commenters stated that the rule should be confined in scope to credit ratings on asset-backed securities.[1217] Two NRSROs stated that unless the person providing third-party due diligence services was engaged by the NRSRO, disclosure would be more appropriately made by the party that hired the due diligence provider.[1218] One NRSRO stated that ''[i]ssuers and underwriters, not NRSROs, should pass through the third party's description of the information reviewed and the third party's findings and conclusions,'' but, if the NRSROs must disclose the information, the Commission should clarify that the disclosure requirement can be met by the NRSRO ''passing through the certification that the third party provides to the NRSRO.'' [1219] In addition, one commenter stated that the final amendments should require that NRSROs ''expressly restate'' specific findings and conclusions from third-party due diligence reports to prevent them from being ''mischaracterized or taken out of context.'' [1220] Another commenter suggested that the words ''a description of the findings or conclusions'' should be revised to ''a summary of the findings and conclusions,'' because a ''summary'' better aligns with the requirement in proposed Form ABS Due Diligence–15E.[1221] The commenter further stated that what should be provided is a summary of the findings and conclusions, not the findings and conclusions themselves, and ''there is no reason why the summary would not be substantially similar in each context.'' [1222] One NRSRO stated that publishing the certification of the third-party due diligence provider with the form as required by paragraph (a)(2) of Rule 17g–7, as proposed, makes its use by the NRSRO ''self-evident.'' [1223]

The Commission is adopting the requirement that the form must contain information relating to due diligence services performed by a third party to implement section 15E(s)(3)(A)(v) of the Exchange Act.[1224] This information will help investors and other users of credit ratings to understand how the NRSRO determined the credit rating. In response to the comments that paragraph (a)(1)(ii)(F) should be limited to rating actions involving asset-backed securities, the Commission interprets the text of the rule referring to ''due diligence services of a third party'' as meaning the type of due diligence services that are within the scope of Rule 17g–10, as adopted, and Form ABS Due Diligence–15E (which apply to third-party due diligence services only in connection with asset-backed securities).[1225] Consequently, paragraph (a)(1)(ii)(F) is limited to rating actions involving Exchange Act-ABS.[1226]

In response to comments, the Commission is modifying the rule from the proposal to permit the NRSRO to provide a cross-reference to a Form ABS Due Diligence–15E that is published with the form to meet part of the disclosure requirement in paragraph (a)(1)(ii)(F).[1227] The Commission is persuaded by commenters that if an NRSRO used due diligence services of a third party it would be redundant, and potentially confusing, for the NRSRO to provide a description of the information that the third party reviewed in

[1208] *See CFA/AFR Letter; S&P Letter.*

[1209] *See CFA/AFR Letter.*

[1210] *See S&P Letter.*

[1211] *See id.*

[1212] *See* 15 U.S.C. 78o–7(s)(3)(A)(iv).

[1213] *See* 15 U.S.C. 78o–7(s)(3)(A)(v).

[1214] *See* paragraph (a)(1)(ii)(F) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33460–33461, 33540. This paragraph, as proposed, would require the NRSRO to include in the form whether and to what extent third-party due diligence services were used by the nationally recognized statistical rating organization, a description of the information that such third party reviewed in conducting due diligence services, and a description of the findings or conclusions of such third party.

[1215] *See ASF Letter; DBRS Letter; Deloitte Letter; Moody's Letter; PWC Letter; S&P Letter.*

[1216] *See* paragraph (a)(1)(ii)(F) of Rule 17g–7.

[1217] *See Moody's Letter; PWC Letter.*

[1218] *See Moody's Letter; S&P Letter.*

[1219] *See Moody's Letter.*

[1220] *See Deloitte Letter.*

[1221] *See ASF Letter.*

[1222] *See id.*

[1223] *See DBRS Letter.*

[1224] *See* 15 U.S.C. 78o–7(s)(3)(A)(v).

[1225] *See* paragraph (d)(1) of Rule 17g–10 defining the term *due diligence services* to mean, in pertinent part, ''a review of the assets underlying an asset-backed security, as defined in section 3(a)(79) of the [Exchange] Act . . .'' In addition, section 15E(s)(4) of the Exchange Act is titled ''Due Diligence Services for Asset-Backed Securities.'' *See* 15 U.S.C. 78o–7(s)(4). Moreover, section 15E(s)(4)(A) provides that ''[t]he issuer or underwriter of any *asset-backed security* shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.'' *See* 15 U.S.C. 78o–7(s)(4)(A) (emphasis added). Consequently, as proposed, paragraph (a)(1)(ii)(F)—which refers to *due diligence services*—was intended to address due diligence services in the context of an asset-backed security.

[1226] As stated above in section I.B.1. of this release, the term *Exchange Act-ABS* as used throughout this release refers to an *asset-backed security* as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

[1227] *See* paragraph (a)(1)(ii)(F)(*2*) of Rule 17g–7.

conducting the due diligence services and a description of the findings or conclusions of the third party if that information is in a Form ABS Due Diligence–15E published with the form.[1228]

In addition, as noted above, a commenter proposed modifying the rule to replace the phrase ''a description of the findings or conclusions'' to ''a summary of the findings and conclusions,'' because the commenter believed that a ''summary'' better aligns with the requirement in proposed Form ABS Due Diligence–15E and that, in each case, the rules should require a summary of the findings and conclusions (as opposed to the findings and conclusions themselves).[1229] Item 5 of Form ABS Due Diligence–15E requires the third party to provide a ''summary of the findings and conclusions that resulted from the due diligence services.'' [1230] The Commission agrees with the commenter and has therefore modified the proposal to replace the words ''description of the findings or conclusions of such third party'' with the words ''summary of the findings and conclusions of the third party.'' [1231] However, if an NRSRO chooses to provide a summary of the findings and conclusions, the level of detail in the summary should be comparable to the level of detail a provider of third-party due diligence services provides in Form ABS Due Diligence–15E, as the summary in the form can be a substitute for the NRSRO providing a summary.[1232]

For these reasons, the final amendments provide that the form must contain whether and to what extent the NRSRO used due diligence services of a third party in taking the rating action, and, if the NRSRO used such services, either: (1) A description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party; or (2) a cross-reference to a Form ABS Due Diligence–15E executed by the third party that is published with the form, provided the cross-referenced Form ABS Due Diligence–15E contains a description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party.[1233]

The Commission is not persuaded by the comment that publishing the certification of the third-party due diligence provider with the form as required by paragraph (a)(2) of Rule 17g–7, as proposed, makes its use by the NRSRO ''self-evident.'' [1234] As discussed below in section II.G.5. of this release, section 15E(s)(4)(B) of the Exchange Act requires a third party providing due diligence services to an NRSRO, issuer, or underwriter with respect to an asset-backed security to provide a written certification to any NRSRO that produces a credit rating to which the due diligence services relate.[1235] Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO that receives a certification to disclose the certification to the public at the time at which the NRSRO produces a rating.[1236] Paragraph (a)(2) of Rule 17g–7, as amended, implements section 15E(s)(4)(D) by requiring the NRSRO to publish with the form any certifications it receives. However, the NRSRO's receipt of the certification pursuant to section 15E(s)(4)(B) and publication of the certification pursuant to paragraph (a)(2) of Rule 17g–7, as amended, is not predicated on the NRSRO having used the due diligence services in determining the credit rating. Consequently, the final amendments retain the requirement for the NRSRO to include in the form whether and to what extent the NRSRO used due diligence services of a third party in taking the rating action.[1237]

Paragraph (a)(1)(ii)(G). Section 15E(s)(1)(A)(iii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information relating to, if applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating.[1238] The Commission proposed to implement this section through paragraph (a)(1)(ii)(G) of Rule 17g–7, which mirrored the statutory text.[1239]

One commenter addressed paragraph (a)(1)(ii)(G) of Rule 17g–7, as proposed, by noting its support of the rule text as proposed.[1240] The Commission is adopting paragraph (a)(1)(ii)(E) of Rule 17g–7 as proposed.[1241] The paragraph provides that the NRSRO must include in the form, if applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating.[1242]

Paragraph (a)(1)(ii)(H). Section 15E(s)(3)(A)(vi) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.[1243] The Commission proposed to implement this section through paragraph (a)(1)(ii)(H) of Rule 17g–7, which mirrored the statutory text.[1244] The Commission is adopting paragraph (a)(1)(ii)(H) of Rule 17g–7 with a modification in response to comments.[1245]

One NRSRO stated that the requirement may result in ''effectively overloading'' investors with information and essentially ''reducing rather than enhancing'' the disclosure's value.[1246] This commenter and another commenter expressed concerns that some data may be confidential or provided to the NRSRO under terms restricting public disclosure.[1247] One commenter suggested that the Commission clarify that the requirement for a ''description of the data relied upon'' requires only a description of the general type of data and not of specific data, since specific data can be obtained

[1228] As discussed below in section II.H.3.c. of this release, Item 4 of Form ABS Due Diligence–15E requires the third party to provide a description of the due diligence performed that addresses the information that was reviewed and Item 5 requires the third party to provide a summary of the findings and conclusions of the review.

[1229] *See ASF Letter.*

[1230] *See* Item 5 of Form ABS Due Diligence–15E.

[1231] *See* paragraph (a)(1)(ii)(F)(*1*) of Rule 17g–7.

[1232] The Commission, however, does not believe the rule as proposed (which required ''a description of the findings or conclusions'') and the rule as adopted (which requires a ''summary of the findings and conclusions'') contain standards that differ in any significant way. Under either standard, the NRSRO need not repeat the actual findings and conclusions but rather must provide a higher level disclosure about them.

[1233] *See* paragraph (a)(1)(ii)(F) of Rule 17g–7.

[1234] *See DBRS Letter.*

[1235] *See* 15 U.S.C. 78o–7(s)(4)(B).

[1236] *See* 15 U.S.C. 78o–7(s)(4)(D).

[1237] *See* paragraph (a)(1)(ii)(F) of Rule 17g–7.

[1238] *See* 15 U.S.C. 78o–7(s)(1)(A)(iii).

[1239] *See* paragraph (a)(1)(ii)(G) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461, 33540. This paragraph, as proposed, would require the NRSRO to include in the form, if applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating.

[1240] *See S&P Letter.*

[1241] *See* paragraph (a)(1)(ii)(G) of Rule 17g–7. One commenter addressed this proposal and supported it. *See S&P Letter.*

[1242] *See* paragraph (a)(1)(ii)(G) of Rule 17g–7.

[1243] *See* 15 U.S.C. 78o–7(s)(3)(A)(vi).

[1244] *See* paragraph (a)(1)(ii)(H) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461, 33540–33541. This paragraph, as proposed, would require the NRSRO to include in the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.

[1245] *See* paragraph (a)(1)(ii)(H) of Rule 17g–7.

[1246] *See S&P Letter.*

[1247] *See FSR Letter; S&P Letter.*

from the relevant offering documents.[1248]

In response to these comments, the Commission notes, as stated above, that section 15E(s)(3)(A)(vi) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.[1249] Paragraph (a)(1)(ii)(H) of Rule 17g–7, as proposed, was designed to implement the statute. Moreover, as discussed above, the form must disclose information that can be used by investors and other users of credit ratings to better understand credit ratings [1250] and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. In this regard, the Commission did not intend to require that the form repeat verbatim all the data that were relied upon to determine the credit rating. Instead, it intended the form to include a ''description'' to help users of the credit rating to understand the types of data the NRSRO relied on. To make this more clear and address the commenter's concern, the Commission has modified the final amendments to require the NRSRO to include in the form a description of the *types* of data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.[1251]

Paragraph (a)(1)(ii)(I). Section 15E(s)(3)(A)(vii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a statement containing an overall assessment of the quality of information available and considered in producing a rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar issuances.[1252] The Commission proposed to implement this section through paragraph (a)(1)(ii)(I) of Rule 17g–7, which largely mirrored the statutory text.[1253]

The Commission is adopting paragraph (a)(1)(ii)(I) of Rule 17g–7 as proposed.[1254] The paragraph provides that the NRSRO must include in the form a statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments.[1255]

One NRSRO stated that the requirement to disclose an overall assessment of the quality of information used in its rating ''would present practical, and possibly contractual difficulties,'' and that the Commission should harmonize this requirement with other jurisdictions' requirements by requiring a statement about ''(i) whether essential data was available; (ii) whether such data was believed to be reliable; and (iii) any limitations on access to data for that transaction that differed from typical circumstances.'' [1256] The commenter did not explain how the proposed requirement would present contractual difficulties but, as discussed above, the Commission does not intend the disclosure provisions in the rule to require NRSROs to disclose confidential or proprietary information. In terms of practical issues, as discussed above, the NRSROs must provide narrative disclosures in the form that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. Thus, the practical issue of having to make highly detailed disclosures is not implicated by the rule as proposed and adopted. As for the suggestion to harmonize the rule with other jurisdictions, the text suggested by the commenter generally seems aimed at requiring relatively similar disclosures though it does not explicitly require an assessment of the overall quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments. Consequently, the Commission is not persuaded that it is necessary to implement the statute in a manner that deviates from the proposed rule.[1257]

Paragraph (a)(1)(ii)(J). Proposed paragraph (a)(1)(ii)(J) of Rule 17g–7 [1258] would implement, in part, section 15E(s)(3)(A)(viii) of the Exchange Act, which provides that the Commission shall require, by rule, that the NRSRO disclose on the form information relating to conflicts of interest of the NRSRO.[1259] The Commission proposed to identify three specific items of information that, at a minimum, an NRSRO would need to disclose in the form relating to conflicts of interest.[1260]

First, proposed paragraph (a)(1)(ii)(J)(*1*) would require the NRSRO to include a classification of the credit rating as either *solicited sell-side, solicited buy-side,* or *unsolicited.*[1261] The proposal defined *solicited sell-side* to mean that the credit rating was paid for by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated.[1262] The proposal defined *solicited buy-side* to mean that the credit rating was paid for by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated.[1263] The proposal defined an *unsolicited* credit rating to mean the NRSRO was not paid to determine the credit rating.[1264] The Commission is

[1248] *See FSR Letter.*

[1249] *See* 15 U.S.C. 78o–7(s)(3)(A)(vi).

[1250] See 15 U.S.C. 78o–7(s)(1)(B).

[1251] *See* paragraph (a)(1)(ii)(H) of Rule 17g–7 (emphasis added to highlight the modification).

[1252] *See* 15 U.S.C. 78o–7(s)(3)(A)(vii).

[1253] *See* paragraph (a)(1)(ii)(I) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461, 33541. This paragraph, as proposed, would require the NRSRO to include in the form a statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments. The statute refers to ratings of ''similar issuances.'' However, a credit rating of an obligor commonly means the rating of the obligor as an entity rather than a rating of securities or money market instruments issued by the obligor. Consequently, the rating of an obligor may not relate to an ''issuance'' of a particular security or money market instrument. Therefore, paragraph (a)(1)(ii)(I) of Rule 17g–7, as proposed, substituted the phrase ''similar obligors, securities, or money market instruments'' for the phrase ''similar issuances'' in the statutory text.

[1254] *See* paragraph (a)(1)(ii)(I) of Rule 17g–7.

[1255] *Id.*

[1256] *See S&P Letter.*

[1257] *See* 15 U.S.C. 78o–7(s)(3)(A)(vii).

[1258] *See* paragraph (a)(1)(ii)(J) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1259] *See* 15 U.S.C. 78o–7(s)(3)(A)(viii).

[1260] *See* paragraph (a)(1)(ii)(J) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461–33462, 33541.

[1261] *See* paragraph (a)(1)(ii)(J)(*1*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1262] *See* paragraph (a)(1)(ii)(J)(*1*)(*i*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1263] *See* paragraph (a)(1)(ii)(J)(*1*)(*ii*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1264] *See* paragraph (a)(1)(ii)(J)(*1*)(*iii*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541. The Commission further explained in the proposing release that the intent was to include credit ratings funded by selling subscriptions to access the credit ratings (so-called ''subscriber-paid credit ratings''). *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461–33462. However, if a subscriber paid the NRSRO to determine a credit rating for a specific obligor, security, or money market instrument, the credit rating would need to be classified as either *solicited sell-side,* if the subscriber also was the obligor, issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, or *solicited buy-side* if the subscriber was not the obligor, issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated. *Id.*

adopting paragraph (a)(1)(ii)(J)(*1*) of Rule 17g–7 with modifications in response to comments about these definitions.[1265]

One NRSRO stated that equating the concept of solicitation with payment would result in confusion in the market, and that the definition should be harmonized with that of other jurisdictions, where an *unsolicited credit rating* is defined as one that is initiated by the credit rating agency and not requested by the issuer.[1266] The Commission is persuaded that requiring the NRSRO to classify the credit rating using one of these terms could be confusing given other views as to what constitutes a *solicited* or *unsolicited* credit rating. Further, disclosing the conflict through a classification may not be as helpful as simply having the NRSRO include a statement in the form as to whether another person paid for the credit rating. For these reasons, the final amendments have been modified to exclude the specific terms proposed and instead require the NRSRO to include in the form, as applicable, a statement that the NRSRO was: (1) Paid to determine the credit rating by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; (2) paid to determine the credit rating by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; or (3) not paid to determine the credit rating.[1267]

The second type of conflict disclosure was specified in proposed paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7.[1268] Pursuant to this paragraph, if the credit rating was classified as either *solicited sell-side* or *solicited buy-side,* the NRSRO would be required to disclose whether the NRSRO provided services other than determining credit ratings to the person that paid for the credit rating during the most recently ended fiscal year.[1269] The Commission is adopting paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7 with modifications in response to comments.[1270]

A commenter stated that the disclosure about other services provided by an NRSRO does not provide any basis to conclude that a rating may be compromised.[1271] Another commenter strongly opposed the requirement due to the difficulty of shielding analysts from such information so as to promote independence in the credit rating process.[1272] A third commenter supported the proposed requirement and added that the Commission should also require NRSROs to disclose the revenue they received from a particular issuer.[1273]

The Commission does not agree with the commenter that being paid for other services does not present a potential conflict. As the Commission stated in the proposing release, clients paying an NRSRO for services in addition to determining credit ratings may pose an increased risk of exerting undue influence on the NRSRO with respect to its determination of credit ratings.[1274] The Commission has adopted rules that address this conflict.[1275] The proposed disclosure requirement about paying for other services was intended to complement these requirements.[1276]

The Commission acknowledges the concern raised by the commenter about the objective of shielding analysts from information that could compromise their independence.[1277] Nonetheless, the Commission believes that the proposed disclosure that the NRSRO was paid for other services is appropriate because it will provide users of credit ratings with relevant information about this conflict even when balanced against the concern that an analyst reading the report will learn that the NRSRO was paid for other services. If the NRSRO was required to disclose the amount of revenue received (as suggested by the third commenter), this concern that the analyst might be influenced by the disclosure would be increased.[1278]

For all of these reasons, the Commission is adopting the requirement that the NRSRO must include a disclosure in the form if it was paid for other services.[1279] The Commission modified the final amendments to correspond to the modifications discussed above with respect to eliminating the proposed classification of the credit rating as either *solicited* or *unsolicited.* Specifically, the final amendments require the NRSRO, if applicable, to include in the form a statement that the NRSRO also was paid for services other than determining credit ratings during the most recently ended fiscal year by the person that paid the NRSRO to determine the credit rating.[1280]

The third type of conflict disclosure was specified in (a)(1)(ii)(J)(*3*) and related to rating actions resulting from look-back reviews.[1281] As discussed above in section II.C.1. of this release, the proposal would require the disclosure of information about a conflict of interest influencing a credit rating action discovered as a result of a look-back review conducted pursuant to section 15E(h)(4)(A) of the Exchange Act and proposed paragraph (c) of Rule 17g–8. Also, as discussed above in section II.C.1. of this release, the Commission is adopting paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7 with modifications in response to comments that eliminate the required disclosure that would have accompanied the placement of the credit rating on credit watch, modify the required disclosure with respect to estimating the impact of the conflict, and make certain related and technical modifications.[1282]

Paragraph (a)(1)(ii)(K). Section 15E(s)(3)(B)(i) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form an explanation or measure of the potential volatility of the credit rating, including: (1) Any factors that might lead to a change in the credit rating; and (2) the magnitude of the

[1265] *See* paragraph (a)(1)(ii)(J)(*1*) of Rule 17g–7.

[1266] *See Moody's Letter.*

[1267] *See* paragraph (a)(1)(ii)(J)(*1*) of Rule 17g–7. For the purpose of these disclosures, the Commission does not consider a subscriber to an NRSRO's credit ratings to be a person who paid for the credit rating simply because the subscriber paid a fee to access the credit ratings of the NRSRO. However, the NRSRO would need to state that it was paid to determine the credit rating if, for example, the subscriber paid for the credit rating because it was the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, or the subscriber paid for determination of the credit rating because the subscriber was an investor or potential investor in the security or money market instrument and hired the NRSRO to rate the security or money market instrument.

[1268] *See* paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1269] *See* paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7, as proposed.

[1270] *See* paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7.

[1271] *See S&P Letter.*

[1272] *See Moody's Letter.*

[1273] *See CFR/AFR Letter.*

[1274] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461–33462. In this regard, the Commission notes that section 939H of the Dodd-Frank Act contains a sense of Congress that the Commission should exercise rulemaking authority under section 15E(h)(2)(B) of the Exchange Act to prevent improper conflicts of interest arising from employees of NRSROs providing services to issuers of securities that are unrelated to the issuance of credit ratings, including consulting, advisory, and other services. *See* Public Law 111–203, 939H. *See also* 2013 Staff Report on Credit Rating Agency Independence (a report on the potential conflict of interest that arises from a credit rating agency providing other services).

[1275] *See* 2013 Staff Report on Credit Rating Agency Independence, pp. 9–13 (summarizing and describing the relevant rules).

[1276] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33461–33462.

[1277] *See Moody's Letter.*

[1278] *See CFR/AFR Letter.*

[1279] *See* paragraph (a)(1)(ii)(J)(*2*) of Rule 17g–7.

[1280] *Id.*

[1281] *See* paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1282] *See* paragraph (a)(1)(ii)(J)(*3*) of Rule 17g–7.

change that a user can expect under different market conditions.[1283] The Commission proposed to implement this section through paragraph (a)(1)(ii)(K) of Rule 17g–7, which largely mirrored the statutory text.[1284] The Commission is adopting paragraph (a)(1)(ii)(K) of Rule 17g–7 with modifications in response to comment.[1285]

Three commenters addressed paragraph (a)(1)(ii)(K) of Rule 17g–7, as proposed.[1286] An NRSRO suggested that the Commission modify the rule to require the disclosure of any factors that are ''reasonably likely to'' (rather than ''might'') lead to a change in the credit rating.[1287] A second NRSRO stated that ''each NRSRO should decide for itself what conditions merit discussion in light of the characteristics of the rated instrument and whatever other information the NRSRO believes it is appropriate to take into account.'' [1288] A third commenter stated that the Commission should require the NRSROs to be very specific about the events and the magnitude of those events that would cause ratings to be in ''error'' and provided a five percent drop in housing prices as an example.[1289]

The Commission agrees with the modifications suggested by the first commenter. The word ''might'' as used in the proposed rule text is imprecise and could lead to disclosures that seek to identify any conceivable factor that could lead to the change in the credit rating no matter how remote the possibility. This could diminish the usefulness of the disclosure by including information that is not highly relevant to understanding the credit rating and generally making the disclosure too long.

Regarding the second comment, the magnitude of the change that could occur under different market conditions will depend on an NRSRO's procedures and methodologies for determining credit ratings that apply to the credit rating that is subject to the rating action.[1290] Consequently, the required disclosure—as proposed and adopted—will be based on those procedures and methodologies and how they account for different market conditions. In other words, the NRSRO will need to ''decide for itself'' the potential market conditions that could cause a change in the credit rating given its rating procedures and methodologies. However, to make this clear, the Commission is modifying the rule to specify that the different market conditions are those that are determined by the NRSRO to be relevant to the rating.[1291]

Finally, the Commission generally agrees with the third commenter that the disclosure by the NRSRO must specify the factors (for example, market conditions) that would lead to a change in the credit rating. As discussed above, the NRSRO must disclose factors that might lead to a change in the credit rating. In doing so, the NRSRO must explain the factors.

For these reasons, the final amendments require the NRSRO to include in the form an explanation or measure of the potential volatility of the credit rating, including: (1) Any factors that are reasonably likely to lead to a change in the credit rating; and (2) the magnitude of the change that could occur under different market conditions determined by the NRSRO to be relevant to the rating.[1292]

Paragraph (a)(1)(ii)(L). Section 15E(s)(3)(B)(ii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information on the content of the credit rating, including: (1) The historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.[1293] The Commission proposed to implement this section through paragraph (a)(1)(ii)(L) of Rule 17g–7, which mirrored the statutory text.[1294]

The Commission is adopting paragraph (a)(1)(ii)(L) of Rule 17g–7 as proposed.[1295] The paragraph provides that the NRSRO must include in the form information on the content of the credit rating, including: (1) If applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.[1296]

Two NRSROs addressed paragraph (a)(1)(ii)(L) of Rule 17g–7, as proposed.[1297] One stated that it supports the disclosure elements specified in this paragraph.[1298] The other commenter stated that the proposal is sufficiently explicit, but indicated that its credit ratings do not connote a ''particular'' expectation of the probability of default.[1299] The Commission recognizes that credit ratings generally are intended to indicate the relative degree of credit risk of an obligor or debt instrument rather than reflect a measure of a specific default probability or loss expectation.[1300] The Commission does not expect NRSROs to alter the meanings of their credit ratings or rating procedures and methodologies to conform to the disclosure requirement. Rather, the Commission expects NRSROs to provide ''information'' to the extent it is consistent with their procedures and methodologies for determining credit ratings, on the expected probability of default and expected loss in the event of default. This information could consist of, for example, historical default and loss statistics, respectively, for the class or subclass of the credit rating.

Paragraph (a)(1)(ii)(M). Section 15E(s)(3)(B)(iii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on a rating if the assumptions were proven false or inaccurate; and (2) an analysis, using specific examples, of how each of the five assumptions identified impacts a credit rating.[1301] The Commission proposed to implement this section through paragraph (a)(1)(ii)(M) of Rule 17g–7, which mirrored the statutory

[1283] *See* 15 U.S.C. 78o–7(s)(3)(B)(i).

[1284] *See* paragraph (a)(1)(ii)(K) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33462, 33541. This paragraph, as proposed, would require the NRSRO to include in the form an explanation or measure of the potential volatility of the credit rating, including: (1) Any factors that might lead to a change in the credit rating; and (2) the magnitude of the change that could occur under different market conditions.

[1285] *See* paragraph (a)(1)(ii)(K) of Rule 17g–7.

[1286] *See CFR/AFR Letter; DBRS Letter; S&P Letter.*

[1287] *See DBRS Letter.*

[1288] *See S&P Letter.*

[1289] *CFR/AFR Letter.*

[1290] *See, e.g.,* 2012 Staff Report on Credit Rating Standardization, pp. 25–29 (discussing the feasibility and desirability of standardizing the market stress conditions under which ratings are evaluated).

[1291] *See* paragraph (a)(1)(ii)(K)(*2*) of Rule 17g–7.

[1292] *Id.*

[1293] *See* 15 U.S.C. 78o–7(s)(3)(B)(ii).

[1294] *See* paragraph (a)(1)(ii)(L) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33462, 33541. This paragraph, as proposed, would require the NRSRO to include in the form information on the content of the credit rating, including: (1) If applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.

[1295] *See* paragraph (a)(1)(ii)(L) of Rule 17g–7.

[1296] *Id.*

[1297] *See Kroll Letter; S&P Letter.*

[1298] *See Kroll Letter.*

[1299] *See S&P Letter.*

[1300] *See* 2012 Staff Report on Credit Rating Standardization, pp. 29–34 (discussing the feasibility and desirability of requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress).

[1301] *See* 15 U.S.C. 78o–7(s)(3)(B)(iii).

text.[1302] The Commission is adopting paragraph (a)(1)(ii)(M) of Rule 17g–7 with modifications in response to comments.[1303]

Several commenters addressed paragraph (a)(1)(ii)(M) of Rule 17g–7, as proposed.[1304] An NRSRO stated that the disclosure of assumptions will tend to become a ''mechanical exercise'' where disclosure is ''sufficiently vague so as to be unimpeachable,'' but will not be useful.[1305] Another NRSRO stated that it should be permissible to disclose fewer than five assumptions if fewer than five significant assumptions exist.[1306] Two other NRSROs stated that it may be difficult to identify five single assumptions[1307] because, according to one NRSRO, many assumptions are ''cross-dependent,'' and different assumptions may ''play out differently in various economic scenarios.'' [1308] Another commenter stated that the Commission should also require NRSROs to disclose the sensitivity of the credit rating to several assumptions changing at the same time and the dependencies assumed between the assumptions.[1309]

The Commission agrees with the commenter that an NRSRO should not disclose five assumptions if there are fewer than five assumptions that would have an impact on the credit rating if proven false or inaccurate. Otherwise, the disclosure could contain information that is potentially misleading by, for example, creating the impression the assumption is important when it is not. Consequently, the final amendments are modified to include a provision that the NRSRO need only disclose information on the assumptions that would have an impact on the credit rating if there are fewer than five such assumptions.[1310] Specifically, the final amendments require the NRSRO to include in the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if the assumptions were proven false or inaccurate, provided that, if the NRSRO has made fewer than five such assumptions, it need only disclose information on the assumptions that would have an impact on the credit rating; and (2) an analysis, using specific examples, of how each of the assumptions impacts the credit rating.[1311]

In response to the comment that this disclosure will become ''mechanical'' and not useful, the Commission—as stated above—expects NRSROs to make the disclosures as specific to the particular rating action, and as relevant to investors, as possible, and to strike a reasonable balance between standardizing the disclosures and tailoring them to specific rating actions. With respect to the comments on isolating the assumptions and the co-dependencies between assumptions, the Commission understands that certain assumptions may be co-dependent. The NRSRO should provide an explanation of this co-dependency in the disclosure of the assumptions to the extent it is relevant to understanding how they would impact the credit rating.

Paragraph (a)(1)(ii)(N). Paragraph (a)(1)(ii)(N) of Rule 17g–7, as proposed, would contain the disclosure requirements in paragraphs (a) and (b) of Rule 17g–7 before today's amendments.[1312] Specifically, this paragraph would provide that if the credit rating is issued with respect to an asset-backed security, as that term is defined in section 3(a)(79) of the Exchange Act, the NRSRO must include in the form a description of: (1) The representations, warranties, and enforcement mechanisms available to investors; and (2) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, each time there was a rating action with respect to an asset-backed security.[1313] The Commission is adopting paragraph (a)(1)(ii)(N) of Rule 17g–7 with modifications in response to comments.[1314]

Several commenters addressed paragraph (a)(1)(ii)(N) of Rule 17g–7, as proposed.[1315] Two NRSROs objected to the frequency of the required disclosures under the proposed paragraph.[1316] One NRSRO stated that, while the disclosures are relevant at the time an initial credit rating is published, the disclosures may not be relevant at later times because the representations, warranties, and enforcement mechanisms likely will not change in the course of a rated security's existence.[1317] Another NRSRO stated that requiring the disclosures with each rating action ''unacceptably'' expands the disclosure requirement in Rule 17g–7 before today's amendments, which required the disclosures when a rating report is published, noting that some rating actions ''would not necessarily be accompanied by the issuance of a credit rating report.'' [1318]

One NRSRO stated that the disclosures required by Rule 17g–7 before today's amendments are ''enormously costly to the NRSROs'' and are ''of very little value to investors'' according to feedback from institutional clients and an analysis of the NRSRO's Internet Web site usage data.[1319] This NRSRO suggested that the rule be modified to require disclosures that ''relate to the asset pool underlying the ABS transaction'' and which ''the issuer has disclosed in the prospectus, private placement memorandum or other offering document for that transaction.'' [1320] Similarly, one commenter stated that the required disclosures should be limited to representations, warranties, and enforcement mechanisms that ''appear in the prospectus or other offering document for [the applicable] security'' because otherwise the information

[1302] *See* paragraph (a)(1)(ii)(M) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541. This paragraph, as proposed, would require the NRSRO to include in the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on a credit rating if the assumptions were proven false or inaccurate; and (2) an analysis, using specific examples, of how each of the five assumptions impacts a rating.

[1303] *See* paragraph (a)(1)(ii)(M) of Rule 17g–7.

[1304] *See Barnard Letter; CFA/AFR Letter; DBRS Letter; Kroll Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[1305] *See Kroll Letter.*

[1306] *See Moody's Letter.*

[1307] *See Morningstar Letter; S&P Letter.*

[1308] *See S&P Letter.*

[1309] *See Barnard Letter.*

[1310] *See* paragraph (a)(1)(ii)(M)(*1*) of Rule 17g–7. For the reasons stated above, the Commission believes this modification is necessary or appropriate in the public interest, and is consistent with the protection of investors. *See* 15 U.S.C. 78mm (providing the Commission with general exemptive authority).

[1311] *See* paragraph (a)(1)(ii)(M) of Rule 17g–7.

[1312] *See* paragraph (a)(1)(ii)(N) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33463, 33541; 17 CFR 240.17g–7.

[1313] *See* paragraph (a)(1)(ii)(N) of Rule 17g–7, as proposed.

[1314] *See* paragraph (a)(1)(ii)(N) of Rule 17g–7.

[1315] *See Mills Letter; DBRS II Letter; Kroll Letter; S&P Letter.*

[1316] *See Kroll Letter; S&P Letter.*

[1317] *See Kroll Letter.*

[1318] *See S&P Letter.*

[1319] *See DBRS II Letter. See also DBRS PRA Letter; Kroll PRA Letter; Moody's PRA Letter.*

[1320] *See DBRS II Letter.* In support of its suggestion, the NRSRO cited the Senate Committee on Banking, Housing, and Urban Affairs, Committee Report No. 111–176, April 30, 2010 (''Senate Banking Committee Report''), stating that the deficiencies in the securitization process that the applicable provision of the Dodd-Frank Act was designed to address ''included the fact that 'investors in asset-backed securities could not assess the risks of the underlying assets, particularly when those assets were resecuritized into complex instruments like collateralized debt obligations.'" *DBRS II Letter* (quoting Senate Banking Committee Report at 35–37).

would not be material to an investor's ability to make an informed decision.[1321] Finally, an NRSRO suggested that the benchmarks for the representations, warranties, and enforcement mechanisms should be displayed in ''a dedicated area of the NRSROs' Web sites'' instead of in the form.[1322]

The Commission has modified the final amendments in response to some of these comments and consistent with the Commission's objective of making the information in the form disclosed with a credit rating helpful to investors and other users of credit ratings in understanding how the credit rating was determined. The first significant modification is to narrow the disclosure requirement so that it addresses the representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security. The Commission agrees with commenters that this is highly relevant information for investors. Therefore, focusing the disclosure requirement in this way may make the required disclosure more relevant and useful to investors and other users of credit ratings than the disclosures required under Rule 17g–7 before today's amendments. Specifically, paragraph (a)(1)(ii)(N) of Rule 17g–7 requires an NRSRO, if the credit rating is assigned to an asset-backed security as defined in section 3(a)(79) of the Exchange Act, to disclose in the form information on: (1) The representations, warranties, and enforcement mechanisms available to investors *which were disclosed in the prospectus, private placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security;* and (2) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities.[1323]

The second significant modification is to reduce the frequency of the disclosure. As commenters stated, the proposal—by incorporating the requirements of Rule 17g–7 before today's amendments into the new form disclosure requirements—would increase the number of times an NRSRO would need to disclose the information about representations, warranties, and enforcement mechanisms. The Commission believes that the critical time for disclosing this information is when investors are making investment decisions about a new issuance, which would have no performance history. The Commission also believes the disclosure would be useful if there is a material change in the representations, warranties, or enforcement mechanisms after issuance because the change could be relevant to investment decisions made in the secondary market for the security. Finally, because Rule 17g–7 became effective on September 26, 2011, the final amendments provide that the requirement to make the disclosure after a material change is triggered only if the rating action involves an asset-backed security that was initially rated by the NRSRO on or after September 26, 2011. This will further limit the burden associated with the rule. It also will address the practical issue of an NRSRO having to make a disclosure involving historical information that it may not have collected and retained because it was not required to make the disclosure about the representations, warranties, or enforcement mechanisms when it initially rated the asset-backed security. For these reasons, the final amendments require the information to be disclosed if the rating action is a preliminary credit rating or an initial credit rating or if the rating action is the first one taken after a material change in the representations, warranties, or enforcement mechanisms and the rating action involves an asset-backed security that was initially rated by the NRSRO on or after September 26, 2011.[1324]

4. Paragraph (a)(1)(iii) of Rule 17g–7—Attestation

Section 15E(q)(2)(F) of the Exchange Act provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.[1325] While section 15E(q) relates to the disclosure of information about the performance of credit ratings, the Commission proposed that this attestation provision would more appropriately be implemented with respect to all disclosures that must be made when a specific rating action is published.[1326] Accordingly, the Commission proposed that the attestation be included in the form accompanying a credit rating.[1327]

As proposed, an NRSRO would be required to attach to the form with each rating action a signed statement by a person within the NRSRO stating that the person has responsibility for the credit rating and, to the best knowledge of the person: (1) No part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the risks and merits of the obligor, security, or money market instrument.[1328] Thus, the proposed rule text mirrored the statutory text in terms of the representations that would be included in the attestation.[1329]

The Commission received several comments that addressed the proposal.[1330] One commenter stated that the ''strong'' attestation requirement is a ''valuable enhancement'' because it promotes increased accountability and ''more meaningful disclosures.''[1331] One NRSRO endorsed the attestation requirement substantially as proposed.[1332] Two NRSROs were concerned that the attestation requirement would result in an employee or officer being personally liable for a rating action.[1333] One

[1321] *See Mills Letter.*

[1322] *See DBRS II Letter.*

[1323] *See* paragraph (a)(1)(ii)(N)(*1*) of Rule 17g–7. As noted above, one NRSRO suggested that the benchmarks for the representations, warranties, and enforcement mechanisms should be displayed in ''a dedicated area of the NRSROs' Web sites'' instead of in the form. *See DBRS II Letter.* In response, the Commission notes that the final amendments require the NRSRO disclose in the form information on the representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security, and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities. The Commission does not intend the rule to preclude including an Internet address where the benchmarks can be found on the NRSRO's Web site, provided the disclosure in the form meets the requirement in the rule. Moreover, to the extent the benchmarks are lengthy, this approach could make the form easier to use.

[1324] *See* paragraph (a)(1)(ii)(N)(*2*) of Rule 17g–7.

[1325] *See* 15 U.S.C. 78o–7(q)(2)(F).

[1326] *See* paragraph (a)(1)(iii) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR 33464–33465, 33541.

[1327] *See* 15 U.S.C. 78o–7(s); 15 U.S.C. 78o–7(q).

[1328] *See* paragraphs (a)(1)(iii)(A) through (C) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33541.

[1329] *See* 15 U.S.C. 78o–7(q)(2)(F).

[1330] *See A.M. Best Letter; Better Markets Letter; DBRS Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[1331] *See Better Markets Letter.*

[1332] *See DBRS Letter.*

[1333] *See A.M. Best Letter; Morningstar Letter.* While the Commission understands the commenters' concerns about potential liability, the

Continued

NRSRO stated that a ratings committee already attests to the rating's independence by signing its internal rating forms and stated ''[t]hus, such an attestation is already part and parcel of the ratings package that is . . . available to Commission staff during their annual exams, or at any other time.'' [1334] One NRSRO suggested that rather than an attestation, the NRSRO should be required to disclose the name of the chair of the rating committee because doing so is an implicit attestation that the credit rating was determined in accordance with the NRSRO's rating procedures and methodologies.[1335]

The Commission is adopting paragraph (a)(1)(iii) of Rule 17g–7 with one modification in response to comments. Specifically, one NRSRO suggested that the wording of the proposed attestation—because it used the phrase ''risks and merits''—could inadvertently lead users of credit ratings to believe that credit ratings address other types of risk, such as liquidity risk, market value risk, or price volatility.[1336] The commenter suggested the phrase ''credit risk'' be used instead.

The Commission agrees. Credit ratings are assessments of creditworthiness.[1337] Consequently, the attestation should reference credit risk so as not to be misleading. In addition, the NRSRO should have the flexibility to designate the individual who will execute the certification, as more than one individual within the NRSRO may have responsibility for the rating action.[1338] For these reasons, the final amendments provide that the NRSRO must attach to the form a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) No part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the *credit risk* of the obligor, security, or money market instrument.[1339]

The Commission does not believe the alternatives suggested by commenters—relying on internal records or disclosure of the identity of the rating committee chair—would adequately implement the statute. As discussed above, section 15E(q)(2)(F) of the Exchange Act provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.[1340] Consequently, the attestation must be included with the credit rating the NRSRO issues rather than being documented in an internal record. Further, the Commission believes that having an individual attest to the information disclosed in the form will promote analytical independence. In particular, the individual executing the attestation will want to ensure that it contains no untrue or inaccurate statements. Consequently, the individual will have an incentive to take steps to verify that the credit rating was not influenced by any other business activities, was based solely on the merits of the instruments being rated, and was an independent evaluation of the risks and merits of the instrument. Moreover, if the individual does not believe such an attestation can be truthfully made, the individual will have a reason to refuse to make the attestation. This could prevent the NRSRO from taking a rating action that, for example, was inappropriately influenced by conflicts of interest arising from business considerations.

The Commission is not persuaded that disclosing the name of the rating chair would provide an implicit attestation that that no part of the credit rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument. Moreover, as discussed above, having an individual execute the attestation will promote analytical independence. Accordingly, the final amendments (as was proposed) require that the form include an attestation executed by an individual responsible for the rating action.

Finally, one NRSRO stated that every NRSRO should be able to determine who within the NRSRO should be responsible for making the proposed attestation.[1341] The Commission agrees with the commenter that the NRSRO has flexibility to select the appropriate person within the NRSRO to execute the attestation, provided the person has responsibility for the credit rating. For example, the analyst or another member of the rating committee could execute the attestation.

5. Paragraph (a)(2) of Rule 17g–7—Third-Party Due Diligence Certification

As discussed in more detail below in section II.H. of this release, section 15E(s)(4)(B) of the Exchange Act requires a third party providing due diligence services to an NRSRO, issuer, or underwriter with respect to an Exchange Act-ABS to provide a written certification to any NRSRO that produces a credit rating to which the due diligence services relate.[1342] Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt a rule requiring an NRSRO that receives a certification from a provider of third-party due diligence services to disclose the certification to the public in a manner that allows the public to determine the adequacy and level of the due diligence services provided by the third party.[1343] The Commission proposed to implement section 15E(s)(4)(D) through paragraph (a)(2) of Rule 17g–7, as proposed.[1344] As proposed, paragraph (a)(2) identified the second item of information an NRSRO would need to publish with a credit rating when taking a rating action: Any written certification related to the credit rating received from a third-party provider of due diligence services pursuant to section 15E(s)(4)(B) of the Exchange Act.[1345] The proposed approach was intended to provide disclosure of the certification to the public in a manner that allows the

Commission believes the attestation requirement is an important provision that will promote analytic independence. The Commission does not believe it would be necessary or appropriate in the public interest, or consistent with the protection of investors, to refrain from implementing section 15E(q)(2)(F) of the Exchange Act, which, as discussed above, requires rulemaking establishing an attestation requirement. *See* 15 U.S.C. 78mm. Further, the Commission notes that, consistent with all other provisions of the Exchange Act and rules that impose an obligation on an entity, there is a potential for secondary liability for an individual that aids and abets, or causes, a violation.

[1334] *See A.M. Best Letter.*

[1335] *See S&P Letter.*

[1336] *See Moody's Letter.*

[1337] *See* 15 U.S.C. 78o–7(c)(60) (defining a *credit rating* to mean ''an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments'').

[1338] For example, if the rating action was determined through a rating committee, each of the individuals on the committee could be designated by the NRSRO as having responsibility for the rating action.

[1339] *See* paragraph (a)(1)(iii) of Rule 17g–7 (emphasis added to highlight the modification).

[1340] *See* 15 U.S.C. 78o–7(q)(2)(F).

[1341] *See DBRS Letter.*

[1342] *See* 15 U.S.C. 78o–7(s)(4)(B). As stated above in section I.B.1. of this release, the term *Exchange Act-ABS* as used throughout this release refers to an *asset-backed security* as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

[1343] *See* 15 U.S.C. 78o–7(s)(4)(D).

[1344] *See* paragraph (a)(2) of Rule 17g–7, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33465, 33541.

[1345] *See* paragraph (a)(2) of Rule 17g–7, as proposed.

public to determine the adequacy and level of the due diligence services provided.[1346]

The Commission received a number of comment letters regarding proposed paragraph (a)(2) of Rule 17g–7.[1347] An NRSRO stated that requiring the NRSRO to deliver ''information and commentary generated by other market participants'' may lead to confusion about ''the appropriate role of NRSROs,'' [1348] and another NRSRO stated that the proposed requirements may cause NRSROs to ''include in their rating disclosure form information that they believe is not from a reliable source and that they did not use in their rating analysis.'' [1349] The second NRSRO also stated that ''NRSROs do not typically engage third-party due diligence providers'' and ''obtaining and disclosing this certification should be the obligation of the issuer.''[1350] On the other hand, two commenters expressed their support for requiring NRSROs to disclose information related to third-party due diligence reviews.[1351] Another commenter stated that only the NRSRO is in a position to know which reports it used in issuing a credit rating.[1352] A fourth commenter stated that the due diligence providers have a ''limited role'' in the transaction and that ''the onus for making the certification publicly available should rest solely with the NRSRO.'' [1353]

The Commission is adopting paragraph (a)(2) of Rule 17g–7 with modifications designed to address comments made in the context of proposed Rule 17g–10.[1354] Specifically, the final amendments are modified to explicitly reference Form ABS Due Diligence–15E.[1355] In addition, the final amendments are modified to correspond to modifications to Rule 17g–10 (discussed below) to provide that an NRSRO must publish with a rating action any executed Form ABS Due Diligence–15E containing information about the security or money market instrument subject to the rating action that is received by the NRSRO or obtained by the NRSRO through an Internet Web site maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to paragraph (a)(3) of Rule 17g–5. As discussed below in section II.H.2.c. of this release, the Commission is modifying Rule 17g–10 from the proposal to provide that a person employed to provide third-party due diligence services can meet its statutory obligation to provide the written certification relating to those services to any NRSRO that produces a credit rating to which such services relate by promptly responding to a written request from an NRSRO for the executed Form ABS Due Diligence–15E *and* promptly delivering the Form ABS Due Diligence–15E to the issuer, sponsor, or underwriter of the security or money market instrument that maintains the relevant Internet Web site pursuant to Rule 17g–5.[1356] Further, the Commission is amending Rule 17g–5 to provide for the issuer, sponsor, or underwriter to represent that it will promptly post the Form ABS Due Diligence–15E to the Internet Web site it maintains under paragraph (a)(3) of Rule 17g–5.[1357]

As discussed above, two NRSROs raised concerns about requiring the NRSRO to disclose the due diligence certifications.[1358] The Commission notes that section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt a rule requiring an NRSRO that receives a certification from a provider of third-party due diligence services to disclose the certification to the public in a manner that allows the public to determine the adequacy and level of the due diligence services provided by the third party.[1359] Moreover, the Commission believes that the information contained in Form ABS Due Diligence–15E will be useful to investors and to other users of the NRSRO's credit ratings. Therefore, disclosing the information in the form that will accompany the credit rating will associate the information with the credit rating. This will make it easier for investors and other users of credit ratings to locate the information and it will promote their use of the information in evaluating the credit rating and asset-backed security that is the subject of the rating action. For these reasons, the Commission does not believe it would be necessary or appropriate in the public interest, or consistent with the protection of investors to exempt NRSROs from the requirement to include the due diligence certifications with their forms.[1360]

6. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to the forms and certifications that an NRSRO must publish when taking certain rating actions.[1361] The baseline that existed before today's amendments was one in which NRSROs were not required by Commission rules to publish specified information when taking a rating action. However, today's amendments contain requirements for the disclosure of certain types of information with the publication of certain rating actions that an applicant or NRSRO was required, before these amendments, to report generally with respect to all of its credit ratings on Form NRSRO. For example, before today's amendments, the instructions for Exhibit 2 to Form NRSRO required the disclosure of a general description of the procedures and methodologies used by the NRSRO to determine credit ratings. This description must address, among other items, the quantitative and qualitative models and metrics and the public and non-public sources of information, including data and analysis provided by third-party vendors, used to determine credit ratings. This information was not, however, required to be disclosed at the level of individual rating actions, so users of credit ratings interested in a particular rating action may not have known, for example, the ''version of the procedure or methodology used'' or the ''types of data . . . that were relied on'' to determine the credit rating in question, as required to be disclosed with the publication of certain credit rating actions under the amendments.

Before today's amendments, some NRSROs provided, but were not required by the Commission to provide, additional disclosures on their public Web sites with respect to all of their credit ratings, such as a description of

[1346] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33465.

[1347] *See ASF Letter; CII Letter; Clayton Letter; Levin Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[1348] *See Moody's Letter.*

[1349] *See S&P Letter.*

[1350] *Id.*

[1351] *See CII Letter; Levin Letter.*

[1352] *See ASF Letter.*

[1353] *See Clayton Letter.*

[1354] *See* paragraph (a)(2) of Rule 17g–7. *See also* section II.H.2. of this release (discussing the ''safe harbor'' provision that incorporates the use of the Internet Web site maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to paragraph (a)(3) of Rule 17g–5).

[1355] *See* paragraph (a)(2) of Rule 17g–7. As proposed, the paragraph referred to ''any certification.''

[1356] *See* paragraph (c) of Rule 17g–10.

[1357] *See* paragraph (a)(3)(iii)(E) of Rule 17g–5.

[1358] *See Moody's Letter; S&P Letter.*

[1359] 15 U.S.C. 15E(s)(4)(D).

[1360] *See* 15 U.S.C. 78mm (providing the Commission with exemptive authority).

[1361] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today. The economic effects related to the certification of third-party due diligence providers are discussed below in more detail in section II.H.4. of this release.

the intended informational content of their credit ratings and a general discussion of the uncertainty and risk factors to which their credit ratings are subject. Also, in some public press releases and reports to subscribers issued in connection with rating actions, NRSROs have discussed certain risk factors specific to a given rating action or provided information or Web addresses directing interested persons to the descriptions of methodologies that are relevant for that particular rating action, though such disclosures were not required.

Relative to this baseline, the amendments being adopted today may benefit users of credit ratings because the forms may provide new information specific to a given rating action or may clearly direct users of credit ratings to information that may already have been available. Specifically, as discussed above, the information provided in the forms will include, among other things: (1) Information about the content of the credit rating; (2) the main assumptions and principles and the version of the methodology used to determine the credit rating; (3) a description of the types of data that were relied on and whether due diligence services and servicer or remittance reports were used for the purpose of determining the credit rating; (4) information relating to potential conflicts of interest; and (5) information about the potential limitations, uncertainty, sensitivity to assumptions, and potential volatility of the credit rating.[1362]

The disclosure of this information and the other required content of the forms may benefit users of credit ratings by allowing them to better understand how credit ratings are produced and the information content of credit ratings, including how these factors vary across NRSROs. Also, the information disclosed in the form—particularly information about the potential limitations, uncertainty and potential volatility of the credit rating, the sensitivity of the credit rating to assumptions made by the NRSRO, and information regarding the due diligence services used in rating Exchange Act-ABS—may discourage undue reliance on credit ratings by investors and other users of credit ratings in making investment and other credit-based decisions. The disclosures, and particularly the attestation requirement, also may encourage enhanced integrity in the production of credit ratings.

If the forms increase the ability of users of credit ratings to compare the assumptions, data, and due diligence relied on by different NRSROs, the adopted rules and amendments may have beneficial competitive effects by enhancing the reputation of NRSROs that users of credit ratings view as being more thorough or as providing more informative credit ratings on the basis of these reviews. Also, to the extent that the forms allow investors to more accurately interpret the information conveyed by credit ratings, they may result in more efficient investment decisions and higher overall market efficiency.[1363] However, the benefits of the forms may be limited to the extent that standardized language and a high level of narrative in the forms limit the amount of useful information that can readily be acquired from the disclosures or the extent to which the information may be easily compared across NRSROs.

The amendments will result in compliance costs to NRSROs. The Commission believes that NRSROs will be able to develop disclosures that are standardized to some degree for particular types of credit ratings and, when they publish individual rating actions, to tailor those disclosures appropriately to each such rating action. NRSROs will therefore bear one-time costs to develop a template for the form and to produce any disclosures that can be standardized across and within various credit rating classes, asset classes, and types of rating actions. As part of this process, NRSROs will likely identify the required disclosure items that, based on their individual credit rating methodologies and procedures, may share common elements across these various subgroups. For example, some or all of the disclosure required by paragraph (a)(1)(ii)(C) of Rule 17g–7 (with respect to the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating) can likely be standardized across credit ratings generated using the same procedures and methodologies. NRSROs may then have to draft, review, and finalize any such common components of these disclosures.

NRSROs will bear additional one-time costs to establish systems, protocols, and procedures for generating and publishing the form, attestation, and certifications when required. These systems, protocols, and procedures may include processes by which the latest versions of any standardized components of the disclosures will be stored, retrieved, and input into the form when required. NRSROs may also have to consider how the other newly required information will be generated, including how analyses constructed in the process of applying their credit rating procedures and methodologies can be translated into some of the required disclosure and whether additional analyses may be required, as well as at what stage and by which staff the generation of this information will be undertaken. NRSROs also will need to establish systems, protocols, and procedures to ensure that the form is populated with the required information (including that any certifications received from a provider of third-party due diligence services are attached to the form) and that the form, attestation, and certifications are published with the associated credit rating.

The amendments also will result in ongoing costs to NRSROs. At the time of any rating action that triggers the requirement, an NRSRO must produce disclosures for the particular rating action and compile these into the form. This process may include retrieving any applicable standardized components of the disclosure, revising this content if necessary to tailor it to the particular rating action, and generating and including any additional tailored content that is specific to the particular rating action. Some of the tailored components of the disclosure may be relatively straightforward because they are primarily factual in nature, such as the assigned credit rating, the identity of the obligor, security, or instrument, the version of the procedure or methodology used to determine the credit rating, and the required information relating to conflicts of interest. Other tailored components of the disclosure may require more consideration and the application of analysis that was produced in the course of producing the credit rating or the completion of additional analysis. Examples of required disclosure items that may require more consideration or analysis include the explanation or measure of the potential volatility of the credit rating and the information on the sensitivity of the credit rating to assumptions made by the NRSRO required by paragraphs (a)(1)(ii)(K) and (a)(1)(ii)(M) of Rule 17g–7.

NRSROs also will bear ongoing costs to review the form, include any relevant hyperlinks, attach applicable attestations and certifications to the form, and to publish the form as required. Also, NRSROs will periodically need to update the

[1362] *See* paragraph (a)(1)(ii) of Rule 17g–7 (prescribing the information that must be disclosed in the form).

[1363] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

standardized components of the disclosures (for example, when methodologies are revised). The Commission's estimates of the total costs of these compliance efforts—which are based on analyses for purposes of the PRA—are provided below.

The Commission received comments identifying costs and burdens, including significant administrative, recordkeeping, technological, and compliance costs, including costs associated with time spent by rating analysts and other NRSRO employees in complying with the proposed amendments.[1364] Commenters also expressed concerns about the potential for the publication of confidential or proprietary information.[1365] As stated above, the Commission is sensitive to the costs resulting from its rules. In this regard, the Commission has modified the amendments from the proposal in a number of ways to mitigate burdens. The Commission narrowed the scope of rating actions that will trigger the disclosure requirement and provided an exemption for certain rating actions involving foreign obligors or foreign-issued securities or money market instruments. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. All of these modifications were made in response to concerns about burdens raised by commenters. The Commission also has clarified the type of information that is required to be included in the form, which may address concerns about burdens as well as concerns about the disclosure of confidential information raised by commenters.

One NRSRO commented that the Commission, in the proposing release, had underestimated the burden associated with the form because the proposed disclosure items would not be able to be standardized across rating actions or asset class types and would require an individual analysis of the rated transaction.[1366] While the Commission encourages NRSROs to make the disclosures as specific to the particular rating action and as relevant to investors as possible, it also believes, as discussed above, that NRSROs will be able to develop disclosures that are standardized to some degree for particular types of credit ratings and, when they publish individual rating actions, to tailor those disclosures appropriately to each such rating action.

Compliance costs should vary across NRSROs due to differences in the number of sectors (such as asset classes, industries, and geographies) rated—which may affect the number of standardized disclosures that will be created—and the number of rating actions each year subject to the requirements, as well as the frequency with which the NRSROs change their approaches to producing credit ratings or the sectors for which they produce credit ratings, and any differences in the complexity of rating procedures and methodologies that may impact the complexity of the forms. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to paragraph (a) of Rule 17g–7 will result in total industry-wide one-time costs to NRSROs of approximately $15,613,000 and total industry-wide annual costs to NRSROs of approximately $196,783,000.[1367]

Given that some of the compliance costs associated with creating and revising standardized disclosures may not scale proportionately with size, and that costs should also vary across NRSROs for the other reasons listed above, these amendments may negatively affect competition through the disproportionate burden on small NRSROs and, for example, NRSROs with procedures and methodologies that would result in more complex disclosure.[1368] The amendments also may result in other costs. The Commission received comments from NRSROs expressing concerns about potential delays in the issuance of ratings.[1369] The Commission is sensitive to concerns that, in some instances, the need to draft and review these additional disclosures may delay NRSROs in publishing preliminary and initial credit ratings, may result in NRSROs taking fewer rating actions, may result in NRSROs taking more time to take rating actions in response to changing conditions, and may particularly extend the amount of time required for NRSROs to take steps which would require the NRSRO to revise the standardized language prepared for the disclosures for certain asset classes or other sectors, such as making appropriate changes to credit rating methodologies. Commenters also predicted a decline in the transparency of credit ratings over time due to the increased standardization of disclosure, and raised concerns that very extensive disclosures could overwhelm users of credit ratings or obfuscate key points.[1370] As mentioned above, though section 15E(s)(3) identifies specific qualitative and quantitative information that must be included in the form, the Commission has modified the amendments from the proposals in a number of ways to mitigate burdens, which may reduce the likelihood or extent of such impacts. However, any such effects may reduce the information readily available to users of credit ratings and thus reduce the efficiency of their investment decisions and potentially the efficiency of the overall market.[1371]

The Commission considered the costs and benefits of reasonable alternatives to the amendments. Section 15E(s)(3) of the Exchange Act identifies a significant amount of information that the Commission's rule must require to be disclosed in the form. Because the statute is specific about the type of information to be included in the form, and the information thus detailed by the statute is quite comprehensive, the rule text prescribing the required contents of the form largely mirrors the statutory text. However, the Commission has applied some discretion with respect to the format of the form and which rating actions must be accompanied by the forms and certifications. One alternative to the approach in the amendments would be to prescribe a specific form in which NRSROs would input the information required by the amendments. Requiring NRSROs to use a standardized form could assist users of the form in locating and analyzing items of information disclosed. On the other hand, a standardized form with line items and fields to input information could cause NRSROs to provide disclosures that are less thorough or tailored to their individual approaches, which could reduce transparency. The Commission believes the approach it has taken in requiring that the content of the forms be disclosed in numbered items that are presented in a consistent

[1364] *See Kroll Letter; Morningstar Letter; S&P Letter.*

[1365] *See Barnard Letter; Siff Letter.*

[1366] *See Morningstar Letter.*

[1367] *See* section V.H. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.6. of this release.

[1368] *See* section IV.D.6. of this release for the Commission's estimates of the different components of the compliance burden and a further discussion of how they may vary across NRSROs. *See also* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1369] *See S&P Letter; DBRS Letter.*

[1370] *See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter.*

[1371] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

order across NRSROs, without, for example, requiring that a prescribed form be filled out, strikes an appropriate balance in implementing section 15E(s)(2) of the Exchange Act between the comparability of the information provided and the flexibility to allow for meaningful disclosure.

Other alternatives would be, as the Commission proposed, to require the forms to be disclosed even with affirmations or withdrawals that are not based on the NRSRO applying its procedures and methodologies for determining credit ratings or, as the Commission proposed, to require broader disclosures of representations, warranties, and enforcement mechanisms. However, the additional information that these alternatives would make available to users of credit ratings would likely not be significant, while, as raised by several commenters,[1372] the burden to create these additional disclosures could be substantial.

H. Third-Party Due Diligence for Asset-Backed Securities

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add paragraph (s)(4), ''Due diligence services for asset-backed securities,'' which contains four provisions regarding due diligence services relating to an Exchange Act-ABS.[1373] Specifically, section 15E(s)(4)(A) requires the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[1374] Section 15E(s)(4)(B) requires that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide written certification in a format provided in section 15E(s)(4)(C) to any NRSRO that produces a rating to which such services relate.[1375] Section 15E(s)(4)(C) requires the Commission to establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B) to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate credit rating.[1376] Finally, as discussed above in section II.G.5. of this release, section 15E(s)(4)(D) of the Exchange Act directs the Commission to adopt rules requiring an NRSRO, at the time at which it produces a credit rating, to disclose the certification required by section 15E(s)(4)(B) to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by a third party.[1377]

The Commission proposed amendments to Rule 314 of Regulation S–T and Form ABS–15G, and proposed Rule 15Ga–2 to implement section 15E(s)(4)(A) of the Exchange Act.[1378] The Commission proposed amendments to Rule 17g–7 and proposed Rule 17g–10 and related Form ABS Due Diligence–15E to implement sections 15E(s)(4)(B), (C), and (D) of the Exchange Act.[1379] The proposals, comments received on the proposals, and final rules are discussed below.

1. New Rule 15Ga–2 and Amendments to Form ABS–15G

The Commission re-proposed rules to implement section 15E(s)(4)(A) of the Exchange Act, which requires that an issuer or underwriter of any Exchange Act-ABS make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[1380] In October 2010, the Commission proposed to implement section 15E(s)(4)(A) of the Exchange Act as part of a set of rules proposed to implement section 945 of the Dodd-Frank Act.[1381] After reviewing the comments to that proposal regarding issuer review of assets in offerings of asset-backed securities,[1382] the Commission was persuaded that section 15E(s)(4)(A) of the Exchange Act, when considered in the context of sections 15E(s)(4)(B), (C), and (D),[1383] should be interpreted more narrowly than in the proposal.[1384] Therefore, the Commission re-proposed Rule 15Ga–2 to require an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS–15G [1385] containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[1386] The Commission also proposed that if Form ABS–15G was furnished by the issuer, it must be signed by the senior officer of the depositor in charge of securitization, and if Form ABS–15G was furnished by the underwriter, then it must be signed by a duly authorized officer of the underwriter.[1387]

In addition, the Commission proposed that an issuer or underwriter would not need to furnish Form ABS–15G if it obtains a representation from an NRSRO engaged to produce a credit rating for the Exchange Act-ABS that the NRSRO will publicly disclose the findings and conclusions of the third-party due diligence report obtained by the issuer or underwriter.[1388] As proposed, the NRSRO's representation must state that it will make the disclosure with the publication of the credit rating five business days prior to the first sale in the offering in the form generated pursuant to proposed paragraph (a)(1) of Rule 17g–7.[1389] In this context, the Commission stated in the proposing release that the term *publicly disclose*

[1372] As discussed above, commenters raised concerns regarding the rating actions that would trigger the disclosure requirement. *See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.* Commenters also raised concerns regarding the disclosures of representations, warranties and enforcement mechanisms. *See DBRS II Letter. See also DBRS PRA Letter; Kroll PRA Letter; Moody's PRA Letter.*

[1373] *See* Public Law 111–203, 932(a)(8); 15 U.S.C. 78o–7(s)(4). As stated above in section I.B.1. of this release, the term *Exchange Act-ABS* as used throughout this release refers to an *asset-backed security* as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

[1374] *See* 15 U.S.C. 78o–7(s)(4)(A).

[1375] *See* 15 U.S.C. 78o–7(s)(4)(B).

[1376] *See* 15 U.S.C. 78o–7(s)(4)(C).

[1377] *See* 15 U.S.C. 78o–7(s)(4)(D).

[1378] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466–33471.

[1379] *See id.* at 33465, 33471–33476.

[1380] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466–33471.

[1381] *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* Securities Act Release No. 9150 (Oct. 13, 2010), 75 FR 64182 (Oct. 19, 2010).

[1382] *See, e.g.,* comment letters from the American Bar Association (stating that ''[section] 15E(s)(4)(A) was not intended to be applied to all manner of third-party due diligence reports that may be obtained by an issuer or underwriter, but instead was intended to be applied more narrowly, to any third-party due diligence report prepared for an ABS issuer or underwriter specifically for the purpose of sharing it with a given NRSRO'') and the National Association of Bond Lawyers. The comment letters are available at *http://www.sec.gov/comments/s7-26-10/s72610.shtml.*

[1383] *See* 15 U.S.C 78o–7(s)(4)(A) through (D), which relate to due diligence performed by third parties with respect to Exchange Act-ABS.

[1384] *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* Securities Act Release No. 9176 (Jan. 20, 2011), 76 FR 4231 (Jan. 25, 2011).

[1385] As discussed below, Form ABS–15G is being amended today to incorporate Rule 15Ga–2. Form ABS–15G was originally adopted for the purpose of providing disclosures required by the new disclosure requirements of Rule 15Ga–1 (17 CFR 240.15Ga–1). *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4499–4501.

[1386] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466–33470, 33538. The Commission stated in the proposing release that the term *issuer* would mean the depositor or sponsor that participates in the issuance of Exchange Act-ABS, which was consistent with proposed Rule 17g–10, but did not include a definition of *issuer* within proposed Rule 15Ga–2. The Commission proposed to define the term *third-party due diligence report* to mean any report containing findings and conclusions relating to *due diligence services* as defined in paragraph (c)(1) of Rule 17g–10, as proposed. *See id.* at 33467, n.532.

[1387] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466–33470.

[1388] *See id.* at 33466–33470, 33538.

[1389] *See id.*

means to make the findings and conclusions readily available to any users of credit ratings.[1390] Consequently, an NRSRO that agreed to make the findings and conclusions available only to its subscribers or prospective investors in the Exchange Act-ABS would not satisfy this proposed requirement. The Commission recognized, however, that there may be instances where, notwithstanding an issuer's or underwriter's reasonable reliance on a representation by an NRSRO, the NRSRO fails to make the required information publicly available in the form pursuant to proposed paragraph (a)(1) of Rule 17g–7 five business days prior to the first sale in the offering.[1391] Therefore, the Commission proposed to require that if the NRSRO failed to make the information publicly available, an issuer or underwriter must furnish, two business days prior to the first sale in the offering, Form ABS–15G with the information required by proposed Rule 15Ga–2.[1392]

The Commission did not propose to require that disclosure about a third-party due diligence report for registered Exchange Act-ABS transactions required by proposed Rule 15Ga–2 be provided in the prospectus because such information only pertains to the findings and conclusions of a third-party due diligence report relevant to the determination of a credit rating.[1393] Under Rule 193,[1394] on the other hand, if an issuer were to use the third-party due diligence report in connection with its review of disclosure in the prospectus about the pool assets as required under Rule 193, it would be required to include the findings and conclusions in the prospectus [1395] and, if the issuer attributed the findings and conclusions to the third party, that third party's consent to be named as an expert in the registration statement would need to be obtained.[1396]

The Commission also proposed that Rule 15Ga–2 would apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS.[1397] Accordingly, if a municipal entity that sponsors or issues Exchange Act-ABS (''municipal Exchange Act-ABS'') or an underwriter of municipal Exchange Act-ABS obtained a third-party due diligence report, as defined by the proposed rule, and the municipal Exchange Act-ABS is to be rated by an NRSRO, the proposal noted that Rule 15Ga–2 would apply.[1398] The Commission proposed to permit municipal securitizers of Exchange Act-ABS, or underwriters in the offering, to provide the information required by Form ABS–15G on the Electronic Municipal Market Access system (''EMMA'').[1399]

Commenters generally supported the overarching principle of proposed Rule 15Ga–2 but were mixed about the specifics of how the rule should be implemented.[1400] As a result, the Commission is adopting Rule 15Ga–2 and revised Form ABS–15G with some revisions to address comments and to make clarifying changes.[1401] Commenters generally agreed that Rule 15Ga–2 should only apply to an Exchange Act-ABS that is to be rated by an NRSRO.[1402] The Commission continues to believe for the reasons stated in the proposing release that section 15E(s)(4)(A) of the Exchange Act should be interpreted to relate only to Exchange Act-ABS that are rated.[1403] Therefore, the Commission is adopting, generally as proposed, the requirement that an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO must furnish a Form ABS–15G containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, with modifications to provide limited exclusions for issuers and underwriters of Exchange Act-ABS in certain offshore transactions and municipal issuer offerings, as discussed further below.[1404] Rule 15Ga–2 applies to Exchange Act-ABS transactions that are rated by an NRSRO regardless of who pays for the credit rating, and regardless of whether the Exchange Act-ABS is sold in a registered or unregistered transaction, as described in more detail below. Several commenters suggested that the issuer's or underwriter's requirement under Rule 15Ga–2 should apply only to third-party due diligence reports that were provided to an NRSRO.[1405] The Commission is not, however, limiting the applicability of Rule 15Ga–2 as these commenters suggest. The Commission does not believe it is appropriate to limit the applicability of Rule 15Ga–2 in this manner because most, if not all, third-party due diligence reports will be made available to NRSROs pursuant to Rule 17g–10.[1406] In the instance a third-party due diligence report that is obtained by the issuer or underwriter is not provided to an NRSRO under Rule 17g–10, the

[1390] *See id.* at 33468, n.534.

[1391] *See id.* at 33468. Under the proposal, an NRSRO's failure to disclose the certification would be a violation of the requirement in proposed paragraph (a)(2) of Rule 17g–7. *See id.* at 33540–33541.

[1392] *See id.* at 33468, 33538.

[1393] *See id.* at 33469.

[1394] *See* 17 CFR 230.193. Rule 193 implemented section 945 of the Dodd-Frank Act by requiring that any issuer registering the offer and sale of an Exchange Act-ABS perform a review of the assets underlying the asset-backed security.

[1395] *See* 17 CFR 229.1111.

[1396] *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* 76 FR 4238.

[1397] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33469.

[1398] *See id.* at 33469.

[1399] *See id.* at 33469, 33538.

[1400] *See, e.g., CRE Letter* (stating that it ''does not oppose the concept of third-party asset review and disclosure'' but stated that the proposed rule and form needed ''certain clarifications and modifications regarding disclosure requirements and logistics''); *Deloitte Letter* (stating that it ''support[s] the goals of transparency and accountability underlying Section 932, but [believes] it is essential that the Commission clarify certain aspects of the proposed rule'').

[1401] The modifications to proposed Form ABS–15G are technical rather than substantive and include: (1) Re-ordering the information supplied on the cover page to reflect the differences between Rule 15Ga–1 filings and Rule 15Ga–2 furnishings; (2) changing ''file'' to ''furnish'' wherever it relates to Rule 15Ga–2 requirements; (3) removing references to the proposed NRSRO representation allowance that is not being adopted; (4) revising the language in Item 2.02 to reflect that Rule 15Ga–2 refers to third-party due diligence reports obtained by the underwriter rather than third parties managed by the underwriter; and (5) adding ''Depositor'' as an option to the signature block. *See* Form ABS–15G.

[1402] *See, e.g., ABA Letter; ASF Letter; CRE Letter; DBRS Letter; Deloitte Letter.*

[1403] As explained in the proposing release, the Commission continues to believe that section 15E(s)(4)(A) should be interpreted in the context of the accompanying provisions of section 15E(s)(4) to relate to a particular type of report that is relevant to the determination of a credit rating by an NRSRO. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33467–33469. This is in contrast with the October 2010 proposal, where Rule 15Ga–2 was not limited to transactions rated by NRSROs. *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* 75 FR at 64183.

[1404] As discussed below in section II.H.2. of this release, the term *issuer* as defined for purposes of Rule 17g–10, includes the sponsor or depositor that participates in the issuance of Exchange Act-ABS. *See* paragraph (d)(2) of Rule 17g–10.

[1405] *See, e.g., Deloitte Letter; DBRS Letter.* Some commenters further suggested that Rule 15Ga–2 should only apply if the third-party due diligence report is actually used by the NRSRO. *See ABA Letter* (suggesting an additional recommendation that ''Rule 15Ga–2 should not apply to an Exchange Act-ABS transaction in which the only rating that is issued is a rating that is paid for by a party other than the issuer, sponsor or underwriter''); *ASF Letter; CRE Letter* (stating that the third-party due diligence report should be material to the credit rating of the ABS in order for Rule 15Ga–2 to apply).

[1406] As discussed below in sections II.H.2. and II.H.3. of this release, Rule 17g–10 (which defines terms such as *due diligence services*) requires third-party due diligence providers to use new Form ABS Due Diligence–15E to make the written certification to be provided to the NRSRO under section 15E(s)(4)(B) of the Exchange Act. The form elicits information about the due diligence performed including a description of the work performed, a summary of the findings and conclusions of the third party, and the identification of any relevant NRSRO due diligence criteria that the third party intended to meet in performing the due diligence.

Commission believes it is important for these reports to be made publicly available by the issuer or underwriter in accordance with Rule 15Ga–2 in order for users of credit ratings to evaluate the level of due diligence obtained by the issuer or underwriter as compared to the due diligence services used by an NRSRO rating the securities. Similarly, the Commission is not persuaded to adopt the more restrictive interpretation suggested by some commenters that Rule 15Ga–2 should only apply when a third-party due diligence report is both provided to an NRSRO and used by that NRSRO in its credit rating determination. The Commission understands there may be instances when the NRSRO may not actually use that third-party due diligence report in determining a credit rating; however, it is not clear that an issuer or underwriter would be able to determine whether a third-party due diligence report was actually used by the NRSRO.[1407] Moreover, by not limiting Rule 15Ga–2 in this way, users of credit ratings will be able to determine if there are differences between the information provided to NRSROs, as disclosed under Rules 17g–7 and 17g–10, and the information obtained by the issuer or underwriter, as disclosed in accordance with Rule 15Ga–2, and evaluate the significance, if any, of those differences.

A few commenters suggested that section 15E(s)(4)(A) should not apply to privately offered, unregistered Exchange Act-ABS,[1408] while one commenter suggested that the findings and conclusions of third-party due diligence providers should not be made publicly available on EDGAR for private or confidential transactions.[1409] After considering these comments, the Commission continues to believe that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS. The Commission is not persuaded that Congress' use of the term *underwriters* was meant to limit the applicability of section 15E(s)(4)(A) to registered offerings, as the definition of *underwriter* in the Exchange Act is not explicitly limited to registered offerings.[1410] Moreover, section 15E(s)(4)(A) uses the Exchange Act definition of *asset-backed securities,* which is much broader than the definition of *asset-backed security* in Regulation AB.[1411] The definition of *asset-backed security* in section 3(a)(79) of the Exchange Act expressly includes securities that are almost exclusively offered in unregistered offerings, such as CDOs.[1412] In other contexts where the Commission has adopted or proposed rules that apply to Exchange Act-ABS, those rules have been applied to both registered and unregistered offerings of asset-backed securities.[1413] Moreover, the Commission believes there are sound policy reasons why both registered and unregistered Exchange Act-ABS offerings should be covered by section 15(E)(s)(4)(A) of the Exchange Act. The Commission believes that the benefits of making the findings and conclusions of third-party due diligence reports publicly available, which would include providing more information about the contents of these reports,[1414] equally apply to registered or unregistered offerings since both types of offerings can be the subject of a credit rating.[1415] The Commission continues to believe that, since section 15E(s)(4) relates to oversight of NRSROs and the ratings process and such oversight is not limited to registered offerings, it is not appropriate to exempt any particular issuers or underwriters who offer securities to U.S. investors if they receive a credit rating for the securities.[1416]

Commenters were also concerned that requiring issuers and underwriters to make information available for private placements would violate rules prohibiting general solicitation.[1417] The Commission continues to believe, as explained in the proposing release,[1418] that issuers and underwriters can disclose information required by Rule 15Ga–2 without jeopardizing their reliance on private offering exemptions and safe harbors under the Securities Act, provided the only information made publicly available on Form ABS–15G is required by the rule, and the issuer does not otherwise use Form ABS–15G to offer or sell securities in a manner that conditions the market for offers or sales of its securities. Moreover, issuers are now permitted to engage in general solicitation or general advertising if they are offering and selling securities pursuant to Rule 506(c) or Rule 144A under the Securities Act, provided that all purchasers of the securities are accredited investors and the issuer has taken reasonable steps to verify that such purchasers are accredited investors, for Rule 506(c) offerings, or qualified institutional buyers, for Rule 144A offerings.[1419]

Commenters suggested that Rule 15Ga–2 should exclude offshore transactions.[1420] The Commission agrees that, in light of the practical and legal considerations raised by commenters, certain offshore transactions should be exempted and is adopting revisions to provide that Rule 15Ga–2 as well as section 15E(s)(4)(A) will not apply to certain offshore offerings of Exchange Act-ABS,[1421] consistent with revisions being adopted

[1407] *See, e.g., ASF Letter* (stating that the ''issuer or underwriter would not or may not know whether: (a) An engaged NRSRO elected to disregard a report provided to it, (b) an engaged NRSRO accessed and considered a report provided to a different engaged NRSRO via its Rule 17g–5 Web site, (c) an engaged NRSRO directly retained a [third-party due diligence services] [p]rovider, or (d) a non-engaged NRSRO accessed and considered a report provided to an engaged NRSRO via its Rule 17g–5 Web site.'').

[1408] *See ABA Letter* (commenting that the use of the terms *underwriter* and *publicly available* in section 932 of the Dodd-Frank Act makes the requirement fundamentally inconsistent with private placements). *See also ASF Letter* (suggesting that (1) Congress may have intended to exclude unregistered offerings by the use of the term *underwriter* and (2) ''[i]n the unregistered context, the timing related rationale for the issuer and underwriter's disclosure duty under Rule 15Ga–2 is entirely inapplicable'').

[1409] *See S&P Letter.* This commenter does not indicate if ''private or confidential transactions'' means something other than unregistered offerings.

[1410] *See* section 3(c)(20) of the Exchange Act (15 USC 78c(a)(20)) which refers to the definition of *underwriter* set forth in the Investment Advisers Act of 1940. *See also* section 202(a)(20) of the Investment Advisers Act of 1940 (15 USC 80b-2(a)(20)).

[1411] *See* Item 1101(c) of Regulation AB.

[1412] *See* 15 U.S.C. 78c(a)(79).

[1413] *See, e.g., Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR 4489.

[1414] As discussed below, the Commission believes this information would necessarily include the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those criteria. *See* instruction to paragraph (a) of Rule 15Ga–2.

[1415] As noted above, one commenter suggested the rule should not apply to ''private or confidential transactions.'' To the extent such transactions are rated, the Commission believes the disclosures required by Rule 15Ga–2 would be equally beneficial to an assessment of the resulting credit ratings.

[1416] As discussed below, issuers and underwriters of municipal Exchange Act-ABS are being excluded from the requirements of Rule 15Ga–2 but will continue to be subject to the statutory obligation under section 15E(s)(4)(A) to make the findings and conclusions of any third-party due diligence reports they obtain publicly available.

[1417] *See, e.g., ABA Letter.*

[1418] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33469.

[1419] *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings,* Securities Act Release No. 9415 (July 10, 2013), 78 FR 44771 (July 24, 2013).

[1420] *See ABA Letter* (indicating that the application of Rule 15Ga–2 to offshore transactions invokes the same issues identified in connection with the extra-territorial application of paragraph (a)(3) of Rule 17g–5 and may conflict with foreign securities laws, stock exchange rules, and other applicable laws, rules, and regulations); *DBRS Letter.*

[1421] *See* paragraph (e) of Rule 15Ga–2.

in Rule 17g–7.[1422] Under this exemption, the requirements of Rule 15Ga–2 and section 15E(s)(4)(A) will not apply to an offering of Exchange Act-ABS if: (1) The offering is not required to be, and is not, registered under the Securities Act; (2) the issuer of the rated security is not a U.S. person (as defined under Securities Act Rule 902(k)); [1423] and (3) the security issued by the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States.[1424]

Several commenters provided views on the proposed timeframe for furnishing Form ABS–15G. One commenter noted that the proposed five business day timeframe parallels a requirement in the proposed revisions to asset-backed securities regulations (''Regulation AB II'') [1425] and suggested that, in the event the timeframe is shortened in the adopted Regulation AB II rules, then a corresponding change under Rule 15Ga–2 should be made.[1426] This commenter also suggested that Rule 15Ga–2 should not impose a deadline for furnishing Form ABS–15G in an unregistered offering that differs from the time an NRSRO is required to publish its report under Rule 17g–7.[1427] Another commenter stated that the proposed five business day delay prior to the first sale in an offering under Regulation AB II would be unnecessarily long in many circumstances.[1428] Another commenter, however, stated that the proposed five business day timeframe prior to a first sale would not be sufficient time for an NRSRO to review most issuances of asset-backed securities,[1429] while one commenter supported the proposed five business day timeframe.[1430] After considering the comments, the Commission has decided to adopt, as proposed, the requirement that an issuer or underwriter must furnish Form ABS–15G at least five business days prior to the first sale in the offering.[1431] The Commission believes that the proposed five business day time period strikes an appropriate balance between issuers' and underwriters' timing concerns and allows users of credit ratings, including investors, NRSROs, and other market participants, in combination with the disclosure mandated by Rules 17g–7 and 17g–10, adequate time to evaluate the extent to which the rating process has incorporated the findings and conclusions of third-party due diligence reports obtained and disclosed by the issuer and underwriter.[1432] The Commission believes that adopting a deadline to furnish Form ABS–15G that matches the deadlines for an NRSRO to publish its reports under Rule 17g–7 or Rule 17g–10 would not provide enough certainty about how far in advance of sale a user of a credit rating could expect the information, because NRSROs are required to make this information available when they take a rating action, which could vary among NRSROs and Exchange Act-ABS issuances. The Commission also believes that the timeframe for Rule 15Ga–2 should not be tied to the timeframe under Regulation AB II, as they serve different purposes.[1433] Finally, for the same reasons noted above, the Commission does not believe it is appropriate to differentiate between registered and unregistered offerings under this rule, so the Commission is adopting the five business-day requirement regardless of whether the transaction is registered or exempt.

The Commission is adopting, as proposed, the requirement that a Form ABS–15G furnished by the issuer must be signed by the senior officer of the depositor in charge of securitization, and a Form ABS–15G furnished by the underwriter must be signed by a duly authorized officer of the underwriter. The Commission agrees with the commenter that suggested [1434] that a single Form ABS–15G may be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report and has revised the final rule to clarify this point.[1435] For example, if the issuer and an underwriter obtain the same third-party due diligence report related to a particular asset-backed security and the issuer timely furnishes a Form ABS–15G for that report, the underwriter has no obligation to furnish a Form ABS–15G for the same third-party due diligence report. Similarly, if a transaction has more than one underwriter, and two or more of those underwriters obtain the same third-party due diligence report related to a particular asset-backed security, only one of those underwriters must timely furnish Form ABS–15G for that report. Commenters also requested clarification that a requirement to provide the findings and conclusions of third-party due diligence reports would apply only to the initial credit rating and not to any subsequent upgrades, downgrades, or other rating actions.[1436] The Commission agrees that once the information has been disclosed in connection with an initial credit rating, it does not need to be furnished again in connection with any subsequent rating actions. Accordingly, as clarified

[1422] As discussed above in section II.G.1. of this release, paragraph (a)(3) of Rule 17g–7 provides an exemption from the requirement that NRSROs publish a form and any required third-party due diligence certifications when taking a rating action if the rated obligor or issuer of the rated security is not a U.S. person and if the NRSRO has a reasonable basis to conclude that the security will be offered and sold upon issuance and that any underwriter or arranger linked to the security will effect transactions in the security after issuance only in transactions outside the United States. *See* paragraph (a)(3) of Rule 17g–7. While one commenter requested that the Commission adopt an exemption for foreign transactions in Rule 15Ga–2 similar to that proposed in the credit risk retention rules, the Commission believes it is more appropriate for this exemption to be aligned with the exemption in Rule 17g–7 so that there is a consistent approach to determining when the Commission's NRSRO rules apply to offshore transactions. *See ABA Letter.*

[1423] 17 CFR 230.902(k).

[1424] *See* paragraph (a)(3) of Rule 17g–7.

[1425] *See Asset-Backed Securities,* Securities Act Release No. 9117 (Apr. 7, 2010), 75 FR 23328 (May 3, 2010) (proposing release); *Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities,* Securities Act Release No. 9244 (July 26, 2011), 76 FR 47948 (Aug. 5, 2011).

[1426] *See ASF Letter* (noting that the timeframes for Rule 15Ga–2 and Regulation AB II should match because they both directly relate to the timing of finalizing the composition of the asset pool).

[1427] *See id.* As noted above, this commenter also suggested that Rule 15Ga–2 should not apply to unregistered offerings.

[1428] *See FSR Letter* (also stating that tying the disclosure of third-party due diligence information in the forms to accompany a credit rating prior to the first sale in an offering may not be practical and may create an impediment to prompt market access for many issuers).

[1429] *See S&P Letter.*

[1430] *See CFA/AFR Letter.*

[1431] *See* paragraph (a) of Rule 15Ga–2. One commenter requested that the meaning of the term *first sale in the offering* be clarified in the final rule. *See ABA Letter.* As with other regulations adopted by the Commission, the date of first sale in the offering is the date at which the purchaser makes an investment decision and commits to purchase the securities offered. *See, e.g., Electronic Filing and Revision of Form D,* Securities Act Release No. 8891 (Feb. 6, 2008), 73 FR 10599 (Feb. 27, 2008). *See also* instruction to paragraph (a) of Rule 15Ga–2.

[1432] As stated above, the findings and conclusions that are made public under Rule 15Ga–2 include all third-party due diligence reports that are obtained by the issuer or underwriter, which is more than what an NRSRO may receive under Rule 17g–10 or may use and disclose under Rule 17g–7. Users of credit ratings would have five business days before the first sale to compare the totality of third-party due diligence information with what was provided to, and used by, an NRSRO, as disclosed under Rules 17g–7 and 17g–10.

[1433] As discussed in this section, the disclosure made under Rule 15Ga–2 is for the benefit of the users of credit ratings including investors looking to make an investment decision. Accordingly, the timing of the publication of third-party due diligence report findings and conclusions, which may be available far in advance of the first sale in the offering, serves a different purpose than delivery of preliminary offering materials under Regulation AB II.

[1434] *See ABA Letter.*

[1435] *See* paragraph (b) of Rule 15Ga–2.

[1436] *See ABA Letter; DBRS Letter.*

in the instructions to the final rule, Form ABS–15G does not need to be furnished for any subsequent updates to a credit rating issued by an NRSRO.

While one commenter supported the Commission's proposed approach of defining the third-party due diligence reports covered by the rule,[1437] a number of other commenters wanted the definitions of *third-party due diligence report* and *due diligence services* (defined in proposed Rule 17g–10,[1438] which is the basis for the term *third-party due diligence report* in Rule 15Ga–2) to be narrowed in a variety of ways. After considering these comments, the Commission is adopting, as proposed, the definition of *third-party due diligence report* to mean any report containing findings and conclusions of any *due diligence services* (as defined in Rule 17g–10) performed by a third party.[1439] One commenter suggested that, in the definition of *third-party due diligence report,* the phrase ''final report'' replace the phrase ''any report.'' [1440] The Commission is not, however, replacing the phrase ''any report'' with the phrase ''final report,'' as suggested by some commenters, in part because ''any report'' was specified by Congress in the Dodd-Frank Act. Moreover, the Commission believes all third-party due diligence reports obtained by the issuer or underwriter, including interim reports, related to an offering of asset-backed securities should be made publicly available in order for users of credit ratings to more thoroughly evaluate the level of due diligence obtained by the issuer or underwriter as compared to the due diligence services used by an NRSRO rating the Exchange Act-ABS. One commenter requested that the Commission revise the phrase ''containing the findings and conclusions'' to ''containing a summary of the findings and conclusions,'' noting that providing a summary is more appropriate than providing the findings and conclusions themselves, and that there is no reason why the summary would not be substantially similar in each context.[1441] The Commission is not adopting this alternative for several reasons. First, the Commission notes that Congress specified in the Dodd-Frank Act that ''the findings and conclusions'' must be made publicly available, which the Commission believes would be most appropriately interpreted as precluding a summary. Moreover, the Commission believes it is important for the third-party due diligence provider's findings and conclusions themselves to be made public rather than an issuer or underwriter's summary of those findings and conclusions because a summary runs the risk of excluding information that could be important to a user of credit ratings.[1442] Specifically, the Commission believes that disclosure of the findings and conclusions necessarily requires disclosure of the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those criteria.[1443] The Commission is also revising the rule to clarify that the term *issuer* is defined in Rule 17g–10.[1444]

Several commenters objected to the proposal that an issuer or underwriter would not be required to furnish Form ABS–15G if it reasonably relies upon the representation from an NRSRO rating the transaction that the NRSRO will publicly disclose the required information five business days prior to the first sale in the offering.[1445] One commenter supported this part of the proposal, noting that it could reduce duplicative disclosures.[1446] After considering these comments, the Commission is not adopting this part of the proposal. While the Commission would like to avoid duplicative disclosure wherever possible, it has determined that the representation may be difficult to implement in practice. NRSROs generally opposed this proposal,[1447] and a number of NRSROs, as well as a trade organization with NRSRO members, noted that it is unlikely that any NRSRO would make such a representation,[1448] making it unlikely that much duplicative disclosure would actually be avoided. One commenter thought that there could be a potential for discrepancies in the representations made by NRSROs that operate under the subscriber-pay business model and the issuer-pay model. This commenter noted that these NRSROs could be in compliance with Rule 17g–7, as proposed to be amended, without actually making the findings and conclusions of a third-party due diligence report publicly available.[1449] As explained in the proposing release, an NRSRO that operates under the

[1437] *See CFA/AFR Letter* (stating that they ''share the view, cited by the Commission, that the variation for reviews of different types of offerings is likely to be significant and that this area therefore is better served by principles-based standards than by prescriptive rules''). However, this commenter did object to the Commission's decision to withdraw the approach proposed in the October 2010 proposal, where issuers and underwriters of registered Exchange Act-ABS would have been required to make third-party due diligence disclosures in the prospectus. The commenter suggested that the revised approach is unnecessarily complex and should be simplified.

[1438] A summary of comments addressing the definition of *due diligence services* is provided in section II.H.2. of this release.

[1439] *See* paragraph (d) of Rule 15Ga–2; *see also* paragraph (d)(1) of Rule 17g–10 (defining the term *due diligence services*). Although the Commission is not modifying the definition of *third-party due diligence report,* it is making some changes to, and providing guidance on some aspects of, the definition of *due diligence services* in Rule 17g–10. For example, as discussed below in section II.H.2. of this release, the Commission is: (1) Modifying the first prong of the definition of *due diligence services* by replacing the phrase ''quality and integrity'' of the data with the word ''accuracy;'' (2) providing guidance that the ''catchall'' provision of the definition of *due diligence services* relates to reviews of the assets underlying the Exchange Act-ABS (as opposed to the reviews of the Exchange Act-ABS itself); and (3) providing guidance that it would not object to the inclusion of the description of the requirements and limitations resulting from relevant professional standards generally described within the reports being included in the disclosure.

[1440] *See Clayton Letter.*

[1441] *See ABA Letter.*

[1442] As noted above, the Commission believes users of credit ratings should be able to compare the totality of third-party due diligence information with what was provided to, and used by, an NRSRO, as disclosed under Rules 17g–7 and 17g–10.

[1443] *See* instruction to paragraph (a) of Rule 15Ga–2. This is the same disclosure standard for findings and conclusions that is required under Item 1111(a)(7)(ii) of Regulation AB. *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* 76 FR 4238.

[1444] *See* paragraph (d) of Rule 15Ga–2 and paragraph (d)(2) of Rule 17g–10. As explained above, the proposing release did not include a definition of *issuer* in Rule 15Ga–2 but indicated that the term would be interpreted in a manner consistent with the definition in Rule 17g–10. For clarity and consistency, the Commission has revised the rule text to expressly refer to the definition in Rule 17g–10.

[1445] *See CRE Letter; DBRS Letter; Moody's Letter; Morningstar Letter; S&P Letter.*

[1446] *See Deloitte Letter.*

[1447] *See, e.g., Moody's Letter* (strongly opposing the exemption because the commenter believes: (1) It is contrary to the express intent of Congress to promote greater transparency and accountability among Exchange Act-ABS issuers; (2) it is contrary to the efforts of Congress, the Commission and others to clarify the limited role of credit rating agencies in the financial markets; (3) it is unlikely to reduce the potential for multiple, inconsistent disclosures about the due diligence services; and (4) it will create incentives for issuers and underwriters to select NRSROs who are willing to make these representations). *See also S&P Letter* (stating that issuers and underwriters should bear this obligation because NRSRO disclosure of the required information could confuse investors regarding who is providing the required information).

[1448] *See CRE Letter* (suggesting that the rule allow NRSROs and underwriters to rely on disclosure made by issuers); *Morningstar Letter; S&P Letter.*

[1449] *See ASF Letter.* As discussed above in section II.G.1. of this release, Rule 17g–7, as proposed to be amended, required, in part, that NRSROs must, when taking a rating action, publish and make available to the same persons who can receive or access the credit rating that is the result or the subject of the rating action, a form and any written certification received by the NRSRO from a provider of third-party due diligence services under section 15E(s)(4)(B) of the Exchange Act. The form would include, among other things, a description of the findings or conclusions of any third-party due diligence services used by the NRSRO.

subscriber-pay model (rather than the issuer-pay model) and only makes the third-party due diligence findings and conclusions available to its subscribers would not be able to make a representation to an issuer or underwriter that it is making the required information publicly available.[1450] Consequently, this may give issuer-paid NRSROs a competitive advantage over subscriber-paid NRSROs. Further, the disclosure of the findings and conclusions in the third-party due diligence report made by an NRSRO would need to be as comprehensive as what is required for issuers and underwriters under Rule 15Ga–2 in order to make such a representation. Because Rule 17g–7 only requires that an NRSRO disclose a description of the findings and conclusions, NRSROs, issuers, and underwriters would have to make judgments as to whether the disclosure made in accordance with Rule 17g–7 meets the standard for disclosure of the findings and conclusions under Rule 15Ga–2, as set forth in the instruction to paragraph (a) of Rule 15Ga–2, before an NRSRO could make, or an issuer or underwriter could rely, on such a representation. In addition, if issuers and underwriters were allowed to rely on such a representation in order to not furnish Form ABS–15G, there would be no central location where users of credit ratings could obtain the findings and conclusions of all third-party due diligence reports on Exchange Act-ABS. Finally, allowing issuers and underwriters to rely on a representation may have resulted in gaps in the information that is disclosed on Form ABS–15G.[1451] These results would impair the intended benefits of the rule. Based on the totality of comments and the implications of allowing issuers and underwriters to rely on a representation from an NRSRO in lieu of furnishing Form ABS–15G, the Commission has determined that the potential benefit of eliminating redundant disclosure by allowing the representation does not justify the uncertainty and costs that it may create.

As stated above, the Commission continues to believe that there is no need to separately require that disclosure provided in connection with Rule 15Ga–2 about any third-party due diligence report be provided in the prospectus for a registered offering.[1452] The Commission considered one commenter's suggestion that a separate database be created where all third-party due diligence report findings and conclusions could be centralized.[1453] The Commission, however, believes that the EDGAR system is the more appropriate place for issuers and underwriters to make this information publicly available. When information is electronically filed with the Commission on the EDGAR system, investors, market participants, and Commission staff can access the information from a single, permanent, and centralized location. Creating a new system may be duplicative and may result in additional costs for issuers and underwriters beyond those that would be incurred by using the EDGAR system without providing a significant improvement in making the information available to users of credit ratings. The additional costs incurred by issuers and underwriters of registered Exchange Act-ABS offerings by having to furnish Form ABS–15G on the EDGAR system should be incremental,[1454] as they are already required to file other forms and documents on EDGAR. Issuers and underwriters of unregistered Exchange Act-ABS offerings, however, may incur higher costs compared to those conducting registered offerings if they need to adjust their systems or engage outside counsel to prepare and furnish Form ABS–15G on EDGAR.[1455]

Commenters noted that issuers of registered offerings may incorporate third-party reviews into their registration statement disclosure in order to comply with the review of the underlying assets required by Rule 193. One of these commenters suggested that when disclosures under both Rule 193 and Rule 15Ga–2 might otherwise be required, the Rule 193 disclosures should suffice for both purposes.[1456] Another commenter encouraged the Commission to enhance the efficiency of this new regulatory framework by including an exception that where disclosures about third-party due diligence services comply with Rule 193, those same services would not be subject to Rule 15Ga–2.[1457] After considering these comments, the Commission has revised Rule 15Ga–2 to reflect that if the disclosure required by Rule 15Ga–2 has been made in the prospectus (including an attribution to the third party that provided the due diligence report),[1458] and the prospectus is publicly available at the time Form ABS–15G is furnished by the issuer or underwriter, the issuer or underwriter may refer to that section of the prospectus in Form ABS–15G rather than providing the findings and conclusions directly in Form ABS–15G.[1459] This does not, however, exempt an issuer or underwriter from the requirements of Rule 15Ga–2, including its duty to furnish Form ABS–15G. The Commission continues to believe that, in addition to disclosures made by the NRSROs, Form ABS–15G is the most appropriate place to find information about a particular type of report that is relevant to the determination of a credit rating by an NRSRO.

Two comments submitted in response to the proposing release related to the impact on municipal issuers and underwriters. One commenter cautioned the Commission against imposing the new Exchange Act-ABS disclosure requirements on the municipal securities market until the completion of the reports on municipal securities mandated by the Dodd-Frank Act.[1460] The Commission notes that the reports required by sections 976 and 977 of the Dodd-Frank Act have been completed by the GAO and have not resulted in any legislative changes to disclosure requirements applicable to municipal issuers at this time.[1461] This commenter

[1450] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33468, n.534.

[1451] *See, e.g., Moody's Letter; S&P Letter.*

[1452] Whether the findings and conclusions of a third-party are part of the Rule 193 review and, therefore, included in the prospectus disclosure is dictated by the requirements of Rule 193 and Item 1111 of Regulation AB. *See* 17 CFR 230.193; 17 CFR 229.1111.

[1453] *See CFA/AFR Letter.*

[1454] *See* section IV.D.10. of this release (discussing the PRA burden resulting from this requirement).

[1455] The Commission notes, however, that issuers and underwriters of unregistered Exchange Act-ABS offerings who already file Form ABS–15G on EDGAR in accordance with Rule 15Ga–1 should not incur these additional costs.

[1456] *See CRE Letter.*

[1457] *See Deloitte Letter* (noting that when issuers hire third parties to conduct the Rule 193 due diligence review, the disclosures required under Rule 193 will be substantially similar to the disclosures made about the same findings and conclusions in the context of the rules adopted under section 932).

[1458] The Commission does not intend for all third parties from whom the issuer obtains a third-party due diligence report, as defined in Rule 15Ga–2, to be named in the registration statement and consent to being named as an expert solely because an issuer furnishes Form ABS–15G. If the issuer's prospectus disclosure attributes the findings and conclusions of the Rule 193 review to the third party from whom it obtains a third-party due diligence report, however, the third-party would be required to be named in the registration statement and consent to being named as an expert in accordance with Rule 436 under the Securities Act. *See Issuer Review of Assets in Offerings of Asset-Backed Securities,* 76 FR 4231.

[1459] *See* paragraph (c) of Rule 15Ga–2.

[1460] *See ICI Letter.*

[1461] *See http://www.gao.gov/assets/590/587714.pdf.* The Commission also issued a comprehensive report on the municipal securities market in July 2012. *See Commission Report on the Municipal Securities Market, available at http://www.sec.gov/news/studies/2012/munireport073112.pdf* (''2012 Report on the Municipal Securities Market'').

recommended that the Commission exempt municipal securities from the proposed disclosure requirements to avoid creating confusion for investors and issuers in case different classes of municipal securities are subject to different requirements in the future.[1462] Another commenter supported the proposal to allow municipal securitizers or underwriters of municipal Exchange Act-ABS to provide the required information on EMMA.[1463]

The Commission also has considered the comments objecting to requiring municipal issuers and underwriters to comply with Rule 15Ga–2, which were submitted in response to the October 2010 proposal.[1464] A number of these commenters expressed the view that sections 15B(d)(1) and 15B(d)(2) of the Exchange Act, known collectively as the ''Tower Amendment,'' [1465] expressly prohibit the Commission and the Municipal Securities Rulemaking Board (''MSRB'') from requiring an issuer of municipal securities to make any specific disclosure filing with the Commission or MSRB prior to the sale of these securities to investors.[1466] After considering these comments, the Commission has determined that issuers and underwriters of municipal Exchange Act-ABS should be excluded from the requirements of Rule 15Ga–2. The Commission notes that, in reaching this determination, it does not find it necessary to determine whether the Tower Amendment applies in this situation and no inference should be drawn from this determination regarding the Commission's analysis of the Tower Amendment. In light of the fact that municipal issuers and underwriters will remain subject to the statutory requirement in section 15E(s)(4)(A) of the Exchange Act to make the findings and conclusions of any third-party due diligence reports publicly available, and given the Commission's historical approach of not requiring municipal issuers to file disclosures with the Commission in connection with the issuance of securities, the Commission is persuaded that, as a policy matter, it is unnecessary to apply Rule 15Ga–2 to municipal issuers and underwriters.[1467]

Under the exclusion, the requirements of Rule 15Ga–2 will not apply to issuers and underwriters of an offering of Exchange Act-ABS if: (1) The issuer of the rated security is a municipal issuer; and (2) the offering is not required to be registered under the Securities Act. A *municipal issuer* is defined as an *issuer* (as that term is defined in paragraph (d)(2) of Rule 17g–10) that is any State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory, or the District of Columbia, or any public instrumentality of one or more States, Territories, or the District of Columbia. The exclusion further provides, as discussed below, that issuers and underwriters of municipal Exchange Act-ABS remain subject to the requirements of section 15E(s)(4)(A) of the Exchange Act.[1468]

Although the Commission is excluding issuers and underwriters of municipal Exchange Act-ABS from the application of Rule 15Ga–2, the Commission continues to believe that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to such entities. By its terms, section 15E(s)(4)(A) applies to issuers and underwriters of ''any asset-backed security,'' and the Commission believes the intended benefits of greater transparency with respect to the credit rating process apply equally to credit ratings of municipal Exchange Act-ABS.[1469] The Commission also notes that section 15E(s)(4)(A) requires issuers and underwriters to make the specified information publicly available and does not mandate filing with the Commission, which was the specific concern the Tower Amendment sought to address. Consequently, although municipal issuers and underwriters will not be required to furnish Form ABS–15G pursuant to Rule 15Ga–2, they are subject to the statutory requirement under section 15E(s)(4)(A) to make publicly available the findings and conclusions of any third-party due diligence report they obtain. Municipal issuers and underwriters may make such information available through any means reasonably accessible to the public, including, for example, by posting the information on an issuer or underwriter sponsored Internet Web site, by voluntarily furnishing Form ABS–15G on EDGAR, or by voluntarily submitting a Form ABS–15G on EMMA.

Since the Commission is excluding issuers and underwriters of municipal Exchange Act-ABS from the application of Rule 15Ga–2, it is not adopting the proposed revisions to Rule 314, which would have permitted municipal issuers of Exchange Act-ABS, or underwriters in the offering, to provide the information required by Form ABS–15G on EMMA, as proposed. Notwithstanding the foregoing, as noted above, an issuer or underwriter of municipal Exchange Act-ABS could choose to satisfy its obligation to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, as required by section 15E(s)(4)(A) of the Exchange Act, by voluntarily submitting a Form ABS–15G on EMMA.[1470]

2. New Rule 17g–10

As stated above, section 15E(s)(4)(A) of the Exchange Act requires the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[1471] Section 15E(s)(4)(B) of the Exchange Act requires that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide, to any NRSRO that produces a credit rating to which such services relate, written certification, in a format as provided in section 15E(s)(4)(C).[1472] Section 15E(s)(4)(C) of the Exchange Act provides that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B) to ensure that providers of due diligence services have conducted a thorough

[1462] *See ICI Letter.*

[1463] *See DBRS Letter.*

[1464] *Issuer Review of Assets in Offerings of Asset-Backed Securities,* 75 FR 64182.

[1465] 15 USC 78o–4. *See also* 2012 Report on the Municipal Securities Market, at 27–28.

[1466] *See, e.g.,* letter from Group of 14 Municipal Organizations dated Nov. 15, 2010, National Association of Bond Lawyers dated Nov. 19, 2010; letter from National Association of Local Housing Finance Agencies dated Nov. 15, 2010; letter from Treasurer of the State of Connecticut dated Nov. 15, 2010; letter from National Council of State Housing Agencies dated Nov. 15, 2010; and letter from Robert W. Scott dated Nov. 19, 2010 (each letter submitted in response to the October 2010 proposal).

[1467] Municipal securitizers continue to be subject to Rule 15Ga–1. As the Commission noted at the time Rule 15Ga–1 was adopted, section 943 of the Dodd-Frank Act, pursuant to which Rule 15Ga–1 was adopted, is a stand-alone statutory provision that does not expressly provide the Commission with authority to provide exemptions for particular classes of securitizers, including municipal securitizers. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4493.

[1468] *See* paragraph (f) of Rule 15Ga–2.

[1469] As discussed above, the Commission believes that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS.

[1470] The Commission adopted Rule 314 to permit municipal securitizers to satisfy the obligation to furnish the information required by Rule 15Ga–1 by filing the information on EMMA. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR 4489. Accordingly, EMMA will be prepared to accept Form ABS–15G in connection with this requirement.

[1471] *See* 15 U.S.C. 78o–7(s)(4)(A).

[1472] *See* 15 U.S.C. 78o–7(s)(4)(B).

review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating.[1473] The Commission proposed to implement these sections through Rule 17g-10 and Form ABS Due Diligence–15E.[1474] As proposed, Rule 17g-10 would require a provider of third-party due diligence services to provide the written certification required by section 15E(s)(4)(B) of Exchange Act on Form ABS Due Diligence–15E.

The Commission is adopting Rule 17g-10 with modifications from the proposal in response to comments.[1475] As discussed below, the modifications add a ''safe harbor'' for the third-party due diligence provider in order to satisfy its obligations under section 15E(s)(4)(B) of the Exchange Act, clarify the proposed definition of *due diligence services,* and make certain technical modifications.[1476]

As proposed, paragraph (a) of Rule 17g–10 provided that the written certification that a person employed to provide third-party due diligence services is required to provide to an NRSRO pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence–15E.[1477] The Commission did not receive comments on paragraph (a) as proposed and is adopting the paragraph with one technical modification.[1478] As adopted, the paragraph provides that the written certification that a person employed to provide third-party due diligence services is required to provide to an NRSRO pursuant to section 15E(s)(4)(B) must be on Form ABS Due Diligence–15E.[1479]

Paragraph (b) of Rule 17g–10, as proposed, provided that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.[1480] The proposed requirement was designed to ensure that the person executing the certification on behalf of the provider of third-party due diligence services has responsibilities that will make the person aware of the basis of the information being provided in the form.[1481] The Commission did not receive comments on paragraph (b) and is adopting the paragraph as proposed.[1482]

As discussed above, the Commission did not receive comments specifically addressing paragraphs (a) and (b) of Rule 17g–10, as proposed.[1483] However, the Commission did receive comments raising concerns about how a third-party due diligence provider can meet the requirement in section 15E(s)(4)(B) of the Exchange Act, which—as discussed above—provides that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide, to any NRSRO that produces a rating to which such services relate, written certification in a format as provided in section 15E(s)(4)(C) of the Exchange Act.[1484]

Commenters stated that the third-party due diligence provider or NRSRO may not know the identities of the NRSROs producing credit ratings to which the due diligence services relate.[1485] One of these commenters stated that the proposed requirements ''unfairly place a heavy burden on the third-party due diligence provider to determine which NRSRO is rating the transaction'' because this information ''lies with the issuer.''[1486]

The Commission anticipated this concern and, consequently, in the proposing release the Commission asked a number of questions regarding how a third-party due diligence provider could comply with section 15E(s)(4)(B) of Exchange Act and whether the Commission should take steps to implement the statutory requirement.[1487] One of the potential approaches identified by the Commission in the proposing release was to use the Web site referred to in paragraph (a)(3)(iii) of Rule 17g–5 maintained by issuers, sponsors, or underwriters of structured finance products (''Rule 17g–5 Web site''), as the mechanism for providing the written certification to all NRSROs producing a credit rating to which the due diligence services relate.[1488]

Commenters responded that the Rule 17g–5 Web site would be an appropriate mechanism to provide the certification to the NRSROs.[1489] One of these commenters stated that using the Rule 17g–5 Web site would be ''the most efficient way'' to provide the certification and that it would be a better approach than applying a ''reasonableness test'' in terms of assessing whether the third-party due diligence provider submitted the certification to all NRSROs that are required to receive the certification.[1490] Another commenter stated that the proposed requirements should ''accommodate situations'' in which an NRSRO obtains the written certification indirectly from, for example, a Rule 17g–5 Web site.[1491] An NRSRO stated that using the Rule 17g–5 Web sites as a ''delivery mechanism for the Rule 17g–10 certification'' would ensure that ''certifications are supplied to all affected NRSROs at roughly the same time.''[1492]

Another alternative suggested by the Commission was to establish a centralized database administered by the Commission (such as the Commission's EDGAR system) or by market participants to be used for the purpose of providing the written certifications in accordance with section 15E(s)(4)(B) of the Exchange Act.[1493] An NRSRO and another commenter stated that creating a new centralized database or similar alternative for distributing the

[1473] *See* 15 U.S.C. 78o–7(s)(4)(C).

[1474] *See Nationally Recognized Statistical Rating Organizations,* 76 FR 33471–33476. Form ABS Due Diligence–15E is discussed below in section II.H.3. of this release.

[1475] *See* Rule 17g–10.

[1476] *See id.*

[1477] *See* paragraph (a) of Rule 17g-10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1478] *See* paragraph (a) of Rule 17g–10. The modification corrects an incorrect reference to Form ABS Due Diligence–15E in the proposal by replacing the phrase ''(§ 240b.400 of this chapter)'' with the phrase ''(§ 249b.500 of this chapter)''.

[1479] *See* paragraph (a) of Rule 17g–10. Form ABS Due Diligence–15E is discussed below in section II.H.3. of this release.

[1480] *See* paragraph (b) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1481] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471.

[1482] *See* paragraph (b) of Rule 17g–10.

[1483] As discussed below in section II.H.3. of this release, the Commission did receive comments in response to the proposed format of the Form ABS Due Diligence–15E. Those comments and the Commission's response to the commenters are discussed in section II.H.3. of this release.

[1484] *See* 15 U.S.C. 78o–7(s)(4)(B).

[1485] *See Clayton Letter; Deloitte Letter; S&P Letter.*

[1486] *See Clayton Letter.*

[1487] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466.

[1488] *See id. See also* 17 CFR 240.17g–5(a)(3). Among other things, paragraph (a)(3) of Rule 17g–5 requires an NRSRO, among other things, to maintain on a password-protected Internet Web site a list of each structured finance product for which it currently is in the process of determining an initial credit rating, and to provide free and unlimited access to any NRSRO that, among other things, certifies it will access the Web site solely for the purpose of determining and monitoring credit ratings. Paragraph (a)(3)(iii) of Rule 17g–5 requires an NRSRO to obtain from the issuer, sponsor, or underwriter of the structured product a written representation that can reasonably be relied upon that the arranger will, among other things, maintain on a password-protected Internet Web site the information it provides to the NRSRO and will provide access to the Web site to an NRSRO that, among other things, certifies it will access the Web site solely for the purpose of determining and monitoring credit ratings.

[1489] *See ASF Letter; Clayton Letter; DBRS Letter.*

[1490] *See Clayton Letter.*

[1491] *See ASF Letter.*

[1492] *See DBRS Letter.*

[1493] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466.

due diligence certification would be costly.[1494]

Commenters suggested other alternatives.[1495] One commenter stated that the due diligence provider should be required to deliver the certification ''promptly upon receipt of a written request from an NRSRO'' for use by the NRSRO ''in preparing its published report under Rule 17g–7.'' [1496] Another commenter stated that the party engaging the due diligence provider should be required to obtain the certification from the service provider and that the service provider should ''be able to rely on the engaging party to transmit the form'' to the required NRSROs.[1497]

In the proposing release, the Commission sought comment on how soon after it completes its review the provider of third-party due diligence services should provide the written certification to all NRSROs required to receive the certification, and the Commission provided examples of potential timeframes (within twenty-four hours, two business days, or ten business days).[1498] One commenter stated that the due diligence provider should be required to deliver the certification ''promptly upon receipt of a written request from an NRSRO.'' [1499] Another commenter suggested that the certification be provided five business days after the service provider finishes reviewing the data in connection with its due diligence report.[1500] One NRSRO stated that the certification should be provided ''within two business days following completion of the due diligence review'' and added that ''all required NRSROs should be in receipt of the certification at the same time.'' [1501] Another NRSRO stated that the certification should be provided ''within one business day after the service provider completes its review.'' [1502]

The Commission is persuaded that the final rule should provide a means for providers of third-party due diligence services to be certain that they have met their obligation under section 15E(s)(4)(B) of the Exchange Act to provide Form ABS Due Diligence–15E to any NRSRO that produces a credit rating to which the due diligence services relate.[1503] The Commission also is persuaded that the most efficient means of providing certainty to the providers of third-party due diligence services that they have met their obligations under section 15E(s)(4)(B) is to require the third party to provide Form ABS Due Diligence–15E to any NRSRO that specifically requests the form and to post the form on the Rule 17g–5 Web site maintained by the issuer, sponsor, or underwriter of the Exchange Act-ABS.[1504]

This will provide access to the form to an NRSRO that is producing a credit rating for the Exchange Act-ABS but is unaware that the third party is conducting the due diligence services because, for example, the NRSRO is using the Rule 17g–5 Web site to determine an unsolicited credit rating. In addition, the third party will not be burdened with the task of trying to identify every NRSRO that is producing a credit rating to which the due diligence services relate. For these reasons, the Commission believes it is appropriate to modify Rule 17g–10 from the proposal to add a ''safe harbor'' provision that incorporates the Rule 17g–5 Web sites.

Further, as discussed above, commenters suggested relatively short timeframes for providing the written certification to the NRSROs producing a credit rating to which the due diligence services relate. The Commission agrees that the written certification should be provided soon after the provider of third-party due diligence services completes its review. As discussed below, the certification will provide information that can be used by the NRSRO in determining a credit rating for the Exchange Act-ABS. Consequently, the Commission believes the certification should be provided to the appropriate NRSROs as soon as the third party completes the review so that NRSROs can consider it in determining a credit rating for the Exchange Act-ABS before the security is issued and purchased by investors. However, prescribing a specific timeframe (such as within twenty-four hours or two days) may result in situations—depending on the circumstances—where the certification could have been provided sooner than required (for example, within minutes of it being finalized) or where practical issues would prevent it from being submitted within the required timeframe. Therefore, the Commission believes the ''safe harbor'' for the written certification should incorporate a ''promptly'' standard.

For all the foregoing reasons, the Commission is establishing a ''safe harbor'' provision in paragraph (c) of Rule 17g–10 pursuant to which a person employed to provide third-party due diligence services will be deemed to have satisfied its obligations under section 15E(s)(4)(B) of the Exchange Act if the person promptly delivers an executed Form ABS Due Diligence–15E after completion of the due diligence services to: (1) An NRSRO that provided a written request for the form prior to the completion of the due diligence services stating that the services relate to a credit rating the NRSRO is producing; (2) an NRSRO that provides a written request for the form after the completion of the due diligence services stating that the services relate to a credit rating the NRSRO is producing; and (3) the issuer or underwriter of the asset-backed security for which the due diligence services relate that maintains the Rule 17g–5 Web site with respect to the asset-backed security.[1505] Consequently, the third-party provider of due diligence services can fulfill its obligations under the statute by responding promptly to specific requests that Form ABS Due Diligence–15E be delivered to a particular NRSRO and by promptly delivering the form to the issuer or underwriter of the Exchange Act-ABS that maintains the Rule 17g–5 Web site. This establishes a process that can provide certainty to the third party that it has met its obligation under section 15E(s)(4)(B) of the Exchange Act.

The Commission is making a corresponding amendment to Rule 17g–5 that is designed to provide for the

[1494] *See Clayton Letter* (''[W]e do not believe that it is cost-effective for the Commission or the ABS community to have the industry adopt a new system for distributing the Form ABS Due Diligence–15E information nor do we believe it is cost-effective for such parties to have to utilize a for-profit centralized database service for such purposes, especially in light of the amount of time and resources that have already been directed to the development of the Rule 17g–5 system of distribution. And as we described above, the Rule 17g–5 system more fairly allocates responsibility for dissemination of the information among the issuer, underwriter and NRSRO.''); *DBRS Letter* (''Mandating the creation of a new centralized database or any other costly alternative is not warranted under the circumstances.'').

[1495] *See ASF Letter; Deliotte Letter.*

[1496] *See ASF Letter.*

[1497] *See Deloitte Letter.*

[1498] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33466.

[1499] *See ASF Letter.*

[1500] *See Clayton Letter.*

[1501] *See S&P Letter.*

[1502] *See DBRS Letter.*

[1503] *See* 15 U.S.C. 78o–7(s)(4)(B).

[1504] *See, e.g., DBRS Letter* (''DBRS believes that the most efficient and cost-effective approach is to utilize existing regulations as much as possible. As it stands today, issuers and underwriters who hire an NRSRO to rate a structured finance product such as an Exchange Act-ABS are required to make available to other NRSROs all information the issuer or underwriter 'contracts with a third party to provide to' the hired NRSRO. Thus, if the issuer or underwriter contracts with a third-party service provider to supply a hired NRSRO with a due diligence report, a copy of that report would already be made available to other NRSROs pursuant to Rule 17g–5(a)(3).'').

[1505] *See* paragraphs (c)(1) through (3) of Rule 17g–10.

prompt posting of Form ABS Due Diligence–15E to the Rule 17g–5 Web site so that other NRSROs can have access to it contemporaneously with an NRSRO that knew the third party was performing due diligence and requested that the form be delivered upon completion of the services.[1506] Specifically, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g–5 to require that an NRSRO hired to rate a structured finance product must obtain an additional representation that can reasonably be relied upon from the issuer, sponsor, or underwriter of the product: Namely, that the issuer, sponsor, or underwriter will post to the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E containing information about the security delivered by a person employed to provide third-party due diligence services with respect to the structured finance product.[1507]

Paragraph (c) of Rule 17g–10, as proposed, contained definitions of *due diligence services, issuer, originator,* and *securitizer* for purposes of section 15E(s)(4)(B) of the Exchange Act and Rule 17g–10. As proposed, paragraph (c)(1) defined the term *due diligence services.*[1508] Under the proposed definition, an entity would be deemed to have provided due diligence services if it engaged in a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any one of the five types of activities identified in proposed paragraphs (c)(1)(i) through (v) of Rule 17g–10.[1509]

Paragraph (c)(1)(i) of Rule 17g–10, as proposed, would identify the first category of *due diligence services* as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to the quality or integrity of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets.[1510] Paragraph (c)(1)(ii), as proposed, would identify the second category of *due diligence services* as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to whether the origination of the assets conformed to stated underwriting or credit extension guidelines, standards, criteria, or other requirements.[1511] Paragraph (c)(1)(iii), as proposed, would identify the third category of *due diligence services* as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to the value of collateral securing such assets.[1512] Paragraph (c)(1)(iv), as proposed, would identify the fourth category of *due diligence services* as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to whether the originator of the assets complied with federal, state, or local laws or regulations.[1513]

Paragraph (c)(1)(v) of Rule 17g–10, as proposed, would identify the fifth category of *due diligence services*—the catchall—as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any other factor or characteristic of such assets that would be material to the likelihood that the issuer of the Exchange Act-ABS will pay interest and principal according to its terms and conditions.[1514] The proposed catchall was intended to apply to due diligence services used for pools of other asset classes (for example, commercial loans, corporate loans, student loans, or credit card receivables) to the extent that providers of third-party due diligence services currently provide or in the future begin providing due diligence services with respect to other asset classes and those services, because of the different nature of the assets, do not fall into one of the other four categories.[1515]

Paragraph (c)(2), as proposed, defined the term *issuer* as including a sponsor, as defined in 17 CFR 229.1011, or depositor, as defined in 17 CFR 229.1011, that participates in the issuance of an Exchange Act-ABS.[1516] Paragraphs (c)(3) and (c)(4), as proposed, provided that the terms *originator* and *securitizer,* respectively, have the same meanings as in section 15G of the Exchange Act.[1517] Defining these two terms was intended to provide greater clarity as to the proposed meaning of *due diligence services.*[1518]

The definitions of *due diligence services, issuer, originator,* and *securitizer* in Rule 17g–10, as adopted, are contained in paragraph (d) (rather than paragraph (c), as proposed) because of the addition of the new ''safe harbor'' provision in paragraph (c) as discussed above.[1519] The definitions are being adopted substantially as proposed with modifications, in part, in response to comments.[1520]

Commenters focused on the definition of *due diligence services* because the requirement to provide the written certification under section 15E(s)(4)(B) of the Exchange Act is triggered when a third party is employed to provide these services with respect to an

[1506] *See, e.g., DBRS Letter* (''By adding a note to paragraph (a)(3)(iii)(C) [of Rule 17g–5], the Commission could confirm that where an issuer or underwriter contracts for the delivery of a due diligence report to the hired NRSRO, the posted information must include the related Rule 17g–10 certification.'').

[1507] *See* paragraph (a)(3)(iii)(E) of Rule 17g–5. The Commission also is amending paragraphs (a)(3)(i) and (a)(3)(iii)(A) of Rule 17g–5 to add references to new paragraph (a)(3)(iii)(E).

[1508] *See* paragraph (c)(1) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1509] *See* paragraphs (c)(1)(i) through (v) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33472, 33544.

[1510] *See* paragraph (c)(1)(i) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1511] *See* paragraph (c)(1)(ii) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1512] *See* paragraph (c)(1)(iii) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1513] *See* paragraph (c)(1)(iv) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1514] *See* paragraph (c)(1)(v) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1515] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33472. In the proposing release, the Commission stated that the first four prongs of the definition of due diligence services addressed reviews that persons commonly understood as due diligence providers conducted with respect to RMBS. *Id.*

[1516] *See* paragraph (c)(2) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544. As explained in the proposing release, the Commission interprets the term *issuer* to refer to the depositor of an asset-backed security. *See id.* at 33467, n.532, 33473, n.594. This treatment is consistent with the Commission's historical regulatory approach to that term, including the Securities Act and the rules promulgated under the Securities Act and the Exchange Act. *See, e.g.,* 17 CFR 230.191; 17 CFR 240.3b–19.

[1517] *See* paragraphs (c)(3) through (4) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544. Section 15G(a)(4) of the Exchange Act defines the term *originator* to mean ''a person who—(A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (B) sells an asset directly or indirectly to a securitizer.'' *See* 15 U.S.C. 78o–9(a)(4). Section 15G(a)(3) of the Exchange Act defines the term *securitizer* to mean: ''(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.'' *See* 15 U.S.C. 78o–9(a)(3).

[1518] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33473.

[1519] *See* paragraphs (d)(1) through (4) of Rule 17g–10.

[1520] *See* paragraphs (d)(1) through (4) of Rule 17g–10. In addition to the modifications discussed below, the final rule is modified from the proposal in the following ways. First, the citation to the definition of *asset-backed security* in the Exchange Act is corrected in the prefatory text of paragraph (d) and in paragraphs (d)(1) and (3). Second, the word ''such'' in third prong of the definition of *due diligence services* (paragraph (d)(1)(iii)) has been replaced with the word ''the''. Third, references in the definition of *issuer* in paragraph (d)(2) have been corrected by replacing in two places the phrase ''§ 229.1011'' with the phrase ''§ 229.1101''. These modifications are not intended to substantively change the meaning of the terms as compared to the proposed definitions.

Exchange Act-ABS.[1521] A commenter that provides due diligence services recommended modifying the first prong of the definition by replacing the phrase ''quality and integrity'' of the data with the word ''accuracy'' because that would ''more accurately reflects the role of the due diligence provider and the nature of its objective review.'' [1522] The Commission believes that this change will more accurately describe the nature of the work undertaken by a provider of third-party due diligence services, as suggested by the commenter. Consequently, the Commission is making the modification.[1523]

Commenters were concerned that the definition of *due diligence services* could be interpreted to include services that have not traditionally been viewed as third-party due diligence services. In this regard, several commenters focused on the fifth prong of the definition: The catchall.[1524] As proposed, this prong included within the definition a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any other factor or characteristic of such assets that would be material to the likelihood that the issuer of the Exchange Act-ABS will pay interest and principal according to its terms and conditions.[1525] Some commenters recommended eliminating this catchall provision.[1526] Two commenters recommended it be narrowed.[1527] One of these commenters stated that the provision should only include ''factors or characteristics that were material to determining the credit rating.'' [1528] The other commenter stated that the provision should be limited to ''factors that materially impact the likelihood that the assets themselves would pay interest and principal according to their terms and conditions.'' [1529]

The Commission is not persuaded that the catchall provision should be eliminated. As the Commission explained in the proposing release, the first four prongs of the definition were based on the Commission's understanding of the types of reviews undertaken with respect to the pools of mortgage loans underlying issuances of RMBS because due diligence services traditionally have been performed with respect to RMBS.[1530] The first four prongs also may cover due diligence services performed with respect to other types of Exchange Act-ABS. However, there also may be reviews now or in the future that are more tailored to the different nature of the assets underlying these other types of Exchange Act-ABS. The proposed catchall was designed to apply to due diligence services provided with respect to the assets (for example, commercial loans, corporate loans, student loans, or credit card receivables) underlying other types of Exchange Act-ABS to the extent not covered by the first four prongs of the definition. For these reasons, the Commission believes it is appropriate to retain the catchall prong of the definition and, therefore, is adopting it as proposed.[1531]

One commenter stated that, if the catchall provision is not eliminated, ''the final rule should limit the provision's application to other factors that materially impact the likelihood that [the underlying] assets themselves would pay interest and principal according to their terms and conditions'' so that the ''focus of the diligence services will be on the assets themselves, not the issuer's ability to pay as is set forth in the proposed definition.'' [1532] The Commission agrees that due diligence services typically focus on the assets underlying an Exchange Act-ABS. Indeed, the prefatory text of paragraph (d)(1) of Rule 17g–10 provides that the term *due diligence services* means a review of the assets *underlying* an Exchange Act-ABS for the purpose of making findings with respect to certain matters.[1533] Moreover, the catchall provision includes within the definition of *due diligence services* a review of any other factor or characteristic of the assets underlying an Exchange Act-ABS that would be material to the likelihood that the issuer will pay interest and principal in accordance with applicable terms and conditions.[1534] Consequently, in response to the commenter, the Commission confirms that a review must be of the assets underlying the Exchange Act-ABS in order to fall within the definition of *due diligence services.* However, the performance of the underlying assets (for example, their ability to pay principal and interest) ultimately will impact whether the Exchange Act-ABS itself will be able to pay interest and principal because the payments received on the underlying assets are passed through to the holders of the Exchange Act-ABS. Moreover, a review of the underlying assets that is relevant to whether the Exchange Act-ABS will pay interest and principal according to its terms is the type of information that would be useful to an NRSRO that is assessing the creditworthiness of Exchange Act-ABS. The catchall provision is designed to account for such reviews to the extent they are not addressed in the other prongs of the definition of *due diligence services.*[1535]

While the catchall provision is not being eliminated, the definition of *due diligence services* in Rule 17g–10 (including the catchall prong) is not intended to bring within the definition's scope activities that are performed today in connection with the issuance of an Exchange Act-ABS that are not commonly understood as being third-party due diligence services. Rather, it is designed to cover reviews of the assets underlying an Exchange Act-ABS that are commonly understood in the securitization market to be third-party due diligences services.[1536] For

[1521] *See* 15 U.S.C. 78o–7(s)(4)(B).

[1522] *See Clayton Letter.*

[1523] *See* paragraph (d)(1)(i) of Rule 17g–10. The commenter also recommended this modification be made to Item 4 of Form ABS Due Diligence–15E, which used similar text to describe due diligence services. *See Clayton Letter.* As discussed below in section II.H.3. of this release, the Commission is making a corresponding modification to Item 4.

[1524] *See CRE Letter; Deloitte Letter; Morningstar Letter; S&P Letter.*

[1525] *See* paragraph (c)(1)(v) of Rule 17g–10, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33544.

[1526] *See CRE Letter; Deloitte Letter; Morningstar Letter; S&P Letter.*

[1527] *See Morningstar Letter; Deloitte Letter.*

[1528] *See Morningstar Letter.*

[1529] *See Deloitte Letter.*

[1530] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33472.

[1531] *See* paragraph (d)(1)(v) of Rule 17g–10.

[1532] *See Deloitte Letter.*

[1533] *See* prefatory text of paragraph (d)(1) of Rule 17g–10.

[1534] *See* paragraph (d)(1)(v) of Rule 17g–10.

[1535] *See id.* One commenter suggested that the Commission clarify that the catchall definition of due diligence services includes only the review of the assets in connection with the issuance of the asset-backed securities as specifically requested by the issuer, underwriter, or NRSRO. *See Clayton Letter.* In response, the Commission notes that the certification under Rule 17g–10 must be provided by the person who is employed to provide third-party due diligence services. Accordingly, the catchall definition is not intended to cover reviews that the third-party provider itself was not employed to perform by the issuer, underwriter, or NRSRO.

[1536] Generally, third-party due diligence services have been performed with respect to RMBS. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471. Generally, in the RMBS context, the provider of third-party due diligence services is hired by the entity (for example, the underwriter, sponsor, or depositor) purchasing the pool of mortgage loans for the purpose of securitizing them. In conducting a review, the provider of third-party due diligence services analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) To assess the quality of the loan-by-loan data in the electronic file (''loan-tape'') that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file; (2) to determine whether each loan in the sample adheres to the underwriting guidelines of the loan originator; (3) to assess the validity of the appraised value of the property indicated on the loan tape that collateralizes each loan in the sample; and (4) to determine whether the originator complied with

example, it is not intended to cover every type of service that involves the performance of diligence in the offering process. The catchall provision is designed to incorporate within the definition reviews that are commonly understood in the securitization market to be third-party due diligences services or analogous services that may develop in the future but are not expressly covered by the first four prongs of the definition.

Several commenters argued that agreed-upon procedures engagements performed by accounting firms should not be considered third-party due diligence services as contemplated by section 15E(s)(4) of the Exchange Act.[1537] Some of these commenters suggested that the proposed definition should apply only to reports that were prepared specifically with the intent to provide those reports to an NRSRO or otherwise in connection with obtaining a credit rating.[1538] Two of these commenters stated that accountants would be unlikely to perform any services that could fall within the proposed definition.[1539] In support of the position to exclude agreed-upon procedures engagements from the definition of due diligence services, commenters noted that these engagements generally include one or more of the following: (1) Comparing the loan tape to the loan file; (2) recalculating projected future cash flows due to investors; and (3) performing procedures that address other information included in the offering document. Commenters argued that these procedures are performed primarily to assist issuers or underwriters in verifying the accuracy of disclosures in registration statements and prospectuses.

The Commission agrees that the second and third examples performed as part of an agreed-upon procedure engagement and for the purpose referenced are not commonly understood as being due diligence services and should not trigger the requirements of section 15E(s)(4) of the Exchange Act. However, comparing the information on a loan tape with the information contained on the hard-copy documents in a loan file is an activity that falls within the definition of *due diligence services* in Rule 17g–10 because the work undertaken involves reviewing of the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets.[1540] Consequently, the Commission is not persuaded that it would be appropriate to exclude this type of review solely because it is being performed in the context of an agreed-upon procedures engagement. As a result, comparing information on a loan tape with information contained on the hard-copy documents in a loan file, even if performed under an agreed-upon procedure engagement, is a third-party due diligence service under Rule 17g–10.[1541]

The Commission understands there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession.[1542] The requirements and limitations resulting from relevant professional standards generally are described within the reports issued and, to the extent such requirements or limitations are based upon professional standards, the Commission would not object to the inclusion of the same description in the written certifications on Form ABS Due Diligence–15E required under Rule 17g–10.

Commenters suggested that Form ABS Due Diligence–15E should be required to be provided to NRSROs only at the time the Exchange Act-ABS is initially issued or rated.[1543] One of these commenters stated that the due diligence provider's obligations should ''come to an end'' after providing the certification and suggested that for later rating actions, the NRSRO should be permitted to ''disclose that it is relying on'' an earlier report.[1544] Another of these commenters stated that the proposed requirements should be limited to services provided ''prior to the issuance of the ABS'' and suggested that the certification be prepared on a ''one-time basis per report.'' [1545] A third commenter stated that the certification should not ''sunset'' and instead should be provided ''for the life of the transaction/rated security.'' [1546]

The Commission recognizes that third-party due diligence services commonly are performed prior to the issuance of an Exchange Act-ABS. Consequently, the Commission expects most of the forms will be executed and provided at this time. However, if an NRSRO, issuer, or underwriter employs a person to provide third-party due diligence services after the issuance, the Commission believes that NRSROs monitoring the credit rating will benefit from obtaining a Form ABS Due Diligence–15E relating to the due diligence services, as will investors in the Exchange Act-ABS. Consequently, the Commission is not persuaded that it would be appropriate to exempt post-issuance performance of due diligence services from the requirements of section 15E(s)(4) of the Exchange Act.

One commenter recommended that the obligations of the third-party due diligence provider should come to an end after the person provides the certification.[1547] As discussed above, the Commission has added a ''safe harbor'' to Rule 17g–10 under which a provider of third-party due diligence services can meet its obligations under section 15E(s)(4)(B) of the Exchange Act.[1548] In short, in order to be deemed to have satisfied those obligations, the provider must promptly deliver an executed Form ABS Due Diligence–15E after completion of the due diligence services to each NRSRO that previously requested or that requests the form and deliver the form to the issuer or underwriter that maintains the Rule 17g–5 Web site with respect to the Exchange Act-ABS. At this point, the third party will have met its obligation under section 15E(s)(4)(B) and Rule 17g–10. However, if the third party is employed by an NRSRO, issuer, or underwriter to perform subsequent due diligence services with respect to the Exchange Act-ABS, it will incur new obligations under section 15E(s)(4)(B) and Rule 17g–10.

Commenters also sought clarification of the application of Rule 17g–10, as proposed, to transactions or entities located outside the United States.[1549] After considering comments, as discussed above in section II.G.1. of this release, the Commission has added an

federal, state, and local laws in making each loan in the sample. *Id.*

[1537] *See ABA Letter; AICPA Letter; ASF Letter; CRE Letter; Deloitte Letter; Ernst & Young Letter; FSR Letter; KPMG Letter; PWC Letter.*

[1538] *See ABA Letter; AICPA Letter; Ernst & Young Letter.*

[1539] *See AICPA Letter; Ernst & Young Letter.*

[1540] *See* paragraph (d)(1)(i) of Rule 17g–10. *See also Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471 (''In conducting a review, the provider of third-party due diligence services analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) To assess the quality of the loan-by-loan data in the electronic file ('loan-tape') that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file. . .'').

[1541] *See* paragraph (d)(1)(i) of Rule 17g–10.

[1542] *See, e.g.,* Public Company Accounting Oversight Board, Interim Attestation Standard, AT Section 201, at ¶¶ .06 and .31.

[1543] *See Clayton Letter; DBRS Letter; Deloitte Letter; S&P Letter.*

[1544] *See Deloitte Letter.*

[1545] *See Clayton Letter.*

[1546] *See S&P Letter.*

[1547] *See Deloitte Letter.*

[1548] *See* paragraph (c) of Rule 17g–10.

[1549] *See ABA Letter; DBRS Letter.*

exemption in paragraph (a)(3) of Rule 17g–7. The provision exempts an NRSRO from the disclosure requirements upon taking a rating action, including the requirement that the NRSRO publish any Form ABS Due Diligence–15E it receives or obtains from a Rule 17g–5 Web site, if the rating action involves a rated obligor or issuer of the rated security that is not a U.S. person and if the NRSRO has a reasonable basis to conclude that transactions in the securities issued by the obligor or the issuer will be effected only outside the United States.[1550] Further, the Commission has issued a temporary order exempting NRSROs from the Rule 17g–5 Web site requirements if similar conditions are met.[1551] Consequently, if a person is employed by an NRSRO, issuer, or underwriter to perform third-party due diligence services with respect to an Exchange Act-ABS that is exempt from the Rule 17g–5 Web site provisions the person will not need to deliver an executed Form ABS Due Diligence–15E to the issuer or underwriter of the Exchange Act-ABS to meet the ''safe harbor'' requirement in paragraph (c)(3) of Rule 17g–10, as adopted.[1552] Instead, the person only will need to promptly deliver an executed Form ABS Due Diligence–15E to any NRSRO that requests it under paragraphs (c)(1) or (c)(2).[1553]

3. New Form ABS Due Diligence–15E

Section 15E(s)(4)(C) of the Exchange Act provides that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating.[1554] The Commission proposed Form ABS Due Diligence–15E to implement section 15E(s)(4)(C).[1555] As proposed, the form contained five items and a signature line with a corresponding representation.[1556]

In the proposing release, the Commission sought comment on matters such as should proposed Form ABS Due Diligence–15E be more prescriptive in terms of the steps a provider of third-party due diligence services would need to take in performing the review.[1557] Commenters stated that the proposed Form ABS Due Diligence–15E should not prescribe more requirements regarding the due diligence review.[1558] Two NRSROs added that more prescriptive standards may violate section 15E(c)(2) of the Exchange Act,[1559] which prohibits the Commission from regulating the substance of credit ratings. Another NRSRO stated that the proposed form should ''follow a more general approach'' rather than prescribe minimum requirements for the third-party due diligence reviews.[1560]

The Commission believes for now that the steps to be taken by a third party-due diligence provider in reviewing the assets underlying an Exchange Act-ABS should be decided upon by the party engaging the provider (most commonly the underwriter, sponsor, or depositor). As a provider of third-party due diligence services noted in its comment letter, ''[t]raditionally, our services have been used by loan purchasers to make better decisions about how they price portfolios and manage risk'' and ''[p]rospectively, we anticipate playing a valuable role by independently validating the information used by market participants to make decisions relating to loans being included in securitization transactions.''[1561] The Commission believes that the parties engaging the services of third-party due diligence providers should have the flexibility to prescribe the steps they believe are necessary to help them evaluate the assets underlying an Exchange Act-ABS. Consequently, the form requires a provider of third-party due diligence services to disclose information about its review of the assets underlying an Exchange Act-ABS but does not prescribe how the review must be conducted. For these reasons, the Commission, as discussed below, is adopting Form ABS Due Diligence–15E substantially as proposed, with modifications to the disclosure requirements in Items 3 and 4, a modification to the representation requirement in the certification, and certain technical modifications.[1562] The modifications do not substantively alter the form from the proposal.

As proposed, Item 1 of the form elicited the identity and address of the provider of third-party due diligence services.[1563] The Commission is adopting Item 1 as proposed.[1564] This Item elicits the identity and address of the provider of third-party due diligence services.

As proposed, Item 2 of the form elicited the identity and address of the issuer, underwriter, or NRSRO that employed the provider of third-party due diligence services.[1565] Those disclosures were intended to notify users of the certification of which third party conducted the review described in the certification and which person employed the third party to conduct the review, respectively.[1566]

The Commission is adopting Item 2 with a technical, non-substantive modification from the proposal.[1567] Commenters asked whether the form must be addressed to a specific NRSRO.[1568] It does not. The form is a general certification. However, as discussed above in section II.H.2. of this release, the provider of third-party due diligence services must deliver the form promptly, to each NRSRO that requests it as well as to the issuer or underwriter that maintains the Rule 17g–5 Web site with respect to the Exchange Act-ABS that is the subject of the due diligence services, to be deemed to have met its obligation under section 15E(s)(4)(B) of the Exchange Act.

As proposed, Item 3 of the form provided that if the manner and scope of the due diligence provided by the third party satisfied the criteria for due diligence published by an NRSRO, the third party must identify the NRSRO and the title and date of the published criteria in a table provided on the form.[1569] The proposed table and instructions would permit the

[1550] *See* paragraph (a)(3) of rule 17g–7.

[1551] *See Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g–5 Under the Securities Exchange Act of 1934 and Request for Comment,* Exchange Act Release No. 68286 (Nov. 26, 2012).

[1552] *See* paragraph (c)(3) of Rule 17g–10.

[1553] *See* paragraphs (c)(1) and (2) of Rule 17g–10.

[1554] *See* 15 U.S.C. 78o–7(s)(4)(C).

[1555] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33474–33476, 33562–33563; Form ABS Due Diligence–15E, as proposed.

[1556] *See* Form ABS Due Diligence–15E, as proposed.

[1557] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476.

[1558] *See ASF Letter; Clayton Letter; CRE Letter; DBRS Letter; Morningstar Letter.*

[1559] *See DBRS Letter; Morningstar Letter.*

[1560] *See S&P Letter.*

[1561] *See Clayton Letter.*

[1562] *See* Form ABS Due Diligence–15E.

[1563] *See* Item 1 of Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33562.

[1564] *See* Item 1 of Form ABS Due Diligence–15E.

[1565] *See* Item 2 of Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33562.

[1566] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33474.

[1567] *See* Item 2 of Form ABS Due Diligence–15E. The modification adds the phrase ''the third-party'' before the phrase ''due diligence services.'' As modified, Item 2 is consistent with Item 1, as proposed and adopted (which uses the phrase ''third-party due diligence services''). This modification is not substantive.

[1568] *See ASF Letter; Clayton Letter.*

[1569] *See* Item 3 of Form ABS Due Diligence 15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33562.

identification of more than one NRSRO, which would allow the third party to reflect in a single form that it conducted due diligence services in a manner that satisfied the due diligence requirements of multiple NRSROs.[1570] The Commission is adopting Item 3 with one modification to clarify the instruction for the Item in response to comments.[1571]

Specifically, commenters raised concerns about what it would mean for the third party to certify that it had satisfied the criteria for due diligence published by an NRSRO.[1572] For example, one NRSRO stated that due diligence providers are ''not in a position'' to opine on ''whether the NRSRO's criteria have been satisfied.'' [1573] Another commenter stated that it should be ''up to the NRSRO to determine'' whether the criteria were satisfied.[1574] A third commenter stated that the disclosure should only be required where the due diligence provider is expressly engaged to ''comply with a particular set of NRSRO-published criteria.'' [1575] A fourth commenter—an NRSRO—stated that the disclosure requirement should be limited to criteria published by the NRSRO involved in the engagement.[1576] Another NRSRO stated that it would ''continue to make its own assessment of whether its criteria are satisfied.'' [1577]

In response to the comments, the Commission notes that certain NRSROs, as part of the rating criteria for RMBS, have specified the steps a person engaged to perform third-party due diligence services must take in performing the services in order for them to rate the RMBS.[1578] For example, in the RMBS context, the provider of third-party due diligence services typically is hired by the entity (for example, the underwriter, sponsor, or depositor) purchasing the pool of mortgage loans for the purpose of securitizing them. In conducting a review, the provider of third-party due diligence services typically analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) To assess the quality of the loan-by-loan data in the electronic file (''loan-tape'') that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file; (2) to determine whether each loan in the sample adheres to the underwriting guidelines of the loan originator; (3) to assess the validity of the appraised value of the property indicated on the loan tape that collateralizes each loan in the sample; and (4) to determine whether the originator complied with federal, state, and local laws in making each loan in the sample.[1579] The NRSROs most active in rating RMBS have incorporated requirements for the engagement of providers of third-party due diligence services by the entities requesting such ratings (for example, the underwriter or sponsor of the RMBS) into their procedures and methodologies for determining RMBS credit ratings.[1580] These engagement requirements prescribe the minimum scope and manner of the review of the assets underlying an RMBS that the provider of third-party due diligence services must conduct in order for the NRSRO to determine a credit rating for the RMBS, including the minimum sample size of the loans to be selected from the pool.[1581]

Item 3 was designed to require the third party to record in the form that the third party had endeavored to perform its due diligence in accordance with the due diligence criteria an NRSRO had published. Further, by executing the form, the third party would certify that it had performed the due diligence in accordance with the NRSRO's criteria.[1582]

The Commission acknowledges that certifying to having followed a given NRSRO's due diligence criteria does not establish that the third party in fact followed the criteria. However, the objective of sections 15E(4)(B) and (C) of the Exchange Act is to require third-party due diligence providers to provide a certification to NRSROs to ''ensure'' that the providers ''have conducted a thorough review of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.'' [1583] In the Commission's view, if an NRSRO has published criteria for performing due diligence reviews and the third party has sought to follow the criteria, the form should provide a means for the third party to certify that it sought to follow the criteria. For these reasons, the Commission is adopting Item 3 to the form substantially as proposed. However, in response to the comments, the Commission has modified the instruction for Item 3 so that it contains the words ''if the due diligence provided by the third party is *intended* to satisfy'' the criteria of an NRSRO.[1584]

[1570] *See* Item 3 of Form ABS Due Diligence 15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33562.

[1571] *See* Item 3 of Form ABS Due Diligence–15E.

[1572] *See Clayton Letter; DBRS Letter; Deloitte Letter; Moody's Letter; S&P Letter.*

[1573] *See Moody's Letter.*

[1574] *See Clayton Letter.*

[1575] *See Deloitte Letter.*

[1576] *See DBRS Letter.*

[1577] *See S&P Letter.*

[1578] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471, 33474–33475.

[1579] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471.

[1580] *See, e.g.,* Fitch, *U.S. RMBS Originator Review and Third-Party Due Diligence Criteria* (April 26, 2013) (''Fitch expects third-party loan-level reviews to be performed on all residential mortgage pools where the agency has been asked to assign ratings. The reviews should be conducted by independent due diligence companies prior to the transaction closing.''); Moody's, *Moody's Criteria for Evaluating Independent Third-Party Loan Level Reviews for U.S. Residential Mortgage Backed Securities (RMBS)* (Sept. 22, 2009) (''Moody's will not rate a U.S. RMBS transaction unless there has been a [third-party loan level review, ('TPR')] that at least meets our minimum sample size. If the minimum sample size is met, but the sample size is still less than Moody's target sample size or if the TPR findings are poor, Moody's may decide i) that more credit protection is needed to achieve a given rating level, ii) to assign a lower rating or iii) to decline to rate the transaction . . . Moody's will not rate a transaction unless it has received a report from the TPR firm as to the TPR scope, procedure and findings. The report must include a narrative summary of the review and an initial TPR findings report before input from the TPR sponsor.''); S&P, *Incorporating Third-Party Due Diligence Results into the U.S. RMBS Rating Process* (Mar. 14, 2012) (''Standard & Poor's believes that using third-party due diligence results in its rating analysis will increase transparency and strengthen the rating process. Our criteria for due diligence reviews are intended to increase our insight into the quality and validity of the information used to originate the mortgage loans pooled into securities.'').

[1581] For example, Fitch requires, at a minimum, a randomly selected minimum sample size to be the greater of 200 loans or 10% of the pool. *See* Fitch, *U.S. RMBS Originator Review and Third-Party Due Diligence Criteria.* Moody's defines its minimum sample size through statistical techniques. Specifically, Moody's requires that the sample size must not be less than that computed using a 95% confidence level, a 5% precision level, and an assumed error rate equal to the higher of the historic error rate for the originator or a Minimum Assumed Error Rate. *See* Moody's, *Moody's Criteria for Evaluating Independent Third-Party Loan Level Reviews for U.S. Residential Mortgage Backed Securities (RMBS).* S&P requires a sample that is the greater of either the number of loans needed for a statistically valid sample, or a 10% random sample for subprime and 5% sample for prime. At a minimum, S&P states that the number of loans in the sample should be 200 for subprime, and 100 for prime. S&P defines a statistically valid sample as the number of loans based on a 5% one-tailed level of significance with a 2% level of precision. S&P expects that the number of loans in the sample also will be a function of an estimate of an error rate. *See* S&P, *Incorporating Third-Party Due Diligence Results into the U.S. RMBS Rating Process.*

[1582] *See* 15 U.S.C. 78o–7(s)(4)(C) (providing that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating).

[1583] *See* 15 U.S.C. 78o–7(s)(4)(B) and (C).

[1584] *See* Item 3 to Form ABS Due Diligence–15E. As proposed, the instruction read, in pertinent part, ''[i]f the manner and scope of the due diligence provided by the third party *satisfied''* the criteria of

Continued

As proposed, Item 4 of the form required the provider of the third-party due diligence services to describe the scope and manner of the due diligence services provided in connection with the review of assets in sufficient detail to provide an understanding of the steps taken in performing the review, including: (1) The type of assets that were reviewed; (2) the sample size of the assets reviewed; (3) how the sample size was determined and, if applicable, computed; (4) whether the quality or integrity of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; (5) whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines; (6) whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted; (7) whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and (8) any other type of review conducted with respect to the assets.[1585] The proposed disclosure was intended to allow the NRSRO and users of credit ratings to determine whether the provider of third-party due diligence services, based on its description, appeared to satisfy published criteria of the NRSRO if such a claim was made in Item 3.[1586] Alternatively, if no criteria had been published for the type of Exchange Act-ABS or no claim to satisfying criteria was made in Item 3, the proposed disclosure was intended to provide an understanding of the due diligence performed.[1587] The instructions for Items 4, as proposed, required the summary to be provided in an attachment to the Form, which would be considered part of the form.[1588]

The Commission is adopting Item 4 of Form ABS Due Diligence–15E with modifications, in part, in response to comments.[1589] Consistent with the modification to Item 3 discussed above, the Commission is modifying the last sentence of the instructions for the Item to replace the phrase ''satisfied the criteria for minimum due diligence'' with the phrase ''is intended to satisfy the criteria for due diligence.'' [1590] As adopted, Item 4 requires the third party to provide a description of the scope and manner of the due diligence services provided in connection with the review of assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review and to include in the description:

- The type of assets that were reviewed;
- The sample size of the assets reviewed;
- How the sample size was determined and, if applicable, computed;
- Whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; [1591]
- Whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements was reviewed and, if so, how the review was conducted; [1592]
- Whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted;
- Whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and
- Any other type of review that was part of the due diligence services conducted by the person executing the Form.[1593]

One commenter stated that the instruction that the description must be ''sufficiently detailed'' to provide an understanding of the steps taken in performing the review should be replaced with a standard that is not subjective.[1594] The Commission is not persuaded that this is necessary. First, this instruction is consistent with the instructions for Exhibit 2 to Form NRSRO, which has been in use since 2007.[1595] Second, by identifying the matters that must be included in the description, the instruction provides objective guidance on the topics that the description must address. Another commenter suggested that examples of each of the categories of information would be helpful.[1596] The discussion above provides some examples of the matters that providers of third-party due diligence services review in the context of RMBS issuances. As discussed above, Form ABS Due Diligence–15E is designed to account for due diligence services provided with respect to other types of Exchange Act-ABS (in addition to RMBS). Consequently, providing specific examples could create confusion if new types of reviews tailored to non-RMBS Exchange Act-ABS develop in the future. The description of the types of reviews in Item 4 provides detail on the matters that must be addressed in the form in a way that is designed to provide

an NRSRO. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33562 (emphasis added).

[1585] *See* Item 4 of Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33563. The proposed instructions would require the third party to provide this description regardless of whether the third party represented in Item 3 of the form that its review satisfied published criteria of an NRSRO. In other words, the third party would not be able to simply rely on a cross-reference to the NRSRO's published criteria to explain the work completed in performing the due diligence.

[1586] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33475.

[1587] *See id.*

[1588] *See id.* at 33563.

[1589] *See* Item 4 to Form ABS Due Diligence–15E.

[1590] The Commission also removed the word ''minimum'' before the phrase ''due diligence'' in the last sentence because it was unnecessary.

[1591] As discussed above in section II.H.2. of this release, a commenter that provides due diligence services recommended modifying this description of due diligence services by replacing the phrase ''quality and integrity'' of the data with the word ''accuracy.'' *See Clayton Letter.* The Commission believes that this change will more accurately describe the nature of the work undertaken by a provider of third-party due diligence services, as suggested by the commenter, and, therefore, has revised the instruction accordingly.

[1592] As proposed, the phrase in the instruction stated ''whether the origination of the assets conformed to stated underwriting or credit extension guidelines, standards, criteria or other requirements was reviewed and, if so, how the review was conducted.'' *See* Item 4 of Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33472. The final instruction was modified to replace the phrase ''origination of the assets conformed'' with the phrase ''conformity of the origination of the assets.'' *See* Item 4 to Form ABS Due Diligence–15E. This modification is intended to provide a clearer description of the category without substantively changing it.

[1593] One commenter stated that the due diligence provider should only be required to describe ''those of the eight steps that relate to the services it actually performed'' and suggested that the requirement to describe ''any other type of review conducted with respect to the assets'' be omitted. *See Deloitte Letter.* The instruction requires the third-party due diligence provider to describe only the reviews that the provider conducted (that is, not reviews conducted by other service providers). The instruction has been modified to clarify this point. Specifically, it now states ''any other type of review that was part of the due diligence services conducted by the *person executing this Form''* (emphasis added).

[1594] *See Clayton Letter.*

[1595] *See* instructions for Exhibit 2 to Form NRSRO (instructing, in pertinent part, that an applicant for registration as an NRSRO or NRSRO submitting the form must provide in the Exhibit a general description of the procedures and methodologies used by the applicant or NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the applicant or NRSRO is seeking registration or is registered and that the description must be *sufficiently detailed* to provide users of credit ratings with an understanding of the processes employed by the applicant or NRSRO in determining credit ratings, including, as applicable, descriptions of a number of matters enumerated in the instructions) (emphasis added).

[1596] *See Deloitte Letter.*

guidance without narrowing the matters to the RMBS context.[1597]

As proposed, Item 5 of the form would require the provider of third-party due diligence services to provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2 (that is, conveyed to the issuer, underwriter, or NRSRO that employed the third party to perform due diligence services).[1598] As with Item 4, the instructions for Items 5, as proposed, required the summary to be provided in an attachment to the form, which would be considered part of the Form.[1599]

The Commission is adopting Item 5 of Form ABS Due Diligence–15E with a technical non-substantive modification in response to comment.[1600] The Item provides that the person providing due diligence services must provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person that employed the third party to perform the services. One commenter stated that the instruction regarding the summary be ''sufficiently detailed to provide an understanding of the findings and conclusions'' should be eliminated.[1601] The Commission is adopting the ''sufficiently detailed'' standard in this Item as it is doing with respect to Item 4.[1602] As stated above, the standard is consistent with the instructions for Exhibit 2 to Form NRSRO.

Finally, as proposed, the individual executing the form on behalf of a provider of third-party due diligence services would need to make two representations: (1) That he or she has executed the form on behalf of, and on the authority of, the third party; and (2) that the third party conducted a thorough review in performing the due diligence described in Item 4 and that the information and statements contained in the form, including Items 4 and 5 attached to the form, are accurate in all significant respects.[1603] The proposed representation was intended to implement section 15E(s)(4)(C) of the Exchange Act, which provides that the Commission shall establish the appropriate format and content of the written certifications ''to ensure that providers of due diligence services have conducted a *thorough review* of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.'' [1604]

The Commission is adopting the certification in Form ABS Due Diligence–15E with one modification. Commenters stated that the certification should indicate that it is as of the date signed.[1605] The Commission agrees. As adopted, the certification contains the representation that the third-party due diligence provider conducted a thorough review in performing the due diligence described in Item 4 of the form and that the information and statements contained in the form, including Items 4 and 5 attached to the form, are accurate in all significant respects *on and as of the date hereof*.[1606]

One commenter stated that ''professional standards as well as liability concerns would prevent an accountant from stating that he or she has performed a 'thorough review' of information because that term is undefined.'' [1607] Another commenter stated that the words ''thorough review'' should be replaced with ''due care.'' [1608] This commenter stated that, ''[b]y their very nature, due diligence procedures often relate to a sample, rather than the entire population of assets, and in this sense the review may not be 'thorough' as to the scope of assets reviewed and ''the procedures themselves are limited in that choices were made to perform certain procedures and not others.'' [1609] This commenter also suggested that the phrase ''accurate in all significant respects'' be omitted from the certification.[1610] Two commenters stated that the phrase ''accurate in all significant respects'' should be changed to a ''materiality'' standard.[1611] One of these commenters also suggested that the certification should be ''based on objective standards that can be verified by the signer'' and should state that the due diligence provider did not conduct any reviews in addition to those expressly requested.[1612]

In response to these comments, the Commission notes that, as stated in the proposing release, including ''thorough review'' in the certification was designed to implement section 15E(s)(4)(C) of the Exchange Act, which provides that the Commission shall establish the appropriate format and content of the written certifications ''to ensure that providers of due diligence services have conducted a *thorough review* of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.'' [1613] Further, this language will provide some assurance to persons using the certification to evaluate the underlying assets (including NRSROs determining credit ratings for the Exchange Act-ABS) that the third-party due diligence provider undertook the review described in Item 4 in a thorough manner. Also, it should create an incentive for a provider of third-party due diligence services to perform these reviews in a competent manner because the third party must certify that the work was thorough.[1614] In response to comment, the Commission notes that the provider of third-party due diligence services must certify that it ''conducted a thorough review in performing the due diligence described in Item 4 attached to [the] Form.'' [1615] Consequently, the third party need only certify that a ''thorough review'' was conducted with respect to

[1597] The descriptions in Item 4 correspond to the prongs of the definition of *due diligence services* in Rule 17g–10. A provider of third-party due diligence services noted in its comment letter that the definition of *due diligence services* in Rule 17g–10 (subject to certain modification suggested by the commenter) ''captures the scope of due diligence services provided to issuers or underwriters by third-party due diligence providers in connection with the rating of an issuance of ABS . . .'' *See Clayton Letter.* As discussed above and in section II.H.2. of this release, this commenter suggested, among other things, that the phrase ''quality and integrity'' of the data as used in the definition of *due diligence services* and in Item 4 should be replaced with the word ''accuracy.'' *Id.*

[1598] *See* Item 5 of Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33563.

[1599] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33563.

[1600] *See* Item 5 of Form ABS Due Diligence–15E. One commenter suggested that the word ''description'' in the second sentence of the instruction be replaced with the word ''summary.'' *See Clayton Letter.* The Commission agrees with this suggestion because Item 5 is titled ''Summary of findings and conclusions of review'' and the first sentence of the instruction provides that the person executing the certification should provide a ''summary'' of the findings and conclusions.

[1601] *See Clayton Letter.*

[1602] *See* Item 5 of Form ABS Due Diligence–15E.

[1603] *See* ''Certification'' on Form ABS Due Diligence–15E, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33563.

[1604] *See* 15 U.S.C. 78o–7(s)(4)(C) (emphasis added); *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476.

[1605] *See Deloitte Letter; S&P Letter.*

[1606] *See* ''Certification'' on Form ABS Due Diligence–15E (emphasis added to highlight the modification).

[1607] *See AICPA Letter.*

[1608] *See Deloitte Letter.*

[1609] *Id.*

[1610] *Id.*

[1611] *See Clayton Letter; DBRS Letter.*

[1612] *See Clayton Letter.*

[1613] *See* 15 U.S.C. 78o–7(s)(4)(C) (emphasis added).

[1614] As discussed above in section II.H.2. of this release, the Commission understands that in making the certification there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession.

[1615] *See* ''Certification'' on Form ABS Due Diligence–15E.

the work actually performed as specified in Item 4 of the form (for example, reviewing a sample of the assets). This limits the scope of the certification to the matters reflected in Item 4. Consequently, in response to the comment that the third-party due diligence provider should state that it did not conduct any reviews in addition to those expressly requested, Item 4 will reflect the nature and scope of the review work performed, which will be determined by the engagement.

Further, in response to comments, the Commission notes that the part of the certification as to the accuracy of the information contained in the report is modeled on the certification NRSROs must make on Form NRSRO.[1616] This has proven to be a workable attestation standard as to the accuracy of information disclosed in a form since it was implemented in 2007. It also provides an incentive for the person executing the form to take steps to verify that the information contained in the form is accurate. In response to comments that the standard should be changed to a materiality standard, the Commission notes that the ''accurate in all significant respects'' is a standard that is intended to incorporate materiality. For all of these reasons, the Commission is adopting the certification substantially as proposed.

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments and new rules related to disclosing information about third-party due diligence services.[1617] In particular, this section addresses the potential economic effects of Rule 15Ga–2 and Rule 17g–10 and the related amendments, including effects related to amended Form ABS–15G and new Form ABS Due Diligence–15E, as well as effects of the amendments to Rule 17g–7 requiring that NRSROs publish any written certifications received from third-party due diligence providers when taking certain rating actions.[1618] The baseline that existed before today's amendments and new rules was one in which, under Rule 193, the issuer of any registered Exchange Act-ABS offering was required to perform due diligence with respect to the assets underlying the security.[1619] The issuer could conduct the review directly or engage one or more third-party vendors to perform the review. Under Item 1111(a)(7) of Regulation AB, the nature as well as the findings and conclusions of the review performed under Rule 193 was required to be disclosed in the prospectus.[1620] These requirements applied whether or not the registered Exchange Act-ABS would be rated by an NRSRO. Commission rules did not require that issuers review assets or disclose to investors the nature, findings, and conclusions of any reviews in the case of unregistered Exchange Act-ABS offerings, whether or not rated by an NRSRO.

Even in the case of registered offerings, information about the nature, findings, and conclusions of all the third-party due diligence that was undertaken might not have been disclosed under the existing rules. Rule 193 requires a review that provides reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects. The rule requires that issuers disclose the nature of their review but does not require issuers to disclose the specifics of each report where they have engaged third parties to perform multiple reviews and/or produce multiple reports, including interim reports, and does not require that the issuer disclose the identity of the third party or third parties engaged to perform a review. Any third party to which the findings and conclusions of the review disclosed in the prospectus are attributed must be named as an expert in the prospectus, though the issuer is permitted to attribute the findings and conclusions of the review to itself.

In the baseline, the issuer or underwriter of a rated Exchange Act-ABS, whether registered or unregistered, typically provided some information about third-party due diligence reports to any NRSROs they hired to rate the security. Further, some NRSROs, for certain asset classes of Exchange Act-ABS, have adopted minimum standards for due diligence that are required to be met in order for a security to be rated. For example, as discussed above, some NRSROs, as a condition to rating an RMBS, require that a non-affiliated third party perform a due diligence review of the assets underlying the RMBS. An NRSRO may also require that due diligence reviews be performed in accordance with specified criteria, and/or that due diligence be performed by one of a specified set of third-party due diligence providers that has been approved by the NRSRO. Under the baseline requirements, any information about due diligence provided by an issuer or underwriter to an NRSRO hired to rate an Exchange Act-ABS also was required to be disclosed on a password-protected Rule 17g–5 Web site, which could be accessed by other NRSROs that provided the required certification.[1621] However, the information transmitted by issuers and underwriters to NRSROs was not subject to mandatory disclosure requirements, and any disclosure may have involved editing or filtering by issuers or underwriters.[1622] In addition, issuers and underwriters who received multiple due diligence reports need not have provided information about all of the reports to NRSROs. The Commission does not believe that NRSROs typically hire third-party due diligence providers directly, but prior to the amendments and new rules, information about third-party due diligence services employed directly by NRSROs was not required to be disclosed to other NRSROs.

In addition to concerns about due diligence information potentially being withheld from NRSROs, market participants, academics, and other observers have expressed concern about decreased standards of due diligence in Exchange Act-ABS offerings.[1623] For example, it has been reported that the percentage of loans in mortgage pools subject to review dropped from 30% to 5% from the year 2000 to 2005.[1624] Also, litigation in the wake of the financial crisis alleged systemic abuses in due diligence practices with respect to asset-backed securities.[1625]

[1616] *See* ''Certification'' on Form NRSRO.

[1617] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1618] The new requirements with respect to disclosing information about due diligence services are discussed in sections II.G.5., II.H.1., II.H.2., and II.H.3. of this release.

[1619] *See* Public Law 111–203, 945.

[1620] *See* 17 CFR 229.1111(a)(7).

[1621] *See* 17 CFR 240.17g–5.

[1622] *See, e.g.,* John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, *Enhancing Investor Protection and the Regulation of Securities Markets* (Mar. 10, 2009) (testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs), pp. 64–65, *available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=d5da9848-ea57-475a-b6e9-93fc74b85abd* (''Coffee Testimony II'') (''An offering process for structured finance that was credible would look very different than the process we have recently observed. First, a key role would be played by the due diligence firms, but their reports would not go only to the underwriter (who appears to have at times ignored them). Instead, without editing or filtering, their reports would also go directly to the credit rating agency.'').

[1623] *See* Coffee Testimony II, pp. 54–56 (describing ''the rapid decline in due diligence after 2000'' and citing market participants and journalists raising related concerns).

[1624] *See* Vikas Bajaj and Jenny Anderson, *Inquiry Focuses on Withholding of Data on Loans,* New York Times, January 12, 2008, at A–1.

[1625] *See Complaint,* People of the State of New York, by Eric T. Schneiderman, against J.P. Morgan

Relative to the baseline, the amendments and new rules should benefit NRSROs, the users of credit ratings, and investors and other Exchange Act-ABS market participants who may or may not be users of credit ratings. NRSROs that are hired by the issuer or underwriter of any Exchange Act-ABS to provide a credit rating, and any other NRSROs that are not hired but are producing credit ratings related to the due diligence services, should benefit from receiving the information in Form ABS Due Diligence–15E. Each Form ABS Due Diligence–15E will contain important details about the third-party due diligence performed with respect to the Exchange Act-ABS to which the services relate, including a description of the scope and manner of the due diligence services provided in connection with the review of the assets underlying the Exchange Act-ABS and a summary of the findings and conclusions that resulted from the due diligence services. The form will be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification, promoting confidence in the accuracy of the content of the form. To the extent that there are any additional due diligence reports obtained by an issuer or underwriter subject to Rule 15Ga–2 [1626] that are not related to credit ratings and therefore are not required to be disclosed to the NRSROs on Form ABS Due Diligence–15E, NRSROs will also have access to the findings and conclusions of these reports, via the Form ABS–15G required to be furnished at least five business days prior to the first sale in the offering.

NRSROs may therefore receive information derived from additional reports of third-party due diligence providers, and more detail about the third-party due diligence services, than they would have obtained under the baseline requirements. Importantly, issuers and underwriters can no longer select what part of this information to provide to NRSROs, reducing the possibility of less favorable information being withheld from NRSROs. Having access to more complete data may allow NRSROs to generate higher quality credit ratings, both in the case of solicited credit ratings and in the case of unsolicited credit ratings by NRSROs. Non-hired NRSROs that choose not to access the Rule 17g–5 Web sites because of the requirement to provide the annual certification under paragraph (e) of the rule may benefit less from the amendments and new rules.[1627] Specifically, though these non-hired NRSROs can request Form ABS Due Diligence–15E from the provider of third-party due diligence services, they will not be able to request this form until they become aware of a given offering and which third-party has provided services related to that offering, and so they may not have the required information to provide unsolicited credit ratings in as timely a manner as NRSROs that do have access to these Web sites. However, prior to today's amendments and new rules, non-hired NRSROs that did not have access to the Rule 17g–5 Web sites were already disadvantaged in providing unsolicited credit ratings given that they likely lacked timely access to other information about the Exchange Act-ABS.

Users of credit ratings, as well as investors and other market participants who may or may not be users of credit ratings, may also benefit from the Form ABS–15G and Form ABS Due Diligence–15E disclosures, particularly in cases where information that was not previously disclosed to these persons becomes available as a consequence of the amendments and new rules. As noted above, the findings and conclusions of all third-party due diligence reports obtained by issuers and underwriters of rated Exchange Act-ABS will be made public through disclosures on Form ABS–15G, except in the case of municipal Exchange Act-ABS for which the issuer or underwriter chooses to make such information publicly available through some other means and in the case of certain offshore transactions.[1628] In the case of registered rated Exchange Act-ABS, the Form ABS–15G disclosures may include findings and conclusions of reports (for example, interim reports) other than the report(s) supporting the results reported in the prospectus under Rule 193 and Item 1111(a)(7) of Regulation AB. Consequently, information that would not have been available to the public under the baseline requirements may now be disclosed publicly. In the case of unregistered rated Exchange Act-ABS, because Rule 193 and Item 1111(a)(7) of Regulation AB do not apply to such offerings, all of the information about the findings and conclusions of third-party due diligence reports disclosed in Forms ABS–15G should be information that may not have been available to potential investors, and would not have been disclosed to the broader public, under the baseline requirements.

In addition, any disclosures on Form ABS Due Diligence–15E will be published by NRSROs with their credit ratings when taking rating actions covered by Rule 17g–7 with respect to the Exchange Act-ABS. The Forms ABS Due Diligence–15E will contain additional detailed information about third-party due diligence with respect to an Exchange Act-ABS for which the NRSRO is producing a credit rating beyond the findings and conclusions that must be disclosed by issuers and underwriters, including a description of the scope and manner of the due diligence services provided in connection with the review of the assets underlying an Exchange Act-ABS. In the case of any review that is also discussed in the prospectus pursuant to Rule 193, the description of such review disclosed in Form ABS Due Diligence–15E may include information that is not already disclosed as part of the ''nature of the review'' discussed in the prospectus. Also, Form ABS Due Diligence–15E information with respect to any due diligence services employed by an NRSRO rating the security will also be published together with each NRSRO's credit rating, for credit rating actions subject to Rule 17g–7.

In particular, in the case of registered and certain unregistered Exchange Act-ABS with issuer-paid credit ratings, any disclosures on Form ABS Due Diligence–15E will be made publicly

Securities LLC, JPMorgan Chase Bank, EMS Mortgage LLC (Oct. 2012).

[1626] As discussed above, the Commission has excluded issuers and underwriters of municipal and certain offshore offerings of Exchange Act-ABS from Rule 15Ga–2. Issuers and underwriters of municipal Exchange Act-ABS remain subject to the statutory obligation under section 15E(s)(4)(A) to make publicly available the findings and conclusions of any third-party due diligence reports they obtain, and could choose to satisfy their obligation by voluntarily submitting Form ABS–15G on EMMA.

[1627] *See* 17 CFR 240.17g–5(e) (requiring, among other things, that the NRSRO certify that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to the rule, if it accesses such information for ten or more issued securities or money market instruments in the calendar year covered by the certification).

[1628] As discussed above, in light of the practical and legal considerations raised by commenters, the Commission adopted revisions to the proposal to provide that Rule 15Ga–2, as well as section 15E(s)(4)(A), will not apply to certain offshore offerings of Exchange Act-ABS. The criteria for exemption include, among other things, that the security issued will be offered and sold upon issuance, and that any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States. It is therefore possible that the rule may result in foreign issuers seeking to avoid the disclosure requirement by limiting certain offerings of Exchange Act-ABS to transactions outside the United States, thus potentially depriving U.S. investors of diversification and related investment opportunities.

available by the issuer-paid NRSRO pursuant to Rule 17g–7, perhaps, for example, on its corporate Internet Web site. However, if Exchange Act-ABS, whether registered or unregistered, is rated only by subscriber-paid NRSROs, then the Form ABS Due Diligence–15E information is only required by Rule 17g–7 to be made available to subscribers of these NRSROs. Finally, a commenter indicated that in some unregistered offerings of Exchange Act-ABS, credit ratings are distributed only to potential investors in the offering.[1629] Because Rule 17g–7 requires that Forms ABS Due Diligence–15E are made available to the same persons who can receive or access the credit rating, the information in these forms about the scope and manner of the due diligence services provided in connection with the review of assets may then only be made available to these potential investors.

In the above cases in which, relative to the baseline, new information becomes available to users of credit ratings and investors and other market participants who may or may not be users of credit ratings, many of these persons should benefit from the information. The information on the findings and conclusions of reviews disclosed using Form ABS–15G may be of particular use in understanding the quality of the asset pool underlying the Exchange Act-ABS, and possibly may represent a more balanced view of such quality than would have been provided in the absence of the amendments and new rules, since the findings and conclusions of all reviews obtained by issuers and underwriters must be reported. The information from Form ABS Due Diligence–15E may be of particular use in determining the adequacy and the level of due diligence services provided by the third parties. The information in both forms may be of use to users of credit ratings and investors and market participants who may or may not be users of credit ratings in evaluating rated Exchange Act-ABS, both in isolation and in comparison to other rated Exchange Act-ABS. The additional information available relative to the baseline—because it provides insights into the quality of the asset pool and the due diligence procedures of the parties involved—also may help these persons in evaluating the NRSROs, issuers and underwriters of Exchange Act-ABS, third-party due diligence providers, and other parties involved in the issuance process. Consequently, the additional information may be of use in current and future investment decisions as well as other interactions among the various parties involved. The benefits of this information may be constrained, however, by the fact that Form ABS Due Diligence–15E disclosures for different securities which may be rated by different NRSROs are not consolidated in a single location, potentially increasing the effort required to collect and compare these disclosures.

Users of credit ratings and investors and other market participants who may or may not be users of credit ratings may also benefit from other effects of the adopted rules. To the extent that NRSROs obtain more complete information about Exchange Act-ABS that they rate, users of credit ratings may benefit from the higher quality credit ratings that may result. The new information available to investors and other market participants, together with these higher quality credit ratings, may result in more informed investment decisions—potentially improving individual portfolio efficiency as well as market efficiency—and may benefit capital formation by encouraging more participation in the Exchange Act-ABS market. Also, the detailed disclosures and the accompanying certification requirements may promote greater rigor and discipline of due diligence procedures and thus benefit investors and other market participants who may or may not be users of credit ratings. In particular, the detailed disclosures and the identification of the third parties involved may enhance the ability of third-party due diligence providers to form a market reputation for providing thorough and accurate due diligence reviews, increasing the competition among these third parties on the basis of quality. In addition, the increased comparability of the quality of due diligence across transactions may enhance competition among issuers.[1630]

Relative to the baseline, the amendments and new rules will result in compliance costs to issuers and underwriters in offerings of Exchange Act-ABS, third-party due diligence providers, and NRSROs. Rule 15Ga–2 will result in costs to issuers and underwriters in offerings of rated Exchange Act-ABS, whether registered or unregistered (other than municipal Exchange Act-ABS and certain offshore Exchange Act-ABS). Although they are excluded from Rule 15Ga–2, issuers and underwriters of municipal Exchange Act-ABS will still incur costs to comply with their statutory disclosure obligation under section 15E(s)(4)(A) of the Exchange Act, and the Commission has estimated costs to these issuers and underwriters based on the assumption that they will satisfy the disclosure obligation by furnishing Form ABS–15G on EMMA.[1631] The Commission believes that the entities that will furnish Form ABS–15G pursuant to Rule 15Ga–2 and/or section 15E(s)(4)(A) of the Exchange Act generally will already have processes and protocols in place to file Form ABS–15G in order to disclose repurchase activity as required by Rule 15Ga–1.[1632] However, they will bear any costs of adapting their current processes and protocols to provide the information required to comply with the new disclosure requirements, including modifying their existing Form ABS–15G processes and protocols to accommodate these requirements. They also will incur ongoing costs to prepare and furnish Form ABS–15G to the Commission through EDGAR or, in the case of municipal Exchange Act-ABS, potentially through EMMA. Based on analysis for purposes of the PRA, the Commission estimates that Rule 15Ga–2 and the amendments to Form ABS–15G will result in total industry-wide one-time costs to issuers and underwriters of approximately $9,509,000 and total industry-wide annual costs to issuers and underwriters of approximately $202,000.[1633]

Rule 17g–10 will result in one-time and recurring costs for providers of third-party due diligence services. Initially, they will need to develop processes and protocols for preparing the information required, certifying, and promptly delivering Form ABS Due Diligence–15E to NRSROs and to issuers and underwriters maintaining Rule 17g–5 Web sites. They also may engage outside counsel, and/or consult with in-house counsel, to advise them on how to comply with the new requirements. Providers of third-party due diligence

[1629] *See DBRS Letter.*

[1630] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1631] To the extent that issuers and underwriters of municipal Exchange Act-ABS use another means to make the required information publicly available, such as through an Internet Web site, the compliance costs to these parties could be greater or less than the Commission's estimates, depending on the method chosen to disclose the information.

[1632] As discussed above, the Commission has revised the final rule to clarify that a single Form ABS–15G may be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report. The Commission thus expects that the securitizer responsible for filing Rule 15Ga–1 disclosures on Form ABS–15G will most likely also file the Rule 15Ga–2 disclosures.

[1633] *See* section V.I. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.10. of this release.

services also will bear recurring costs. Each time they are employed by an issuer, underwriter, or NRSRO to perform due diligence services, they will need to prepare and execute the Form. Based on analysis for purposes of the PRA, the Commission estimates that Rule 17g–10 and Form ABS Due Diligence–15E will result in total industry-wide one-time costs to third-party due diligence providers of approximately $1,405,000 and total industry-wide annual costs of approximately $67,000.[1634] Third-party due diligence providers and the individuals executing the forms on behalf of the third parties may also bear the risk of future liability and associated costs due to the certification requirements in the rule.

The amendments and new rules related to Form ABS Due Diligence–15E also will result in one-time costs for NRSROs to amend their standard agreement forms with issuers and underwriters of Exchange Act-ABS to include the new representation required under Rule 17g–5. Further, the amendments and new rules will result in recurring costs for issuers and underwriters to promptly post the form on their Rule 17g–5 Web sites. Based on analysis for purposes of the PRA, the Commission estimates that these compliance efforts will result in total industry-wide costs of approximately $1,902,000 in one-time costs to NRSROs and approximately $34,000 in annual costs to issuers and underwriters.[1635] NRSRO compliance costs with respect to attaching Forms ABS Due Diligence–15E to the forms that they must publish when taking certain credit rating actions are addressed above in section II.G.6. of this release.

Rule 17g–10 and the associated amendments may also lead to other costs. One commenter stated that it ''remains possible that certain third-party due diligence providers may refuse to provide these certifications'' or ''it may make it more difficult for certain relatively smaller transactions to come to market, since third-party due diligence providers may only be willing to provide these certifications for the largest of transactions, where fees are at levels high enough to justify the associated costs and legal risks.'' [1636] The Commission acknowledges that the required certification by third-party due diligence providers may increase the litigation risk and liability of these providers, particularly for those third party providers that do not already bear expert liability under Rule 193. The required certification therefore may increase the fees charged by these providers—which may be borne by issuers, underwriters, or investors—and may diminish competition by reducing the number of providers who are willing to provide due diligence in these offerings. These effects could impact capital formation, in that it may be more costly or difficult to issue Exchange Act-ABS to the extent that the performance of third-party due diligence services is necessary to bring these securities to market. Also, though the Commission believes that NRSROs have not generally employed third-party due diligence services, the disclosures related to any third-party due diligence services employed by NRSROs may reduce any incentives NRSROs have to employ such services, given that the details about, and the results of, such due diligence will be disclosed to competing NRSROs.[1637]

Together, all of the adopted rules regarding third-party due diligence services may result in additional costs. The required disclosures may be detrimental to capital formation by delaying market access by issuers.[1638] There also may be other costs to investors and other market participants. The disclosure requirements with respect to any third-party due diligence report obtained may incentivize issuers and underwriters to decrease the number and scope of due diligence reviews undertaken in order to decrease the likelihood that they reveal problems that would have to be disclosed to market participants. If fewer or more limited reviews are undertaken, the information available directly or indirectly (such as through credit ratings) to investors and other market participants may ultimately be reduced. Alternatively, the required disclosures with respect to third-party due diligence reports may cause issuers and underwriters to undertake their own due diligence internally or via related subsidiaries, rather than by employing third parties, in order to avoid making the required disclosure or because third-party due diligence providers increase their fees or become unwilling to provide these services. These potential changes in issuer and underwriter behavior could result in a reduced quality of due diligence undertaken with respect to Exchange Act-ABS because of the lack of independent reviews. The possibility of less comprehensive or less independent due diligence being undertaken may be mitigated by market pressures because, as noted above, some NRSROs require that due diligence be undertaken by an independent third party and that this due diligence meet certain criteria before they will produce a credit rating for certain types of Exchange Act-ABS. Also, if no Form ABS–15G disclosure is made, investors will be put on notice that the issuer or underwriter did not employ a provider of third-party due diligence services in connection with the offering of an Exchange Act-ABS, and thus these investors may be less likely to participate in the offering or may demand a lower offering price.

The Commission has considered the costs and benefits of reasonable alternatives relative to the amendments and new rules, including certain alternatives that have been raised by commenters and discussed above. As noted above, the Commission considered alternative approaches to the required timing of the disclosures, namely a greater or fewer number of days before the first sale in an offering by which Forms ABS–15G must be furnished or a more explicit requirement than the ''promptly'' standard governing the provision of Form ABS Due Diligence–15E.[1639] If Forms ABS–15G are furnished closer in time to the first sale in an offering, the informational benefits of the disclosures may be reduced, because NRSROs and market participants may not have enough time to thoroughly and accurately analyze the included information before investment or credit rating decisions are made. However, the longer the delay between the required furnishing of Forms ABS–15G and the first sale in the offering, the more of an impediment the requirement may be to prompt market access by issuers and underwriters. The Commission believes it has appropriately balanced these considerations in requiring that Forms ABS–15G be furnished five business days prior to the first sale in the offering. In the case of Form ABS Due Diligence–15E, it is possible that prescribing a required timeframe for provision of the form could provide more assurance that NRSROs are able to

[1634] *See* section V.J. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.9. of this release.

[1635] *See* section V.J. of this release (discussing implementation and annual compliance considerations). These costs are derived by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

[1636] *See Morningstar Letter.*

[1637] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1638] *See id.*

[1639] *See* sections II.H.1. and II.H.3. of this release.

thoroughly review the information and incorporate it into their credit ratings. However, an explicit timeframe does not seem appropriate given the variation and uncertainty in how quickly the disclosures will be able to be provided in practice.

The Commission also considered whether, as suggested by a commenter,[1640] only information about final due diligence reports should have to be disclosed on Form ABS–15G. Limiting the disclosure requirement to final reports may reduce compliance costs to issuers and underwriters. However, as discussed above, the Commission believes that NRSROs, users of credit ratings, and investors and market participants who may or may not be users of credit ratings should benefit from the information derived from interim as well as final due diligence reports.[1641] In particular, requiring that all reports, including interim reports, received by issuers or underwriters be disclosed further limits the possibility that issuers and underwriters can prevent less favorable information from being revealed (for example, by requesting a change in the due diligence methodology or hiring a different third party due diligence provider after viewing a less favorable interim report).

Another alternative would be to require NRSROs to publish each Form ABS Due Diligence–15E on EDGAR and allow them to incorporate the forms by reference when publishing a related credit rating. This approach would, in some cases, increase the persons that have access to the information in the form. Also, it may increase the benefits of the disclosure by including all third-party due diligence disclosures in a consolidated location, rather than a combination of EDGAR (with respect to Form ABS–15G information) and each of the various means by which each NRSRO publishes their ratings (with respect to Form ABS Due Diligence–15E information). However, this approach would increase the total compliance costs borne by NRSROs.

I. Standards of Training, Experience, and Competence

Section 936 of the Dodd-Frank Act provides that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings: (1) Meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates; and (2) is tested for knowledge of the credit rating process.[1642] The Commission proposed new Rule 17g–9 and adding paragraph (b)(15) to Rule 17g–2 to implement section 936 of the Dodd-Frank Act.[1643]

1. New Rule 17g–9

Rule 17g–9, as proposed, had three paragraphs: (a), (b) and (c).[1644] Paragraph (a), as proposed, contained a requirement that an NRSRO design and administer standards of training, experience, and competence.[1645] Paragraph (b), as proposed, identified factors an NRSRO would need to consider in designing the standards.[1646] Paragraph (c), as proposed, set forth two requirements—one relating to periodic testing and the other relating to minimum experience—that an NRSRO would need to incorporate into the standards.[1647] The Commission is adopting Rule 17g–9 substantially as proposed but with modifications in response to comments.[1648]

As discussed below, some commenters raised concerns that the proposed rule provided too much flexibility to an NRSRO to design its standards of training, experience, and competence. The Commission intended the proposed rule to provide flexibility because, among other reasons, the NRSROs vary significantly in the size and the scope of their activities. The Commission reiterates its view, as stated in the proposing release, that the standards established by an NRSRO with more than a thousand credit analysts and that produces tens of thousands of credit ratings across a wide range of asset classes may need to be different from the standards of an NRSRO with fewer than ten credit analysts and that focuses on a particular class of credit ratings.[1649] Moreover, the rating methodologies used by NRSROs and potential NRSRO applicants to determine credit ratings may vary significantly. For these and other reasons, as discussed below, Rule 17g–9, as adopted, provides flexibility to NRSROs to customize their standards, provided they consider the factors in proposed paragraph (b) and incorporate the standards required under proposed paragraph (c) of Rule 17g–9.

As proposed, paragraph (a) of Rule 17g–9 provided that an NRSRO must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings that are reasonably designed to achieve the objective that such individuals produce accurate credit ratings in the classes and subclasses of credit ratings for which the NRSRO is registered.[1650] Under the proposal, an NRSRO would be permitted to design standards for its credit analysts that are customized to its size, business model, and procedures and methodologies for determining credit ratings, which vary widely across NRSROs.[1651] At the same time, the proposed rule specified an objective for the standards which was consistent with section 936 of the Dodd-Frank Act.[1652] In particular, the standards needed to be reasonably designed to achieve the objective that the individuals employed by the NRSRO to determine credit ratings produce accurate credit ratings in the classes and subclasses of credit ratings for which the NRSRO is registered.[1653]

The Commission is adopting paragraph (a) of Rule 17g–9 substantially as proposed but with modifications in response to comments.[1654] As adopted, the paragraph provides that an NRSRO must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that

[1640] *See Clayton Letter.*

[1641] *See* section II.H.1. of this release.

[1642] Public Law 111–203, 936. A related provision, section 939E of the Dodd-Frank Act, requires the GAO to conduct a study on the feasibility and merits of creating an independent professional organization for rating analysts employed by NRSROs that would be responsible for: (1) Establishing independent standards for governing the profession of rating analysts; (2) establishing a code of ethical conduct; and (3) overseeing the profession of rating analysts. A report on the results of the study must be submitted to Congress not later than one year after the publication of Commission rules pursuant to section 936 of the Dodd-Frank Act. Public Law 111–203, 939E. In this regard, a commenter stated that it ''looks forward to a robust discussion on the merits and feasibility of creating an independent professional organization for ratings analysts once the [GAO] issues its report on the matter.'' *See AFSCME Letter.*

[1643] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476–33480.

[1644] *See id.* at 33476–33480.

[1645] *See id.* at 33476–33477.

[1646] *See id.* at 33477–33478.

[1647] *See id.* at 33478–33480.

[1648] *See* Rule 17g–9.

[1649] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476.

[1650] *See* paragraph (a) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476–33477, 33543.

[1651] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33476.

[1652] *See id.* at 33476–33477.

[1653] *See* Public Law 111–203, 936 (providing, in pertinent part, that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates).

[1654] *See* paragraph (a) of Rule 17g–9.

are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.[1655]

Commenters addressed paragraph (a), as proposed.[1656] Several commenters stated that in general it was not appropriate to permit NRSROs to design their own credit analyst training and testing programs and that, for example, the Commission or a private certification program should provide standards and requirements.[1657] One commenter stated that ''the Commission should provide a set of minimum standards'' and that the standards ''should include individual sector experience, minimum education such as an MBA, and certifications such as a CFA, which includes a strong ethics standard.'' [1658] A second commenter stated that ''[t]he standards must include a system for periodically reviewing ratings for 'accuracy,' specifically for the purpose of adjusting'' the standards for credit analysts based on the results of such reviews.[1659] A third commenter stated that the Commission should prescribe the minimum content for training, to include topics such as ethics, conflicts of interest, and regulations on the ratings process, as well as the proper development of methodologies.[1660]

On the other hand, several NRSROs stated that it was appropriate that the rule provide flexibility to NRSROs in designing the standards required under the proposed rule.[1661] One NRSRO stated that credit rating agencies ''come in many shapes and sizes and they determine credit ratings in many different ways'' and, therefore, ''[i]mposing prescriptive analyst standards on such a diverse group would diminish the value of the rule.'' [1662]

In response to comments that NRSROs should not have flexibility to design their own standards and that the rule should prescribe specific requirements, the Commission believes at this time, as discussed above, that the proposed approach achieves an appropriate balance between prescribing objectives, factors that must be considered, and specific standards that must be included and allowing NRSROs to tailor the standards to their business models, size, and rating methodologies, which vary significantly across NRSROs and potential NRSRO applicants. For example, prescribing minimum education requirements (such as an MBA) and certification requirements (such as a CFA)—as suggested by one commenter—may not be appropriate for all NRSROs because, for example, it could disqualify an analyst that has substantial experience in conducting credit analysis but does not have the requisite degree or certification.[1663] Further, this could burden smaller NRSROs to the extent they would need to hire new analysts to meet the requirements or need to pay for their analysts to obtain the necessary degrees or certifications.

An NRSRO stated that ''as forward-looking statements of opinion, ratings should not be categorized as 'accurate' or 'inaccurate'" and that the Commission should instead focus on whether the ratings have been derived in a manner consistent with the NRSRO's policies and procedures.[1664] In response, the Commission re-iterates that section 936 of the Dodd-Frank Act requires the Commission to issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience, and competence necessary to produce ''accurate'' credit ratings for the categories of issuers whose securities the person rates.[1665] Paragraph (a) of Rule 17g–9, as proposed and adopted, implements this requirement by providing that the standards must be reasonably designed to achieve the objective of producing accurate credit ratings.[1666] The Commission acknowledges that there is no consensus as to whether or how credit ratings can be measured for accuracy.[1667] The Commission also recognizes that the credit rating assigned to an obligor or obligation today may need to be revised in the future if circumstances change and that even the most creditworthy obligors or obligations may default. Consequently, for the purposes of Rule 17g–9, as adopted, an ''accurate'' credit rating does not mean a credit rating that once issued will never need to be upgraded or downgraded or classified as a default. Instead, to be accurate under the rule, the credit rating should be a credible assessment of the relative creditworthiness of an obligor or obligation.[1668] To be a credible assessment at the time of issuance, the credit rating, among other things, should be determined in accordance with the applicable rating methodology of the NRSRO; take into account all relevant information as specified by the rating methodology; not be influenced by conflicts of interest; be based solely upon the merits of the obligor, security, or money market instrument being rated; and be an independent evaluation of the credit risk and merits of the obligor, security, or money market instrument.[1669] Historical performance statistics can play a role in evaluating whether an NRSRO's credit ratings over time are providing credible assessments of the relative creditworthiness of obligors and obligations.

An NRSRO suggested that NRSROs should not be required to comply with Rule 17g–9 ''to the extent the NRSRO reasonably believes it is prohibited by applicable law or binding agreements in the relevant jurisdiction from doing so.'' [1670] In response, the Commission notes that the rule as adopted gives NRSROs the flexibility to design their standards of training and testing for credit analysts. Consequently, an NRSRO can tailor its standards to accommodate local laws. These standards, must, however, meet the requirements of Rule 17g–9. The Commission does not believe a blanket

[1655] *Id.*

[1656] *See Better Markets Letter; CFA/AFR Letter; Clark Letter; COPERA Letter; Davis Letter DBRS Letter; Morningstar Letter; S&P Letter.*

[1657] *See Better Markets Letter; CFA/AFR Letter; Clark Letter; COPERA Letter; Davis Letter.*

[1658] *See COPERA Letter.*

[1659] *See Better Markets Letter.*

[1660] *See id.*

[1661] *See DBRS Letter; Morningstar Letter; S&P Letter.*

[1662] *See DBRS Letter.*

[1663] *See COPERA Letter.*

[1664] *See S&P Letter.*

[1665] *See* Public Law 111–203, 936(1).

[1666] *See* paragraph (a) of Rule 17g–9.

[1667] *See, e.g.,* Staff 2012 Staff Report on Assigned Credit Ratings, pp. 52–53.

[1668] *See id.* at 14–21 (describing credit rating symbols and their definitions).

[1669] *See, e.g.,* section 15E(q)(2)(F) of the Exchange Act (providing that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument). As discussed above in section II.G.4. of this release, the Commission is implementing section 15E(q)(2)(F) through paragraph (a)(1)(iii) of Rule 17g–7, as adopted. This paragraph, as adopted, provides that the NRSRO must attach to the form accompanying a credit rating a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) No part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

[1670] *See Moody's Letter* (''[I]in some jurisdictions it might not be possible to require an existing employee to meet new competence, experience, training, or testing requirements unless he or she agrees to such requirements in an amended employment agreement or collective bargaining agreement. If the employee, union or works council declines to sign the amended agreement, it might not be possible for the NRSRO to modify unilaterally the employment relationship.'').

exemption would be appropriate, but if laws or binding agreements in certain jurisdictions prohibit the NRSRO from complying with certain provisions of Rule 17g–9, the NRSRO can seek appropriate targeted relief.

Finally, one NRSRO suggested that the words ''and subclasses'' be removed from paragraph (a) of proposed Rule 17g–9 because ''NRSROs are registered only for various credit rating classes; there is no subclass registration.'' [1671] A second NRSRO stated that it determines ''credit ratings by committee and no one individual is responsible for any credit rating.'' [1672] Another commenter stated that ''[i]ndividuals do not 'produce . . . credit ratings,' accurate or otherwise.'' [1673]

While the use of the term ''subclasses'' was designed to account for the different types of obligors and obligations assigned credit ratings within a class of credit ratings, the Commission agrees with the comment that the use of the term in paragraph (a) was potentially confusing because NRSROs do not register in subclasses of credit ratings.[1674] Accordingly, the Commission has modified proposed paragraph (a) of Rule 17g–9 to remove the reference to ''subclasses,'' and paragraph (a) as adopted refers only to ''the classes of credit ratings'' for which the NRSRO is registered.[1675] In response to comments that individuals generally do not ''determine'' credit ratings (the language in the proposed rule),[1676] paragraph (a) of Rule 17a–9 has been modified from the proposal to refer to credit analysts as individuals an NRSRO employs ''to participate in the determination of credit ratings'' instead of individuals who ''produce'' credit ratings, and the rule as adopted refers to the NRSRO as producing credit ratings.[1677]

As proposed, paragraphs (b)(1) through (4) of Rule 17g–9 identified certain factors that the NRSRO would need to consider when establishing standards of training, experience, and competence.[1678] Specifically, the NRSRO would have been required to consider:

- If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated; [1679]
- If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies; [1680]
- The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses; [1681] and
- The complexity of the obligors, securities, or money market instruments being rated by the individual.[1682]

The proposed factors were intended to provide guidance to NRSROs about the Commission's expectations for the design of the standards of training, experience, and competence.[1683]

The Commission is adopting paragraph (b) of Rule 17g–9 substantially as proposed but with modifications in response to comments.[1684] As adopted, paragraph (b) requires an NRSRO to consider the following factors when establishing the standards required under paragraph (a):

- If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated; [1685]
- If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies; [1686]
- The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses; [1687] and
- The complexity of the obligors, securities, or money market instruments for which the individual participates in determining credit ratings.[1688]

Commenters addressed paragraph (b) of Rule 17g–9, as proposed.[1689] One commenter stated that ''the Commission should set forth more specific expectations'' and that, for example, ''the Commission should provide guidance regarding what kind of technical expertise in quantitative analysis should be required, depending on how the person will be using quantitative procedures and methodologies.'' [1690] Another commenter stated that the factors listed in paragraph (b) should include that certain types of securities (for example new or highly complex securities) may require more training and specialized expertise.[1691] On the other hand, an NRSRO stated that the factors set forth in paragraph (b) of proposed Rule 17g–9 ''sufficiently capture the general issues an NRSRO should consider in designing its analyst training program.'' [1692] Another NRSRO stated that the factors were ''reasonable.'' [1693]

In response to the comment that the rule should include more specific expectations,[1694] the Commission believes the factors strike an appropriate balance in terms of identifying critical matters an NRSRO should take into

[1671] *See DBRS Letter.*

[1672] *See S&P Letter.*

[1673] *See Harrington Letter.*

[1674] *See DBRS Letter.*

[1675] *See* paragraph (a) of Rule 17g–9. However, paragraphs (b) and (c) of Rule 17g–9, as adopted, refer to classes and subclasses of credit ratings. The references to ''subclasses'' are designed to account for the fact that rating methodologies used within a class of credit ratings (for example, structured finance) may be substantially different for certain subclasses (for example, a CDO as compared to an RMBS).

[1676] *See S&P Letter; Harrington Letter.*

[1677] *See* paragraph (a) of Rule 17g–9.

[1678] *See* paragraphs (b)(1) through (4) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33477–33478, 33543.

[1679] *See* paragraph (b)(1) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1680] *See* paragraph (b)(2) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1681] *See* paragraph (b)(3) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1682] *See* paragraph (b)(4) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1683] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33477.

[1684] *See* paragraph (b) of Rule 17g–9.

[1685] *See* paragraph (b)(1) of Rule 17g–9.

[1686] *See* paragraph (b)(2) of Rule 17g–9.

[1687] *See* paragraph (b)(3) of Rule 17g–9.

[1688] *See* paragraph (b)(4) of Rule 17g–9. Consistent with the modifications to paragraph (a) discussed above, the Commission is modifying paragraph (b)(4) from the proposal by replacing the phrase ''rated by the individuals'' with the phrase ''for which the individual participates in determining credit ratings''.

[1689] *See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; DBRS Letter; S&P Letter.*

[1690] *See AFSCME Letter.*

[1691] *See CFA/AFR Letter.*

[1692] *See DBRS Letter.*

[1693] *See S&P Letter.*

[1694] *See AFSCME Letter; CFA/AFR Letter; COPERA Letter; S&P Letter.*

consideration but with sufficient generality to have broad application across NRSROs with different business models, sizes, and rating methodologies, while identifying specific factors the Commission believes are important for an NRSRO to consider when designing the standards. Further, as discussed below, the Commission is adopting, in paragraph (c) of Rule 17g–9, specific items that an NRSRO must include in its standards of training, experience, and competence.[1695]

One commenter stated that the rule should recognize that certain types of securities (for example new or highly complex securities) may require more training and specialized expertise.[1696] The factor listed in paragraph (b)(4) of Rule 17g–9, as adopted, requires NRSROs to consider the complexity of the obligors or securities rated by the analyst when establishing the standards required under paragraph (a) of Rule 17g–9. The Commission believes that this requirement achieves the commenter's objective of having the standards take into account the complexity of securities being rated by the analyst.

As proposed, paragraphs (c)(1) and (2) of Rule 17g–9 provided that an NRSRO must include the following in the standards, respectively:

- A requirement for periodic testing of the individuals employed by the NRSRO to determine credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings; [1697] and
- A requirement that at least one individual with three years or more experience in performing credit analysis participates in the determination of a credit rating.[1698]

The Commission is adopting paragraph (c)(1) of Rule 17g–9 substantially as proposed but with modifications in response to comments.[1699] As adopted, paragraph (c)(1) provides that an NRSRO must include in the standards required under paragraph (a) a requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings.[1700]

Commenters addressed paragraph (c)(1) of Rule 17g–9, as proposed.[1701] Some commenters stated that the Commission or another regulatory body or independent credentialing organization should establish and administer NRSRO testing regimes or establish minimum testing standards.[1702] One of these commenters stated that the testing requirement should be more detailed, and should include requirements related to the ''frequency of testing, basic content, consequences of failure, and eligibility for retesting.'' [1703] In contrast, three NRSROs stated that an NRSRO should be able to design its own testing programs.[1704]

In response to comments that the Commission or another independent entity should establish and administer NRSRO credit analyst testing programs or that the testing requirement should be more detailed,[1705] the Commission notes that section 936 of the Dodd-Frank Act requires that NRSRO credit analysts be ''tested for knowledge of the credit rating process.'' [1706] As rating methodologies vary among the NRSROs, the Commission believes it is appropriate for NRSROs to design their own testing programs, subject to the requirements of paragraphs (a), (b), and (c) of Rule 17g–9. In particular, the standards for testing must be reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.[1707]

An NRSRO stated that the testing program should ''apply only to the credit rating procedures and methodologies that fall within the scope of the individual's primary area or areas of analytical responsibility'' and that credit analysts should be tested on the ''principal methodologies'' used by the NRSRO to determine credit ratings.[1708] The Commission notes that the question of whether an NRSRO's standards for testing are reasonably designed to ensure that credit analysts meet standards of training, experience, and competence necessary to produce accurate ratings for categories of issuers whose securities the person rates and that they are tested for knowledge of the credit rating process will depend on the NRSRO's rating methodologies and how the NRSRO requires its credit analysts to apply them. An individual's primary area or areas of responsibility certainly will be relevant to the designing testing standards that will apply to the employee. For example, an NRSRO may need to tailor its training and testing program to account for the different rating methodologies it uses to determine credit ratings across classes and subclasses of credit ratings so that a given employee is trained and tested on the particular rating methodology or methodologies the employee uses to determine credit ratings.

An NRSRO stated that analysts with certain qualifications and subject to professional examinations and continuing education requirements should be exempt from the testing requirement.[1709] In response, the Commission notes that section 936 of the Dodd-Frank Act provides that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings is tested for knowledge of *the credit rating process*.[1710] Paragraph (c)(1) of Rule 17g–9, as adopted, implements this section by providing that an NRSRO must include in the standards required under paragraph (a) a requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their *knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings* in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings.[1711] Consequently, the subject matter of the training must be the NRSRO's rating methodologies. This does not mean that the standards of training established by the NRSRO cannot take into account qualifications, professional

[1695] *See* paragraph (c) of Rule 17g–9.

[1696] *See CFA/AFR Letter.*

[1697] *See* paragraph (c)(1) Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1698] *See* paragraph (c)(2) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1699] Consistent with the modifications to paragraph (a) discussed above, the Commission is modifying paragraph (c)(1) from the proposal to replace the phrase ''individuals employed by [the NRSRO] to determine credit ratings'' with the phrase ''individuals employed by [the NRSRO] to participate in the determination of credit ratings''. *See* paragraph (c)(1) of Rule 17g–9.

[1700] *See* paragraph (c)(1) Rule 17g–9.

[1701] *See Better Markets Letter; CFA/AFR Letter; COPERA Letter; DBRS Letter; Fitch Letter; Harrington Letter; Moody's Letter; Morningstar Letter.*

[1702] *See Better Markets Letter; CFA/AFR Letter; COPERA Letter.*

[1703] *See Better Markets Letter.*

[1704] *See DBRS Letter; Morningstar Letter; S&P Letter.*

[1705] *See Better Markets Letter; CFA/AFR Letter; COPERA Letter.*

[1706] Public Law 111–203, 936(2).

[1707] *See* paragraph (a) of Rule 17g–9.

[1708] *See Moody's Letter.*

[1709] *See Fitch Letter.*

[1710] *See* Public Law 111–203, 936(2) (emphasis added).

[1711] *See* paragraph (c)(1) of Rule 17g–9 (emphasis added).

examinations, and continuing education requirements. However, unless external professional examinations and continuing education requirements address the NRSRO's specific rating methodologies, exemptions from the required testing and continuous education requirements would not be appropriate.

One commenter stated that testing of credit analysts on their knowledge of the credit rating process could be abused by managers.[1712] The Commission believes testing credit analysts for knowledge of the credit rating process as mandated by section 936 and Rule 17g–9 will benefit the NRSRO, the analysts employed by the NRSRO, and investors and other users of credit ratings by promoting the analysts' adherence to, the proper application of, the NRSRO's rating methodologies. In response to the commenter's concern, the Commission notes that section 15E(j) of the Exchange Act requires the NRSRO to designate an individual responsible for, among other things, ensuring compliance with the securities laws.[1713] This individual is responsible for, among other things, establishing procedures for the receipt, retention, and treatment of confidential anonymous complaints by employees of the NRSRO.[1714] Thus, employees have the recourse of submitting confidential and anonymous complaints if managers seek to abuse the training program administered by the NRSRO. For all of these reasons, the Commission does not believe it would be appropriate or necessary to refrain from implementing the statute in response to the concern raised by the commenter.

The Commission is adopting paragraph (c)(2) of Rule 17g–9 with a modification from the proposal in response to comments.[1715] In particular, a number of commenters addressed the proposed requirement that at least one individual with three or more years of experience in performing credit analysis participate in the determination of a credit rating.[1716] Some commenters stated that the three-year requirement was not sufficient, for example, with respect to complex securities.[1717] For example, one of these commenters stated that ''[g]iven the enormous complexity of the ratings process, and the importance of ratings in our financial markets, requiring the involvement of a person with only three years of experience in each rating is woefully insufficient'' and that ''[s]ubstantially more seasoning is necessary to ensure that each rating is properly supervised.'' [1718] Similarly, an NRSRO stated that the proposed requirement ''sets such a low bar that it is almost meaningless.'' [1719] Another NRSRO stated that ''the Commission should not establish a minimum number of years experience for participating in the determination of a rating'' and that ''NRSROs should establish their own requirements.'' [1720] In contrast, one commenter stated that requiring that at least three years of credit rating committee experience would be ''sensible.'' [1721]

The Commission is persuaded that the rule should not solely require three years of experience. For example, there may be types of obligors or obligations that—because of their complexity—require an individual to participate in determining the credit rating who has more than three years of experience. Consequently, as adopted, paragraph (c)(2) of Rule 17g–9 provides that an NRSRO must include in the standards required under paragraph (a) a requirement that at least one individual with an appropriate level of experience in performing credit analysis, which may in some instances be more than, but cannot be less than, three years participates in the determination of a credit rating.[1722] Thus, the rule requires that the level of experience be commensurate with the type of obligor or obligation being rated and it sets a floor of a minimum of three years of experience.

As proposed, paragraph (c)(2) provided that the experience must be in performing credit analysis.[1723] In the proposing release, the Commission noted that performing credit analysis is not synonymous with determining credit ratings and that many financial institutions have credit risk departments staffed by individuals who analyze the creditworthiness of existing and future counterparties and borrowers.[1724] The Commission stated in the proposing release that it preliminarily intended that this type of work would qualify a credit analyst to meet the three-year requirement in paragraph (c)(2) of proposed Rule 17g–9.[1725]

One commenter stated that the experience should be in determining credit ratings and that ''other experiences in assessing credit should not serve to fulfill this requirement.'' [1726] In contrast, an NRSRO stated that the requisite experience should not be limited to having worked for an NRSRO because such a requirement ''could negatively impact smaller NRSROs and possible new entrants, given the small number of entities in the industry.'' [1727] The Commission continues to believe that experience performing credit analysis whether in determining credit ratings or in other contexts (for example, in the credit department of a financial institution) can qualify an individual to meet the requirement in paragraph (c)(2) of Rule 17g–9, as adopted. In fact, the fresh perspective of a credit analyst who has been performing credit analysis for purposes other than determining credit ratings could promote the quality of credit ratings and innovation.

Finally, one commenter stated that that an experienced analyst also should be required to certify approval of the rating in writing.[1728] At this time, due to other measures in place, the Commission does not believe such a requirement is necessary. First, as discussed above, the Commission is implementing section 15E(q)(2)(F) through paragraph (a)(1)(iii) of Rule 17g–7, as adopted. This paragraph, as adopted, provides that the NRSRO must attach to the form accompanying a credit rating a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) No part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument. Second, paragraph (a)(2) of Rule 17g–2 requires NRSROs to make and retain records with respect to each current credit rating, including the identity of any credit analyst that participated in determining the rating and the identity of any person that approved the credit rating.

[1712] *See Harrington Letter.*

[1713] *See* 15 U.S.C. 78o–7(j).

[1714] *See* 15 U.S.C. 78o–7(j)(3)(B).

[1715] *See* paragraph (c)(2) of Rule 17g–9.

[1716] *See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; DBRS Letter; Harrington Letter; Morningstar Letter; S&P Letter.*

[1717] *See AFSCME Letter; Better Markets Letter; CFA/AFR Letter.*

[1718] *See Better Markets Letter.*

[1719] *See DBRS Letter.*

[1720] *See S&P Letter.*

[1721] *See Harrington Letter.*

[1722] *See* paragraph (c)(2) of Rule 17g–9.

[1723] *See* paragraph (c)(2) of Rule 17g–9, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543.

[1724] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33479.

[1725] *Id.* at 33479.

[1726] *See Harrington Letter.*

[1727] *See Morningstar Letter.*

[1728] *See Better Markets Letter.*

2. Amendment to Rule 17g–2

The Commission proposed adding paragraph (b)(15) to Rule 17g–2 to identify the standards of training, experience, and competence the NRSRO must establish, maintain, enforce, and document pursuant to proposed Rule 17g–9 as a record that must be retained.[1729] As a result, the standards would have been subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g–2.[1730] The Commission stated that this record, along with other records the proposal would have required NRSROs to make, should be subject to the same recordkeeping requirements applicable to other records an NRSRO is required to retain pursuant to Rule 17g–2.[1731]

One commenter stated that ''we strongly support the Commission proposal to make training, testing, and experience policies subject to recordkeeping requirements'' and that the Commission ''should make clear that this includes testing results.'' [1732] Another commenter stated that ''the documentation requirement should include documentation not only of the standards, but also of the implementation, including records showing that analysts have been tested, that ratings have been reviewed for accuracy to identify weaknesses in the training regime, and that a seasoned analyst has participated in and approved of each credit rating.'' [1733] The Commission does not believe for now that it is necessary to require the documentation and/or retention of these specific types of records. The Commission notes that NRSROs may need to be able to demonstrate compliance with Rule 17g–9 and that making and retaining records showing that analysts have been tested and the experience level of persons participating in credit ratings is one way to demonstrate compliance with the rule. Further, as noted above, paragraph (a)(2) of Rule 17g–2 requires NRSROs to make and retain records with respect to each current credit rating, including the identities of any credit analyst that participated in determining the rating and the identity of any person that approved the credit rating.[1734] Finally, using credit rating performance statistics could be a useful input in evaluating the effectiveness of training programs.[1735]

The Commission is adding paragraph (b)(15) to Rule 17g–2 as proposed.[1736] This will provide a means for the Commission to monitor the NRSROs' compliance with Rule 17g–9. The record must be retained until three years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g–2 discussed above in section II.A.2. of this release.[1737]

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule relating to the standards of training, experience, and competence.[1738] The baseline that existed before today's adoption of Rule 17g–9 and the amendment to Rule 17g–2 was one in which an NRSRO was not required to establish, maintain, enforce, and document standards of training, experience, and competence for its credit analysts that are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered and that include a requirement to conduct periodic testing of its credit analysts for knowledge of the NRSRO's procedures and methodologies to determine credit ratings and a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating. Further, NRSROs were not required to retain a record documenting the procedures and methodologies. However, NRSROs and applicants for registration as NRSROs were required to disclose in Exhibit 8 to Form NRSRO a general description of the minimum qualifications required of their credit analysts and credit analyst supervisors, including education level and work experience.

Relative to this baseline, Rule 17g–9 and the amendment to Rule 17g–2 will likely provide benefits. These new requirements should result in higher levels of competency among NRSRO credit analysts, which should result in higher quality credit ratings. The factors enumerated in paragraph (b) of Rule 17g–9 could serve an investor protection function by providing benchmarks that could be used by the Commission and the NRSRO to evaluate whether a given NRSRO's standards are reasonably designed to meet the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered. In particular, the first two factors should help the Commission and the NRSRO evaluate the degree to which knowledge and technical expertise with respect to data and models is emphasized in the standards of an NRSRO. The latter two factors should help the Commission and the NRSRO evaluate the degree to which expertise in factors relevant to credit ratings and the complexity of obligors, securities, or money market instruments are emphasized in the NRSRO's standards of training for its credit analysts.

The requirement in paragraph (c)(2) of Rule 17g–9 that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating should help achieve the objective that an NRSRO produces accurate credit ratings. The requirement in paragraph (c)(1) of Rule 17g–9 for periodic testing of an NRSRO's credit analysts on their knowledge of the NRSRO's procedures and methodologies to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings should also enhance integrity and quality of the credit ratings. Higher quality credit ratings should benefit those who use credit ratings in making investment and credit-based decisions. The requirement to document the standards will also help the NRSRO to adhere to the standards.

The record the NRSROs must retain under the amendment to Rule 17g–2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which it is registered and whether the NRSRO is complying with the policies and procedures.

[1729] *See* section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[1730] *See* 17 CFR 240.17g–2(c) through (f).

[1731] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33423.

[1732] *See CFA/AFR Letter.*

[1733] *See Better Markets Letter.*

[1734] *See* paragraph (a)(2) of Rule 17g–2.

[1735] *See Better Markets Letter.*

[1736] *See* paragraph (b)(15) of Rule 17g–2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[1737] *See* paragraphs (b)(15) and (c) of Rule 17g–2.

[1738] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

Relative to the baseline, the amendments and new rule will result in costs for NRSROs. NRSROs will incur one-time costs when establishing and documenting the standards of training, experience, and competence for NRSRO credit analysts and ongoing costs to update these standards and conduct periodic testing. Based on analysis for purposes of the PRA, the Commission estimates that Rule 17g–9 will result in total industry-wide one-time costs to NRSROs of approximately $7,834,000 and total industry-wide annual costs to NRSROs of approximately $1,629,000.[1739] Further, NRSROs will incur costs in conducting periodic testing for knowledge of the credit rating process. The cost of this testing will likely vary significantly across NRSROs and depend on their size, the different types of credit ratings they issue, and the complexity of their methodologies. However, based on analysis for purposes of the PRA, the Commission estimates that Rule 17g–9 will result in additional total industry-wide annual costs for NRSROs to conduct periodic testing of their credit analysts of approximately $5,990,000.[1740]

Relative to the baseline, the amendments to Rule 17g–2 prescribing retention requirements for the documentation of the standards will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g–2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(15) of Rule 17g–2 and the amendment to paragraph (c) of Rule 17g–2 will result in total industry-wide one-time costs to NRSROs of approximately $12,000 and total industry-wide annual costs to NRSROs of approximately $3,000.[1741]

A possible additional cost is that the requirements could distort the labor market for individuals with at least three years of experience in performing credit analysis. For example, NRSROs may need to pay a premium to retain such individuals, which may inhibit them from moving to productive activity in other industries. The magnitude of this cost is infeasible to estimate as the degree to which these salaries may increase is unknown.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.[1742] First, they could improve the quality of credit ratings. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also improve if this information is reflected in asset prices. Consequently, capital formation could also improve as capital could flow to more efficient uses with the benefit of this enhanced information. These amendments also will result in costs, which may have a component that is fixed in magnitude across NRSROs and does not depend on the size of an NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs, creating adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO. These costs also will depend on the complexity of operations within the NRSRO.

There are reasonable alternatives to the requirements in the amendments and new rule. First, the Commission or an independent entity could provide standards for training and testing programs or administer these programs as suggested by commenters.[1743] As discussed earlier, the Commission believes at this time that allowing NRSROs the flexibility to design their own standards achieves an appropriate balance between prescribing standards and allowing NRSROs to tailor the standards to their business models, size, and rating methodologies, which vary significantly across NRSROs and potential NRSRO applicants.

Another alternative is that the Commission could make the requirements of paragraph (c)(2) of Rule 17g–9 less restrictive. For example, one commenter suggested that the Commission not require a minimum number of years of experience for individuals participating in the determination of credit ratings and that NRSROs should establish their own requirements.[1744] However, if NRSROs established a lower requirement, this alternative could decrease the quality of credit ratings by decreasing the level of expertise brought to determinations of credit ratings. However, it could also decrease costs if it eliminates the potential distortions to the labor market for analysts with at least three years of experience discussed earlier.

J. Universal Rating Symbols

Section 938(a) of the Dodd-Frank Act provides that the Commission shall require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures that: (1) Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument;[1745] (2) clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating;[1746] and (3) apply any symbol described in item (2) in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.[1747] Section 938(b) of the Dodd-Frank Act provides that nothing in section 938 shall prohibit an NRSRO from using distinct sets of symbols to denote credit ratings for different types of securities or money market instruments.[1748]

Further, section 939(h)(1) of the Dodd-Frank Act provides that the Commission shall undertake a study on the feasibility and desirability of:

- Standardizing credit rating terminology, so that all credit rating agencies issue credit ratings using identical terms;
- standardizing the market stress conditions under which ratings are evaluated;
- requiring a quantitative correspondence between credit ratings

[1739] *See* section V.K. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.8. of this release.

[1740] *See* section V.K. of this release (discussing implementation and annual compliance considerations). The annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.8. of this release.

[1741] *See* section V.K. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[1742] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1743] *See Better Markets Letter; CFA/AFR Letter; COPERA Letter; Davis Letter.*

[1744] *See S&P Letter.*

[1745] *See* Public Law 111–203, 938(a)(1).

[1746] *See* Public Law 111–203, 938(a)(2).

[1747] *See* Public Law 111–203, 938(a)(3).

[1748] *See* Public Law 111–203, 938(b).

and a range of default probabilities and loss expectations under standardized conditions of economic stress; and

• standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.[1749]

Section 939(h)(2) of the Dodd-Frank Act provides that the Commission shall submit to Congress a report containing the findings of the study and the recommendations, if any, of the Commission with respect to the study.[1750] The Commission submitted the staff report to Congress in September 2012.[1751]

Finally, section 15E(c)(2) of the Exchange Act provides, in pertinent part, that the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.[1752]

The Commission proposed to implement section 938(a) of the Dodd-Frank Act by proposing paragraph (b) of Rule 17g–8 and by adding paragraph (b)(14) to Rule 17g–2.[1753]

1. Paragraph (b) of New Rule 17g–8

Section 938(a) of the Dodd-Frank Act prescribes the policies and procedures the Commission shall require, by rule, of each NRSRO.[1754] Consequently, paragraph (b) of Rule 17g–8, as proposed, was modeled on the statutory text.[1755]

As proposed, the prefatory text of paragraph (b) provided that an NRSRO must establish, maintain, enforce, and document policies and procedures that are reasonably designed to achieve three objectives identified in paragraphs (b)(1), (2), and (3).[1756] The prefatory text of paragraph (b), as proposed, mirrored the prefatory text of section 938(a) of the Dodd-Frank Act, except that the proposed rule text included the word ''document'' so that the rule, as proposed, would require the NRSRO to document the policies and procedures it establishes, maintains, and enforces.[1757] The requirement was added so that an NRSRO would need to set forth its policies and procedures in writing.[1758] This requirement, coupled with the Commission's proposed amendment to Rule 17g–2, was designed, among other things, to make the policies and procedures more readily available to Commission examiners.[1759] Documenting the policies and procedures in writing also will promote the NRSRO's compliance with them. For all these reasons, the Commission is adopting the prefatory text as proposed.[1760]

Paragraph (b)(1) of Rule 17g–8, as proposed, would require the NRSRO to have policies and procedures reasonably designed to assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.[1761] The text of this provision mirrored the text of section 938(a)(1) of the Dodd-Frank Act.[1762] One commenter stated that the paragraph, as proposed, was ''sufficiently explicit.'' [1763] The Commission is adopting paragraph (b)(1) of Rule 17g–8 as proposed.[1764]

The Commission noted in the proposing release that section 15E(s)(3)(B)(ii) of the Exchange Act provides that the Commission's rule requiring an NRSRO to generate a form to disclose information with the publication of a credit rating requires disclosure of information on the content of the credit rating, including: (1) The historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.[1765] As discussed above in section II.G.3. of this release, the Commission has implemented this requirement in paragraph (a)(1)(ii)(L) of Rule 17g–7, as adopted.[1766] The Commission continues to believe that paragraph (b)(1) of Rule 17g–8, as adopted, will work in conjunction with the requirement in paragraph (a)(1)(ii)(L) of Rule 17g–7, as adopted, in that the policies and procedures required under paragraph (b)(1) of Rule 17g–8 will assist the NRSRO in generating the information required to be disclosed pursuant to paragraph (a)(1)(ii)(L) of Rule 17g–7. The information produced by an NRSRO's policies and procedures under paragraph (b)(1) is expected to be relevant to the credit analyses performed by the NRSRO.

Paragraph (b)(2) of Rule 17g–8, as proposed, would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings for which the NRSRO is registered and to include such definitions in Exhibit 1 to Form NRSRO.[1767] This proposed provision would implement section 938(a)(2) of the Dodd-Frank Act.[1768] One commenter stated that the paragraph, as proposed, was ''sufficiently explicit.'' [1769]

The Commission is adopting paragraph (b)(2) of Rule 17g–8 substantially as proposed.[1770] As adopted, the paragraph provides that an NRSRO must establish, maintain, enforce, and document policies and procedures that are reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class of credit ratings for which the NRSRO is registered (including subclasses within each class) and to include such definitions in Exhibit 1 to Form NRSRO.[1771]

In the proposing release, the Commission stated that paragraph (b)(2) of Rule 17g–8 would work in conjunction with the requirements to

[1749] *See* Public Law 111–203, 939(h)(1).

[1750] *See* Pub. L. 111–203, 939(h)(2).

[1751] *See* 2012 Staff Report on Credit Rating Standardization.

[1752] *See* 15 U.S.C. 78o–7(c)(2).

[1753] *See* paragraph (b) of Rule 17g–8, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33543. *See also* paragraph (b)(14) of Rule 17g–2, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539.

[1754] *See* Public Law 111–203, 938(a).

[1755] *See* paragraph (b) of proposed Rule 17g–8; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33480–33481, 33543.

[1756] *See* prefatory text of paragraph (b) of Rule 17g–8, as proposed.

[1757] *See* Public Law 111–203, 938(a).

[1758] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33480.

[1759] *See id.*

[1760] *See* prefatory text of paragraph (b) of Rule 17g–8.

[1761] *See* proposed paragraph (b)(1) of Rule 17g–8.

[1762] *See* Public Law 111–203, 938(a)(1).

[1763] *See S&P Letter.*

[1764] *See* paragraph (b)(1) of Rule 17g–8.

[1765] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33480; 15 U.S.C. 78o–7(s)(3)(B)(ii).

[1766] *See* paragraph (a)(1)(ii)(L) of Rule 17g–7 (providing that the form to accompany a credit rating must include information on the content of the credit rating, including: (1) If applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default).

[1767] *See* proposed paragraph (b)(2) of Rule 17g–8.

[1768] *See* Public Law 111–203, 938(a)(2).

[1769] *See S&P Letter.*

[1770] *See* paragraph (b)(2) of Rule 17g–8.

[1771] *See id.* The text of paragraph (b)(2), as proposed, referred to ''each class and subclass of credit ratings'' for which the NRSRO is registered. As discussed above in section II.I.1. of this release, the Commission has modified paragraph (a) of Rule 17g–9 to, among other things, remove a reference to an NRSRO being registered in a subclass of credit ratings. Consistent with this modification, the Commission is modifying paragraph (b)(2) from the proposal to remove the reference to being registered in a subclass of credit ratings. However, the Commission added a parenthetical to the rule text to include a reference to ''subclasses'' of credit ratings.

disclose definitions of symbols, numbers, or scores that denote credit rating categories and notches within categories in Exhibit 1 to Form NRSRO.[1772] As discussed above in section II.E.1. of this release, Exhibit 1 requires, among other things, that an NRSRO clearly define, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit.[1773] Consequently, taken together, paragraph (b)(2) of Rule 17g–8, as adopted, and the instructions for Exhibit 1 to Form NRSRO require an NRSRO to have policies and procedures that clearly define the meaning of each symbol, number, or score used by the NRSRO to denote a credit rating and to disclose those meanings in Exhibit 1 where investors and other users of credit ratings can find them.

Paragraph (b)(3) of Rule 17g–8, as proposed, would require the NRSRO to have policies and procedures reasonably designed to apply any symbol, number, or score defined pursuant to paragraph (b)(2) of Rule 17g–8 in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[1774] This provision mirrored the text of section 938(a)(3) of the Dodd-Frank Act, except that the proposed rule text added the term ''obligors.'' [1775] The Commission proposed this addition in order to apply the provisions of paragraph (b)(3), as proposed, to credit ratings of obligors as entities in addition to credit ratings of securities and money market instruments.[1776] One commenter stated that the paragraph, as proposed, was ''sufficiently explicit.'' [1777] The Commission is adopting paragraph (b)(3) of Rule 17g–8 as proposed.[1778]

The Commission received comments regarding paragraph (b) of proposed Rule 17g–8.[1779] One NRSRO stated that it supported the proposal and that it ''is generally consistent'' with what the NRSRO ''does today.'' [1780] Another NRSRO stated, as noted above, that the rule text was ''sufficiently explicit'' and also stated that it did not support the addition of further detail regarding the objectives of the rule, and that additional requirements with respect to the rule may ''interfere with the analytical independence of NRSROs in violation of Section 15E(c)(2) of the Exchange Act.'' [1781]

Several commenters were critical of the proposal.[1782] One commenter stated that paragraph (b) of proposed Rule 17g–8 did not achieve the objective of section 938 of the Dodd-Frank Act.[1783] This commenter raised concerns about how municipalities are assigned credit ratings as compared to other types of obligors and recommended that the Commission ''adopt language that would clearly require NRSROs to apply symbols consistently across classes and subclasses of credit ratings.'' [1784] Similarly, another commenter stated that because the proposed rule does not ''require that rating symbols would have to be designed to clearly reflect the potential degree of default,'' the rule will not ''correct the discrepancy between what AAA means in the municipal or corporate debt context and what it means in the structured product context.'' [1785] One commenter stated that the Commission should re-propose the rule and, in doing so, require NRSROs ''to specify an acceptable range of default probabilities and corresponding loss expectations for each asset class and rating symbol.'' [1786] The commenter also provided its analysis of NRSROs' credit rating performance statistics as disclosed in Exhibit 1 to Form NRSRO through 2012, which the commenter stated shows that ''performance across asset classes has not been comparable.'' [1787]

The Commission shares the concerns raised by these commenters that the historical performance of credit ratings at the same notch in a global rating scale of some NRSROs has been significantly different for certain classes of credit ratings, particularly the historical performance of credit ratings of structured finance products. The Commission staff noted this inconsistency of performance in its 2012 report on credit rating standardization, which was submitted to Congress as required by section 939(h)(2) of the Dodd-Frank Act.[1788]

In drafting paragraph (b) of Rule 17g–8, the Commission has sought to address this concern in a manner that strikes an appropriate balance between adopting a measure designed to address inconsistencies in the performance of credit ratings in different classes to which an NRSRO applies the same rating scale and definitions with the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.[1789] In seeking to strike this balance, the Commission modeled the rule closely on the text of section 938(a) of the Dodd-Frank Act.[1790] This section provides, in pertinent part, that the Commission shall require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures to, among other things, apply any defined credit rating symbol in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.[1791] The Commission also considered the fact that section 939(h)(1) of the Dodd-Frank Act required the Commission to study certain matters relating to credit rating standardization (as opposed to mandating rulemaking), including the feasibility and desirability of standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.[1792] Comments received in response to the study argued that that the Commission does not have the authority to require credit rating standardization because, by statute, the Commission may not regulate the methodologies NRSROs use to

[1772] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33480–33481.

[1773] *See* paragraph (2) of the instructions for Exhibit 1.

[1774] *See* paragraph (b)(3) of Rule 17g–8, as proposed.

[1775] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33481.

[1776] *See id.* at 33481.

[1777] *See S&P Letter.*

[1778] *See* paragraph (b)(3) of Rule 17g–8.

[1779] *See AFSCME Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter; DBRS Letter; Moody's Letter; S&P Letter.*

[1780] *See DBRS Letter.*

[1781] *See S&P Letter.*

[1782] *See AFSCME Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter.*

[1783] *See AFSCME Letter. See also* Committee on Banking, Housing, and Urban Affairs, U.S. Senate, *The Restoring American Financial Stability Act of 2010,* Committee Report No. 111–176, at 124 (Apr. 30, 2010), *available at http://www.gpo.gov/fdsys/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf.*

[1784] *See AFSCME Letter* (''An AAA rating for a municipal bond should indicate the same likelihood of default or non-payment as an AAA rating for any other kind of security. Failure to do so would eviscerate Section 938 and continue to burden municipal issuers unfairly.'').

[1785] *See COPERA Letter.*

[1786] *See CFA II Letter.*

[1787] *See CFA II Letter. See also* CFA/AFR Letter (citing findings that the 5-year default rate prior to 2005 of one NRSRO's ratings at the Baa notch was 0.l% for municipal bonds, 2.2% for corporate bonds, and 24% for CDOs).

[1788] *See* 2012 Staff Report on Credit Rating Standardization, pp. 37–38. *See also* Pub. L. 111–203, 939(h)(2).

[1789] *See* 15 U.S.C. 78o–7(c)(2).

[1790] *See* Public Law 111–203, 938(a).

[1791] *See id.*

[1792] *See* Public Law 111–203, 939(h)(1).

determine credit ratings.[1793] Moreover, as required under section 939(h)(2) of the Dodd-Frank Act, the Commission was required to report its findings to Congress upon completion of the study.[1794] The Commission submitted a staff report to Congress in 2012 and the findings in the report have not resulted in any legislative changes relating to credit rating standardization at this time.[1795]

The Commission believes at this time that paragraph (b) of Rule 17g–8, as adopted, implements section 938(a) of the Dodd-Frank Act in a manner that appropriately balances relevant concerns. The rule requires NRSROs to have policies and procedures that are reasonably designed to apply the definition of any credit symbol, number, or score in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[1796] An NRSRO—in establishing, maintaining, and enforcing these policies and procedures—will need to take into consideration how it applies its rating scales and definitions to classes of credit ratings and the rating methodologies it uses to determine credit ratings in those classes. Moreover, the prefatory text of the rule requires that the policies and procedures must be reasonably designed.[1797] Consequently, Rule 17g–8, as adopted, requires an NRSRO to have policies and procedures reasonably designed to achieve the objective of consistency without specifically mandating how an NRSRO's credit ratings and rating methodologies must be designed to achieve this consistency.

Commenters raised concerns about how the Commission would enforce Rule 17g–8, as proposed.[1798] One commenter stated that ''the Commission fails to make clear how it will enforce the requirement that ratings be based on an assessment of the likelihood of default and applied consistently across different rating categories.'' [1799] In particular, the commenter asked what standards the Commission will use to determine whether ratings are being applied consistently across categories of ratings and what steps will NRSROs be required to take if their performance statistics reveal discrepancies in the performance of ratings across different rating categories.[1800] The commenter that suggested that the Commission re-propose the rule stated that, if ratings of certain asset classes diverge significantly from the expected norms, the Commission should require the NRSRO to identify the source of the error that led to the divergence and what it is doing to remedy the problem and ''where the divergence in ratings performance across asset classes persists, the Commission should require the NRSRO to adjust its methodology—which in turn could affect its outstanding and prospective ratings—to correct the problem.'' [1801] The commenter further stated that a different system of symbols should be used for certain asset classes ''where comparability cannot be achieved.'' [1802] In addition, the commenter stated that the Commission should hold NRSROs accountable if they fail to achieve a high degree of ratings comparability between asset classes by, for example, seeking fines or the disgorgement of profits or suspending or revoking the NRSRO's registration for the affected asset class.[1803] In contrast, an NRSRO stated that ''because credit ratings reflect forward-looking opinions, we would be concerned about any attempt to judge an NRSRO's adherence to this proposed rule based on an analysis of its ratings performance over any defined period of time'' and that ''an NRSRO's compliance with this rule should be measured by whether the NRSRO has policies and procedures in place to promote comparability of ratings across the asset classes it rates and has adhered to such policies and procedures.'' [1804]

In response to these comments, the Commission notes that paragraph (b) of Rule 17g–8, as adopted, sets forth an objective: That the definition of any credit rating symbol, number, or score is applied in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[1805] Further, the rule provides that an NRSRO must establish, maintain, enforce, and document policies and procedures that are reasonably designed to achieve this objective.[1806] Consequently, in enforcing the rule, the Commission will consider whether the NRSRO is achieving the objective through the use of established procedures and methodologies that are reasonably designed. In response to the commenters, the Commission agrees that the performance of credit ratings (transition and default statistics) in each class of credit ratings for which the NRSRO applies the same rating scale and definitions will be relevant to considering whether the objective of consistency is being met.[1807] If the Commission staff believes the objective of consistency is not being met, the staff will need to consider whether the NRSRO has established, maintained, enforced, and documented policies and procedures that are reasonably designed to achieve this objective before making a recommendation to the Commission that the Commission institute an enforcement action. The staff may also bring a potential violation to the attention of the NRSRO. In response to the commenters, the Commission notes that if appropriate the Commission can take enforcement action for such a violation.[1808] Finally, an NRSRO that has not complied with paragraph (b) of Rule 17g–8 may take steps to adjust its rating methodology or use different rating scales and definitions for different classes of credit ratings, as suggested by one of the commenters, to the extent doing so is necessary and appropriate to address the failure.[1809]

2. Amendment to Rule 17g–2

The Commission proposed adding paragraph (b)(14) of Rule 17g–2 to identify the policies and procedures an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g–8 as a record that must be retained.[1810] As a result, the policies and procedures would be subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g–2. One NRSRO stated that it ''supports'' the amendment to Rule 17g–2.[1811] The Commission is adding paragraph (b)(14)

[1793] *See* 2012 Staff Report on Credit Rating Standardization, pp. 2, 12–14 (summarizing commenters' views).

[1794] *See* Public Law 111–203, 939(h)(2).

[1795] *See* 2012 Staff Report on Credit Rating Standardization.

[1796] *See* paragraphs (b)(2) and (3) of Rule 17g–8.

[1797] *See* prefatory text of paragraph (b) of Rule 17g–8.

[1798] *See CFA/AFR Letter; CFA II Letter; S&P Letter.*

[1799] *See CFA/AFR Letter.*

[1800] *See id.*

[1801] *See id.*

[1802] *See id.*

[1803] *See CFA II Letter.*

[1804] *See S&P Letter.*

[1805] *See* paragraphs (b)(2) and (3) of Rule 17g–8.

[1806] *See* prefatory text of paragraph (b) of Rule 17g–8.

[1807] *See S&P Letter.*

[1808] *See CFA II Letter.* As discussed above in section II.D. of this release, the Exchange Act provides the Commission with authority to impose a wide range of fines, penalties, and other sanctions on NRSROs for violations of any section of the Exchange Act and the rules under the Exchange Act. *See* 15 U.S.C. 78o–7(d); 15 U.S.C. 78u; 15 U.S.C. 78u; 15 U.S.C. 78u–2; 15 U.S.C. 78u–3; 15 U.S.C. 78ff.

[1809] *See CFA II Letter* (suggesting the NRSRO adjust its rating methodology or use different rating scales and definitions).

[1810] See paragraph (b)(14) 0f Rule 17g–2, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33481.

[1811] *See DBRS Letter.*

to Rule 17g–2 as proposed.[1812] This will provide a means for the Commission to monitor the NRSROs' compliance with paragraph (b) of Rule 17g–8 as a record. The record must be retained until three years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g–2 discussed above in section II.A.2. of this release.[1813]

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule regarding NRSRO credit rating symbols, numbers, or scores.[1814] The economic baseline that existed before today's new rules was one in which an NRSRO was not required to establish, maintain, enforce, document, and retain records of policies and procedures reasonably designed to: Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument; clearly define each symbol, number, or score in the NRSRO's rating scale for each class of credit ratings (including subclasses within each class) for which the NRSRO is registered; or to apply any such symbol, number, or score in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used. However, the instructions for Exhibit 1 to Form NRSRO required an NRSRO or a credit rating agency applying for registration as an NRSRO to ''define the credit rating categories, notches, grades, and rankings used'' by the NRSRO or applicant.[1815]

One academic study finds that performance within comparable rating categories has been inconsistent across asset classes from 1980 until 2010.[1816] In addition, it has been reported that five-year default rates for CDOs at the lowest investment-grade rating as determined by a large NRSRO were roughly ten times higher from 1993 to 2005 than for corporate bonds at the same rating for the same NRSRO from 1983 to 2005.[1817] Another academic study concludes that having new structured products rated similarly to corporate bonds created the illusion of comparability with existing ''single-name'' securities and provided access to a large pool of potential buyers in the years prior to the financial crisis.[1818] This academic study also finds evidence suggesting that differences in observed default rates between structured products and comparable corporate bonds may be explained by differences in the types of risk to which these instruments are exposed.[1819]

Relative to this baseline, paragraph (b) of Rule 17g–8 should provide benefits. In particular, it should promote greater consistency by NRSROs in terms of assigning credit ratings across different classes of credit ratings and, thereby, promote the information value of credit ratings as assessments of relative creditworthiness for the benefit of users of credit ratings. The requirement that an NRSRO have policies and procedures reasonably designed to assess the probability that an issuer will default, fail to make timely payments, or otherwise not make payments to investors should facilitate this outcome. Specifically, this assessment may provide additional inputs in terms of the relative creditworthiness of obligors and issuers, which may be used to inform credit ratings if deemed appropriate by the NRSRO, and thereby improve the quality of credit ratings as assessments of relative creditworthiness. The requirement that an NRSRO have policies and procedures to disclose the meaning of credit rating symbols, numbers, and scores could benefit users of credit ratings by promoting a better understanding of credit rating terminology and allowing these parties to better compare the various credit ratings issued by a single NRSRO and credit ratings across NRSROs.

The records the NRSRO must retain under the amendments to Rule 17g–2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are reasonably designed and the NRSRO is adhering to them. Setting forth the policies and procedures in writing also will promote adherence to them by the NRSRO.

Relative to the baseline, paragraph (b) of Rule 17g–8 will result in costs for NRSROs. NRSROs will need to expend resources to develop the policies and procedures required by the rule, to document, comply with, and enforce them, and to update them periodically as appropriate. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b) of Rule 17g–8 will result in total industry-wide one-time costs to NRSROs of approximately $566,000 and total industry-wide annual costs to NRSROs of approximately $142,000.[1820]

NRSROs may also incur costs expending resources to modify credit rating symbols, numbers, scores, and their definitions in order to conform to the requirement that these symbols, numbers, and scores be applied consistently across applicable asset classes. For example, one NRSRO claimed that the new rule would require some NRSROs to change their rating symbol systems or how they apply their symbols to certain categories of obligors or obligations.[1821] However, another NRSRO stated that the new rule ''is generally consistent'' with what it ''does today.''[1822] This cost will likely vary significantly across NRSROs and depend on the number of asset classes rated and the degree to which their current symbols, numbers, and scores are applied consistently.

Relative to the baseline, the amendments to Rule 17g–2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g–2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with

[1812] *See* paragraph (b)(14) of Rule 17g–2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

[1813] *See* paragraphs (b)(14) and (c) of Rule 17g–2.

[1814] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1815] Before today's amendments, paragraph (i) of Rule 17g–1 required an NRSRO to make Form NRSRO and Exhibits 1 through 9 publicly available on its Web site ''or through another comparable, readily accessible means.''

[1816] *See* Jess Cornaggia, Kimberly J. Cornaggia, and John E. Hund, *Credit Ratings across Asset Classes* (2014), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1909091.*

[1817] *See* Charles Calomiris and Joseph Mason, *Reclaim Power from the Ratings Agencies,* Financial Times (Aug. 24, 2007), p. 11.

[1818] *See* Coval, Jurek, and Stafford, *The Economics of Structured Finance.*

[1819] *See id.* (A ''feature of the securitization process is that it substitutes risks that are largely diversifiable for risks that are highly systematic. As a result, securities produced by structured finance activities have far less chance of surviving a severe economic downturn than traditional corporate securities of equal rating.'').

[1820] *See* section V.L. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[1821] *See Moody's Letter.*

[1822] *See DBRS Letter.*

these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(14) of Rule 17g–2 and the amendment to paragraph (c) of Rule 17g–2 will result in total industry-wide one-time costs to NRSROs of approximately $12,000 and total industry-wide annual costs to NRSROs of approximately $3,000.[1823]

As an additional possible cost, the final rule has the potential to decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process could improve the quality of ratings. In order to ensure that rating symbols, numbers, and scores are applied consistently across applicable ratings in compliance with these requirements, an NRSRO may establish credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. The credit ratings may not therefore benefit fully from the expertise of the participants in the rating process. These amendments may also increase costs associated with understanding the definition of rating symbols, numbers, and scores. In order to ensure that rating symbols, numbers, and scores are applied consistently across applicable ratings in compliance with these requirements, an NRSRO may create different rating symbols, numbers, and scores for different asset classes. As a result, users of credit ratings may need to expend more effort in understanding a greater number of definitions.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.[1824] First, they could improve the quality and consistency of credit ratings as well as increasing the information available to users of credit ratings regarding the meaning of rating symbols, numbers, and scores. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also improve if this information is reflected in asset prices. Consequently, capital formation also could improve as capital could flow to more efficient uses with the benefit of this enhanced information. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the quality of credit ratings may decrease, which could decrease the efficiency of investment decisions made by users of credit ratings. Market efficiency and capital formation also may be adversely impacted if lower quality information is reflected in asset prices, which may impede the flow of capital to efficient uses. These amendments will result in costs, some of which may have a component that is fixed in magnitude across NRSROs, and does not vary with the size of the NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs, creating adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

K. Annual Report of Designated Compliance Officer

Section 932(a)(5) of the Dodd-Frank Act amended section 15E(j) of the Exchange Act to re-designate paragraph (j) as paragraph (j)(1) and to add paragraphs (j)(2) through (j)(5).[1825] Section 15E(j)(1) of the Exchange Act contains a self-executing provision that requires that an NRSRO designate an individual (the ''designated compliance officer'') responsible for administering the policies and procedures that are required to be established pursuant to sections 15E(g) and (h) of the Exchange Act,[1826] and for compliance with the securities laws and the rules and regulations under the securities laws, including those promulgated by the Commission under section 15E of the Exchange Act.[1827] Sections 15E(j)(2) through (4) of the Exchange Act contain self-executing requirements with respect to, among other things, the activities, duties, and compensation of the designated compliance officer.[1828]

Section 15E(j)(5)(A) of the Exchange Act contains a self-executing requirement that the designated compliance officer must submit to the NRSRO an annual report on the compliance of the NRSRO with the securities laws and the policies and procedures of the NRSRO that includes: (1) A description of any material changes to the code of ethics and conflict of interest policies of the NRSRO; and (2) a certification that the report is accurate and complete.[1829] Section 15E(j)(5)(B) of the Exchange Act contains a self-executing requirement that the NRSRO shall file the report required under section 15E(j)(5)(A) together with the financial report that is required to be submitted to the Commission under section 15E of the Exchange Act.[1830]

Section 15E(k) of the Exchange Act provides that each NRSRO 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.[1831] The Commission implemented section 15E(k) by adopting Rule 17g–3.[1832] Therefore, under the self-executing requirement in section 15E(j)(5)(B) of the Exchange Act, an NRSRO must file the report of the designated compliance officer with the reports required to be filed with the Commission pursuant to Rule 17g–3.[1833]

Before today's amendments, paragraph (a) of Rule 17g–3 required an NRSRO to furnish five or, in some cases, six separate reports within ninety days after the end of the NRSRO's fiscal year and identified the reports that must be furnished.[1834] The first report—on the

[1823] *See* section V.L. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

[1824] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1825] *See* Public Law 111–203, 932(a)(5); 15 U.S.C. 78o–7(j)(1) through (5).

[1826] *See* 15 U.S.C. 78o–7(g) (''Prevention of misuse of nonpublic information''); 15 U.S.C. 78o–7(h) (''Management of conflicts of interest'').

[1827] *See* 15 U.S.C. 78o–7(j)(1).

[1828] *See* 15 U.S.C. 78o–7(j)(1) through (4).

[1829] *See* 15 U.S.C. 78o–7(j)(5)(A).

[1830] *See* 15 U.S.C. 78o–7(j)(5)(B).

[1831] The Dodd-Frank Act replaced the phrase ''furnish to the Commission'' with the phrase ''file with the Commission'' in section 15E(k) of the Exchange Act. *See* 15 U.S.C. 78o–7(k).

[1832] *See* 17 CFR 240.17g–3; *see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33590–33593.

[1833] *See* 15 U.S.C. 78o–7(j)(5)(B); 15 U.S.C. 78o–7(k); 17 CFR 240.17g–3.

[1834] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33481–33482. As discussed above in section II.A.3. of this release, an NRSRO must file an additional internal controls report and, as discussed below, an NRSRO must file the report

Continued

NRSRO's financial statements—must be audited; the remaining reports may be unaudited.

1. Amendment to Rule 17g–3

The Commission proposed adding paragraph (a)(8) to Rule 17g–3 to identify the report on the compliance of the NRSRO with the securities laws and the policies and procedures of the NRSRO required to be filed with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other reports required under Rule 17g–3.[1835] Paragraph (a)(8) of Rule 17g–3 would provide that the report would be ''unaudited.'' [1836] As stated above, section 15E(j)(5)(A)(ii) of the Exchange Act provides that the designated compliance officer must certify that the report is accurate and complete.

Commenters addressed this proposal.[1837] One commenter supported the Commission's proposal to include the report as one of the annual financial reports an NRSRO is required to file with the Commission,[1838] and another stated that the proposed requirement would facilitate effective NRSRO oversight by the Commission.[1839] This commenter stated that the requirement could be strengthened, however, by requiring the annual report be subjected to a third-party audit.[1840] Two commenters stated that the rule should not prescribe how the report must be certified because another section of the Exchange Act already provides that the designated compliance officer must certify that the report is accurate and complete.[1841] Specifically, one commenter stated that this requirement would be ''unnecessarily duplicative.'' [1842] The other commenter stated that the certification already required by section 15E(j)(5)(A)(ii) of the Exchange Act is sufficient.[1843]

The Commission is adopting paragraph (a)(8) to Rule 17g–3 as proposed. In response to the comment suggesting that the Commission require that the report be subject to a third-party audit,[1844] the Commission is not persuaded that such a requirement is necessary at this time, given the cost of requiring a third-party audit. Section 15E(j)(5)(A) of the Exchange Act provides that the report shall be filed with ''together with the financial report that is required to be submitted to the Commission under'' section 15E.[1845] Section 15E(k) provides, in pertinent part, that the financial reports shall be filed on a confidential basis.[1846] Consequently, the report of the designated compliance officer is not a public document that will be relied upon by investors and other users of credit ratings. The report is a non-public report that will be used by Commission examiners, who can consider the accuracy of the report in the context of their annual examinations of NRSROs.[1847] Finally, the Commission agrees with the commenters that it is not necessary to prescribe how the report must be certified because section 15E(j)(5)(A)(ii) of the Exchange Act provides that the designated compliance officer must certify that the report is accurate and complete.[1848]

2. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendment regarding the annual report of the designated compliance officer.[1849] The economic baseline which existed before today's amendments was one in which section 15E(j)(5)(A) of the Exchange Act requires that the designated compliance officer of an NRSRO submit to the NRSRO an annual report on the NRSRO's compliance with its policies and procedures and the securities laws, that includes a description of any material changes to the NRSRO's code of ethics and conflicts of interest policies and a certification that the report is accurate and complete. In addition, section 15E(j)(B) of the Exchange Act requires the NRSRO to file the report with the financial report that is required to be submitted to the Commission under section 15E of the Exchange Act. The Commission is adding paragraph (a)(8) to Rule 17g–3 to reflect the baseline requirement that the report must be filed with the other reports filed pursuant to Rule 17g–3. The amendment is not expected to result in benefits or costs relative to the economic baseline and is not expected to affect efficiency, competition, or capital formation.

One reasonable alternative to the amendment, as adopted, is to establish a requirement that the report be audited by a third party, as suggested by one commenter.[1850] This alternative would increase the cost of compliance with the rule, as NRSROs would be required to pay a third party to conduct the audit. However, an audit by a third party may improve the accuracy, reliability, and thoroughness of the report. As a result, this alternative could enhance Commission oversight of NRSROs as well as improve an NRSRO's internal compliance controls, which could improve the integrity and quality of an NRSRO's credit ratings.

As discussed above, the Commission is not persuaded that such a requirement is necessary at this time, given the cost of requiring a third-party audit and how the audit would be used.[1851] The report of the designated compliance officer is not a public document that will be relied upon by investors and other users of credit ratings. Instead, it will be used by Commission examiners, who can consider the accuracy of the report in the context of their annual examinations of NRSROs.

L. Electronic Submission of Form NRSRO and the Rule 17g–3 Annual Reports

1. Amendments to Rule 17g–1, Form NRSRO, Rule 17g–3, and Regulation S–T

Before today's amendments, applicants for registration as an NRSRO and NRSROs submitted Form NRSRO to the Commission in paper form.[1852] In addition, NRSROs submitted their annual reports under Rule 17g–3 in paper form.[1853] The Commission proposed amending Rule 17g–1, the instructions to Form NRSRO, Rule 17g–3, and Regulation S–T [1854] to implement a program for filing Forms NRSRO

of the designated compliance officer. *See* paragraphs (a)(7) and (a)(8) of Rule 17g–3. Consequently, an NRSRO must now file seven or, in some cases, eight reports.

[1835] *See* paragraph (a)(8) of Rule 17g–3, as proposed; *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33481–33482, 33539.

[1836] *See* paragraph (a)(8) of Rule 17g–3, as proposed.

[1837] *See DBRS Letter; Levin Letter; S&P Letter.*

[1838] *See DBRS Letter.*

[1839] *See Levin Letter.*

[1840] *See id.*

[1841] *See DBRS Letter; S&P Letter.*

[1842] *See S&P Letter.*

[1843] *See DBRS Letter.*

[1844] *See Levin Letter.*

[1845] *See* 15 U.S.C. 78o–7(j)(5)(B).

[1846] *See* 15 U.S.C. 78o–7(k).

[1847] The report also will be used as governance tool by the NRSRO to evaluate its compliance with the securities laws and its policies and procedures.

[1848] *See* 15 U.S.C. 78o–7(j)(5)(A)(ii).

[1849] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1850] *See Levin Letter.*

[1851] *See* section II.K.1. of this release (discussing how the report is not a public document that will be relied upon by investors and other users of credit ratings but rather will be used by Commission examiners).

[1852] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33482.

[1853] *See id.* at 33482.

[1854] 17 CFR 232 *et seq.* Regulation S–T contains ''General Rules and Regulations for Electronic Filers.''

(other than in the case of a registration application) and the annual reports electronically.[1855] Under the proposals, an NRSRO would be required to use the Commission's EDGAR system to: (1) Electronically file or furnish, as applicable, Form NRSRO and the information and documents contained in the exhibits required to be submitted with Form NRSRO if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g–1 (an update of registration, an annual certification, or a withdrawal from registration, respectively);[1856] and (2) electronically file or furnish, as applicable, the annual reports required by Rule 17g–3.[1857] In the proposing release, the Commission stated that it intended that Form NRSRO would be an electronic, fillable, form and that the exhibits would be submitted with the Form.[1858]

Under the proposal, an applicant or NRSRO would continue to submit in paper format Forms NRSRO pursuant to paragraphs (a), (b), (c), and (d) of Rule 17g–1 (initial applications for registration, applications to register for an additional class of credit ratings, supplements to an initial application or application to register for an additional class of credit ratings, and withdrawals of initial applications or applications to register for an additional class of credit ratings, respectively). The Commission stated in the proposing release that these materials are appropriately received in paper form because of the iterative nature of the NRSRO registration application process.[1859] For example, an applicant often will have a number of phone conferences and meetings with the Commission staff during the application process to clarify the information submitted in the application. These interactions may result in applicants informally providing additional information relating to the application and informally amending or augmenting information provided in the form and its exhibits. The Commission continues to believe paper submissions facilitate this type of iterative process.

The Commission also proposed amending Items A.8 and A.9 of the instructions to Form NRSRO to distinguish between Form NRSRO submissions under paragraph (a), (b), (c), or (d) of Rule 17g–1 and submissions under paragraph (e), (f), or (g) of Rule 17g–1.[1860] Before today's amendments, Item A.8 provided the address of Commission headquarters as the address where a Form NRSRO submitted under paragraph (a), (b), (c), (d), (e), (f), or (g) of Rule 17g–1 must be submitted.[1861] The Commission proposed amending Item A.8 to add above the address a sentence that would instruct an applicant to submit to the Commission at the address indicated two paper copies of a Form NRSRO submitted pursuant to paragraph (a), (b), (c), or (d) of Rule 17g–1 and adding a sentence below the address providing that after registration, an NRSRO must submit Form NRSRO electronically to the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T, if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g–1.[1862]

Before today's amendments, Item A.9 of the Instructions to Form NRSRO provided that a Form NRSRO will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form.[1863] The Commission proposed amending the instruction to provide that a Form NRSRO will be considered filed with or furnished to, as applicable, the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form, including the instructions in Item A.8 with respect to how a Form NRSRO must be filed with or furnished to the Commission.[1864]

The Commission proposed amending Rule 17g–3 to add paragraphs (d) and (e).[1865] Proposed paragraph (d) of Rule 17g–3 would provide that the reports required by the rule must be submitted electronically with the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.[1866] In addition, because the Rule 17g–3 annual reports are not required to be made public, the Commission proposed adding paragraph (e) to Rule 17g–3, which would provide that information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law and that confidential treatment may be requested by marking each page ''Confidential Treatment Requested'' and by complying with Commission rules governing confidential treatment.[1867]

Electronic submissions using the EDGAR system are subject to Regulation S–T and the EDGAR Filer Manual.[1868] The EDGAR Filer Manual contains detailed technical specifications concerning EDGAR submissions and provides technical guidance concerning how to begin making submissions on EDGAR.

One technical specification the EDGAR Filer Manual includes is the electronic ''submission type'' for each submission made through the EDGAR system, and under the proposal, the EDGAR Filer Manual and the EDGARLink software would provide for two EDGAR electronic submission types: One for the submission of Form NRSRO and one for the submission of the annual reports under Rule 17g–3.[1869]

The Commission proposed amending Rule 101 of Regulation S–T [1870] by adding paragraph (a)(1)(xiv).[1871] Proposed paragraph (a)(1)(xiv) would

[1855] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33482–33485.

[1856] *See id.* at 33538. Under the proposal, the electronic submissions of Form NRSRO and the exhibits required to be submitted with Form NRSRO would be made available to the public on EDGAR immediately upon filing. The amendments to paragraph (f) of Rule 17g–1 referred to a Form NRSRO and Exhibits 1 through 9 as the submissions that would be required to be made electronically. The proposed amendments to paragraph (e) of Rule 17g–1 also referred to a Form NRSRO and Exhibits 1 through 9. However, Exhibit 1 (performance statistics) should not have been included with respect to the proposed amendments to paragraph (e) because section 15E(b)(1)(A) of the Exchange Act provides that NRSROs are not required to update performance statistics if they becomes materially inaccurate, but that NRSROs must file updated performance statistics with the annual certification. Accordingly, as adopted, the amendments to paragraph (e) of Rule 17g–1 refer to Exhibits 2 through 9 to Form NRSRO. The proposed amendments to paragraph (g) of Rule 17g–1 did not refer to exhibits to Form NRSRO because an NRSRO is not required to include exhibits to Form NRSRO with a notice of withdrawal from registration under this paragraph.

[1857] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539. Under the proposal, the electronic submission of the annual reports required under Rule 17g–3 would not be available to the public. The information submitted under Rule 17g–3 is, and would continue to be, kept confidential to the extent permitted by law.

[1858] *See id.* at 33483.

[1859] *See id.*

[1860] *See id.* at 33552.

[1861] *See id.* at 33483.

[1862] *See id.* at 33552.

[1863] *See id.* at 33483.

[1864] *See id.* at 33552.

[1865] *See id.* at 33484.

[1866] *See id.* at 33539.

[1867] *See id.*

[1868] *See* 17 CFR 232.101 *et seq. See also EDGAR Filer Manual, available at http://www.sec.gov/info/edgar/edmanuals.htm; Information for EDGAR Filers, available at http://www.sec.gov/info/edgar.shtml#guidance.*

[1869] *See, e.g., EDGAR Filer Manual,* Vol. II, section 5.1 (''Non-Public and Confidential''), section 5.4 (''Document Types in EDGAR''), *available at http://www.sec.gov/info/edgar/edgarfm-vol2-v26.pdf.*

[1870] 17 CFR 232.101(a)(1).

[1871] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33484.

identify the Forms NRSRO and the information and documents submitted in Exhibits 1 through 9 to Form NRSRO submitted to the Commission under paragraphs (e), (f), and (g) of Rule 17g–1 and the annual reports submitted under Rule 17g–3 as submissions to the Commission that must be made in electronic format.[1872]

The Commission also proposed an amendment to Rule 201 of Regulation S–T.[1873] Rules 201 and 202 [1874] of Regulation S–T address hardship exemptions from EDGAR filing requirements, and paragraph (b) of Rule 13 of Regulation S–T [1875] addresses the related issue of filing date adjustments. Under Rule 201, if an electronic filer experiences unanticipated technical difficulties that prevent the timely preparation and submission of an electronic filing, the filer may file a properly legended paper copy of the filing under cover of Form TH [1876] no later than one business day after the date on which the filing was to be made.[1877] A filer who files in paper form under the temporary hardship exemption must submit an electronic copy of the filed paper document within six business days of the filing of the paper document.[1878]

In addition, an electronic filer may apply for a continuing hardship exemption under Rule 202 of Regulation S–T if it cannot file all or part of a filing without undue burden or expense.[1879] The application must be made at least ten business days before the due date of the filing. In contrast to the self-executing temporary hardship exemption process, a filer can obtain a continuing hardship exemption only by submitting a written application, upon which the Commission, or the Commission staff pursuant to delegated authority, must then act. Under paragraph (b) of Rule 13 of Regulation S–T, if an electronic filer in good faith attempts to file a document, but the filing is delayed due to technical difficulties beyond the filer's control, the filer may request that the Commission grant an adjustment of the filing date.

The Commission proposed making the temporary hardship exemption in Rule 201 unavailable for the submissions of Form NRSRO and the information and documents submitted in Exhibits 1 through 9 to Form NRSRO under paragraph (e), (f), or (g) of Rule 17g–1 and the annual reports required under Rule 17g–3 by amending the introductory text of paragraph (a) of Rule 201 of Regulation S–T to add this group of submissions to the list of submissions for which the temporary hardship exemption is unavailable.[1880] An NRSRO would continue to have the ability to apply for a continuing hardship exemption under Rule 202 if it could not submit all or part of an application without undue burden or expense or for an adjustment of the due date under paragraph (b) of Rule 13 if there were technical difficulties beyond the NRSRO's control.

The Commission received three comments that addressed these proposals.[1881] One commenter stated that it supported the proposal, and that having information available immediately and in one location would benefit users of credit ratings by making it easier to access information about NRSROs and to compare the information provided by different NRSROs.[1882] An NRSRO stated that it would have no objection to the proposal, that providing the information as PDF documents would be ''the preferred and simplest'' way to provide the information, and that providing the information in XBRL or XML format would not provide additional analytical benefit and could make it more difficult for users to access Form NRSRO.[1883] This commenter also stated, however, that the temporary hardship exemption should be available for electronic filings of Form NRSRO.

One NRSRO objected to the proposal, stating that the Commission ''vastly overstated the benefits and understated the costs'' of the proposal.[1884] The commenter stated that having the public information available immediately and in one place would not be useful to users of credit ratings, as the information is not time-sensitive and it is relatively easy to retrieve the information from the NRSROs' Web sites. This commenter also stated that the Commission did not estimate ''the expense an NRSRO would incur in compiling Form NRSRO, its exhibits, and the annual reports into an EDGAR-acceptable format'' and that the Commission underestimated the costs of becoming familiar with Regulation S–T and the EDGAR Filer Manual and other ''start-up tasks'' as well as ongoing expenses. In addition, the commenter stated that requiring that the documents be submitted in XBRL format would increase costs without conferring benefits. The commenter suggested, alternatively, that NRSROs be required to make the submissions as PDF documents via electronic mail to a designated Commission email address, with confidential information encrypted before transmission.

The Commission is adopting the amendments to Rule 17g–1, Form NRSRO, Rule 17g–3, and Regulation S–T substantially as proposed, with modifications, in response to comment.[1885] The amendments specify that the information that is required to be submitted to the Commission electronically on EDGAR be submitted as PDF documents and, in contrast to the proposal, make the temporary hardship exemption in Rule 201 of Regulation S–T available for these submissions.

In response to the comment objecting to the proposal, stating that the Commission underestimated the costs and overstated the benefits of the proposal, and stating that the Commission should instead require that NRSROs email the submissions as PDF documents to the Commission,[1886] the final amendments provide that the submissions must be made as PDF documents, which another NRSRO described as ''the most preferred and simplest'' way to provide the information.[1887] However, in response to this comment, as explained below in the economic analysis, the Commission has increased its estimate of the cost of the proposal. In addition, as explained below in the economic analysis, the Commission agrees with another commenter that the amendments will benefit users of credit ratings [1888] and also that the amendments will benefit NRSROs and Commission staff.

Accordingly, the amendments to paragraphs (e), (f), and (g) of Rule 17g–1, as adopted, provide that a Form NRSRO and the information and documents in the exhibits required to be submitted with the form must be filed electronically with the Commission on EDGAR as a PDF document in the

[1872] *See id.* at 33537.

[1873] 17 CFR 232.201. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33484.

[1874] 17 CFR 232.202.

[1875] 17 CFR 232.13(b).

[1876] 17 CFR 239.65, 249.447, 269.10, and 274.404.

[1877] *See* 17 CFR 232.201(a).

[1878] *See* 17 CFR 232.201(b).

[1879] *See* 17 CFR 232.202(a).

[1880] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33537. The Commission previously has made the temporary hardship exemption unavailable for EDGAR submissions of beneficial ownership reports filed by officers, directors and principal security holders under section 16(a) of the Exchange Act. *See Mandated Electronic Filing and Web site Posting for Forms 3, 4 and 5,* Securities Act Release No. 8230 (May 7, 2003), 68 FR 25788 (May 13, 2010).

[1881] *See DBRS Letter; ICI Letter; S&P Letter.*

[1882] *See ICI Letter.*

[1883] *See S&P Letter.*

[1884] *See DBRS Letter.*

[1885] *See DBRS Letter; S&P Letter.*

[1886] *See DBRS Letter.*

[1887] *See S&P Letter.*

[1888] *See ICI Letter.*

format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.[1889] Similarly, amended Item A.8 to the Instructions for Form NRSRO has been modified from the proposal to provide that an NRSRO must make these submissions ''electronically on EDGAR as a PDF document in the format required by the EDGAR Filer Manual as defined in Rule 11 of Regulation S–T.'' [1890] The amendments to Instruction A.9 to Form NRSRO, to include a reference to the instructions in Item A.8, are adopted as proposed.[1891]

Paragraph (d) of Rule 17g–3 has similarly been modified from the proposal to provide that the reports must be filed with or furnished to, as applicable, the Commission electronically on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.[1892] Paragraph (e) of Rule 17g–3 is adopted as proposed.[1893]

Rule 104 of Regulation S–T [1894] provides for ''unofficial PDF copies'' that are included in electronic submissions through EDGAR. Under the amendments, however, the electronic submissions will be ''official'' filings with the Commission. Accordingly, as adopted, paragraph (xiv) of Regulation S–T adds Form NRSRO and the information and documents in Exhibits 1 through 9 of Form NRSRO, filed with or furnished to, as applicable, the Commission pursuant to paragraphs (e), (f), and (g) of Rule 17g–1 and the annual reports filed with or furnished to, as applicable, the Commission pursuant to Rule 17g–3 as documents that must be filed electronically with the Commission; that the documents must be filed or furnished on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T; and that notwithstanding Rule 104 of Regulation S–T, the PDF documents filed or furnished pursuant to this paragraph will be considered as officially filed with or furnished to, as applicable, the Commission.[1895]

Finally, the Commission is modifying the proposal in response to comment,[1896] to make the temporary hardship exemption in Rule 201 available for the submissions of Form NRSRO and the information and documents submitted in the exhibits that must be filed with the form under paragraph (e), (f), or (g) of Rule 17g–1 and the annual reports required under Rule 17g–3. Accordingly, if an NRSRO has unanticipated technical difficulties beyond its control, such as a power outage or equipment failure, that prevent the timely preparation and submission of an electronic submission, the NRSRO may make the submission in paper form under the temporary hardship exemption under cover of Form TH no later than one business day after the submission was to be made. The NRSRO must submit an electronic copy within six business days of the submission of the paper document. This should mitigate the burden for an NRSRO that experiences a technical problem.

2. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to the requirement that NRSROs make certain submissions to the Commission electronically.[1897] The baseline that existed before today's amendments was one in which, as discussed above, applicants for registration as an NRSRO and NRSROs were required to submit Form NRSRO to the Commission in paper form.[1898] In addition, NRSROs were required to submit their annual reports under Rule 17g–3 in paper form.[1899] NRSROs were also required under paragraph (i) of Rule 17g–1 to make the public portions of their most recent Forms NRSRO publicly available within ten business days after submission to the Commission (or, in the case of an application for registration as an NRSRO or for an additional class of credit ratings, within ten business days after a Commission order granting such an application), and did so by posting electronic copies of their current Forms NRSRO and Exhibits 1 to 9 to these forms on their public Web sites. Investors interested in comparing the content of these forms across all NRSROs could visit each of the individual NRSRO Web sites to locate the forms, or use direct hyperlinks to the relevant Web pages published on the Commission's Web site.[1900]

Relative to the baseline, the amendments may provide benefits to users of credit ratings. In the proposing release, the Commission preliminarily identified potential benefits resulting from the proposed amendments.[1901] As discussed above, one commenter stated that having the information available immediately and in one location would benefit users of credit ratings by making it easier to access information about NRSROs and to compare the information provided by different NRSROs.[1902] However, an NRSRO commented that the Commission ''vastly overstated'' the benefits of the proposal.[1903] In response, the Commission more specifically identifies the sources of expected benefits in this release.

The electronic submission of Form NRSRO will allow the Commission to make the public portions of the Form NRSRO of each NRSRO publicly available on EDGAR immediately upon submission. Moreover, past submissions of Form NRSRO on the EDGAR system will remain available even after updated versions are submitted, benefitting users of credit ratings relative to the baseline by maintaining the availability of historical data that they may find useful in evaluating and comparing NRSROs.[1904] The Commission believes that the availability of these forms on EDGAR may also marginally benefit users of credit ratings by reducing the time and effort required to retrieve Forms NRSRO, since they will be consolidated in a single location rather than located on separate Web sites, and potentially reducing (by up to ten days, given the time allowed for NRSROs to post these forms on their Web sites) the delay before the forms are made publicly available. One NRSRO commented that users of credit ratings would be ''far more likely'' to continue to access Forms NRSRO from NRSRO Web sites instead of EDGAR, given that they may use these Web sites to access other useful information.[1905] In response, the Commission notes that Forms NRSRO are likely to be a helpful

[1889] *See* paragraphs (e) through (g) of Rule 17g–1.

[1890] *See* Instruction A.8 to Form NRSRO.

[1891] *See* Instruction A.9 to Form NRSRO.

[1892] *See* paragraph (d) of Rule 17g–3.

[1893] *See* paragraph (e) of Rule 17g–3.

[1894] 17 CFR 232.104.

[1895] *See* paragraph (a)(1)(xiv) of Rule 101 of Regulation S–T.

[1896] *See S&P Letter.*

[1897] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1898] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33482.

[1899] *See id.*

[1900] Hyperlinks to the NRSROs' Forms NRSRO are available on the Commission's Web site at *http://www.sec.gov/ocr.*

[1901] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33531.

[1902] *See ICI Letter.*

[1903] *See DBRS Letter.*

[1904] *See* section II.E.4. of this release (discussing the limitations of interpreting performance statistics computed using the single cohort approach using only the most current Forms NRSRO, since these forms would only contain information about the most recent cohorts of credit ratings).

[1905] *See DBRS Letter.*

starting point for evaluating and comparing NRSROs.

The Commission believes that the electronic submission of the Forms NRSRO and the Rule 17g–3 annual reports may marginally benefit NRSROs because they will avoid the uncertainties, delay, and expense related to the physical delivery of multiple paper copies of the submissions.

The Commission believes that the requirement that Forms NRSRO and the Rule 17g–3 annual reports be submitted through the EDGAR system may promote efficiency. As stated above, the availability of the public portions of Forms NRSRO on EDGAR will provide a centralized location for users of credit ratings to access these disclosures. The electronic submission of Forms NRSRO, including the confidential portions of these forms, and the annual reports, which will not be made public, will also assist the Commission staff in storing and accessing these records in furtherance of the Commission's NRSRO oversight function. To the extent that the ready access to the public portions of the current and, in the future, previous Forms NRSRO on EDGAR improves the ability of users of credit ratings to evaluate and compare NRSROs, the electronic submission requirement may also indirectly enhance competition.[1906]

These amendments will result in compliance costs to NRSROs, including costs to gain access to and become familiar with the EDGAR system. In the proposing release, the Commission stated that it believed that the initial costs to become familiar with the EDGAR system and adopt processes for using the system would be minimal and that the annual costs would be no greater than the costs attributable to paper submissions.[1907] One NRSRO commented that the Commission understated the initial costs of the proposal as ''an NRSRO will have to familiarize itself with the roughly 35 Rules of Regulation S–T as well as the first two volumes of the EDGAR Filer Manual (which currently total more than 600 pages) and related EDGAR technical guidance.'' [1908] However, the commenter did not provide a different estimate of the cost associated with the proposal.[1909] In response to this comment, the Commission notes that not all of Regulation S–T or the EDGAR Filer Manual applies to NRSRO submissions. In addition, the Commission has published on its Web site staff guidance for EDGAR filers and staff answers to frequently asked questions that may reduce the time required for NRSROs to familiarize themselves with the EDGAR system. Nonetheless, as discussed in section IV.D.1. of this release, the Commission has revised its estimate of the time required for an NRSRO to become familiar with the EDGAR system. The same commenter also stated that the Commission failed to consider the significant annual costs of monitoring changes in EDGAR filing requirements, but the commenter did not provide an estimate of these costs.[1910] In response, the Commission has added an estimated annual burden attributable to monitoring changes in EDGAR filing requirements.[1911] The Commission's estimates of these costs are provided below.

As discussed above, the Commission has also modified the requirement to submit certain Forms NRSRO and annual reports under Rule 17g–3 to the Commission electronically. One NRSRO described documents in PDF format as ''the most preferred and simplest'' way to provide the information.[1912] Another NRSRO commented that submission formats other than PDF would require ''very expensive'' reformatting and, because NRSROs post PDF versions of Form NRSRO on their Web sites, would result in costs of ''producing two sets of these documents in two different electronic formats on an ongoing basis.'' [1913] In response to these comments, the Commission has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents.

Based on analysis for purposes of the PRA, the Commission estimates that the amendments to Rule 17g–1, Form NRSRO, Rule 17g–3, and Regulation S–T regarding electronic submission of certain Forms NRSRO and NRSRO annual reports under Rule 17g–3 will result in total industry-wide one-time costs to NRSROs of approximately $46,000 and total industry-wide annual costs to NRSROs of approximately $6,000.[1914]

As discussed above, the Commission has modified the proposal to make the temporary hardship exemption available to NRSROs. Because the temporary hardship exemption process is self-executing, the Commission expects that any costs borne by NRSROs when availing of the temporary hardship exemption, including the cost to make the submission in paper form under the cover of Form TH, will be *de minimis.* Also, given that the Commission has simplified the technical requirements for the submissions by requiring PDF rather than XML or XBRL documents, and that the temporary hardship exemption will be available if an NRSRO nonetheless experiences unanticipated technical difficulties that prevent the timely preparation and submission of an electronic filing, the Commission does not expect NRSROs to apply for continuing hardship exemptions.

As discussed above, one reasonable alternative to the Commission's approach would be to require that the electronic submissions be made in XBRL or XML format. Two NRSROs stated that such formats would not provide incremental benefits, while one of these commenters stated that requiring such formats ''would substantially increase an NRSRO's costs'' and the other noted that ''a detailed technical analysis would need to be performed to determine the impact and any associated costs.'' [1915] However, one commenter suggested that requiring Exhibit 1 to Form NRSRO in particular to be submitted in XML or XBRL format would benefit investors, regulators, and other market participants.[1916] While the Commission agrees that submissions in these formats may benefit certain users of credit ratings by facilitating the comparative analysis of the quantitative data in the forms over time and across NRSROs, the Commission is sensitive to the concerns raised by NRSROs and has determined not to impose at this time a requirement that the submissions be made in XML or XBRL formats, in part to limit the additional compliance costs that would be borne by NRSROs. One NRSRO suggested that PDF copies of the required submissions should be transmitted via email, with the confidential submissions being encrypted before transmission.[1917] While such an approach may reduce the compliance costs associated with electronic submission, the Commission

[1906] *See* section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

[1907] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33531.

[1908] *See DBRS Letter.*

[1909] *See id.*

[1910] *See id.*

[1911] *See* section IV.D.1. of this release.

[1912] *See S&P Letter.*

[1913] *See DBRS Letter.*

[1914] *See* section V.N. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.1. and section IV.D.12. of this release.

[1915] *See DBRS Letter; S&P Letter.*

[1916] *See CFA II Letter.*

[1917] *See DBRS Letter.*

believes that the costs of using the EDGAR system are balanced by the benefits discussed above of using this system not only for delivery of electronic submissions to the Commission, but also for the dissemination and storage of these submissions.

M. Other Amendments

The Commission proposed additional amendments to several NRSRO rules in response to amendments the Dodd-Frank Act made to sections of the Exchange Act that authorize or otherwise are relevant to these rules and to clarify certain provisions of the NRSRO rules.[1918] The Commission is adopting these amendments as proposed.[1919]

1. Changing ''Furnish'' to ''File''

Before the enactment of the Dodd-Frank Act, the Exchange Act contained provisions requiring NRSROs to ''furnish'' certain items to the Commission. For example, section 15E(k) of the Exchange Act required NRSROs to ''furnish'' financial information to the Commission.[1920] Section 932(a) of the Dodd-Frank Act amended several Exchange Act provisions relating to NRSROs to replace the word ''furnish'' with the word ''file'' in section 15E(b) (which addresses NRSRO submission of updates of registration and annual certifications to the Commission); section 15E(d) (which addresses Commission sanctions on NRSROs); section 15E(k) (which addresses NRSRO submission of financial information to the Commission); and section 15E(l) (which provides that registration under section 15E of the Exchange Act is the sole method of registration as an NRSRO).[1921] For example, section 15E(b)(2), as amended, provides that an NRSRO shall ''file'' its annual certification with the Commission. In accordance with the Dodd-Frank Act amendment to section 15E(b) of the Exchange Act, the Commission proposed amending paragraphs (e) and (f) of Rule 17g–1, which address the submission of updates of registration and annual certifications, respectively, to require that the Forms NRSRO submitted to the Commission under those provisions be filed with, rather than furnished to, the Commission.[1922] Similarly, in accordance with the Dodd-Frank Act amendment to section 15E(k) of the Exchange Act, the Commission proposed amending paragraphs (a)(1) through (a)(5) of Rule 17g–3 to require that the reports submitted to the Commission under those provisions be filed with, rather than furnished to, the Commission.[1923]

The Dodd-Frank Act, however, did not replace the word ''furnish'' with the word ''file'' in sections 15E(a) and 15E(e) of the Exchange Act (which address the submission of initial applications for registration as an NRSRO and the submission of voluntary withdrawals from registration, respectively), or in section 17(a)(1) of the Exchange Act (which provides the Commission with authority to, among other things, require NRSROs to furnish reports to the Commission).[1924]

The Commission stated in the proposing release that it preliminarily believed that the failure to replace the word ''furnish'' with the word ''file'' in section 15E(a) of the Exchange Act was an inadvertent omission.[1925] For example, section 15E(b)(1) of the Exchange Act, as amended by the Dodd-Frank Act, refers to information ''required to be *filed*'' under section 15E(a)(1)(B)(i) of the Exchange Act (emphasis added).[1926] Similarly, section 15E(d)(1)(B) of the Exchange Act, as amended by the Dodd-Frank Act, refers to ''the date on which an application for registration is *filed* with the Commission'' (emphasis added).[1927] In addition, the legislative history of section 932(a) states that ''[Title IX, Subtitle C, of the Dodd-Frank Act] requires all references to 'furnish' be replaced with the word 'file' in existing law.'' [1928] Consequently, the Commission proposed amending paragraphs (a), (b), and (c) of Rule 17g–1 (which address initial applications for registration as an NRSRO, applications to register for an additional class of credit ratings, and supplementing an application, respectively) to substitute the words ''file with the Commission two paper copies of'' in place of the words ''furnish the Commission with.'' [1929]

The Commission did not propose replacing the word ''furnish'' with the word ''file'' in paragraph (d) of Rule 17g–1 (which addresses the withdrawal of an application for registration) or in paragraph (g) of Rule 17g–1 (which addresses the submission of voluntary withdrawals from registration).[1930] Consequently, as proposed, when referencing the submission of Form NRSRO to the Commission, paragraphs (h) and (i) of Rule 17g–1 (which include provisions relating to when a Form NRSRO will be considered filed with or furnished to the Commission and the public availability of Form NRSRO, respectively) would use phrases such as ''filing with or furnishing to, as applicable.'' [1931]

The Commission also did not propose to amend paragraph (a)(6) of Rule 17g–3 to treat the report identified in that paragraph (an unaudited report of the number of credit rating actions taken during the fiscal year) as a filing. That paragraph was adopted under section 17(a)(1) of the Exchange Act.[1932] Section 17(a)(1) of the Exchange Act provides that any report an NRSRO ''is required by Commission rules under this paragraph to make and disseminate to the Commission shall be deemed furnished to the Commission.'' [1933] As stated above, the Dodd-Frank Act did not amend this provision.

The Commission proposed amending Form NRSRO and the instructions to Form NRSRO to conform the form and its instructions to the proposed amendments discussed above.[1934] Under the proposed amendments, Form NRSRO and the Instructions to Form NRSRO would use the word ''file'' instead of the word ''furnish'' when referring to a Form NRSRO submitted

[1918] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33485–33489.

[1919] The Commission is also making a technical amendment to paragraphs (e) and (f) of Rule 17g–1 to replace the phrase ''Exhibits . . . of Form NRSRO'' to the phrase ''Exhibits. . . to Form NRSRO'' for consistency with paragraph (i) of Rule 17g–1 and a technical amendment to paragraph (i) of Rule 17g–1 to replace the word ''paragraphs'' with the word ''paragraph.''

[1920] *See* Public Law 109–291, 4(a) (adding section 15E to the Exchange Act).

[1921] *See* Public Law 111–203, 932(a); 15 U.S.C. 78o–7(b), (d), (k), and (l). Among other things, an application, report, or document ''filed'' with the Commission pursuant to the Exchange Act or rules under the Exchange Act is subject to the provisions of section 18 of the Exchange Act. *See* 15 U.S.C. 78o–7r. As explained below, however, the Dodd-Frank Act did not replace all references in Exchange Act provisions relating to NRSROs from ''furnish'' to ''file.''

[1922] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33538.

[1923] *See id.* at 33539. The Commission adopted paragraphs (a)(1) through (a)(5) of Rule 17g–3 under section 15E(k). *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33590–33593.

[1924] *See* 15 U.S.C. 78o–7(e); 15 U.S.C. 78q(a)(1).

[1925] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33485.

[1926] *See* 15 U.S.C. 78o–7(a)(1)(B)(i).

[1927] *See* 15 U.S.C. 78o–7(d)(1)(B).

[1928] *See Conference Report,* H.R. 4173 (June 29, 2010), p. 872.

[1929] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33538.

[1930] *See id.*

[1931] *See id.*

[1932] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6464–6465.

[1933] *See* 15 U.S.C. 78o–7q(a)(1).

[1934] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33546–33561.

under paragraphs (a), (b), (c), (e), and (f) of Rule 17g–1. In addition, in some cases, the Commission proposed using the term ''submit'' when referring to a Form NRSRO that may have been submitted prior to enactment of the Dodd-Frank Act when the submission would have been ''furnished to'' as opposed to ''filed with'' the Commission. The Commission intended the word ''submit'' as used in this context to mean the submission was either ''furnished'' or ''filed'' depending on the applicable securities laws in effect at the time of the submission.

The Commission did not receive comments on the proposals to amend Rule 17g–1, Rule 17g–3, Form NRSRO, and the instructions to Form NRSRO to replace the word ''furnish'' with the word ''file'' and is adopting the amendments as proposed.

2. Amended Definition of NRSRO

The first prong of the definition of *nationally recognized statistical rating organization* in section 3(a)(62) of the Exchange Act, prior to being amended by the Dodd-Frank Act, provided that the entity ''has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under section 15E.'' [1935] Section 932(b) of the Dodd-Frank Act deleted this prong of the definition.[1936] Instruction F.4 to Form NRSRO contained a definition of *nationally recognized statistical rating organization* that incorporated the section 3(a)(62) definition as originally enacted.[1937] The Commission proposed amending this definition to conform it to the section 3(a)(62) definition as amended by the Dodd-Frank Act.[1938]

Two NRSROs supported this amendment,[1939] and the Commission is adopting it as proposed.

3. Definition of Asset-Backed Security

Prior to today's amendments, several of the Commission's NRSRO rules had requirements that were specific to credit ratings for structured finance products by providing that the rules apply to credit ratings with respect to ''a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.'' [1940] This text mirrors the text of section 15E(i) of the Exchange Act, which provides the Commission with authority to prohibit an NRSRO from the practice of ''lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the [NRSRO].'' [1941] The Commission has provided the following interpretation with respect to this text in its rules:

> The term ''structured finance product'' as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This broad category of financial instrument includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities (''RMBS'') and to other types of structured debt instruments such as collateralized debt obligations (''CDOs''), including synthetic and hybrid CDOs, or collateralized loan obligations (''CLOs'').[1942]

Section 941(a) of the Dodd-Frank Act amended section 3 of the Exchange Act to add paragraph (a)(79), which defines the term *asset-backed security*.[1943] The Exchange Act definition of *asset-backed security* includes a ''collateralized mortgage obligation.'' [1944] Consequently, the Commission stated in the proposing release that the current identification of structured finance products in the Commission's rules (namely, ''a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction'') may have redundant terms because the new definition of *asset-backed security* in section 3(a)(79) of the Exchange Act as an ''asset-backed securities transaction'' would include a ''mortgage-backed securities transaction.'' [1945] Consequently, the Commission stated in the proposing release that it preliminarily believed that the inclusion of the term ''mortgage-backed securities transactions'' in certain of the Commission's NRSRO rules may be redundant.[1946] The Commission therefore proposed deleting the term ''or mortgage-backed'' from the identification of structured finance products in these rules.[1947] One NRSRO supported the proposal,[1948] and another NRSRO stated that it would not change the requirements of the affected rules.[1949] The Commission is adopting the amendments as proposed.

4. Other Amendments to Form NRSRO

The Commission proposed clarifying amendments to Form NRSRO to better ensure that disclosures on Form NRSRO are consistent across applicants and NRSROs.[1950]

a. Clarification With Respect to Items 6 and 7

Items 6 and 7 of Form NRSRO elicit information concerning the number of credit ratings an applicant or NRSRO has outstanding in each class of credit ratings for which the applicant is applying to be registered or for which the NRSRO is registered, respectively.[1951] Item 6 applies to initial applications for registration as an NRSRO, application supplements, and applications to add a class of credit ratings. Item 7 applies for updates of registration, annual certifications, withdrawals from registration, and applications to add a class of credit ratings. The classes of credit ratings for which an NRSRO can be registered are: (1) Financial institutions, brokers, or dealers; [1952] (2) insurance companies; [1953] (3) corporate issuers; [1954] (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, ''as in effect on the date of enactment of this paragraph''); [1955] and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.[1956]

NRSROs have raised questions about how they should count the number of credit ratings outstanding in a given class of credit ratings for the purposes

[1935] *See* Public Law 109–291, 3(a) (adding section 3(a)(62) to the Exchange Act).

[1936] *See* Public Law 111–203, 932(b).

[1937] This instruction, ''Explanation of Terms,'' was numbered as ''Instruction F'' before today's amendments. It should have been numbered as ''Instruction I.''

[1938] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33560. The Instruction is numbered I.4 in the Instructions to Form NRSRO.

[1939] *See DBRS Letter; S&P Letter.*

[1940] *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33486 (referencing paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g–2, paragraph (a)(6) of Rule 17g–3, paragraphs (a)(3) and (b)(9) of Rule 17g–5, and paragraph (a)(4) of Rule 17g–6).

[1941] *See* 15 U.S.C. 78o–7(i).

[1942] *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63832, footnote 3 (Dec. 4, 2009).

[1943] *See* Public Law 111–203, 941(a); 15 U.S.C. 78c(a)(77).

[1944] *See* 15 U.S.C. 78c(a)(77)(A)(i).

[1945] *See* 15 U.S.C. 78c(a)(77)(A).

[1946] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33486–33487; 15 U.S.C. 78c(a)(79)(A).

[1947] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33539–33540.

[1948] *See DBRS Letter.*

[1949] *See S&P Letter.* The Commission agrees with the commenter.

[1950] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33487–33489.

[1951] *See* Form NRSRO, Items 6–7.

[1952] *See* 15 U.S.C. 78c(a)(62)(A)(i).

[1953] *See* 15 U.S.C. 78c(a)(62)(A)(ii).

[1954] *See* 15 U.S.C. 78c(a)(62)(A)(iii).

[1955] *See* 15 U.S.C. 78c(a)(62)(A)(iv).

[1956] *See* 15 U.S.C. 78c(a)(62)(A)(v).

of Form NRSRO.[1957] For example, the GAO has found that some NRSROs counted the number of issuers rated but not the number of securities or money market instruments rated, some NRSROs counted the number of securities or money market instruments rated and excluded the number of rated obligors in the total, and some NRSROs counted the number of obligors, securities, and money market instruments rated.[1958]

The Commission's intent in Items 6 and 7 is to elicit the total number of obligors, securities, and money market instruments in a given class of credit ratings for which the applicant or NRSRO has assigned a credit rating that was outstanding as of the applicable date (the date of the application in the case of Item 6 and the date of the most recent calendar year-end in the case of Item 7). Consequently, the Commission proposed amending Items 6.A and 7.A of Form NRSRO to specify that an applicant or NRSRO must provide the ''approximate number of obligors, securities, and money market instruments'' for each class of credit ratings for which the applicant or NRSRO has an outstanding credit rating.[1959]

In addition, the Commission proposed amending Instruction H to Form NRSRO (as it relates to Items 6.A and 7.A) in four ways.[1960] First, in conformity with the proposed amendments to the text of Items 6.A and 7.A in the Form, the instructions would be amended to provide that the applicant or NRSRO must, for each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments in that class for which the applicant or NRSRO presently has a credit rating outstanding as of the date of the application (Item 6.A) or had a credit rating outstanding as of the most recently ended calendar year (Item 7.A).

Second, Instruction H was proposed to be amended to provide that the applicant or NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer.[1961] This proposed instruction was designed to clarify that each security or money market instrument of an issuer must be included in the count if it is assigned a credit rating by the applicant or NRSRO. For example, if the issuer is in the structured finance class, each tranche of the structured finance product that is assigned a credit rating must be included in the count. In addition, if an issuer issues securities or money market instruments that have different maturities, the applicant or NRSRO must include each such security in the count if the NRSRO assigns a credit rating to the security or money market instrument.

Third, Instruction H was proposed to be amended to provide that the applicant or NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating.[1962] In other words, the applicant or NRSRO cannot double count an obligor, security, or money market instrument by including it in the totals for two or more classes of credit ratings. For example, some securities have characteristics that could cause an applicant or NRSRO to classify them as municipal securities or structured finance products.[1963] Nonetheless, under the proposed amendment, the applicant or NRSRO would need to select the most appropriate class for the security or money market instrument and include it in the count for that class.

Fourth, Instruction H was proposed to be amended to provide that the applicant or NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities), to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction.[1964] Section 3(a)(62)(B)(iv) contains a narrower definition of *asset-backed security* than the Commission uses for the purposes of its NRSRO rules.[1965] In fact, the definition is narrower than the new definition of *asset-backed security* in section 3(a)(79) of the Exchange Act.[1966] The Commission intends an applicant and an NRSRO to use the broader definition that captures all structured finance products when providing the number of credit ratings outstanding in this class. The proposed amendments to Instruction H to Form NRSRO were designed to make this intention more clear.

Two NRSROs supported the proposed amendments to Items 6 and 7 of Form NRSRO and the related Instructions to Form NRSRO.[1967] The Commission is adopting them as proposed.

Because some obligors, securities, and money market instruments have characteristics that could cause them to be assigned to more than one class of credit rating, the Commission sought comment on which class would be the most appropriate for these types of obligors, securities, and money market instruments. For example, the Commission requested comment on how tax-exempt housing bonds should be classified for purposes of Items 6 and 7 of Form NRSRO.[1968] Several NRSROs provided comment in response to this request.[1969] One NRSRO stated that the Commission should create a new subclass of credit ratings under the insurance company class to distinguish traditional insurance companies from the special-purpose vehicles set up solely to provide reinsurance to insurance carriers.[1970] Two NRSROs stated that tax-exempt housing bonds should be classified in the category for issuers of government securities; supra-national issuers should be classified in the category for issuers of government securities; and covered bonds should be classified in the category for financial institutions.[1971] One NRSRO stated that if a municipality issues securities on behalf of a for-profit healthcare company, the securities should be classified as government securities, and that securitizations of healthcare receivables and insurance-linked securities are both typically classified in the asset-backed security category.[1972] Another NRSRO stated that covered bonds that are effectively ''repackaged'' should be classified as issuers of asset-backed securities; that healthcare revenue bonds or industrial revenue bonds should be classified as corporate

[1957] *See, e.g.,* GAO Report 10–782, pp. 46–47.

[1958] *See id.*

[1959] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33487–33488, 33547–33549.

[1960] *See id.* at 33487–33488, 33554–33555.

[1961] *See id.*

[1962] *See id.*

[1963] For example, tax exempt housing bonds share characteristics of both municipal securities and structured finance products.

[1964] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33487–33488, 33554–33555.

[1965] *Compare* 15 U.S.C. 78c(a)(62)(B)(iv), *with:* Instructions for Exhibit 1 to Form NRSRO; paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g–2; paragraph (a)(6) of Rule 17g–3; paragraphs (a)(3) and (b)(9) of Rule 17g–5; and paragraph (a)(4) of Rule 17g–6.

[1966] *Compare* 15 U.S.C. 78c(a)(62)(B)(iv), *with* 15 U.S.C. 78c(a)(79).

[1967] *See DBRS Letter; S&P Letter.*

[1968] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33488.

[1969] *See A.M. Best Letter; DBRS Letter; S&P Letter.*

[1970] *See A.M. Best Letter.*

[1971] *See DBRS Letter; S&P Letter.*

[1972] *See DBRS Letter.*

securities; that insurance-linked securities should be classified as insurance companies; that energy prepay transactions should be classified as a corporate issuer; and that Airline Enhanced Equipment Trust Certificates should be classified as corporate debt.[1973]

Given the complexity of trying to classify every type of obligor, security, or money market instrument that potentially could straddle two or more classes of credit ratings, the Commission is deferring making specific classifications for purposes of Items 6 and 7 of Form NRSRO. Instead, an NRSRO should make reasonable and consistent judgments about the classification of these types of obligors, securities, and money instruments.

b. Clarification With Respect to Exhibit 8

The Commission proposed amending Instruction H to Form NRSRO as it relates to Exhibit 8.[1974] Exhibit 8 requires an applicant or NRSRO to provide the number of credit analysts it employs and the number of its credit analyst supervisors. The Commission proposed two amendments to the instructions for Exhibit 8. The first amendment would delete a parenthesis that instructs the applicant or NRSRO to ''see definition below'' of the term *credit analyst* because that term is not defined in the Form. The second amendment would clarify that the applicant or NRSRO, in providing the number of its credit analysts, should include the number of its credit analyst supervisors. This was designed to ensure that the disclosures in Form NRSRO are consistent across applicants and NRSROs.[1975]

One NRSRO stated that it supported the proposal to amend Instruction H as it relates to Exhibit 8 to Form NRSRO,[1976] and the Commission is adopting it as proposed.

c. Clarification With Respect to Exhibits 10 Through 13

Before today's amendments, paragraph (i) of Rule 17g–1 required an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 to Form NRSRO publicly available on its Internet Web site, or through another comparable, readily accessible means within ten business days after the date of the Commission order granting an initial application for registration or an application to register for an additional class of credit ratings and within ten business days after submitting a Form NRSRO under paragraph (e), (f), or (g) of Rule 17g–1 (an update of registration, an annual certification, or a withdrawal from registration).[1977] An NRSRO is not required to make Exhibits 10 through 13 to Form NRSRO publicly available or update them after registration. Instead, an NRSRO must provide similar information in the annual reports required to be filed with the Commission under Rule 17g–3.[1978] In the past, some NRSROs have submitted the annual reports required by Rule 17g–3 in the form of Exhibits 10 through 13, on a confidential basis, as part of the annual certification. Consequently, the Commission proposed amending Instruction H as it relates to Exhibits 10 through 13 to add a ''Note'' instructing that after registration, Exhibits 10 through 13 should not be updated with the filing of the annual certification, but that similar information must be filed with the Commission not more than ninety days after the end of each fiscal year under Rule 17g–3.[1979]

One NRSRO supported the proposal to amend Instruction H as it relates to Exhibits 10 through 13 to Form NRSRO,[1980] and the Commission is adopting it as proposed.

5. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the additional amendments to several NRSRO rules made in response to amendments the Dodd-Frank Act made to sections of the Exchange Act that authorize or otherwise are relevant to these rules and to clarify certain provisions of the NRSRO rules.[1981] Many of these amendments clarify what is required of NRSROs by making terms in Commission rules applicable to NRSROs consistent with the amendments that the Dodd-Frank Act made to terms in section 15E of the Exchange Act. These clarifying amendments—including the replacement of ''furnish'' with ''file'' with respect to updates of registration and annual certifications and the amended definitions of *nationally recognized statistical rating organization* and *asset-backed security*—should result in no incremental costs and may benefit NRSROs by removing the potential ambiguity caused by inconsistent terms.

As discussed above, beyond these clarifying amendments made for consistency with section 15E of the Exchange Act, the Commission has adopted amendments to replace the word ''furnish'' with the word ''file'' in paragraphs (a), (b), and (c) of Rule 17g–1 (which address initial applications for registration as an NRSRO, applications to register for an additional class of credit ratings, and supplementing an application, respectively) based on its belief, as stated in the proposing release, that the failure to make this replacement in section 15E(a) of the Exchange Act was an inadvertent omission and that the legislative history of the Dodd-Frank Act states that the statute requires all references to ''furnish'' to be replaced with ''file.''[1982] These replacements of ''furnish'' with ''file'' may cause applicants for registration as an NRSRO and NRSROs applying to register for an additional class of credit ratings to take the same care in composing these applications as they would in any updates of registration and annual certifications (which are required to be ''filed'' under the baseline), given that section 18 of the Exchange Act imposes liability for material misstatements or omissions contained in reports and other information filed with the Commission, which may result in marginal incremental costs to these applicants.

The amendments discussed in section II.M.4. of this release regarding clarifications to the instructions to Form NRSRO should benefit users of credit ratings. The use by NRSROs of different approaches to computing the numbers of outstanding credit ratings, credit rating analysts, and credit rating analyst supervisors reported in Form NRSRO—without disclosing the method employed—has made it difficult to interpret and compare these numbers in the past.[1983] The amendments therefore

[1973] *See S&P Letter.*

[1974] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33489, 33555.

[1975] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33489.

[1976] *See DBRS Letter.*

[1977] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33489.

[1978] *See* 17 CFR 240.17g–3.

[1979] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33489, 33559–33560.

[1980] *See DBRS Letter.*

[1981] The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

[1982] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33485.

[1983] *See, e.g.,* GAO Report 10–782, p. 46–47. In its review of the disclosure of outstanding credit ratings, the GAO concluded that ''[b]ecause of the inconsistencies in how the NRSROs count their total outstanding ratings, users cannot rely on the disclosures to assess how broad an NRSRO's coverage is within a particular class of credit ratings.'' The GAO also found that NRSROs did not disclose the methodologies applied to count credit ratings, ''so users have no way of knowing that these differences exist.''

will improve the ability of users of credit ratings to interpret this information regarding the breadth of NRSRO coverage and NRSRO staffing and compare the information across NRSROs. Also, the amendments will allow the Commission to develop a clearer picture of the NRSROs and their activities and thus facilitate the Commission's oversight, which may indirectly lead to enhancements in the quality of credit ratings to the benefit of users of credit ratings. The amendments may impose one-time costs on NRSROs because they may need to adjust their calculations of their numbers of outstanding credit ratings, credit rating analysts, and credit rating analyst supervisors. However, the Commission believes these costs will be *de minimis.*

III. Effective Dates

As discussed below, the Commission is establishing effective dates for the amendments to existing rules and new rules that are intended to take into account the period of time NRSROs, issuers, underwriters, and providers of third-party due diligence services will need in order to establish new, or adapt existing, policies, procedures, controls, systems, standards, and practices to comply with the new requirements. If any provision of these amendments or new rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

A. Amendments Effective Sixty Days After Publication In the ***Federal Register***

The following amendments to existing rules are effective sixty days after this release is published in the **Federal Register**: The amendment to Rule 101 of Regulation S–T; the amendments to paragraphs (e), (f), and (g) of Rule 17g–1; and new paragraph (d) of Rule 17g–3. These amendments require Form NRSRO and applicable exhibits (in the case of an update of registration, an annual certification, or a withdrawal from registration) and the annual reports under Rule 17g–3 to be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system. However, these Forms NRSRO (and applicable exhibits) and the annual reports should continue to be submitted to the Commission in paper form until the Commission provides notice that the EDGAR system is ready to receive the forms and reports and specifies a date on or after which the forms and reports must be submitted through the EDGAR system.

Also effective sixty days after publication in the **Federal Register** are: (1) The amendments to paragraphs (a), (b), (c), (e), and (f) of Rule 17g–1 and paragraphs (a)(1), (a)(2), (a)(3), (a)(4), and (a)(5) of Rule 17g–3 replacing the word ''furnish'' with the word ''file;'' (2) the amendments to paragraphs (a), (b), (c), and (d) of Rule 17g–1 requiring two paper copies of submissions; the amendment to paragraph (i) of Rule 17g–1 requiring NRSROs to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet Web sites and to provide a paper copy of Exhibit 1 to individuals who request a paper copy; (3) the amendments to paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g–2, the note to paragraph (a)(6) of Rule 17g–3, paragraphs (a)(3) and (b)(9) of Rule 17g–5, and paragraph (a)(4) of Rule 17g–6, which delete the term ''or mortgage-backed'' from the identification of structured finance products; (4) new paragraph (b)(12) of Rule 17g–2, which identifies the internal control structure an NRSRO must establish, maintain, enforce, and document under section 15E(c)(3)(A) of the Exchange Act as a record that must be retained; (5) the amendment to paragraph (c) of Rule 17g–2, which identifies each record an NRSRO must retain until three years after it is replaced with an updated record; (6) the amendment to paragraph (d) of Rule 17g–2, which repeals paragraph (d)(2) (the 10% Rule); (7) new paragraph (a)(8) of Rule 17g–3, which identifies the annual report of the designated compliance officer as one of the unaudited reports that must be filed with the Commission under that rule; (8) new paragraph (e) of Rule 17g–3, which relates to information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules; (9) new paragraph (f) of Rule 17g–5, which provides that upon written application by an NRSRO, the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest; (10) new paragraph (g) of Rule 17g–5, which provides for penalties the Commission may impose on an NRSRO in a proceeding in which the Commission finds that the NRSRO has violated rules under section 15E(h) of the Exchange Act and the violation affected a credit rating; and (11) the amendments to paragraphs (h) and (i) of Rule 17g–1, paragraphs (b)(1) and (b)(11) of Rule 17g–2, paragraphs (a)(1), (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), and (b)(1) of Rule 17g–3 and the heading thereof, and paragraphs (a)(3)(i), (a)(3)(ii), (a)(3)(iii)(A), (a)(3)(iii)(B), (a)(3)(iii)(C), (a)(3)(iii)(D), and (e) of Rule 17g–5, which are minor amendments such as wording changes. The Commission did not receive comments specifically addressing the effective date for these amendments and does not believe that additional time is needed in order to prepare for the changes that will result from these amendments.

B. Amendments Effective on January 1, 2015

The Commission is delaying the effective date for new paragraphs (a)(7) and (b)(2) of Rule 17g–3 and the amendments to Form NRSRO until January 1, 2015. The Commission intends that the practical effect of having these amendments become effective on January 1, 2015 is that the first internal controls report required to be submitted by an NRSRO will cover the fiscal year that ends on or after January 1, 2015, and the first annual certification on Form NRSRO that follows the amended instructions for Exhibit 1 relating to performance statistics and the amended instructions to Item 7.A relating to the number of credit ratings outstanding will be required for the annual certifications filed after the end of the 2015 calendar year.

Paragraph (a)(7) of Rule 17g–3 requires an NRSRO to include an additional report—a report on the NRSRO's internal control structure established under section 15E(c)(3)(A) of the Exchange Act—with its annual submission of reports to the Commission pursuant to Rule 17g–3, and paragraph (b)(2) requires the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions to provide a signed statement that must be attached to the report.

One NRSRO stated that the Commission should not require the internal controls report to be submitted until ''the Commission publishes its guidance and provides a reasonable time for the implementation of this guidance to be completed and timely exam feedback is provided.'' [1984] The Commission notes that, in addition to the guidance provided above in section

[1984] *See Morningstar Letter.*

II.A.3. of this release, the final amendment provides more specificity than the proposed rule as to the information that must be included in the internal controls report in terms of assessing the effectiveness of the NRSRO's internal control structure. Moreover, the final amendment specifies when the NRSRO is not permitted to conclude that its internal control structure is effective and includes a description of when a material weakness exists, which will provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure. The delayed effective date will provide NRSROs with time to prepare processes to obtain the evidentiary matter necessary to make the assessments necessary to support the information that must be provided in the report. Consequently, an NRSRO must begin filing with the Commission an annual internal controls report no later than ninety calendar days after the end of the NRSRO's fiscal year that ends on or after January 1, 2015.[1985]

The amendments to Form NRSRO include the following: (1) The amendment to the instructions for Form NRSRO adding new Instruction A.10, which provides notice to credit rating agencies applying for registration as NRSROs, and NRSROs, that an NRSRO is subject to the fine and penalty provisions and other available sanctions in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act for violations of the securities laws; (2) the amendment to the instructions for Form NRSRO requiring that Form NRSRO and Exhibits 1 through 9 to Form NRSRO, as applicable, under paragraph (e), (f), or (g) of Rule 17g–1 (an update of registration, an annual certification, or a withdrawal from registration, respectively) be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system;[1986] (3) the clarifying amendments with respect to Items 6 and 7 of Form NRSRO, which elicit information concerning the number of credit ratings an applicant or NRSRO has outstanding in each class of credit ratings for which the applicant is applying to be registered or for which the NRSRO is registered;[1987] (4) the amendments to the instructions for Exhibit 1 to Form NRSRO, which requires standardized ''Transition/Default Matrices'' and prescribes the method of calculating transition and default rates;[1988] and (5) the amendments to Form NRSRO not discussed above, including technical amendments.

C. Amendments and New Rules Effective Nine Months After Publication In the ***Federal Register***

The Commission is delaying the effective date for new paragraphs (a)(9), (b)(13), (b)(14), and (b)(15) of Rule 17g–2, new paragraphs (a)(3)(iii)(E) and (c)(8) of Rule 17g–5, the amendments to paragraphs (c)(6) and (c)(7) of Rule 17g–5, the amendments to paragraphs (a) and (b) of Rule 17g–7, paragraphs (a), (b), (c), and (d) of new Rule 17g–8, new Rule 17g–9, new Rule 17g–10, new Form ABS Due Diligence–15E, new Rule 15Ga–2, and the amendment to Form ABS–15G until nine months after this release is published in the **Federal Register**. This delayed effective date is intended to provide time for NRSROs, issuers, underwriters, and providers of third-party due diligence services to prepare for the changes that will result from these new requirements.

Paragraph (c)(8) of Rule 17g–5 prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations. The amendments to paragraphs (c)(6) and (c)(7) of Rule 17g–5 remove an ''or'' after paragraph (c)(6) and add an ''or'' after paragraph (c)(7) because of the addition of paragraph (c)(8) to the rule.

The amendments to paragraph (a) of Rule 17g–7 require NRSROs, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action and any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.

One NRSRO urged the Commission to provide ''sufficient lead time'' of ''at least one year'' for complying with the proposed amendments to paragraph (a) of Rule 17g–7 to enable NRSROs to ''employ a rigorous process for developing and testing the changes to software and systems needed to implement the requirement,'' stating that several processes and technological systems would need to be updated and implemented.[1989] Another NRSRO stated that it would take at least 270 days to achieve compliance with the requirements of the proposed rule.[1990] The Commission agrees that NRSROs may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements related to the form and certifications to accompany credit ratings. Accordingly, the Commission is delaying the effective date for the amendments to paragraph (a) of Rule 17g–7 until nine months after this release is published in the **Federal Register**.

The amendments to paragraph (b) of Rule 17g–7 recodify requirements formerly prescribed in paragraph (d)(3) of Rule 17g–2 and substantially enhance the requirements, requiring NRSROs to disclose rating history information in XBRL format for free on an easily accessible portion of their Web sites, add more rating histories to the disclosure, provide more information about each rating action, and not remove a rating history from the

[1985] Based on the most recent submissions of Form NRSRO, eight of the NRSROs have December 31 fiscal year ends. Consequently, for these firms, the first internal controls report of the NRSRO must be filed no later than ninety days after December 31, 2015. One NRSRO has a fiscal year end of November 30 and, consequently, the first internal controls report for this firm must be filed no later than ninety days after November 30, 2015. Another NRSRO has a fiscal year end of March 31 and, consequently, the first internal controls report for this firm must be filed no later than ninety days after March 31, 2015. If an NRSRO's fiscal year ends in 2015 before December 31, the NRSRO may submit an internal controls report for that fiscal year that covers the period beginning on January 1, 2015 through the end of the NRSRO's then-current fiscal year. Alternatively, the NRSRO may instead elect to have the report cover its entire fiscal year. *See Frequently Asked Questions Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule* (Apr. 4, 2014), *available at http://www.sec.gov/divisions/marketreg/amendments-to–broker-dealer-reporting–rule-faq.htm* (providing guidance to broker-dealers with respect to the transition period for a similar reporting requirement).

[1986] As discussed above, NRSROs should continue to submit Forms NRSRO and applicable exhibits to the Commission in paper form until the Commission provides notice that the EDGAR system is ready to receive the forms and specifies a date on and after which the forms and reports must be submitted through the EDGAR system.

[1987] The Commission notes that although the amendments to the instructions for Item 7.A of Form NRSRO will not be effective on December 31, 2014, an NRSRO may elect to use the instructions for Item 7.A that are in effect on that date for purposes of submitting an annual certification covering calendar year 2014.

[1988] The Commission notes that although the amendments to the instructions for Exhibit 1 to Form NRSRO will not be effective on December 31, 2014, an NRSRO may elect to use the instructions for Exhibit 1 that are in effect on that date for purposes of submitting an annual certification covering calendar year 2014.

[1989] *See Moody's Letter; see also Morningstar Letter.*

[1990] *See DBRS Letter.*

disclosure until fifteen years after the NRSRO withdraws the rating.

One NRSRO stated that implementing the changes required in proposed paragraph (b) of Rule 17g–7 would generally require ''significant lead time,'' [1991] and another NRSRO stated that it would take at least 270 days to achieve compliance with the proposed rule.[1992] A third NRSRO requested that the Commission provide more time to comply with the proposed new requirements to NRSROs offering subscription-based services which include frequent surveillance.[1993] The Commission agrees that NRSROs may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements relating to rating histories disclosures. Accordingly, the Commission is delaying the effective date for the amendments to paragraph (b) of Rule 17g–7 until nine months after this release is published in the **Federal Register**. The Commission believes that this delayed effective date provides a sufficient amount of time for all NRSROs, including those with a subscription-based business model, to comply with the new requirements.

Paragraph (a) of Rule 17g–8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies the NRSRO uses to determine credit ratings, and new paragraph (b)(13) of Rule 17g–2 identifies the policies and procedures with respect to the procedures and methodologies used to determine credit ratings that an NRSRO must document pursuant to paragraph (a) of new Rule 17g–8 as a record that must be retained.

Paragraph (b) of Rule 17g–8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings, and new paragraph (b)(14) of Rule 17g–2 identifies the policies and procedures with respect to credit rating symbols, numbers, or scores that an NRSRO must document under paragraph (b) of Rule 17g–8 as a record that must be retained.

One NRSRO stated that proposed paragraph (b) of Rule 17g–8 could require some NRSROs to change their rating symbol systems for certain categories of obligors or obligations and requested a compliance deadline of at least twenty-four months for any such change.[1994] The Commission does not believe that all NRSROs will need to change their rating symbol systems in order to comply with new requirements relating to universal rating symbols. If an NRSRO must make such change, however, the Commission believes that the delayed effective date of nine months after this release is published in the **Federal Register** provides sufficient time for such NRSRO to comply with the new requirements in paragraph (b) of new Rule 17g–8 and new paragraph (b)(14) of Rule 17g–2.

Paragraph (c) of Rule 17g–8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed. New paragraph (a)(9) of Rule 17g–2 identifies the policies and procedures of an NRSRO with respect to look-back reviews as a record that must be made and retained.

Paragraph (d) of Rule 17g–8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act.

Rule 17g–9 requires NRSROs to establish, maintain, enforce, and document standards of training, experience, and competence for their credit analysts that are reasonably designed to achieve the objective that the NRSROs produce accurate credit ratings in the classes of credit ratings for which they are registered. The rule identifies four factors the NRSRO must consider when designing the standards and provides that the standards must include a requirement for periodic testing and a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, must participate in the determination of a credit rating. New paragraph (b)(15) of Rule 17g–2 requires that NRSROs retain a record of the standards required to be documented under Rule 17g–9.

One NRSRO stated that the compliance date for proposed Rule 17g–9 should take into account that it will take a significant amount of time to develop, test, and implement the standards.[1995] The Commission agrees that it may take several months for NRSROs to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the requirements relating to the standards of training, experience, and competence for credit analysts. Accordingly, the Commission is delaying the effective date for Rule 17g–9 and paragraph (b)(15) of Rule 17g–2 until nine months after this release is published in the **Federal Register**.

Rule 17g–10 requires that the written certification a provider of third-party due diligence services must provide to an NRSRO be made on Form ABS Due Diligence–15E. New paragraph (a)(3)(iii)(E) of Rule 17g–5 requires an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.

One commenter suggested that proposed Rule 17g–10 should have at least a nine-month transition period because implementation ''will require coordination among market participants . . . as well as the development of industry standards.'' [1996] Another commenter stated that a ''reasonable transition period'' should be provided to allow adequate time ''to assess the applicability of the new requirements . . . and to implement appropriate processes and procedures.'' [1997] A third commenter stated a compliance date of at least 180 days following publication in the **Federal Register** would be required ''in order to get necessary systems and procedures in place.'' [1998] The Commission agrees that market participants may need several months to establish new, or adapt existing,

[1991] *See S&P Letter.*

[1992] *See DBRS Letter.*

[1993] *See Morningstar Letter.*

[1994] *See Moody's Letter.*

[1995] *See S&P Letter.*

[1996] *See ABA Letter.*

[1997] *See Deloitte Letter.*

[1998] *See ASF Letter* (''We also note that a 180-day period will minimize the possibility that a TPDDS Provider might issue a report prior to the publication date of the final rules, which would later be subject to the requirement for a TPDDS Provider Certification because it was provided to and used by an NRSRO in connection with a rating.'').

policies, procedures, controls, systems, and practices to comply with the new requirements related to third-party due diligence for asset-backed securities. Accordingly, the Commission is delaying the effective date for the requirements relating to Rule 17g–10 and new Form ABS Due Diligence–15E until nine months after this release is published in the **Federal Register**.

Finally, new Rule 15Ga–2 generally requires an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS–15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.[1999]

One commenter suggested that Rule 15Ga–2 should have at least a nine-month transition period because implementation ''will require coordination among market participants . . . as well as the development of industry standards.'' [2000] Another commenter stated that a ''reasonable transition period'' should be provided to allow adequate time ''to assess the applicability of the new requirements . . . and to implement appropriate processes and procedures.'' [2001] A third commenter stated there should be a single compliance date of not less than 180 days following publication in the **Federal Register**.[2002] The Commission agrees that market participants may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements related to third-party due diligence for asset-backed securities. Accordingly, the Commission is delaying the effective date for Rule 15Ga–2 and the amendments to Form ABS–15G until nine months after this release is published in the **Federal Register**.

IV. Paperwork Reduction Act

Certain provisions of the rule amendments and new rules contain new ''collection of information'' requirements within the meaning of the PRA.[2003] The Commission solicited comment on the estimated burden associated with the proposed collection of information requirements in the proposing release.[2004] The Commission submitted the proposed collection of information requirements to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11.

An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. The titles and OMB control numbers for the collections of information are:

(1) Rule 17g–1, Application for registration as a nationally recognized statistical rating organization; Form NRSRO, and Form NRSRO Instructions (OMB Control Number 3235–0625);

(2) Rule 17g–2, Records to be made and retained by nationally recognized statistical rating organizations (OMB Control Number 3235–0628);

(3) Rule 17g–3, Annual financial reports to be furnished by nationally recognized statistical rating organizations [2005] (OMB Control Number 3235–0626);

(4) Rule 17g–5, Conflicts of interest (OMB Control Number 3235–0649);

(5) Rule 17g–7, Disclosure requirements (OMB Control Number 3235–0656);

(6) Rule 17g–8, Policies and procedures (a new collection of information);

(7) Rule 17g–9, Standards of training, experience, and competence for credit analysts (a new collection of information);

(8) Rule 17g–10, Certification of providers of third-party due diligence services in connection with asset-backed securities; Form ABS Due Diligence–15E (a new collection of information);

(9) Form ABS–15G (OMB Control Number 3235–0675);

(10) Rule 15Ga–2 (a new collection of information);

(11) Regulation S–T, General Rules and Regulations for Electronic Filing (OMB Control Number 3235–0424); and

(12) Form ID (OMB Control Number 3235–0328).

As discussed above, the Commission received a number of comments regarding the proposal. Some of these comments relate directly or indirectly to the estimates of the burden associated with the collection of information requirements within the meaning of the PRA. These comments are addressed below. In part in response to these comments, the Commission has modified the amendments and new rules being adopted today from the proposals. The impact on the Commission's burden estimates of these modifications, as well as adjustments to reflect updated information used to make the estimates, are also discussed below.

A. Summary of the Collection of Information Requirements

The Commission is adopting amendments to existing rules and new rules that apply to NRSROs, providers of third-party due diligence services for Exchange Act-ABS, and issuers and underwriters of Exchange Act-ABS. The following rule amendments and new rules contain collections of information within the meaning of the PRA.

1. Amendments to Rule 17g–1

The Commission is amending Rule 17g–1. First, the Commission is amending paragraph (i) of Rule 17g–1.[2006] The amendments require an NRSRO to make Form NRSRO and Exhibits 1 through 9 to the form publicly and freely available on an easily accessible portion of its corporate Internet Web site (eliminating an option to make the form and exhibits available ''through another comparable, readily accessible means'') and to make its most recent Exhibit 1 freely available in writing to any individual who requests a copy of the exhibit.

Second, the Commission is amending paragraphs (e), (f), and (g) of Rule 17g–1 to require NRSROs to use the Commission's EDGAR system to electronically submit Forms NRSRO and required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer

[1999] The Commission today is providing no–action relief for municipal issuers and underwriters with regard to the required disclosures under the provisions of section 15E(s)(4)(A) of the Exchange Act for any municipal Exchange Act-ABS issued prior to the effective date of Rule 15Ga–2. Municipal issuers and underwriters are excluded from the application of Rule 15Ga–2, but will have to comply with the statutory requirement in section 15E(s)(4)(A) of the Exchange Act to make the findings and conclusions of any third-party due diligence reports publicly available commencing with the effective date of Rule 15Ga–2. The Commission believes it is appropriate to provide such no–action relief because it proposed to include municipal issuers and underwriters within the scope of Rule 15Ga–2, but has determined not to do so.

[2000] *See ABA Letter.*

[2001] *See Deloitte Letter.*

[2002] *See ASF Letter* (''We believe this amount of time, at a minimum, will be required in order to get necessary systems and procedures in place, especially in light of other regulatory changes in the securitization markets coming into effect in the near term. In the event that the Commission does not use a single compliance date, we note that the compliance date for Rule 15Ga–2 must be no earlier than the compliance date for Rules 17g–7 and 17g–10.'').

[2003] 44 U.S.C. 3501 *et seq.*

[2004] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33490–33511.

[2005] The Commission is amending the title of Rule 17g–3 to read, ''Annual financial and other reports to be filed or furnished by nationally recognized statistical rating organizations.''

[2006] *See* section II.E.2. of this release (providing a more detailed discussion of the amendments).

Manual, as defined in Rule 11 of Regulation S–T.[2007]

2. Amendments to Instructions for Exhibit 1 to Form NRSRO

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.[2008] The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample ''Transition/Default Matrix.'' The amendments also enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

3. Amendments to Rule 17g–2

The Commission is amending Rule 17g–2. First, the Commission is adding paragraph (a)(9) to Rule 17g–2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g–8 as a record that must be made and retained.[2009] Second, the Commission is adding paragraph (b)(12) to Rule 17g–2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.[2010] Third, the Commission is adding paragraph (b)(13) to Rule 17g–2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g–8 as a record that must be retained.[2011] Fourth, the Commission is adding paragraph (b)(14) to Rule 17g–2 to identify the policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g–8 as a record that must be retained.[2012] Fifth, the Commission is adding paragraph (b)(15) to Rule 17g–2 to identify the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g–9 as a record that must be retained.[2013] In addition, the Commission is amending paragraph (c) of Rule 17g–2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g–2 must be retained until three years after the date the record is replaced with an updated record, instead of three years after the record is made or received, which is the retention period for other records identified in paragraphs (a) and (b) of Rule 17g–2.[2014] The Commission also repealed paragraph (d)(2) of Rule 17g–2 (the 10% Rule) and has re-codified (with significant amendments) the requirements in paragraph (d)(3) of Rule 17g–2 (the 100% Rule) in paragraph (b) of Rule 17g–7.[2015]

4. Amendments to Rule 17g–3

The Commission is amending Rule 17g–3. First, the Commission is amending paragraphs (a) and (b) of Rule 17g–3.[2016] The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an unaudited report—a report on the NRSRO's internal control structure—with its annual submission of reports to the Commission pursuant to Rule 17g–3.[2017] The amendment to paragraph (b) of Rule 17g–3 requires that the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the internal controls report that must be attached to the report.[2018]

Second, the Commission is adding paragraph (d) to Rule 17g–3 to require that the annual reports required to be submitted to the Commission pursuant to Rule 17g–3 be submitted electronically through the Commission's EDGAR system as PDF documents.[2019]

Third, the Commission is adding paragraph (a)(8) to Rule 17g–3 to identify the report of the NRSRO's designated compliance officer that an NRSRO is required to file with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other annual reports.[2020] This requirement will not result in a collection of information because the statute requires the NRSRO to file the report with the Commission *and* to file the report with the other annual reports.[2021] Consequently, paragraph (a)(8) of Rule 17g–3 standing alone does not impose a burden. Moreover, the Commission is not adding any additional requirements with respect to the filing other than the requirement that this report and the other annual reports be submitted through the EDGAR system and the burden for filing the reports through the EDGAR system is being allocated to Rule 17g–1.[2022]

5. Amendments to Rule 17g–5

The Commission is amending Rule 17g–5. First, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g–5 to require an NRSRO to obtain a representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.[2023]

Second, the Commission is adding paragraph (c)(8) to Rule 17g–5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[2024]

Third, the Commission is adding paragraph (f) to Rule 17g–5, which provides that upon written application by an NRSRO the Commission may

[2007] *See* section II.L. of this release (providing a more detailed discussion of the amendments).

[2008] *See* section II.E.1. of this release (providing a more detailed discussion of the amendments).

[2009] *See* section II.C.2. of this release (providing a more detailed discussion of this amendment).

[2010] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment).

[2011] *See* section II.F.2. of this release (providing a more detailed discussion of this amendment).

[2012] *See* section II.J.2. of this release (providing a more detailed discussion of this amendment).

[2013] *See* section II.I.2. of this release (providing a more detailed discussion of this amendment).

[2014] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment).

[2015] *See* section II.E.3. of this release (providing a more detailed discussion of this amendment).

[2016] *See* section II.A.3. of this release (providing a more detailed discussion of these amendments).

[2017] *See* paragraph (a)(7) of Rule 17g–3.

[2018] *See* paragraph (b)(2) of Rule 17g–3.

[2019] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2020] *See* section II.K. of this release (providing a more detailed discussion of this amendment).

[2021] *See* 15 U.S.C. 78o–7(j)(5)(B).

[2022] *Compare* 15 U.S.C. 78o–7(j)(5)(B), *with* paragraph (a)(8) of Rule 17g–3.

[2023] *See* sections II.G.5. and II.H.2. of this release (providing more detailed discussions of this amendment).

[2024] *See* section II.B.1. of this release (providing a more detailed discussion of this amendment).

exempt, either conditionally or unconditionally, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[2025]

6. Amendments to Rule 17g–7

The Commission is amending Rule 17g–7. First, the Commission is incorporating the disclosure requirement in Rule 17g–7 regarding representations, warranties, and enforcement mechanisms available to investors in asset-backed securities that existed before today's amendments into paragraph (a) of the rule and is adding significant disclosure provisions to paragraph (a) of the rule that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[2026] The amendments prescribe: (1) The types of rating actions that trigger the requirement to publish the form and, if applicable, any due diligence certifications;[2027] (2) the format of the form;[2028] (3) the content of the form (which must include certain qualitative and quantitative information relating to the credit rating);[2029] and (4) an attestation requirement for the form.[2030]

Second, the Commission is re-codifying in paragraph (b) of Rule 17g–7 the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g–2 before today's amendments.[2031] The amendments to Rule 17g–7 also increase the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.

7. New Rule 17g–8

The Commission is adopting Rule 17g–8, which requires an NRSRO to establish, maintain, enforce, and document certain types of policies and procedures and to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure pursuant to section 15E(c)(3)(A) of the Exchange Act.

Specifically, paragraph (a) of Rule 17g–8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.[2032] The required policies and procedures include policies and procedures relating to: (1) Board approval of the procedures and methodologies for determining credit ratings;[2033] (2) the development and modification of the procedures and methodologies for determining credit ratings;[2034] (3) applying material changes to the procedures and methodologies for determining credit ratings;[2035] (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;[2036] and (5) disclosing the version of a procedure or methodology for determining credit ratings used with respect to a particular credit rating.[2037]

Paragraph (b) of Rule 17g–8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.[2038] The required policies and procedures include policies and procedures relating to: (1) Assessing the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or money market instrument;[2039] (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO;[2040] and (3) applying any symbol, number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[2041]

Paragraph (c) of Rule 17g–8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.[2042]

Paragraph (d) of Rule 17g–8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act. This requirement does not contain a collection of information requirement within the meaning of the PRA.

8. New Rule 17g–9

The Commission is adopting Rule 17g–9. Rule 17g–9 requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.[2043] Paragraph (b) identifies four factors the NRSRO must consider when designing the standards.[2044] Paragraph (c)(1) requires NRSROs to include a requirement for periodic testing in their standards.[2045] Paragraph (c)(2) provides that the standards must include a requirement that at least one

[2025] *See* section II.B.2. of this release (providing a more detailed discussion of this amendment).

[2026] *See* section II.G. of this release (providing a more detailed discussion of these amendments).

[2027] *See* section II.G.1. of this release (providing a more detailed discussion of these amendments). As discussed in section II.G.1. of this release, the Commission is adopting an exemption from the requirements of paragraph (a) for certain non-U.S. rating actions.

[2028] *See* section II.G.2. of this release (providing a more detailed discussion of these amendments).

[2029] *See* section II.G.3. of this release (providing a more detailed discussion of these amendments).

[2030] *See* section II.G.4. of this release (providing a more detailed discussion of these amendments).

[2031] *See* section II.E.3. of this release (providing a more detailed discussion of these amendments). The Commission also is repealing paragraph (d)(2) of Rule 17g–2 (the 10% Rule).

[2032] *See* section II.F.1. of this release (providing a more detailed discussion of this paragraph).

[2033] *See* paragraph (a)(1) of Rule 17g–8.

[2034] *See* paragraph (a)(2) of Rule 17g–8.

[2035] *See* paragraph (a)(3) of Rule 17g–8.

[2036] *See* paragraph (a)(4) of Rule 17g–8.

[2037] *See* paragraph (a)(5) of Rule 17g–8.

[2038] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph).

[2039] *See* paragraph (b)(1) of Rule 17g–8.

[2040] *See* paragraph (b)(2) of Rule 17g–8.

[2041] *See* paragraph (b)(3) of Rule 17g–8.

[2042] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph).

[2043] *See* section II.I.1.a. of this release (providing a more detailed discussion of this paragraph).

[2044] *See* section II.I.1.b. of this release (providing a more detailed discussion of this paragraph).

[2045] *See* section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

individual with an ''appropriate level of experience in performing credit analysis, but not less than three years'' must participate in the determination of a credit rating.[2046]

9. New Rule 17g–10 and New Form ABS Due Diligence–15E

The Commission is adopting Rule 17g–10 and Form ABS Due Diligence–15E.[2047]Paragraph (a) of Rule 17g–10 provides that the written certification providers of third-party due diligence services must provide to NRSROs pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence–15E.[2048]Paragraph (b) of Rule 17g–10 provides that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.[2049] Paragraph (c) of Rule 17g–10 provides a ''safe harbor'' for a provider of third-party due diligence services to meet its obligation under section 15E(s)(4)(B).[2050] Paragraph (d) of Rule 17g–10 contains four definitions to be used for the purposes of section 15E(s)(4)(B) and Rule 17g–10; namely, definitions of *due diligence services*,[2051] *issuer*,[2052] *originator*,[2053] and *securitizer*. [2054]

Form ABS Due Diligence–15E contains five line items identifying information the provider of third-party due diligence services must provide.[2055] It also contains a signature line with a corresponding representation.[2056] Item 1 elicits the identity and address of the provider of third-party due diligence services.[2057] Item 2 elicits the identity and address of the issuer, underwriter, or NRSRO that paid the provider to provide the services.[2058] Item 3 requires the provider of the due diligence services to identify each NRSRO whose published criteria for performing due diligence the third party intended to satisfy in performing the due diligence review.[2059] Item 4 requires the provider of third-party due diligence services to describe the scope and manner of the due diligence performed.[2060] Item 5 requires the provider of third-party due diligence services to describe the findings and conclusions resulting from the review.[2061]

10. New Rule 15Ga–2 and Amendments to Form ABS–15G

The Commission is adopting Rule 15Ga–2 and amendments to Form ABS–15G.[2062] Rule 15Ga–2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish a Form ABS–15G on the Commission's EDGAR system containing the findings and conclusions of any third-party ''due diligence report'' obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. These requirements do not apply to issuers or underwriters of certain offshore offerings of Exchange Act-ABS.[2063] The rule and form also do not apply to issuers and underwriters of municipal Exchange Act-ABS but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. Based on staff experience, the Commission estimates that many of these issuers and underwriters are likely to satisfy this obligation by furnishing Form ABS–15G on EMMA. Rule 15Ga–2 defines *third-party due diligence report* as any report containing findings and conclusions relating to *due diligence services* as defined in Rule 17g–10 performed by a third party.[2064]Under the rule, the disclosure must be furnished using Form ABS–15G for both registered and unregistered offerings of Exchange Act-ABS. However, if the disclosure required by Rule 15Ga–2 has been made in the applicable prospectus, the issuer or underwriter may refer to that section of the prospectus in Form ABS–15G rather than providing the findings and conclusions directly on the form.[2065]

11. Amendments to Regulation S–T

As stated above, the Commission is requiring that certain Forms NRSRO and all Rule 17g–3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system as PDF documents.[2066] In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S–T to require that Forms NRSRO and Exhibits 1 through 9 submitted pursuant to paragraphs (e), (f), and (g) of Rule 17g–1 and the annual reports submitted pursuant to Rule 17g–3 be submitted through the EDGAR system as PDF documents.[2067]

12. Form ID

NRSROs will need to submit Forms NRSRO and the required exhibits to the forms under paragraphs (e), (f), and (g) of Rule 17g–1 and their annual reports under Rule 17g–3 to the Commission through the EDGAR system. NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to make electronic submissions to the Commission.[2068]

Issuers and underwriters of Exchange Act-ABS also will need to furnish Form ABS–15G to the Commission through the EDGAR system pursuant to Rule 15Ga–2. The Commission believes that these issuers and underwriters already have access to the EDGAR system because, for example, they need such access for purposes of Rule 15Ga–1.

[2046] *See* section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

[2047] *See* section II.H.2. of this release (providing a more detailed discussion of Rule 17g–10); section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence–15E).

[2048] *See* paragraph (a) of Rule 17g–10.

[2049] *See* paragraph (b) of Rule 17g–10.

[2050] *See* paragraphs (c)(1) and (2) of Rule 17g–10. *See also* paragraph (a)(3)(iii)(E) of Rule 17g–5 (provisions under which the issuer or underwriter must promptly post the form on the Rule 17g–5 Web site).

[2051] *See* paragraph (d)(1) of Rule 17g–10.

[2052] *See* paragraph (d)(2) of Rule 17g–10.

[2053] *See* paragraph (d)(3) of Rule 17g–10.

[2054] *See* paragraph (d)(4) of Rule 17g–10.

[2055] *See* section II.H.3. of this release (providing a more detailed discussion of the information to be reported in the form).

[2056] *See* Form ABS Due Diligence–15E.

[2057] *See* Item 1 of Form ABS Due Diligence–15E.

[2058] *See* Item 2 of Form ABS Due Diligence–15E.

[2059] *See* Item 3 of Form ABS Due Diligence 15E.

[2060] *See* Item 4 of Form ABS Due Diligence 15E.

[2061] *See* Item 5 of Form ABS Due Diligence 15E.

[2062] *See* section II.H.1. of this release (providing a more detailed discussion of the rule and form).

[2063] *See* paragraph (e) of Rule 15Ga–2.

[2064] *See* paragraph (d)(1) of Rule 17g–10.

[2065] *See* section II.H.1. of this release (providing a more detailed discussion of this rule).

[2066] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2067] *See* paragraph (a)(xiv) of Rule 101 of Regulation S–T.

[2068] *See* section II.L. of this release (providing a more detailed discussion of these requirements).

B. Use of Information

1. Amendments to Rule 17g–1

The amendments to Rule 17g–1 that require an NRSRO to use the EDGAR system to file Form NRSRO and Exhibits 1 through 9 and to make the form and exhibits freely available on an easily accessible portion of the NRSRO's corporate Internet Web site are designed to make the information disclosed in the form and exhibits more readily accessible to investors and other users of credit ratings.[2069]In addition, the filing of the Forms NRSRO and the exhibits on the EDGAR system will allow Commission examiners to more easily retrieve the submissions of a specific NRSRO to prepare for an examination. Furthermore, having the forms filed and stored through the EDGAR system will assist the Commission from a records management perspective by establishing a more automated storage process and creating efficiencies in terms of reducing the volume of paper filings that must be manually processed and stored.

2. Amendments to Instructions for Exhibit 1 to Form NRSRO

The amendments to the instructions for Exhibit 1 to Form NRSRO that standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics an NRSRO must disclose in the exhibit and enhance the information disclosed about these statistics will allow users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different NRSROs.[2070] As the Commission stated when originally adopting Form NRSRO, the information provided in Exhibit 1 is an important indicator of the performance of an NRSRO in terms of its ability to assess the creditworthiness of issuers and obligors and, consequently, will be useful to users of credit ratings in evaluating an NRSRO.[2071] The amendments to the instructions for Exhibit 1 to Form NRSRO are designed to make the required disclosure of an NRSRO's performance statistics more useful to those who use or might use credit ratings, including investors and creditors.

In addition, the amendments should improve the Commission's ability to carry out its oversight of NRSROs, which, in turn, will benefit investors. Improving and standardizing performance statistics provided in an applicant's initial application for registration and in an NRSRO's Form NRSRO could aid the Commission in, among other things, reviewing an applicant's or NRSRO's performance and consistency of performance, which, in turn, could aid in assessing whether the applicant or NRSRO has adequate financial and managerial resources to consistently produce credit ratings with integrity.[2072]

3. Amendments to Rule 17g–2

The requirement to make and retain a record of the policies and procedures identified in paragraph (a)(9) of Rule 17g–2 will promote better understanding of the policies and procedures among individuals within the NRSRO and, therefore, promote compliance with such policies and procedures.[2073] The requirement that the internal controls structure, policies and procedures, and standards identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15), respectively, be retained will subject these records to the various retention and production requirements of paragraphs (c), (d), (e), and (f) of Rule 17g–2.[2074] The Commission staff will use these records to examine an NRSRO's compliance with the provisions of the securities laws requiring the NRSRO to establish, maintain, enforce, and document these controls, policies, procedures, and standards.[2075] The amendment to paragraph (c) of Rule 17g–2 requiring that these records must be retained until three years after the date the record is replaced with an updated record, rather than three years after the record is made or received, will help the Commission better perform its oversight function. For example, if the three-year retention period in Rule 17g–2 began to run when the record is made, an NRSRO could discard the record that is replaced with an updated record if that update occurred more than three years after the replaced record was made. This could prevent the Commission from reviewing whether the NRSRO adhered to its previous internal control structure, policies and procedures, or standards.

4. Amendments to Rule 17g–3

The amendments to Rule 17g–3 requiring an NRSRO to submit to the Commission an annual internal controls report will be used by the Commission to perform its NRSRO oversight function.[2076] For example, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to ''establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.'' [2077] Paragraph (a)(7) of Rule 17g–3 requires that the report describe material weaknesses identified in the internal control structure and how they were addressed and that it state whether the internal control structure was effective as of the end of the NRSRO's

[2069] *See* section II.E.2. of this release (providing a more detailed discussion of the requirement to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of the NRSRO's corporate Internet Web site) and section II.L. of this release (providing a more detailed discussion of the requirement to use the EDGAR system to file Form NRSRO and Exhibits 1 through 9).

[2070] *See* section II.E.1. of this release (providing a more detailed discussion of the amendments).

[2071] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33574; *see also Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6474 (''The amendments to the instructions for Exhibit 1 to Form NRSRO will require NRSROs to provide more detailed performance statistics and, thereby, make it easier for users of credit ratings to compare the performance of the NRSROs. In addition, these amendments will make it easier for an NRSRO to demonstrate that it has a superior ratings methodology or competence and, thereby, attract clients.'').

[2072] *See, e.g.,* 15 U.S.C. 78o–7(a)(2)(C) (setting forth grounds to deny an initial application); 15 U.S.C. 78o–7(d)(1)(E) and (d)(2) (setting forth grounds to sanction an NRSRO, including revoking the NRSRO's registration); *see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33612 (''Form NRSRO requires that a credit rating agency provide information required under Section 15E(a)(1)(B) of the Exchange Act and certain additional information. The additional information will assist the Commission in making the assessment regarding financial and managerial resources required under Section 15E(a)(2)(C)(2)(ii)(I) of the Exchange Act.'').

[2073] *See* section II.C.2. of this release (providing a more detailed discussion of this amendment).

[2074] *See* section II.C.2. of this release (providing a more detailed discussion of paragraph (a)(9) of Rule 17g–2); section II.A.2. of this release (providing a more detailed discussion of paragraph (b)(12) of Rule 17g–2); section II.F.2. of this release (providing a more detailed discussion of paragraph (b)(13) of Rule 17g–2); section II.J.2. of this release (providing a more detailed discussion of paragraph (b)(14) of Rule 17g–2); section II.I.2. of this release (providing a more detailed discussion of paragraph (b)(15) of Rule 17g–2).

[2075] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33582 (June 18, 2007) (''The Commission designed [Rule 17g–2] based on its experience with recordkeeping rules for other regulated entities. These other books and records rules have proven integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws. Rule 17g–2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission in monitoring, through its examination authority, whether an NRSRO is complying with the provisions of Section 15E of the Exchange Act and the rules thereunder.'') (footnotes omitted).

[2076] *See* section II.A.3. of this release (providing a more detailed discussion of these amendments).

[2077] 15 U.S.C. 78o–7(c)(3)(A).

fiscal year. Consequently, the Commission can use the information provided in the report as part of reviewing whether the NRSRO is complying with the requirement in section 15E(c)(3)(A) of the Exchange Act. An NRSRO also can use the report to evaluate the effectiveness of its internal control structure.

The amendment to Rule 17g–3 requiring that NRSROs use the Commission's EDGAR system to file the annual reports as PDF documents will assist the Commission in performing its oversight function.[2078] For example, Commission examiners will be able to more easily retrieve the reports of an NRSRO to prepare for an examination. Moreover, having these reports submitted and stored through the EDGAR system will assist the Commission from a records management perspective by establishing a more automated storage process and reducing the volume of paper submissions that must be manually processed and stored.

5. Amendments to Rule 17g–5

The collection required under the amendment adding paragraph (a)(3)(iii)(E) to Rule 17g–5 will be used by the providers of third-party due diligence services to meet their statutory obligation to deliver the certification to any NRSRO that produces a credit rating to which the services relate.[2079] Furthermore, disclosing these certifications on the Rule 17g–5 Web sites will make them available to NRSROs that may not otherwise be aware that third-party due diligence services are being employed with respect to an Exchange Act-ABS because, for example, they are not hired to rate the Exchange Act-ABS.

The amendment adding paragraph (c)(8) to Rule 17g–5 will require an NRSRO to update its policies and procedures for addressing and managing conflicts of interest to account for this new absolutely prohibited conflict of interest.[2080] The updated policies and procedures will be used by the NRSRO to address this conflict and comply with Rule 17g–5. Furthermore, Exhibit 7 to Form NRSRO requires an applicant for registration as an NRSRO or an NRSRO to provide a copy in the exhibit of the written policies and procedures an applicant or NRSRO must establish, maintain, and enforce to address and manage conflicts of interest pursuant to section 15E(h) of the Exchange Act.[2081] This disclosure by an NRSRO can be reviewed by investors and other users of credit ratings to evaluate the NRSRO's policies and procedures (including those addressing the new absolutely prohibited conflict) and to compare them with the policies and procedures of other NRSROs.

The amendment adding paragraph (f) to Rule 17g–5 to provide a means for an NRSRO to seek an exemption from the Commission because of its small size from the provision establishing the new absolutely prohibited conflict will be used by NRSROs to seek conditional or unconditional exemptions from the new requirement.[2082]

6. Amendments to Rule 17g–7

The amendments to paragraph (a) of Rule 17g–7 that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating will be used by investors and other users of credit ratings to better understand the credit rating issued by the NRSRO.[2083] In addition, the disclosure of the certification will allow investors and other users of credit ratings to determine the adequacy and level of due diligence services provided by the third party executing the certification.[2084]

The amendments to Rule 17g–7 (codified in paragraph (b) of the rule) that require an NRSRO to disclose rating histories may be used by investors and other users of credit ratings to evaluate the performance of the NRSRO's credit ratings.[2085] As the Commission stated when adopting the original rating history disclosure requirement, the ''intent of the rule is to facilitate comparisons of credit rating accuracy across all NRSROs—including direct comparisons of different NRSROs' treatment of the same obligor or instrument—in order to enhance NRSRO accountability, transparency, and competition.'' [2086] The amendments also are designed to provide persons (such as market participants and academics and other market observers) with the ''raw data'' necessary to generate statistical information about the performance of each NRSRO's credit ratings.[2087] The information disclosed pursuant to the amendments also may be used by economists to study the performance of NRSRO credit ratings. The Commission also may use the information as part of its oversight function.

7. New Rule 17g–8

Paragraph (a) of Rule 17g–8 requires an NRSRO to have policies and procedures with respect to the procedures and methodologies the NRSRO uses to determine credit ratings.[2088] These policies and procedures will be used by the NRSRO to achieve the objectives identified in section 15E(r) of the Exchange Act,[2089] namely, that the NRSRO:

- Determines credit ratings using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board; [2090]
- determines credit ratings using procedures and methodologies, including qualitative and quantitative data and models, that are in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies; [2091]

[2078] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2079] *See* sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this amendment, which will require an NRSRO to obtain a representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument).

[2080] *See* section II.B.1. of this release (providing a more detailed discussion of this amendment).

[2081] *See* instructions for Exhibit 7 to Form NRSRO.

[2082] *See* section II.B.2. of this release (providing a more detailed discussion of this amendment).

[2083] *See* section II.G. of this release (providing a more detailed discussion of these amendments).

[2084] *See* 15 U.S.C. 78o–7(s)(4)(D).

[2085] *See* section II.E.3. of this release (providing a more detailed discussion of these amendments).

[2086] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63838 (Dec. 4, 2009) (''Ratings history information for outstanding credit ratings is the most direct means of comparing the performance of two or more NRSROs. It allows an investor or other user of credit ratings to compare how all NRSROs that maintain a credit rating for a particular obligor or instrument initially rated that obligor or instrument and, thereafter, how and when they adjusted their credit rating over time.'').

[2087] *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63837–63838 (''The raw data to be provided by NRSROs pursuant to the new ratings history disclosure requirements . . . will enable market participants to develop performance measurement statistics that would supplement those required to be published by NRSROs themselves in Exhibit 1, tapping into the expertise of credit market observers and participants in order to create better and more useful means to compare the credit ratings performance of NRSROs.'').

[2088] *See* section II.F.1. of this release (providing a more detailed discussion of this paragraph).

[2089] *See* 15 U.S.C. 78o–7(r)(1) through (3).

[2090] *See* 15 U.S.C. 78o–7(r)(1)(A).

[2091] *See* 15 U.S.C. 78o–7(r)(1)(B).

• when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), applies the changes consistently to all credit ratings to which the changed procedures and methodologies apply; [2092]

• when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), to the extent that changes are made to credit rating surveillance procedures and methodologies, applies the changes to then-current credit ratings within a reasonable time period determined by the Commission, by rule; [2093]

• when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), the NRSRO publicly discloses the reason for the change; [2094]

• notifies users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating; [2095]

• notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input; [2096]

• notifies users of credit ratings when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions; [2097] and

• notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input, of the likelihood the change will result in a change in current credit ratings.[2098]

Paragraph (b) of Rule 17g–8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.[2099] These policies and procedures will be used by the NRSRO to achieve the objectives identified in sections 938(a)(1) through (3) of the Dodd-Frank Act; [2100] namely, that the NRSRO establishes, maintains, and enforces written policies and procedures to: (1) Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument; [2101] (2) clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating; [2102] and (3) apply any symbol described in item (2) in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.[2103]

Paragraph (c) of Rule 17g–8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.[2104] These policies and procedures will be used by the NRSRO to achieve the objective specified in section 15E(h)(4)(A)(ii) of the Exchange Act to revise a credit rating, if appropriate, when a look-back review determines the credit rating was influenced by the conflict of interest of the credit analyst seeking employment with the person subject to the credit rating or the issuer, underwriter, or sponsor of a security or money market instrument subject to the credit rating.[2105]

8. New Rule 17g–9

The Commission is adopting Rule 17g–9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings.[2106] These standards will be used by the NRSRO to achieve the objectives specified in sections 936(1) and (2) of the Dodd-Frank Act that any person employed by the NRSRO to perform credit ratings produces accurate ratings for the categories of issuers whose securities the person rates and is tested for knowledge of the credit rating process.[2107] The requirement that the standards be documented in writing will be used by the NRSRO to promote an understanding of the standards within the NRSRO and will be used by the Commission to examine the NRSRO's compliance with Rule 17g–9.

9. New Rule 17g–10 and New Form ABS Due Diligence–15E

The disclosure of information about third-party due diligence services on Form ABS Due Diligence–15E pursuant to Rule 17g–10 will be used by NRSROs, investors, and other market participants to evaluate the adequacy and level of the reviews of the assets underlying an Exchange Act-ABS performed by the third party.[2108]

10. New Rule 15Ga–2 and Amendments to Form ABS–15G

Users of credit ratings who may or may not be investors may use the disclosure of information about third-party due diligence services on Form ABS–15G pursuant to Rule 15Ga–2 to evaluate the adequacy and level of the reviews of the assets underlying an Exchange Act-ABS performed by the third party.[2109]

11. Amendments to Regulation S–T

The amendments to Rule 101 of Regulation S–T, as part of implementing the requirement that NRSROs use the EDGAR system to submit Forms NRSRO and their annual reports under Rule 17g–3 to the Commission, will be used by the Commission as part of its oversight of NRSROs.[2110] In addition, the submission of the Forms NRSRO using the EDGAR system will be used by investors and other users of credit ratings to evaluate and compare NRSROs.

12. Form ID

NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to file Form NRSRO (including applicable exhibits) and their annual reports with the Commission.[2111] The Commission will use the filings of this

[2092] *See* 15 U.S.C. 78o–7(r)(2)(A).

[2093] *See* 15 U.S.C. 78o–7(r)(2)(B).

[2094] *See* 15 U.S.C. 78o–7(r)(2)(C).

[2095] *See* 15 U.S.C. 78o–7(r)(3)(A).

[2096] *See* 15 U.S.C. 78o–7(r)(3)(B).

[2097] *See* 15 U.S.C. 78o–7(r)(3)(C).

[2098] *See* 15 U.S.C. 78o–7(r)(3)(D).

[2099] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph).

[2100] *See* Public Law 111–203, 938(a)(1) through (3).

[2101] *See* Public Law 111–203, 938(a)(1).

[2102] *See* Public Law 111–203, 938(a)(2).

[2103] *See* Public Law 111–203, 938(a)(3).

[2104] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph).

[2105] *See* 15 U.S.C. 78o–7(h)(4)(A)(ii).

[2106] *See* section II.I.1. of this release (providing a more detailed discussion of this rule).

[2107] *See* Public Law 111–203, 936(1) and (2).

[2108] *See* section II.H.2. (providing a more detailed discussion of Rule 17g–10) and section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence–15E).

[2109] *See* section II.H.1. of this release (providing a more detailed discussion of the rule and form).

[2110] *See* section II.L. of this release (providing a more detailed discussion of these amendments).

[2111] *See* section II.L. of this release (providing a more detailed discussion of this requirement).

form to process NRSRO requests for access to the EDGAR system.

C. Respondents

In adopting the first rules under the Rating Agency Act of 2006, the Commission estimated that approximately thirty credit rating agencies ultimately would be registered as NRSROs.[2112] Currently, ten credit rating agencies are registered with the Commission as NRSROs.[2113] This number has remained fairly constant for several years.[2114] Consequently, while the Commission believes several more credit rating agencies may become registered as NRSROs over the next few years, the Commission stated in the proposing release that it believed that the actual number of NRSROs should be used for purposes of the burden estimates under the PRA.[2115] The Commission did not receive comments regarding this statement, and the number of credit rating agencies registered with the Commission as NRSROs has not changed since the proposal was published in 2011. Therefore, the Commission is estimating that there are ten credit rating agencies registered with the Commission as NRSROs for purposes of the burden estimates.

In the proposing release, the Commission stated that it believed that there were approximately 270 unique ''securitizers'' that would be subject to the requirements of Rule 17g–10, Form ABS Due Diligence–15E, Rule 15Ga–2, and the amendments to Form ABS–15G.[2116] In using the term *securitizer,* the Commission meant the person who organizes and initiates the Exchange Act-ABS, rather than the issuing entity.[2117] As discussed above, in this release, the *issuer* of a structured finance product can mean, depending on the context, the issuing entity or the person that organizes and initiates the offering of the structured finance product (for example, the sponsor or depositor). Consequently, for consistency in this release, the Commission is referring to the respondents as *issuers* (rather than *securitizers*) but in doing so means the person that organizes and initiates the offering of the Exchange Act-ABS. This is consistent with the Commission's intention in referring to these respondents as *securitizers* in the proposing release. Further, the Commission is adjusting its estimate of the number of unique securitizers (now referred to as *issuers*) from approximately 270 to approximately 336.[2118] This estimate includes issuers of municipal Exchange Act-ABS.[2119]

The Commission also stated in the proposing release that it believed that there were approximately ten firms that provide, or would begin providing, third-party due diligence services to issuers and underwriters of Exchange Act-ABS and, therefore, be subject to the requirements of Rule 17g–10 and Form ABS Due Diligence–15E.[2120] However, the Commission now estimates that there are approximately fifteen providers of third-party due diligence services.[2121]

D. Total Initial and Annual Recordkeeping and Reporting Burdens

NRSROs vary, in terms of size and complexity, from small entities that employ fewer than ten credit analysts to complex global organizations that employ over a thousand credit analysts.[2122] Given the significant variance in size between the largest and the smallest NRSROs, certain estimates described below are averages across all NRSROs that will be affected by the amendments and new rules being adopted today.

The Commission stated in the proposing release that it believed that it was reasonable to base some of its burden estimates on the approximate number of NRSRO credit ratings outstanding or the number of credit analysts employed by NRSROs, based on the most recent annual certifications submitted to the Commission by the NRSROs.[2123] An NRSRO objected to this method of estimating the burden attributable to the proposal, stating that ''to properly evaluate the actual burden of the rules, particularly as they relate to the seven NRSROs that must compete with the largest three NRSROs, the burden analysis must take into account not only the number of ratings or analysts in isolation, but also must include the amount of legal and compliance resources necessary to implement systemic and simultaneous changes'' and that ''the investments will not be diminished relative to financial resources because an NRSRO may have fewer analysts or credit ratings issued.'' [2124] Similarly, another NRSRO stated that ''the burden on smaller rating agencies may be even more severe than the Commission's numbers suggest'' and that ''[w]hile some aspects of the proposals (such as disclosures and updates) scale in a linear fashion with the number of published ratings, other costs (such as the development of new disclosure templates and implementing new systems) are fixed.'' [2125] The commenter stated that these ''fixed costs have a disproportionate impact on smaller firms.'' [2126] As discussed below, the Commission based some of its burden estimates for three of the proposed amendments or new rules on the number of NRSRO credit ratings outstanding or the number of credit analysts employed by NRSROs and has reviewed these estimates to determine whether they should be modified in response to these comments.

First, the Commission based its estimate of the one-time and annual burden associated with the amendments to the instructions for Exhibit 1 to Form NRSRO on the number of NRSRO credit ratings outstanding. In response to the above comments, the Commission is adding to its one-time burden estimate to account for aspects of the burden that do not depend on the number of NRSRO credit ratings outstanding. For example, some of the burden associated with establishing systems for determining performance statistics according to the amended instructions may not depend on the number of credit ratings in the start-date cohort.[2127]

Second, the Commission based its estimate of the annual burden associated with publishing the form and due diligence certifications with the

[2112] *See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33607.

[2113] *See* section I.B.2.a. of this release (discussing the economic baseline with respect to NRSROs).

[2114] One NRSRO—R&I—withdrew its registration as an NRSRO effective November 27, 2011. *See Notice of Effectiveness of Rating and Investment Information, Inc.'s (''R&I'') Withdrawal from Registration as a Nationally Recognized Statistical Rating Organization (''NRSRO''), available at http://www.sec.gov/news/digest/2011/dig112811.htm#rinotice.* HR Ratings registered as an NRSRO on November 5, 2012.

[2115] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33499.

[2116] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33499.

[2117] Section 15G(a)(3) of the Exchange Act defines the term *securitizer* to mean: ''(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.'' *See* 15 U.S.C. 78o–9(a)(3).

[2118] *See* section I.B.2.b. of this release (discussing the economic baseline with respect to issuers and providers of third-party due diligence services).

[2119] Based on the Asset-Backed Alert database, the Commission estimates there were nine unique issuers of municipal Exchange Act-ABS in 2013.

[2120] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33499.

[2121] *See* section I.B.2.b. of this release.

[2122] *See* 2013 Annual Staff Report on NRSROs, pp. 13–14.

[2123] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33500.

[2124] *See A.M. Best Letter.*

[2125] *See DBRS Letter.*

[2126] *See id.*

[2127] *See* section IV.D.2. of this release (discussing the PRA burden resulting from the amendments to the instructions for Exhibit 1 to Form NRSRO).

taking of a rating action under paragraph (a) of Rule 17g–7, as proposed, in part, on its estimate of the number of rating actions taken by NRSROs. The annual burden estimate also included a component representing the time an NRSRO would spend to update its standard disclosures and to tailor disclosures to particular rating actions. In addition, the Commission estimated a one-time burden to develop the standardized disclosures and to create the systems, protocols, and procedures for generating the forms to accompany rating actions. However, while the Commission agrees that its estimate in the proposal may have been low, as discussed in detail below (and above in section II.G. of this release), the Commission has modified the proposed requirements in a number of ways that will mitigate to some degree the burden of compliance with the requirements. The Commission is therefore not increasing its estimate of the annual and one-time burdens to update disclosures and create systems and procedures to comply with the rule.[2128]

Third, the Commission based its estimate of the one-time and annual burden attributable to establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for the individuals it employs to determine credit ratings pursuant to Rule 17g–9, as proposed, on the number of credit analysts employed by NRSROs. In response to the above comments, the Commission is adding to its burden estimate for this rule to account for a fixed burden that does not depend on the number of credit analysts employed by an NRSRO, in recognition of the fact that the burden associated with establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for credit analysts may not be directly proportional to the number of credit analysts employed by an NRSRO.[2129]

The Commission is updating its estimates of the number of NRSRO credit ratings outstanding and the number of NRSRO credit analysts based on more recent information submitted to the Commission by the NRSROs on Form NRSRO. The Commission now estimates that NRSROs have a total of 2,437,046 credit ratings outstanding in all classes of credit ratings.[2130] The Commission further estimates that NRSROs employ a total of 4,218 credit analysts.[2131]

Finally, in the proposing release, the Commission based some of its estimates for purposes of the PRA on the number of Exchange Act-ABS offerings per year.[2132] For purposes of these estimates, the Commission estimated that there would be approximately 2,067 Exchange Act-ABS offerings per year.[2133] The Commission estimates that in calendar year 2013 there were approximately 715 offering of Exchange Act-ABS.[2134] The Commission believes that the more recent data on the number of offerings of Exchange Act-ABS should be used for purposes of the PRA estimates given significant difference between the 715 offerings per year estimate (which is based on data for calendar year 2013) and the 2,067 offerings per year estimate (which was derived from older data).[2135] Consequently, the Commission is revising the estimate from 2,067 offerings per year to 715 offerings per year.

1. Amendments to Rule 17g–1

The Commission is amending paragraph (i) of Rule 17g–1 to require that an NRSRO make Form NRSRO and Exhibits 1 through 9 to Form NRSRO freely available on an easily accessible portion of its corporate Internet Web site.[2136] The amendment removes the option for an NRSRO to make the form publicly available ''through another comparable, readily accessible means'' as an alternative to Internet Web site disclosure.

As stated above, the Commission believes that a Form NRSRO and Exhibits 1 through 9 will be ''easily accessible'' if they can be accessed through a clearly and prominently labeled hyperlink (including through a hyperlink labeled ''Regulatory Disclosures'') on the homepage of the NRSRO's corporate Internet Web site. NRSROs may need to make changes to their corporate Internet Web sites to place clearly and prominently labeled hyperlinks to Form NRSRO and Exhibits 1 through 9 on the Web sites.[2137] In the proposing release, the Commission estimated that reconfiguring a corporate Internet Web site for this purpose would take an average of approximately five hours (and would be accomplished by NRSROs using their corporate Internet Web site administrators), resulting in an estimated industry-wide one-time burden of approximately fifty hours.[2138] The Commission did not receive comment on this estimate and is adopting the amendment as proposed. Therefore, the Commission is retaining this estimate without revision.

The Commission also is amending paragraph (i) of Rule 17g–1 to require that NRSROs make their most recent Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit to implement the rulemaking mandated in section 15E(q)(2)(D) of the Exchange Act.[2139]

In the proposing release, the Commission stated that it believed that NRSROs would need to establish procedures and protocols for receiving and processing these requests and that this would take an average of approximately forty-eight hours per NRSRO, resulting in an industry-wide one-time hour burden of approximately 480 hours.[2140] The Commission did not receive comment on this estimate and is adopting the amendments as proposed. Therefore, the Commission is retaining this estimate without revision.

The Commission also estimated that each NRSRO would on average receive approximately 200 requests per year and would spend an average of twenty minutes processing each request, resulting in an industry-wide annual hour burden of approximately 670 hours.[2141] The Commission did not receive comments on this estimate and is adopting the amendments as

[2128] *See* section IV.D.6. of this release (discussing the PRA burden resulting from the amendments to Rule 17g–7).

[2129] *See* section IV.D.8. of this release (discussing the PRA burden resulting from Rule 17g–9).

[2130] *See* Table 2 in section I.B.2.a. of this release. In the proposing release, the Commission estimated that NRSROs had a total of 2,905,824 credit ratings outstanding in all classes of credit ratings. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33500.

[2131] *See* Table 1 in section I.B.2.a. of this release. In the proposing release, the Commission estimated that NRSROs employed a total of 3,520 credit analysts. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33500.

[2132] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33506, 33509–33510.

[2133] *See id.* at 33506, 33509–33510. *See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4508 (providing an estimate of 2,067 upon which the estimate in the proposing release was based).

[2134] *See* Table 6 in section I.B.2.b. of this release.

[2135] *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4508, n.217 (noting that the 2,067 estimate was based, in part, on the average number of registered and Rule 144A offerings of asset-backed securities over the period 2004–2009).

[2136] *See* section II.E.2. of this release (providing a more detailed discussion of this amendment).

[2137] *See* section II.E.2. of this release.

[2138] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33501 (5 hours × 10 NRSROs = 50 hours).

[2139] *See* 15 U.S.C. 78o–7(q)(2)(D).

[2140] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33501 (10 NRSROs × 48 hours = 480 hours).

[2141] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33501 (200 requests × 20 minutes per request = 67 hours per year; 10 NRSROs × 67 hours per year = 670 hours per year).

proposed. Therefore, the Commission is retaining this estimate without revision.

In response to comments stating that NRSROs should be able to charge the requesting individual postage and handling fees,[2142] the Commission agrees, as stated above, that an NRSRO may charge a reasonable postage and handling fee.[2143] Because NRSROs may choose not to pass the postage costs on to persons requesting the exhibit in writing, the Commission estimates that the cost of postage will be approximately two dollars per request, for an industry-wide annual cost of approximately $4,000.[2144]

The Commission is also amending paragraphs (e), (f), and (g) of Rule 17g–1 to require NRSROs to use the Commission's EDGAR system to electronically submit Form NRSRO and the required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.[2145] NRSROs currently submit these documents to the Commission in paper form.

The Commission estimated in the proposing release that each NRSRO would spend an average of approximately four and ¾ hours becoming familiar with the EDGAR filing system, resulting in an estimated industry-wide one-time hour burden of forty-seven and a half hours.[2146]

An NRSRO stated that it would have no objection to the proposal, that providing the information as PDF documents would be ''the most preferred and simplest'' way to provide the information, and that providing the information in and XBRL or XML format would not provide additional analytical benefit and could make it more difficult for users to access Form NRSRO.[2147] Another NRSRO, however, stated that the Commission's estimate of the cost of the proposal ''accounts for only a small fraction of the expected cost of compliance'' as ''an NRSRO will have to familiarize itself with the roughly 35 Rules of Regulation S–T as well as the first two volumes of the EDGAR Filer Manual (which currently total more than 600 pages) and related EDGAR technical guidance.'' [2148] This commenter also stated that the Commission did not estimate ''the expense an NRSRO would incur in compiling Form NRSRO, its exhibits, and the annual reports into an EDGAR-acceptable format.'' [2149] However, the commenter did not provide a different estimate of the costs associated with the proposal.

In response to the comment from an NRSRO that the Commission's proposed cost estimate for the proposal ''accounts for only a small fraction of the expected cost of compliance'' and that instead PDF copies of the required submissions should be transmitted via email,[2150] the Commission notes that it has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents, which, as noted above, another NRSRO described as ''the most preferred and simplest'' way to provide the information.[2151] The Commission also points out that not all of Regulation S–T or the EDGAR Filer Manual applies to NRSRO submissions, in particular, as these submissions will be made as PDF documents.[2152] Moreover, having the reports submitted via the EDGAR system—rather than to a Commission email box—will assist the Commission staff in storing and accessing these records in furtherance of the Commission's NRSRO oversight function.

In response to the comment that the Commission underestimated the burden of becoming familiar with the EDGAR system,[2153] the Commission is revising its estimate, based on staff experience, from 4 and ¾ hours on a one-time basis as the amount of time, on average, an NRSRO would need to spend to become familiar with the EDGAR system to sixteen hours, for an industry-wide one-time burden of approximately 160 hours.[2154] This includes developing an understanding of how to use the system for both submitting Forms NRSRO (and applicable exhibits) and for submitting the Rule 17g–3 annual reports. The Commission is allocating this one-time hour burden and corresponding cost solely to Rule 17g–1.

The Commission stated in the proposing release that it did not believe that changing the method of submitting Form NRSRO and Exhibits 1 through 9 from a paper submission to an electronic submission would increase the current annual hour burden for Rule 17g–1.[2155] An NRSRO stated that the Commission failed to consider the significant ongoing expenses of monitoring changes in EDGAR filing requirements.[2156] Because the amendments to Rule 17g–1 require the submission to be made in PDF (the simplest process), the Commission does not believe that changes to the EDGAR filer manual generally will impact the NRSROs. However, the Commission agrees with the commenter that NRSROs will need to spend some time each year reviewing changes to the EDGAR filer manual to determine whether they relate to the NRSRO's submissions.[2157] Consequently, the Commission now estimates, based on Commission staff experience, that each NRSRO will spend an average of approximately two hours per year monitoring changes in EDGAR filing requirements, resulting in a total industry-wide annual hour burden of approximately twenty hours.[2158] This includes monitoring changes in EDGAR filing requirements for both submitting Forms NRSRO and for submitting the Rule 17g–3 annual reports.

The Commission is allocating the one-time and annual hour burdens and corresponding costs of the requirement to submit Form NRSRO and the Rule 17g–3 annual reports to the Commission electronically on EDGAR as PDF documents solely to Rule 17g–1.

The Commission therefore estimates that the total industry-wide one-time hour burden resulting from the amendments to Rule 17g–1 is approximately 690 hours [2159] to reconfigure NRSROs' corporate Internet Web sites, to establish procedures and protocols for receiving and processing requests for a paper copy of Exhibit 1, and for becoming familiar with the EDGAR system, and the total industry-wide annual burden is approximately

[2142] *See DBRS Letter; S&P Letter.*

[2143] *See* section II.E.2. of this release.

[2144] 200 requests × $2.00 = $400; 10 NRSROs × $400 = $4,000.

[2145] *See* section II.L. of this release (providing a more detailed discussion of these amendments).

[2146] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33501 (10 NRSROs × 4.75 hours = 47.5 hours).

[2147] *See S&P Letter.*

[2148] *See DBRS Letter.*

[2149] *See id.*

[2150] *See DBRS Letter.*

[2151] *See S&P Letter.*

[2152] *See EDGAR Filer Manual, available at http://www.sec.gov/info/edgar/edmanuals.htm.* Significant portions of the manual relate to public company filing of information on various Commission forms and to filing forms in formats other than PDF (ASCII, HTML, XML, or XBRL). The third volume of the manual relates to the filing of Form N–SAR by investment management companies registered with the Commission.

[2153] *See DBRS Letter.*

[2154] 16 hours × 10 NRSROs = 160 hours. In addition, as discussed below in section IV.D.12. of this PRA analysis, the Commission estimates that the one-time industry-wide burden resulting from filing Form ID to gain access to the EDGAR system to be approximately two and half hours, for a total industry-wide one-time burden of approximately 162.5 hours.

[2155] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33501.

[2156] *See DBRS Letter.*

[2157] *See, e.g., Adoption of Updated EDGAR Filer Manual,* Securities Act Release No. 9600 (June 16, 2014), 79 FR 35280 (June 20, 2014); *Adoption of Updated EDGAR Filer Manual,* Securities Act Release No. 9554 (Mar. 4, 2014), 79 FR 13216 (Mar. 10, 2014). The Commission succinctly summarizes the updates to the EDGAR filer manual in these releases, which are less than ten pages long.

[2158] 10 NRSROs × 2 hours = 20 hours.

[2159] 50 hours + 480 hours + 160 hours = 690.

690 hours to process requests for a paper copy of Exhibit 1 and to monitor changes in EDGAR filing requirements.[2160] The Commission further estimates that the total industry-wide annual external cost to NRSROs resulting from the amendments to Rule 17g–1 is approximately $4,000.

2. Amendments to Form NRSRO Instructions

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.[2161] The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample ''Transition/Default Matrix.'' The amendments also will enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

In the proposing release, the Commission stated that it believed that the burdens attributable to the amendments to the instructions for Exhibit 1 should be based on the number of NRSRO credit ratings outstanding (which, based on annual certifications submitted by the NRSROs for the 2009 calendar year end, totaled 2,905,824 credit ratings outstanding across the ten NRSROs), that the one-time hour burden would be approximately three seconds per outstanding credit rating, and that the annual hour burden would be approximately one and a half seconds per outstanding credit rating, for an industry-wide one-time burden of approximately 2,420 hours and an industry-wide annual burden of approximately 1,210 hours.[2162]

An NRSRO stated that collecting the data required for purposes of the proposed amendments to the instructions for Exhibit 1 to Form NRSRO would be burdensome, and this NRSRO suggested that NRSROs be exempt from the requirement to include historical data to the extent that the NRSRO does not already capture such information ''in a readily retrievable format.'' [2163] Another NRSRO stated that the definition of *paid off* as applied to obligors ''is not practicable'' because some obligors do not have rated debt outstanding and it would be difficult to track whether all obligations of an obligor are paid off.[2164] In addition, an NRSRO objected to basing burden estimates on the number of credit ratings outstanding or the number of credit analysts employed by NRSROs, stating that the burden estimates ''must include the amount of legal and compliance resources necessary to implement systemic and simultaneous changes.'' [2165]

As discussed in section II.E.1. of this release, in response to comment, the Commission has modified the proposed instructions for Exhibit 1 to Form NRSRO. The final amendments provide that, except for the issuers of asset-backed securities class of credit ratings, to determine the number of credit ratings outstanding as of the beginning of the applicable period, the NRSRO must include only credit ratings assigned to an obligor as an entity or, if there is no such credit rating, the credit rating of the obligor's senior unsecured debt, instead of all of the credit ratings of individual securities or money-market instruments issued by the obligor. Because the Commission has narrowed the scope of the types of credit ratings that will have to be included in the performance statistics for four of the five classes of credit ratings, this should substantially reduce the amount of historical information that will need to be analyzed. The Commission has also revised the standard definition of *paid off,* in response to comment,[2166] to eliminate the prong that applied to credit ratings of obligors as entities. The Commission has clarified that the rule does not require NRSROs to track the outcomes of obligors, securities, or money market instruments after the credit ratings assigned to them have been withdrawn, in response to comments from two NRSROs,[2167] one of which stated that ''the proposed requirement to separately track rating withdrawals, because of repayments and other reasons, likely would be impractical in many cases.'' [2168]

The Commission believes that it is appropriate to base some of the burden estimates attributable to the amendments to the instructions for Exhibit 1 on the number of NRSRO credit ratings outstanding, as the time required to retrieve information will depend on the number of credit ratings outstanding and the time required to calculate the performance statistics should be greater for a larger start-date cohort. However, as stated above, in response to comment, the Commission is adding to its one-time burden estimate to account for burden that does not depend on the number of NRSRO credit ratings outstanding.[2169] For example, some of the burden associated with establishing systems for determining performance statistics according to the amended instructions may not depend on the number of credit ratings outstanding. While commenters did not provide an estimate of the amount of one-time burden that would be unrelated to the number of credit ratings outstanding, the Commission is adding to the one-time hour burden estimated in the proposing release a one-time hour burden that is not linked to the number of credit ratings outstanding. Specifically, the Commission estimates, based on Commission staff experience, a one-time burden of approximately fifty hours per NRSRO, for an industry-wide total of approximately 500 hours on a one-time basis,[2170] attributable to the amendments to the instructions for Exhibit 1 that is in addition to the one-time burden based on the number of credit ratings outstanding.

In order to be conservative, the Commission is not revising its time per credit rating estimates as a result of the modifications to the proposed amendments to the instructions for Exhibit 1 in the final rule, although the modifications may result in lower burdens compared to those of the proposed amendments. However, the Commission is updating its estimate of the number of NRSRO credit ratings outstanding. Based on the annual certifications submitted by the NRSROs for the 2013 calendar year, there were approximately 2,437,046 credit ratings outstanding across all ten NRSROs.[2171] The Commission therefore estimates that the industry-wide one-time hour burden for NRSROs to establish systems to process the relevant information necessary to complete Exhibit 1 to Form NRSRO that is based on the number of outstanding credit ratings is approximately 2,031 hours [2172] and that

[2160] 670 hours + 20 hours = 690 hours.

[2161] *See* section II.E.1. of this release (providing a more detailed discussion of the amendments).

[2162] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33502.

[2163] *See Moody's Letter.*

[2164] *See S&P Letter.*

[2165] *See A.M. Best Letter. See also DBRS Letter.*

[2166] *See S&P Letter.*

[2167] *See Moody's Letter; S&P Letter.*

[2168] *See S&P Letter.*

[2169] *See A.M. Best Letter; DBRS Letter.*

[2170] 50 hours × 10 NRSROs = 500 hours.

[2171] *See* Table 2 in section I.B.2.a. of this release.

[2172] 2,437,046 credit ratings × 3 seconds = 2,030.9 hours (rounded to 2,031 hours).

the industry-wide annual burden is approximately 1,015 hours.[2173]

The Commission therefore estimates that the total industry-wide one-time hour burden to NRSROs resulting from the amendments to the instructions for Exhibit 1 to Form NRSRO is approximately 2,531 hours[2174] to establish systems for determining performance statistics according to the amended instructions and that the annual burden is approximately 1,015 hours to calculate and format the performance statistics according to the amended instructions.

3. Amendments to Rule 17g–2

The Commission is adding paragraph (a)(9) to Rule 17g–2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g–8 as a record that must be made and retained.[2175] In addition, the Commission is adding the following paragraphs to Rule 17g–2 to identify records that must be retained: (1) Paragraph (b)(12) identifies the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act;[2176] (2) paragraph (b)(13) identifies the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g–8;[2177] (3) paragraph (b)(14) identifies the policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g–8;[2178] and (4) paragraph (b)(15) identifies the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g–9.[2179] In addition, in a modification from the proposal, the Commission is amending paragraph (c) of Rule 17g–2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g–2 must be retained until three years after the date record is replaced with an updated record, instead of three years after the date the record is made or received (the retention period for other records identified in paragraphs (a) and (b) of Rule 17g–2).[2180]

With respect to paragraph (b)(12) of Rule 17g–2, one commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, and argued that an NRSRO should be allowed to establish its own documentation policies and procedures.[2181] However, the Commission is not imposing documentation requirements. Rather, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO, among other things, to document its internal control structure.[2182]

The Commission is adding paragraph (a)(9) to Rule 17g–2 to require NRSROs to make and retain a record documenting the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce under section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of proposed Rule 17g–8. The Commission is providing estimates below in section IV.D.7. of this PRA analysis to address the burdens associated with Rule 17g–8, including the one-time and annual hour burdens that will result from establishing, maintaining, enforcing, and *documenting* the policies and procedures with respect to look-back reviews required by section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g–8.

Consequently, for purposes of Rule 17g–2, the Commission is providing estimates of the one-time and annual hour burdens resulting from the requirement to *retain* the records that are identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g–2. The Commission believes that the one-time hour burden will result from the NRSRO needing to update its record retention policies and procedures to incorporate these new records that will need to be retained. NRSROs already have a recordkeeping system in place to comply with the retention requirements of Rule 17g–2 before today's amendments. The Commission estimated in the proposing release that each NRSRO would spend an average of approximately twenty hours updating its record retention policies and procedures, resulting in an industry-wide one-time hour burden of approximately 200 hours.[2183] The Commission did not receive comment on this estimate.

The Commission estimated in the proposing release that it would take approximately one hour per record each year to retain updated versions of these records,[2184] for an annual hour burden for each NRSRO attributable to these proposals of approximately five hours,[2185] and an industry-wide annual hour burden of approximately fifty hours.[2186] The Commission did not receive comment on this estimate and, except for the amendment to paragraph (c) requiring that the record be retained until three years after the date the record is replaced with an updated record, is adopting the amendments to Rule 17g–2 as proposed. The Commission believes that the amendment to paragraph (c) of Rule 17g–2 will not affect the burdens estimated for Rule 17g–2 in the proposing release because the amendment removes an ambiguity in the proposal that could be read to make the retention period shorter than the Commission intended and shorter than the retention period upon which the Commission's estimate in the proposing release was based. Therefore, the Commission is retaining the one-hour per record estimate in the proposing release without revision.

The Commission is repealing paragraph (d)(2) of Rule 17g–2 (the 10% Rule) and re-codifying, with substantial amendments, the requirements in former paragraph (d)(3) of Rule 17g–2 in paragraph (b) of Rule 17g–7 (the 100% Rule).[2187] The one-time and annual hour burdens resulting from the enhancements to the 100% Rule are discussed below in section IV.D.6. of this release, which addresses the one-time and annual hour burdens resulting from the amendments to Rule 17g–7.

Consequently, the Commission estimates that the total industry-wide one-time hour burden for NRSROs resulting from the amendments to Rule 17g–2 to update their record retention policies and procedures to incorporate these new records that will need to be retained is approximately 200 hours and

[2173] 2,437,046 credit ratings × 1.5 seconds = 1015.4 hours (rounded to 1015 hours).

[2174] 500 hours + 2,031 hours = 2,531 hours.

[2175] *See* section II.C.2. of this release (providing a more detailed discussion of this amendment).

[2176] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment).

[2177] *See* section II.F.2. of this release (providing a more detailed discussion of this amendment).

[2178] *See* section II.J.2. of this release (providing a more detailed discussion of this amendment).

[2179] *See* section II.I.2. of this release (providing a more detailed discussion of this amendment).

[2180] *See* paragraph (c) of Rule 17g–2.

[2181] *See A.M. Best Letter.*

[2182] *See* 15 U.S.C. 78o–7(c)(3)(A).

[2183] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33503 (10 NRSROs × 20 hours = 200 hours).

[2184] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33503.

[2185] 5 records × 1 hour = 5 hours.

[2186] 10 NRSROs × 5 hours = 50 hours.

[2187] *See* section II.E.2. of this release (providing a more detailed discussion of these amendments).

the annual hour burden to retain the records is approximately fifty hours.[2188]

4. Amendments to Rule 17g–3

The Commission is amending paragraphs (a) and (b) of Rule 17g–3.[2189] The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an additional report—a report on the NRSRO's internal control structure—with its annual submission of reports to the Commission pursuant to Rule 17g–3. The amendment to paragraph (b) of Rule 17g–3 requires that the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report.

In the proposing release, the Commission stated that because NRSROs already should have developed processes and protocols to prepare the annual reports required by Rule 17g–3, the internal hour burden associated with the first submission of the report on the NRSRO's internal control structure would not be materially different than the hour burden associated with submitting subsequent reports, although the time required to prepare subsequent reports could decrease incrementally over time as the NRSRO gains experience with the requirement.[2190] The Commission stated that an NRSRO likely would engage outside counsel to analyze the requirements for the report and to assist in drafting and reviewing the first report, that the time outside counsel would spend on this work would depend on the size and complexity of the NRSRO, and that an attorney would spend an average of approximately 100 hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the first report, resulting in an industry-wide external one-time hour burden of approximately 1,000 hours.[2191] Based on industry sources, the Commission estimated that the cost of outside counsel would be approximately $400 per hour,[2192] and that the average one-time cost to an NRSRO would be approximately $40,000,[2193] resulting in an industry-wide one-time cost of approximately $400,000.[2194]

In connection with the proposed amendments to Rule 17g–7, an NRSRO stated that the Commission underestimated the hourly rate for retaining outside counsel.[2195] The commenter, however, did not provide alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate without revision.[2196]

In terms of the annual burden relating to the submission of the reports, the Commission estimated, based on staff experience, that each NRSRO would spend on average approximately 150 hours preparing the internal controls report, resulting in an industry-wide annual burden of approximately 1,500 hours.[2197]

In addition, the Commission stated that an NRSRO likely would continue to engage outside counsel to assist in preparing the reports (after filing the first report) and that the time outside counsel would spend assisting in the preparation of subsequent reports would be less than the time spent on preparing the first report, since the counsel's work will not need to include an initial analysis of the new requirements. Consequently, the Commission estimated that an attorney would spend an average of approximately fifty hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the report, resulting in an industry-wide annual hour burden of approximately 500 hours.[2198] As stated above, the Commission estimated that the cost of outside counsel would be approximately $400 per hour.[2199] For these reasons, the Commission estimated that the average annual cost to an NRSRO to comply with this requirement would be approximately $20,000,[2200] resulting in an industry-wide annual cost of approximately $200,000.[2201] The Commission did not receive comment on the hour estimates. As proposed, paragraph (a)(7) of Rule 17g–3 would require that the internal controls report contain a description of the responsibility of management in establishing and maintaining an effective control structure and an assessment of the effectiveness of the internal control structure. In response to comment, paragraph (a)(7), as adopted, has been modified from the proposal to require that the report describe material weaknesses identified in the internal control structure during the fiscal year and how they were addressed and to state whether the internal control structure was effective as of the end of the fiscal year.[2202] In order to include an assessment of the effectiveness of the NRSRO's internal control structure in the annual internal controls report, the NRSRO will need to identify any material weaknesses in the internal control structure. In addition, since the statute requires that the internal control structure be ''effective,'' the NRSRO will have to remediate any such weaknesses to comply with the statutory requirement.[2203] Therefore, the Commission does not believe the modifications discussed above necessitate adjusting the burdens from those that were proposed.

However, the modifications to the amendment from the proposal also require that the internal controls report include a description of material weaknesses identified during the fiscal year and how they were remediated. The Commission believes that documenting these items for inclusion

[2188] The adjusted industry-wide annual hour burden for Rule 17g–2 before today's amendments was 4,000 hours. The elimination of the requirements in paragraph (d)(2) of Rule 17g–2 will subtract seventy hours from that amount. *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6472. In addition, the re-codification of paragraph (d)(3) of Rule 17g–2 in paragraph (b) of Rule 17g–7 will subtract an additional 450 hours from the adjusted industry-wide annual hour burden for Rule 17g–2 and that burden will be attributed to the industry-wide annual hour burden for Rule 17g–7. *See Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63853; section IV.D.6. of this release. Consequently, after these subtractions, the adjusted industry-wide annual hour burden for Rule 17g–2 will be 3,480 hours (4,000 hours − 70 hours − 450 hours = 3,480 hours). The amendments to add paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) to Rule 17g–2 being adopted today will, as discussed above, add approximately fifty hours to the adjusted industry-wide annual hour burden resulting in a total adjusted industry-wide annual hour burden of 3,530 hours (3,480 hours + 50 hours = 3,530 hours).

[2189] *See* section II.A.3. of this release (providing a more detailed discussion of these amendments).

[2190] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504.

[2191] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (10 NRSROs × 100 hours = 1,000 hours).

[2192] *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR 63889 (providing an estimate of $400 per hour to engage outside counsel).

[2193] 100 hours × $400 = $40,000.

[2194] 10 NRSROs × $40,000 = $400,000.

[2195] *See DBRS Letter.*

[2196] *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63889 (''Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately $400 per hour'').

[2197] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (10 NRSROs × 150 hours = 1,500 hours).

[2198] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (10 NRSROs × 50 hours = 500 hours). The Commission is adopting paragraph (a)(7) of Rule 17g–3 as proposed. Accordingly, this estimate remains unchanged from the Commission's preliminary estimate in the proposing release.

[2199] *See also Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR 63889 (''Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately $400 per hour'').

[2200] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (50 hours × $400 = $20,000).

[2201] *See id.* (10 NRSROs × $20,000 = $200,000).

[2202] *See* section II.A.3. of this release (providing a more detailed discussion of these modifications).

[2203] *See* 15 U.S.C. 78o–7(c)(3)(A).

in the internal controls report will take NRSROs an average of approximately fifteen hours per year, resulting in an internal burden of approximately 165 hours per NRSRO per year for preparing the internal controls report, resulting in a total industry-wide annual burden of approximately 1,650 hours.[2204]

As discussed above in section IV.D.1. of this release, the amendments to Rule 17g–3 also require that the annual reports be submitted electronically on the Commission's EDGAR system.[2205] The discussion of the Commission's estimates of the burdens associated with the requirement to submit the Rule 17g–3 annual reports electronically through the EDGAR system in the proposing release, relevant comments on those burdens, the Commission's responses to those comments, and the Commission's final burden estimates (which are revised in response to comments) are discussed in section IV.D.1. of this release. Further, as discussed below in section IV.D.12. of this release, the Commission estimates there will be burdens to complete Form ID for purposes of submitting Form NRSRO (and Exhibits 1 through 9) and the Rule 17g–3 annual reports electronically through EDGAR. For purposes of this PRA analysis, the Commission is allocating the burdens discussed above to Rule 17g–1 and Form ID.

The Commission therefore estimates that the amendments to Rule 17g–3 will result in a total industry-wide one-time cost for NRSROs of approximately $400,000 to engage outside counsel to analyze the requirements for the internal controls report, a total industry-wide annual hour burden of approximately 1,650 hours to prepare the internal controls report, and a total industry-wide annual cost of approximately $200,000 to engage outside counsel to assist in the preparation of the annual internal controls report.

5. Amendments to Rule 17g–5

The Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g–5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security.[2206] This provision, which was not included in the proposal, may require NRSROs to redraft the agreement templates they use with respect to obtaining representations from issuers, sponsors, or underwriters as required under Rule 17g–5. Based on staff experience, the Commission estimates that an NRSRO will spend approximately two hours on a one-time basis to redraft these templates, for a total industry-wide one-time burden of approximately 6,720 hours.[2207] In addition, based on the Commission's estimate that there will be 715 offerings of Exchange Act-ABS per year,[2208] the Commission estimates that issuers, sponsors, and underwriters will need to post approximately 715 Forms ABS Due Diligence–15E on Rule 17g–5 Web sites per year (in addition to the information that is already posted to the Web sites). Based on staff experience, the Commission estimates that it will take the issuer, sponsor, or underwriter approximately ten minutes to upload each form and post it to the Web site, for a total industry-wide annual burden of approximately 119 hours.[2209]

The Commission is adding paragraph (c)(8) to Rule 17g–5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[2210] As a consequence of the new absolute prohibition, the Commission believes that an NRSRO will need to update the written policies and procedures to address and manage conflicts of interest the NRSRO must establish, maintain, and enforce under section 15E(h) of the Exchange Act and Rule 17g–5. The Commission estimates below that it will take an NRSRO an average of approximately 100 hours to establish and make a record of its policies and procedures with respect to look-back reviews.[2211] Based on Commission staff experience, the Commission estimates that updating the conflicts of interest policies and procedures would take an NRSRO an average of approximately 100 hours, for an industry-wide one-time burden of approximately 1,000 hours.[2212]

Exhibit 7 to Form NRSRO requires an NRSRO to provide a copy of the written policies and procedures in the exhibit. Paragraph (e) of Rule 17g–1 requires an NRSRO to promptly file with the Commission an update of its registration on Form NRSRO when information on the form is materially inaccurate. The update of registration must be filed electronically on the Commission's EDGAR system. The Commission estimates, based on staff experience, that it would take an NRSRO an average of approximately twenty-five hours on a one-time basis to prepare and file the update of registration to account for the update of the NRSRO's written policies and procedures to address and manage conflicts of interest, for an industry-wide one-time burden of approximately 250 hours and a total industry-wide one-time burden of approximately 1,250 hours to update the NRSRO's conflicts of interest policies and procedures and to prepare and file an update of registration to account for the update of the NRSRO's written policies and procedures.[2213]

The Commission is adding paragraph (f) to Rule 17g–5, which provides that upon written application by an NRSRO the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) of Rule 17g–5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest.[2214]

[2204] 150 hours + 15 hours = 165 hours; 165 hours × 10 NRSROs = 1,650 hours.

[2205] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2206] *See* sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this provision).

[2207] 336 issuers, sponsors, and underwriters × 2 hours = 672 hours; 672 hours × 10 NRSROs = 6,720 hours.

[2208] *See* Table 6 in section I.B.2.b. of this release. Issuers, underwriters, and NRSROs may not use providers of third-party due diligence services with respect to every issuance of Exchange Act-ABS. For example, the Commission believes that providers of third-party due diligence services are used primarily for RMBS transactions. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471. However, the Commission's estimate uses the total number of estimated Exchange Act-ABS offerings (as opposed to a lesser amount based on an estimate of RMBS offerings) because the use of providers of third-party due diligence services may migrate to other types of Exchange Act-ABS.

[2209] 715 Forms ABS Due Diligence–15E per year × 10 minutes = 119.17 hours, rounded to 119 hours.

[2210] *See* section II.B.1. of this release (providing a more detailed discussion of this provision).

[2211] *See* section IV.D.7. of this release.

[2212] 100 hours × 10 NRSROs = 1,000 hours.

[2213] 10 NRSROs × 25 hours = 250 hours; 1,000 hours + 250 hours = 1,250 hours. *See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR at 33614 (providing a PRA estimate of twenty-five hours for an NRSRO to prepare and furnish an update of its registration).

[2214] *See* section II.B.2. of this release (providing a more detailed discussion of this provision).

Based on staff experience, the Commission believes that an NRSRO applying for the exemption would likely engage outside counsel to assist in drafting an exemption request, that counsel would spend an average of approximately fifty hours for a cost of approximately $20,000 to assist in drafting the request, and that the NRSRO would likely spend an average of approximately 150 hours to draft and submit the application to the Commission.[2215]

6. Amendments to Rule 17g–7

The Commission is incorporating the disclosure requirement with respect to representations, warranties, and enforcement mechanisms in Rule 17g–7 before today's amendments into paragraph (a) of Rule 17g–7 and is adding to paragraph (a) significant disclosure provisions that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[2216]

With respect to the one-time burden attributable to paragraph (a) of Rule 17g–7, the Commission estimated in the proposing release that an NRSRO would spend an average of approximately 5,000 hours to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process, allocated 75% of these burden hours (3,750 hours) to internal burden and 25% of these burden hours (1,250 hours) to external burden, and estimated a $400 per hour cost for outside professionals such as counsel and information technology consultants, resulting in an industry-wide one-time hour burden of approximately 50,000 hours and an industry-wide one-time cost of approximately $5,000,000.[2217] As discussed below, the Commission is not modifying its estimate with respect to the one-time burden attributable to paragraph (a) of Rule 17g–7. Further, as stated above, in response to a comment stating that the Commission's estimate of $400 per hour for retaining outside counsel is too low,[2218] the Commission notes that the commenter did not provide an alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate without revision.[2219]

With respect to the annual hour burden for paragraph (a) of Rule 17g–7, the Commission stated in the proposing release that it believed that the estimate should be divided into two components: The amount of time an NRSRO would spend to update its standardized disclosures and to tailor disclosures to particular rating actions and asset classes; and the amount of time the NRSRO would spend generating and publishing each form and attaching the required certifications to the form.[2220] With regard to the first component, the Commission estimated that an NRSRO would spend an average of approximately 500 hours per year updating the standardized disclosures, for an industry-wide annual hour burden of 5,000 hours.[2221] The Commission stated that it believed that the burden attributable to the second component should be based on the number of rating actions taken per year by the NRSROs because the requirement to generate and publish the form and attach the certifications will be triggered upon the taking of a rating action.[2222] The Commission further estimated that the ten NRSROs take approximately 2,909,958 credit rating actions per year,[2223] and estimated that the time it would take to generate a form with the required disclosures and to publish the form with the credit rating would be an average of approximately fifteen minutes, for an industry-wide annual hour burden of approximately 727,490 hours, which would be allocated to the NRSROs based on the number of credit ratings they have outstanding.[2224]

The Commission received comments from NRSROs stating that the Commission underestimated these costs and time burdens.[2225] However, these commenters did not provide estimates of the costs and time burden. Another NRSRO generally objected to the use of the number of credit ratings outstanding to estimate the burden of the proposed amendments and new rules, because ''the burden analysis must take into account not only the number of ratings or analysts in isolation, but also must include the legal and compliance resources necessary to implement systemic and simultaneous changes.'' [2226]

In part in response to comments,[2227] the Commission has modified paragraph (a) of Rule 17g–7 from the proposal in a number of ways to reduce burdens.[2228] For example, the Commission narrowed the scope of rating actions that will trigger the disclosure requirement and provided an exemption for certain rating actions involving foreign obligors or foreign-issued securities or money market instruments. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. All of these modifications were made in response to concerns about burdens raised by commenters.[2229] Based on the comments above, the Commission believes it underestimated the amount of the burden in the proposing release. However, the Commission also believes the modifications discussed above will ease the burden to the extent that they will compensate for the amount by which the Commission underestimated the burden. Consequently, the Commission is retaining the original burden estimate.

The Commission continues to believe that the estimate of the time required to

[2215] 50 hours × $400 per hour for outside counsel = $20,000.

[2216] *See* section II.G. of this release (providing a more detailed discussion of these amendments).

[2217] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33505. This estimate was based on the Commission's estimate for the amount of time it would take a securitizer to set-up a system to make the disclosures required by Form ABS–15G. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507. The Commission significantly increased the estimate for Form ABS–15G because the form required pursuant to Rule 17g–7 contains substantially more qualitative information.

[2218] *See DBRS Letter.*

[2219] *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63889 (''Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately $400 per hour''); *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4506 (providing an estimate of $400 an hour to engage outside professionals).

[2220] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33505.

[2221] *See id.*

[2222] *See id.*

[2223] Based on information submitted to the Commission by NRSROs, the Commission estimated that NRSROs took approximately 2,000,000 rating actions in 2009, consisting of upgrades, downgrades, placements on credit watch, and withdrawals of credit ratings. The Commission also estimated that NRSROs would issue expected or preliminary ratings primarily with respect to new issuances of structured finance products, which the Commission estimated at 2,067 per year, plus other issuances, for a total of 4,134 preliminary ratings per year. The Commission also estimated that approximately 415,117 initial credit ratings are issued per year and that 490,707 affirmations are issued per year. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33505–33506

[2224] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33505–33506.

[2225] *See A.M. Best Letter; DBRS Letter; Morningstar Letter.*

[2226] *See A.M. Best Letter. See also DBRS Letter.*

[2227] *See A.M. Best Letter; DBRS Letter; Morningstar Letter.*

[2228] *See* section II.G. of this release (providing a more detailed discussion of these modifications).

[2229] *See A.M. Best Letter; ASF Letter; Better Markets Letter; CFA/AFR Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.*

generate and publish the form and attach the certifications should be based on the number of rating actions taken per year by the NRSROs because the requirement will be triggered upon the taking of a rating action. Based on staff experience, the Commission believes that expected or preliminary credit ratings are published primarily (but not exclusively) with respect to new issuances of structured finance products. The Commission estimates that there will be approximately 715 offerings of structured finance products per year.[2230] As stated in the proposing release, the Commission, based on staff experience, believes that expected or preliminary credit ratings are used in other types of offerings as well and, therefore, is increasing that estimate by 100%, to 1,430 preliminary or expected credit ratings per year.[2231]

In terms of estimating the number of initial credit ratings, as stated above, the Commission estimates that there are approximately 2,437,046 credit ratings outstanding across all ten NRSROs.[2232] Based on staff experience, as stated in the proposing release, the Commission estimates that the average maturity of rated securities and money market instruments is approximately seven years.[2233] Consequently, assuming 2,437,046 is the approximate average number of credit ratings outstanding at any given time, the Commission estimates that approximately 348,149 initial credit ratings are issued per year.[2234]

Based on information submitted to the Commission by NRSROs pursuant to paragraph (a)(6) of Rule 17g–3,[2235] the Commission estimates that in calendar year 2013 NRSROs made a total of approximately 236,521 credit rating upgrades and downgrades, placed 176,374 credit ratings on credit watch, and withdrew 191,062 credit ratings. However, the Commission notes that the definition of *rating action* in the prefatory text of paragraph (a) of Rule 17g–7, as adopted, has been modified from the proposed definition to exclude placements of credit ratings on credit watch and to only include an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using applicable procedures and methodologies for determining credit ratings. The Commission estimates that virtually all withdrawals of credit ratings by NRSROs are in connection with routine debt maturities, calls, or redemptions in which case the withdrawal would result from the extinguishment of the debtor's obligation and not from an analysis of the debtor's creditworthiness. Consequently, virtually all withdrawals would not result from the application of the NRSRO's rating procedure or methodology to analyze the creditworthiness of the debtor. Therefore, virtually all withdrawals under the modified definition of *rating action* would not trigger the requirements of paragraph (a) of Rule 17g–7. Consequently, the Commission is excluding the number of withdrawals per year from the total number of rating actions per year that will trigger the requirements of paragraph (a) of Rule 17g–7.

Finally, with respect to affirmations of existing credit ratings, the Commission believes that NRSROs generally affirm existing credit ratings at least once a year. Consequently, the Commission estimates that the number of affirmations would be the total number of credit ratings outstanding (2,437,046), less the number of credit ratings that are upgraded and downgraded (236,521), placed on credit watch (176,374), withdrawn (191,062), and paid off during the year (348,149), for a total of 1,485,940 estimated NRSRO affirmations of existing credit ratings.

Based on these estimates, the Commission estimates that the ten NRSROs take an aggregate of approximately 2,071,040 credit rating actions per year, according to the definition of *rating action* in paragraph (a) of Rule 17g–7, as adopted.[2236] The Commission notes that the exemption in the rule for rating actions involving certain foreign obligors, securities, or money market instruments could reduce the number of rating actions that trigger the requirement to publish the form and any applicable due diligence certifications. However, in light of the comments arguing that the Commission underestimated the burden of the rule, taken in conjunction with the modifications from the proposal that reduce the number of rating actions covered, the Commission is not adjusting the number of rating actions for the purposes of these estimates.

The Commission preliminarily estimated that it would take approximately fifteen minutes on average to generate a form by populating it with the required disclosures and to publish the form. Commenters made general statements that the rule would result in significant burden [2237] or that the Commission underestimated the burden.[2238] Commenters, however, did not provide alternative estimates of the burden. Nonetheless, the Commission is revising its estimate, based on staff experience and in light of the comments, to twenty minutes on average for each rating action, resulting in an industry-wide annual hour burden of approximately 690,347 hours.[2239]

The Commission is not revising its estimate of the amount of time an NRSRO would spend to update its standardized disclosures and to tailor disclosures to particular rating actions and asset classes. The Commission therefore estimates an annual burden per NRSRO of approximately 500 hours and an industry-wide annual hour burden of approximately 5,000

[2230] *See* Table 6 in section I.B.2.b. of this release.

[2231] 715 × 2 = 1,430. *See also Nationally Recognized Statistical Rating Organizations,* 76 FR at 33506.

[2232] *See* Table 2 in section I.B.2.a. of this release.

[2233] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33506.

[2234] 2,437,046 credit ratings/7 = 348,149 credit ratings. In other words, the Commission estimates that issuers pay in full all outstanding principal and interest outstanding with respect to approximately 348,149 rated securities or money market instruments and, consequently, the credit ratings for these securities and money market instruments are withdrawn. Those withdrawn credit ratings, in turn, are replaced by 348,149 initial (or new) credit ratings. Outstanding credit ratings assigned to securities and money market instruments are withdrawn for other reasons, including that the security or money market instrument went into default. In addition, a percent of the outstanding credit ratings are assigned to obligors as entities and, therefore, these credit ratings would not be withdrawn because an obligation was extinguished. However, the credit ratings might be withdrawn for other reasons, including that the obligor went into default. Nonetheless, the Commission continues to believe these estimates are reasonable approximations of the number of initial credit ratings determined per year. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33506, n.1011.

[2235] *See* paragraph (a)(6) of Rule 17g–3.

[2236] 236,521 upgrades and downgrades + 1,484,940 affirmations + 348,149 initial credit ratings + 1,430 preliminary or expected credit ratings = 2,071,040 rating actions per year. For purposes of paragraph (a) of Rule 17g–7, credit ratings placed on credit watch and withdrawn credit ratings are not included in this calculation due to the definition of *rating action.*

[2237] *See A.M. Best Letter* (''We believe that expanding 17g–7 disclosure requirements to non-asset-backed ratings is extremely overly-burdensome . . .'').

[2238] *See DBRS Letter* (''DBRS believes that the Commission has grossly underestimated . . . the amount of time it will take to compile a disclosure form for each rating action''); *Morningstar Letter* (''We disagree with the Commission's estimation that the form of these certificates will be largely standardized and take 15 minutes to complete per rating action. We believe that the Commission's estimation is too low since proposed provisions will not be able to be standardized across rating actions or asset class types and will still require an individual analysis of the securities transaction.'') (footnote omitted).

[2239] 2,071,040 rating actions × ⅓ hour = 690,346.67 hours, rounded to 690,347 hours.

hours.[2240] Based on staff experience, the Commission believes that the update process will be handled by the NRSROs internally.

The Commission is also amending paragraph (b) to Rule 17g–7 to re-codify the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g–2 before today's amendments (the 100% Rule) and increases the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.[2241]

In the proposing release, the Commission estimated that the average one-time burden attributable to the enhancements to the 100% Rule per NRSRO would be approximately 135 hours to program existing systems and initially add the ratings histories for all outstanding credit ratings as of June 26, 2007, for an industry-wide one-time burden of approximately 1,350 hours, and that the average annual burden per NRSRO to comply with the increased requirements, including updating and administering the database, would be approximately forty-five hours per year, for an industry-wide annual burden of approximately 450 hours.[2242]

One NRSRO stated that constantly updating the database for the 100% Rule ''would impose an unwarranted burden on NRSROs.'' [2243] Another NRSRO stated that NRSROs may not have, or may find it difficult to obtain, the additional information required by the amendments.[2244] A third NRSRO stated that because it does not consider affirmations, confirmations, placement of credit ratings on watch or review, and assignment of default status to be credit rating actions and does not subdivide withdrawn credit ratings into the subcategories of withdrawn due to default, withdrawn because paid in full, and ''other,'' it does not capture some of that information in a format that is readily retrievable and therefore it recommends that the rule exempt NRSROs from providing historical data to the extent it does not already capture the data in a readily retrievable format.[2245] One NRSRO that generally supported the amendments also stated that NRSROs may not be able to provide XBRL information as of June 26, 2007, since those rating actions are beyond the scope of the 3-year record retention requirement.[2246] Three NRSROs objected to the requirement to disclose the legal name and CIK number of the rated obligor or issuer of the security or money market instrument and the CUSIP of the security or money market instrument.[2247] One NRSRO stated that it was ''unnecessarily burdensome'' to require the use of identifiers that may become obsolete, that require NRSROs to pay a fee, or that may not be used outside the United States, as long as NRSROs ''use some kind of identifier system sufficient to identify the rated obligor and obligation,'' for example, ''an internationally recognized LEI [Legal Entity Identifier] system.'' [2248]

In response to these comments, the Commission notes that it has modified paragraph (b) of Rule 17g–7 from the proposal to reduce the burden.[2249] To focus the disclosure of rating histories on the rating actions that are most relevant to evaluating performance, the final amendments eliminate the proposed requirement to include placements on watch and affirmations (and the required data associated with these actions) in the rating histories.[2250] The final amendments also significantly shorten the time horizon of historical information that must be retrieved for inclusion in the rating histories. In particular, the proposed requirement to include information for all credit ratings outstanding on or after June 26, 2007 has been replaced with a standard three-year backward looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This, together with the elimination of two types of rating actions that would trigger a requirement to add information to a credit rating's history—placements of the security on credit watch or review and affirmations of the credit rating—should significantly mitigate the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures.[2251] The modifications also should mitigate to some extent concerns about having to obtain information that was not traditionally retained by the NRSRO as it will significantly narrow the scope of such information that will need to be included in the rating histories. Further, the modifications should reduce the burden of updating the XBRL data file with new information. The final amendments also specify a standard for updating the file—no less frequently than monthly—in response to a suggestion by a commenter.[2252] This will make the costs resulting from the requirement lower than if the file needed to be updated more frequently. In addition, the final rule prioritizes identifier disclosure to an LEI and then to a CIK, if the LEI is not available.[2253] Finally, the final amendments modify the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This should reduce the data retention and maintenance costs associated with the final rule as compared to the proposed rule.

The modifications are expected to reduce the burden associated with the rule. However, the Commission is not decreasing the burden estimates, notwithstanding the modifications to the rule that reduce the burdens from the rule as proposed, in light of comments that the estimates in the proposal were too low.

In summary, the Commission estimates that the burden associated with paragraph (a) of Rule 17g–7 will result in a total industry-wide one-time hour burden to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process of approximately 37,500 hours and a total industry-wide one-time cost of approximately $5,000,000 to engage outside professionals such as counsel and information technology consultants to assist in developing the standardized disclosures and programming existing systems, and a total industry-wide annual hour burden to update standardized disclosures, to tailor disclosures to particular rating actions and asset classes, and to generate and publish each form and attach the required certifications to the form, of approximately 695,347 hours.[2254] With respect to the amendments to paragraph (b) of Rule 17g–7, the Commission estimates that

[2240] 500 hours × 10 NRSROs = 5,000 hours.

[2241] *See* section II.E.3. of this release (providing a more detailed discussion of these provisions).

[2242] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33506.

[2243] *See DBRS Letter.*

[2244] *See S&P Letter.*

[2245] *See Moody's Letter.*

[2246] *See Morningstar Letter.*

[2247] *See DBRS Letter; Moody's Letter; S&P Letter.*

[2248] *See Moody's Letter.* As discussed in section II.E.3. of this release, the Commission believes the requirement to disclose the CUSIP of the security or money market instrument that is the subject of the rating action is necessary to make the disclosures readily searchable.

[2249] *See* section II.E.3. of this release (providing a more detailed discussion of the modifications). *See also DBRS letter* (stating that the 100% Rule ''would impose an unwarranted burden on NRSROs''); *Moody's Letter* (stating that collecting data for past rating actions ''would require tens of thousands of hours of analysis'').

[2250] *See Moody's Letter* (stating that it does not consider these activities to be rating actions).

[2251] *See Moody's Letter, Morningstar Letter, S&P Letter.*

[2252] *See DBRS Letter.*

[2253] *See DBRS Letter; Moody's Letter; S&P Letter.*

[2254] 5,000 hours + 690,347 hours = 695,347 hours.

the burden associated with the enhancements to the 100% Rule will result in a total industry-wide one-time hour burden of approximately 1,350 hours to program existing systems and initially add the ratings histories for all applicable outstanding credit ratings and a total industry-wide annual hour burden to comply with the increased requirements, including updating and administering the database, of approximately 450 hours.[2255]

7. New Rule 17g–8

Paragraph (a) of Rule 17g–8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.[2256] In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 200 hours establishing the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 2,000 hours,[2257] and that an NRSRO would spend an average of approximately fifty hours per year reviewing the policies and procedures, updating them (if necessary), and enforcing them, resulting in an industry-wide annual hour burden of approximately 500 hours.[2258] The Commission did not receive comments on these estimates and is adopting the amendments to paragraph (a) of Rule 17g–8 substantially as proposed. The Commission does not believe the modifications will change the burden estimates as they either remove ambiguities or make minor wording revisions. Consequently, the Commission is retaining the estimates without revision.

In addition, the Commission estimates that it will take an NRSRO an average of approximately twenty hours to promptly publish on an easily accessible portion of its Internet Web site information about material changes to its procedures and methodologies to determine credit ratings and the likelihood such changes will result in changes to any current credit ratings, or a notice of significant errors identified in a procedure or methodology.

Paragraph (b) of Rule 17g–8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.[2259] In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 200 hours establishing the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 2,000 hours,[2260] and that an NRSRO would spend an average of approximately fifty hours per year reviewing the policies and procedures, updating them (if necessary), and enforcing them, resulting in an industry-wide annual hour burden of approximately 500 hours.[2261] The Commission did not receive comment on these estimates and is adopting the amendments to paragraph (b) of Rule 17g–8 substantially as proposed. The Commission does not believe the modifications will change the burden estimates as they are minor wording revisions. Consequently, the Commission is retaining the estimates without revision.

Paragraph (c) of Rule 17g–8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed in the form required under paragraph (a) of Rule 17g–7.[2262] In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 100 hours establishing and making a record of the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 1,000 hours,[2263] and that an NRSRO would spend an average of approximately twenty-five hours per year reviewing, and, if necessary, updating the policies and procedures and its record documenting the policies and procedures, maintaining and enforcing the policies and procedures, and taking steps pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict, resulting in an average industry-wide annual hour burden of approximately 250 hours.[2264] The Commission did not receive comment on these estimates and is adopting the amendments to paragraph (c) of Rule 17g–8 with modifications that reduce the burden in terms of the steps an NRSRO must take pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict. However, the PRA burden accounts for the time an NRSRO will spend establishing, reviewing and updating, and documenting the policies and procedures. The time spent establishing, reviewing, updating, and documenting the policies and procedures will not change because of the modifications to the rule from the proposal. Consequently, the Commission is retaining these estimates without revision.

The Commission therefore estimates that the total industry-wide one-time hour burden to the NRSROs resulting from Rule 17g–8, as adopted, is approximately 5,000 hours to: (1) Establish and document policies and procedures with respect to an NRSRO's procedures and methodologies to determine credit ratings; (2) establish and document policies and procedures with respect to the symbols, numbers, or scores an NRSRO uses to denote credit ratings; and (3) establish and make a record of its policies and procedures with respect to look-back reviews.[2265] The Commission estimates that the total industry-wide annual hour burden resulting from Rule 17g–8, as adopted, is approximately 1,250 hours to: (1) Maintain, review, update (if necessary), and enforce an NRSRO's policies and procedures with respect to an NRSRO's procedures and methodologies to determine credit ratings; (2) maintain, review, update (if necessary), and enforce its procedures and methodologies with respect to the symbols, numbers, or scores it uses to denote credit ratings; and (3) maintain, review, update (if necessary), and enforce its policies and procedures with respect to look-back reviews and its record documenting the policies and

[2255] As stated above in section IV.D.3. of this release, the re-codification of paragraph (d)(3) of Rule 17g–2 (the 100% Rule before today's amendments) in paragraph (b) of Rule 17g–7 will subtract 450 hours from the industry-wide annual hour burden for Rule 17g–2. This burden will be attributed to the industry-wide annual hour burden for Rule 17g–7.

[2256] *See* section II.F.1. of this release (providing a more detailed discussion of this paragraph).

[2257] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33507.

[2258] *See id.*

[2259] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph).

[2260] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33507.

[2261] *See id.*

[2262] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph).

[2263] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33507.

[2264] *See id.*

[2265] 2,000 hours + 2,000 + 1,000 hours = 5,000 hours. The burden associated with retaining the record documenting the procedures is attributed to Rule 17g–2.

procedures and take steps when a look-back review determines that a credit rating was influenced by a conflict.[2266]

8. New Rule 17g–9

The Commission is adopting Rule 17g–9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings.[2267]

The Commission stated in the proposing release that in order to account for the significant variance in the size and complexity of NRSROs, the one-time and annual hour burden estimates attributable to Rule 17g–9 should be based on the number of credit analysts employed by the NRSROs.[2268] Based on 2009 annual certifications, the Commission estimated that NRSROs employed approximately 3,520 credit analysts and that the one-time burden to establish the standards required under proposed Rule 17g–9 would be approximately five hours per credit analyst, resulting in an industry-wide one-time hour burden of 17,600 hours.[2269] In addition, the Commission allocated 75% of these burden hours (13,200 hours) to internal burden and 25% of these burden hours (4,400 hours) to external burden to hire outside professionals to assist in setting up training programs.[2270] The Commission stated in the proposing release that it believed that the annual hour burden to comply with Rule 17g–9 would be less than the one-time hour burden since NRSROs will have established the standards of training, experience, and competence for the individuals they employ to determine credit ratings. The Commission estimated that the industry-wide annual hour burden to update the standards and to enforce them would be approximately one hour per credit analyst employed, resulting in an industry-wide annual hour burden of approximately 3,520 hours and allocated 75% of the burden hours (2,640 hours) to internal burden and the remaining 25% of the burden hours (880 hours) to external burden.[2271] The Commission did not receive comment on these allocation percentages and is retaining them as proposed.

However, as stated above, an NRSRO objected to using the number of credit ratings or credit analysts in estimating the burdens associated with the proposal, stating that the burden must also ''include the amount of legal and compliance resources necessary to implement system and simultaneous changes'' and that ''the investments will not be diminished relative to financial resources because an NRSRO may have fewer analysts or credit ratings issued.'' [2272] In response to this comment, the Commission is adding to its burden estimate for Rule 17g–9 to account for burdens that do not depend on the number of credit analysts employed by an NRSRO. For example, the cost of establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for credit analysts, establishing testing programs, and administering training and testing programs may not be directly proportional to the number of credit analysts employed by an NRSRO. The Commission believes that it is appropriate, however, to retain the burdens based on the number of credit analysts employed by NRSROs as some of the burden attributable to Rule 17g–9 (for example, the burden associated with testing credit analysts on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings) may be proportional to the number of credit analysts employed by an NRSRO.

Based on staff experience, the Commission estimates that the additional burden attributable to Rule 17g–9 that does not depend on the number of credit analysts employed by an NRSRO is approximately 400 hours per NRSRO on a one-time basis and approximately 100 hours per NRSRO annually, for an industry-wide one-time hour burden of approximately 4,000 hours and an industry-wide annual hour burden of approximately 1,000 hours. The Commission continues to believe that it is appropriate to allocate 75% of the one-time and annual burden hours to internal burden and the remaining 25% to external burden to hire outside professionals to assist in establishing and updating credit analyst training programs. Of the totals, therefore, 3,000 hours are allocated to internal one-time burden,[2273] 1,000 hours are allocated to external one-time burden,[2274] 750 hours are allocated to internal annual burden,[2275] and 250 hours are allocated to external annual burden.[2276] The Commission estimated that it would cost $400 per hour to retain outside professionals, resulting in industry-wide one-time costs of approximately $400,000 [2277] and industry-wide annual costs of approximately $100,000.[2278]

As stated above, the burdens the Commission estimated above that do not depend on the number of credit analysts are additional to the burdens that depend on the number of credit analysts. In addition, the Commission believes that the modifications to Rule 17g–9 from the proposal will not affect the burden per credit analyst or the allocation of that burden to internal and external burdens that the Commission estimated in the proposing release, as those modifications should not affect the burdens associated with establishing, maintaining, enforcing, and documenting the standards. However, the Commission is revising the total number of credit analysts employed by the NRSROs based on updated information. The Commission now estimates that NRSROs employ a total of approximately 4,218 credit analysts.[2279] Therefore, the Commission estimates the industry-wide one-time hour burden based on the number of credit analysts employed by the NRSROs to be approximately 21,090 hours.[2280] Of this total, 15,818 hours are allocated to internal burden and 5,272 hours are allocated to external burden.[2281] The Commission estimates that it would cost $400 per hour for retaining outside professionals, resulting in an industry-wide one-time cost of approximately $2,108,800.[2282]

Similarly, the Commission now estimates an industry-wide annual hour burden based on the number of credit analysts employed by the NRSROs of approximately 4,218 hours.[2283] The Commission is allocating 75% of these burden hours (3,164 hours) to internal burden and 25% these burden hours

[2266] 500 hours + 500 hours + 250 hours = 1,250 hours. The burden associated with retaining the record documenting the procedures is attributed to Rule 17g–2.

[2267] *See* section II.I.1. of this release (providing a more detailed discussion of this rule).

[2268] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33508.

[2269] *See id.*

[2270] *See id.*

[2271] *See id.*

[2272] *See A.M. Best Letter. See also DBRS Letter.*

[2273] 4,000 hours × .75 = 3,000 hours.

[2274] 4,000 hours × .25 = 1,000 hours.

[2275] 1,000 hours × .75 = 750 hours.

[2276] 1,000 hours × .25 = 250 hours.

[2277] 1,000 hours × $400 = $400,000. *See Nationally Recognized Statistical Rating Organizations,* 76 FR 33508. *See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4506 (providing an estimate of $400 an hour engage outside professionals).

[2278] 250 hours × $400 = $100,000.

[2279] *See* Table 1 in section I.B.2.a. of this release.

[2280] 4,218 credit analysts × 5 hours = 21,090 hours.

[2281] 21,090 hours × 0.75 = 15,818 hours; 21,090 hours × 0.25 = 5,272 hours. These allocations remain unchanged from the Commission's preliminary allocation in the proposing release.

[2282] 5,272 hours × $400 = $2,108,800.

[2283] 4,218 credit analysts × 1 hour = 4,218 hours.

(1,054 hours) to external burden to hire outside professionals to assist in reviewing and updating training and testing programs.[2284] The Commission continues to estimate a cost of $400 per hour for retaining outside professionals, which results in an industry-wide annual cost of $421,600.[2285] Finally, although larger NRSROs may realize economies of scale, the Commission believes that the industry-wide annual and one-time hour burdens and external costs would be allocated to each NRSRO based on the number of credit analysts the firm employs.[2286]

Accordingly, the Commission estimates that Rule 17g–9 will result in a total industry-wide one-time hour burden for NRSROs to establish and document the standards of training, experience, and competence for their credit analysts required under the rule and to establish testing programs of approximately 18,818 hours,[2287] a total industry-wide one-time cost of approximately $2,508,800 to hire outside professionals to assist in setting up training and testing programs,[2288] a total industry-wide annual hour burden to maintain, review, update (if necessary), and enforce the standards and to administer the training and testing programs of approximately 3,914 hours,[2289] and a total industry-wide annual external cost of approximately $521,600 to hire outside professionals to assist in reviewing and updating training and testing programs.[2290]

In addition, the Commission estimates that NRSROs will spend approximately five hours per credit analyst per year to conduct periodic testing of their credit analysts, for a total industry-wide annual hour burden to NRSROs of approximately 21,090 hours.[2291]

9. New Rule 17g–10 and New Form ABS Due Diligence–15E

The Commission is adopting Rule 17g–10 and Form ABS Due Diligence–15E. Rule 17g–10 provides that the written certification a provider of third-party due diligence services must provide to an NRSRO must be made on Form ABS Due Diligence–15E.[2292]

In the proposing release, the Commission estimated that there would be ten providers of third-party due diligence services and each would spend an average of approximately 300 hours per firm developing certain processes and protocols to provide the required information and submit the certifications, and that 75% of these burden hours (225 hours) would be internal burden and 25% of these burden hours (75 hours) would be external burden to hire outside counsel to provide legal advice on the requirements of the new rule and form.[2293] The Commission did not receive comment on these estimates. Further, the modifications to Rule 17g–10 and Form ABS Due Diligence–15E from the proposal will not impact the one-time hour burden or allocation of that burden to internal and external burdens because the modifications—which create a ''safe harbor'' from the requirement to provide the forms to NRSROs—do not require the third party due diligence provider to expend more effort to meet the statutory requirement because they will make the process more certain and efficient. Consequently, the processes and protocols to meet the safe harbor should be no more complex than would have been the case if the provider of third-party due diligence services had to determine each NRSRO that was producing a credit rating in order to provide the NRSRO with the certification as required by 15E(s)(4)(B) of the Exchange Act. For these reasons, the Commission is not revising the estimated one-time and annual hour burdens for the providers of third-party due diligence services.

However, the Commission now estimates that there are approximately fifteen providers of third-party due diligence services.[2294] Accordingly, the Commission estimates that providers of third-party due diligence services will spend an average of approximately 300 hours per firm developing these processes and protocols, resulting in an industry-wide one-time hour burden for providers of third-party due diligence services of approximately 4,500 hours.[2295] In addition, the Commission allocates 75% of these burden hours (3,375 hours) to internal burden and 25% of these burden hours (1,125 hours) to external burden to hire outside counsel to provide legal advice on the requirements of Rule 17g–10 and Form ABS Due Diligence–15E.[2296] The Commission estimates $400 per hour for external costs for retaining outside counsel, resulting in an industry-wide one-time cost of $450,000.[2297]

With respect to the annual burden, the Commission stated in the proposing release that the estimate should be based on the number of issuances per year of Exchange Act-ABS because the requirement to produce the certification and provide it to NRSROs and issuers or underwriters will be triggered when an issuer, underwriter, or NRSRO hires a provider of third-party due diligence services. The Commission estimated that a provider of third-party due diligence services would spend approximately thirty minutes to complete and transmit Form ABS Due Diligence–15E and that there would be an average of 2,067 Exchange Act-ABS offerings per year, for an industry-wide annual burden of approximately 1,034 hours.[2298] The Commission did not receive comments on this estimate. The Commission believes that the modification to the proposal creating the ''safe harbor'' will decrease the annual burden as compared to the burden estimated in the proposal. In particular, the provider of third-party due diligence services in many cases may need to submit only one certification to another party; namely, to the issuer or underwriter that maintains the Rule 17g–5 Web site. Without a safe harbor, the third party would have needed to submit the certification to each NRSRO producing a credit rating

[2284] 4,218 hours × 0.75 = 3,164 hours; 4,218 hours × 0.25 = 1,054 hours.

[2285] 1,054 hours × $400 = $421,600. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4506 (providing an estimate of $400 an hour engage outside professionals).

[2286] *See* Table 1 in section I.B.2.a. of this release.

[2287] 3,000 + 15,818 = 18,818.

[2288] $400,000 + $2,108,800 = $2,508,800.

[2289] 750 + 3,164 = 3,914.

[2290] $100,000 + $421,600 = $521,600.

[2291] 4,218 credit analysts × 5 hours = 21,090 hours.

[2292] *See* sections II.H.2. and II.H.3. of this release (providing a more detailed discussion of this rule and form).

[2293] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33509.

[2294] *See* section I.B.2.b. of this release.

[2295] 15 providers of third-party due diligence services × 300 hours = 4,500 hours. The estimate of 300 hours remains unchanged from the Commission's preliminary estimate in the proposing release. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33509. This estimate is based on the Commission's estimate for the amount of time it would take a securitizer to set-up a system to make the disclosures required by Form ABS–15G. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4506. The Commission, however, has reduced the hour estimate of 850 hours used for Form ABS–15G by approximately two–thirds because information required to be provided in proposed Form ABS Due Diligence–15E is substantially less detailed and complex than the information required in Form ABS–15G.

[2296] 4,500 hours × 0.75 = 3,375 hours; 4,500 hours × 0.25 = 1,150 hours. This allocation remains unchanged from the Commission's preliminary allocation in the proposing release.

[2297] 1,125 hours × $400 = $450,000. *See Proposed Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR 63889 (providing an estimate of $400 per hour to engage outside counsel).

[2298] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33509 (2,067 offerings × 30 minutes = 1,034 hours).

for the Exchange Act-ABS, which frequently would include two or more hired NRSROs and possibly additional non-hired NRSROs. Moreover, the certainty of meeting the ''safe harbor'' provisions will eliminate the additional time a third party may have spent seeking to determine whether it has identified all NRSROs producing a credit rating and provided them with the certification in accordance with its statutory obligation to provide the certification to every NRSRO rating the applicable Exchange Act-ABS. For these reasons, the Commission believes, based on staff experience, that the modifications will reduce the burden attributable to Form ABS Due Diligence–15E from thirty minutes to twenty minutes to complete and transmit Form ABS Due Diligence–15E.

The Commission estimates that there will be 715 Exchange Act-ABS offerings per year.[2299] For these reasons, the Commission estimates that the industry-wide annual hour burden for providers of third-party due diligence services resulting from Rule 17g–10 and Form ABS Due Diligence–15E is approximately 238 hours.[2300]

In summary, the Commission estimates that Rule 17g–10 and Form ABS Due Diligence–15E will result in a total industry-wide one-time burden for providers of third-party due diligence services to develop processes and protocols to provide the required information and submit the certifications of approximately 3,375 hours, a total industry-wide one-time cost to hire outside counsel to provide legal advice on the requirements of the new rule and form of approximately $450,000, and a total industry-wide annual hour burden to provide the required information and submit the certifications of approximately 238 hours.

10. New Rule 15Ga–2 and Amendments to Form ABS–15G

The Commission is adopting Rule 15Ga–2 and amendments to Form ABS–15G. [2301] Rule 15Ga–2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish the Commission with a Form ABS–15G on the Commission's EDGAR system containing the findings and conclusions of any third-party ''due diligence report'' obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. Under the rule, the disclosure will be furnished using Form ABS–15G for both registered and unregistered offerings of Exchange Act-ABS.

The final rule has been modified from the proposal to provide that if the disclosure required by Rule 15Ga–2 has been made in the applicable prospectus, the issuer or underwriter may refer to that section of the prospectus in Form ABS–15G rather than providing the findings and conclusions directly in the form. It also has been modified to provide an exemption for certain offshore issuances of Exchange Act-ABS. Further, the final rule has been modified so that it does not apply to issuers or underwriters of municipal Exchange Act-ABS, but section 15E(s)(4)(A) of the Exchange Act nonetheless requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

The Commission estimated in the proposing release that the new rule and amended form would result in a one-time hour burden to issuers and underwriters in offerings of registered and unregistered Exchange Act-ABS in connection with developing processes and protocols to provide the required information to comply with the statutory disclosure requirement and Rule 15Ga–2, as applicable, including modifying their existing Form ABS–15G processes and protocols to accommodate the requirements of Rule 15Ga–2.[2302] The Commission also estimated that 270 unique issuers would be required to file the form.[2303] Finally, the Commission estimated that each issuer would require approximately 100 hours to develop processes and protocols to comply with Rule 15Ga–2 and to modify their existing Form ABS–15G processes and protocols to provide for the disclosure of the information required pursuant to Rule 15Ga–2 and that this work would be done internally by issuers and underwriters.[2304]

The Commission did not receive comments on these estimates. Further, the Commission does not believe the modifications to the rule from the proposal will impact the one-time burden because issuers and underwriters will still need to develop processes and protocols to provide the required information to comply with Rule 15Ga–2, or section 15E(s)(4)(A) of the Exchange Act in the case of issuers or underwriters of municipal Exchange Act-ABS, including modifying their existing Form ABS–15G processes and protocols to accommodate the requirements of Rule 15Ga–2 or the statute, as applicable. The Commission, however, is adjusting its estimate of the number of unique issuers from approximately 270 to approximately 336 unique issuers that will be required to file the form.[2305] Moreover, this estimate includes issuers and underwriters of municipal Exchange Act-ABS because, even though these offerings are excluded from Rule 15Ga–2, the statutory disclosure requirements apply to them.[2306] Consequently, the Commission estimates an industry-wide one-time burden of approximately 33,600 hours.[2307]

The annual PRA burden associated with Form ABS–15G reflects the burden associated with preparing and furnishing the form on EDGAR. As noted above, the amendment to Form ABS–15G will require that it be furnished by issuers and underwriters in offerings of certain registered and unregistered Exchange Act-ABS. Consequently, the Commission believes that the estimate of the annual hour burden for furnishing Form ABS–15G should be based on an estimate of the number of Exchange Act-ABS offerings per year. In the proposing release, the Commission estimated that, on average, there would be approximately 2,067 Exchange Act-ABS offerings per year.[2308] As discussed above, the

[2299] *See* Table 6 in section I.B.2.b. of this release.

[2300] 715 Exchange Act-ABS offerings × 20 minutes = 238.33 hours, rounded to 238 hours.

[2301] *See* section II.H.1. of this release (providing a more detailed discussion of this rule and form).

[2302] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510.

[2303] *See id. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4506.

[2304] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510. This estimate was based on the Commission's estimate for the amount of time it would take a securitizer to set up a system to make the disclosures required by Form ABS–15G as originally adopted by the Commission. *See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507–4506. The Commission, however, estimated that the hour burden for amending existing Form ABS–15G processes and protocols will be significantly lower than the estimate of 850 hours used to initially develop those processes and protocols. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510, n.1069.

[2305] *See* Table 6 in section I.B.2.b. of this release. The Commission recognizes that underwriters also have a requirement to furnish Form ABS–15G. However, for purposes of calculating PRA numbers, this discussion is limited to issuers because, as discussed above in section II.H.1. of this release, only a single Form ABS–15G is required to be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report. *See* paragraph (b) of Rule 15Ga–2.

[2306] Based on the Asset-Backed Alert database, the Commission estimates there were nine unique sponsors of municipal Exchange Act-ABS in 2013.

[2307] 336 unique issuers × 100 hours = 33,600 hours.

[2308] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510. *See also Disclosure*

Commission now estimates that there will be approximately 715 Exchange Act-ABS offerings.[2309] Further, the exemption for certain foreign issued Exchange Act-ABS should reduce the number of Exchange Act-ABS offerings that trigger the disclosure requirement. However, to be conservative, the Commission is retaining its estimate of 2,067 Exchange Act offerings per year for purposes of the burden estimates. Moreover, this estimate includes offerings of municipal Exchange Act-ABS because, even though these offerings are excluded from Rule 15Ga–2, the statutory disclosure requirement does apply to them.[2310]

In the proposing release, the Commission estimated that an issuer or underwriter would spend approximately one hour completing and submitting Form ABS–15G for purposes of meeting the requirement in Rule 15Ga–2 and that this work would be performed internally.[2311] The Commission based this estimate on the fact that Form ABS–15G will elicit much less information when used solely for the purpose of complying with Rule 15Ga–2.[2312] In addition, the Commission based this estimate on the fact that the information required in the form could be drawn directly from the due diligence reports the Commission expects providers of third-party due diligence services to generate with respect to their performance of due diligence services.[2313]

The Commission did not receive comments on these estimates. The Commission believes that the modification to the proposal providing that issuers and underwriters will not need to provide the findings and conclusions directly in Form ABS–15G if the Rule 15Ga–2 disclosures are included in the applicable prospectus may decrease slightly the hour burden for issuers and underwriters. However, this reduction in burden could be offset to the extent that issuers and underwriters decide that they should keep a record to support their reliance on the off-shore exemption and because the Commission eliminated the proposed ability for an issuer or underwriter to rely on a representation from an NRSRO. Further, although Rule 15Ga–2 excludes issuers and underwriters of municipal Exchange Act-ABS, issuers and underwriters of these securities will still incur costs to comply with the statutory disclosure obligation. Based on staff experience, the Commission estimates that many of these issuers and underwriters are likely to satisfy this obligation by furnishing Form ABS–15G on EMMA and that the time to prepare and submit the form will be one hour (the same as the time to prepare and submit the form on EDGAR). However, to the extent that these issuers and underwriters use another means to make the required information publicly available, such as through a Web site, the burden could be incrementally more or less, depending on the method chosen to disclose the information. Accordingly, the Commission estimates that the industry-wide annual hour burden resulting from Rule 15Ga–2 and the amendments to Form ABS–15G is approximately 715 hours.[2314]

For the foregoing reasons, the Commission estimates that Rule 15Ga–2, the amendments to Form ABS–15G, and section 15E(s)(4)(A) of the Exchange Act will result in a total industry-wide one-time hour burden to develop processes and protocols to provide the required information to comply with Rule 15Ga–2 and/or section 15E(s)(4)(A), including modifying their existing Form ABS–15G processes and protocols to accommodate the requirements of Rule 15Ga–2, of approximately 33,600 hours and a total industry-wide annual hour burden to prepare and make the required disclosures of approximately 715 hours for issuers and underwriters.

11. Amendments to Regulation S–T

The Commission is requiring that certain Forms NRSRO (and applicable exhibits to the form) and all Rule 17g–3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system.[2315] In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S–T to require the electronic submission using the EDGAR system of Form NRSRO (and applicable exhibits to the form) pursuant to paragraphs (e), (f), and (g) of Rule 17g–1 and annual reports pursuant to Rule 17g–3.[2316]

The Commission is adopting Rule 15Ga–2, which will require an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS–15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[2317]

The amendments revise Regulation S–T. However, the collection of information requirements are reflected in the burden hours estimated for Rule 17g–1 and Rule 15Ga–2. The rules in Regulation S–T do not impose any separate burden. Consistent with historical practice, the Commission has retained an estimate of one burden hour to Regulation S–T for administrative convenience.

12. Form ID

NRSROs will need to file a Form ID with the Commission in order to gain access to the EDGAR system. Form ID is used to request the assignment of access codes to make submissions on EDGAR. The current OMB approved hour burden for Form ID is fifteen minutes per respondent.[2318] Thus, the Commission estimates that the total industry-wide one-time hour burden resulting from filing Form ID will be approximately two and a half hours.[2319]

The Commission believes that the issuers and underwriters of Exchange Act-ABS that will need to furnish Form ABS–15G to the Commission through the EDGAR system pursuant to proposed Rule 15Ga–2 already have access to the EDGAR system because, for example, they need such access for the purpose of Rule 15Ga–1. Consequently, they will not need to execute and file Form ID as a result of Rule 15Ga–2.

for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507–4508. As noted above, issuers, underwriters, and NRSROs may not use providers of third-party due diligence services with respect to every issuance of Exchange Act-ABS. For example, the Commission believes that providers of third-party due diligence services are used primarily for RMBS transactions. *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33471. However, the Commission's estimate uses the total number of estimated Exchange Act-ABS offerings (as opposed to a lesser amount based on an estimate of RMBS offerings) because the use of providers of third-party due diligence services may migrate to other types of Exchange Act-ABS.

[2309] *See* Table 6 in section I.B.2.b. of this release.

[2310] Based on the Asset-Backed Alert database, the Commission estimates there were eleven separate offerings of municipal Exchange Act-ABS in 2013.

[2311] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510.

[2312] *See id. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* 76 FR at 4507 (estimating thirty hours to prepare the form when filed pursuant to Rule 15Ga–1).

[2313] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33510.

[2314] 715 Exchange Act-ABS transactions × 1 hour = 715 hours.

[2315] The Commission is allocating the one-time and annual hour burdens and costs of these requirements solely to Rule 17g–1. *See* section IV.D.1. of this release.

[2316] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2317] *See* section II.H.1. of this release (providing a more detailed discussion of this rule and form).

[2318] *See* Form ID (OMB Number 3235–0328).

[2319] 10 NRSROs × 15 minutes = 150 minutes; 150 minutes/60 minutes = 2.5 hours.

13. Total Paperwork Burdens

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for NRSRO respondents resulting from the rule amendments and new rules will be approximately 74,062 industry-wide one-time hours,[2320] $7,908,800 industry-wide external one-time costs,[2321] 725,456 industry-wide annual hours,[2322] and $725,600 industry-wide external annual costs.[2323] In addition, as discussed above, the Commission estimates that the burden resulting from a request for an exemption under paragraph (f) of Rule 17g–5 will be approximately 150 hours in internal burden and $20,000 in external costs; and the burden resulting from publishing information about material changes to an NRSRO's credit rating procedures and methodologies or a notice of significant errors identified in a procedure or methodology as described in paragraph (a)(4) of Rule 17g–8 will be approximately twenty hours in internal burden.

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for respondents that are providers of third-party due diligence services resulting from the rule amendments and new rules will be approximately 3,375 industry-wide one-time hours, $450,000 industry-wide external one-time costs, and 238 industry-wide annual hours.

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for issuer and underwriter respondents resulting from the rule amendments and new rules will be approximately 33,600 industry-wide one-time hours and 834 industry-wide annual hours.[2324]

E. Collection of Information Is Mandatory

The collections of information pursuant to the rule amendments and new rules are mandatory, as applicable, for NRSROs, providers of third-party due diligence services, and issuers and underwriters.

F. Confidentiality

The Forms ABS–15G furnished to the Commission by issuers and underwriters of offerings of asset-backed securities under Rule 15Ga–2 will be publicly available on the Commission's EDGAR system.

The Forms NRSRO and Exhibits 1 through 9 to the form an NRSRO must submit to the Commission electronically under the amendments to Rule 17g–1, Form NRSRO, and Regulation S–T will be publicly available on the Commission's EDGAR system. In addition, an NRSRO must make its current Form NRSRO and Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet Web site and must make its most recently filed Exhibit 1 freely available in writing to any individual who requests a copy under Rule 17g–1, as amended.

The records that an NRSRO must make and retain or retain under the amendments to Rule 17g–2 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

The annual internal controls report an NRSRO must file with the Commission under amendments to Rule 17g–3 will be generated from the internal records of the NRSRO. Under paragraph (e) to Rule 17g–3, information in a report filed under Rule 17g–3 on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be afforded confidential treatment to the extent permitted by law.

The Forms ABS Due Diligence–15E that an issuer, sponsor, or underwriter of an asset-backed security posts on the password-protected Rule 17g–5 Web site under the amendments to Rule 17g–5 will be made available to other NRSROs that provide the Commission with a certification agreeing, among other things, to keep the information confidential. The representations the issuer, sponsor, or underwriter provides to the NRSRO regarding the Rule 17g–5 Web site will not be made public, unless the parties choose to make them public.

An NRSRO may need to update its policies and procedures to address and manage conflicts of interest in connection with the new absolutely prohibited conflict related to sales and marketing in Rule 17g–5. An NRSRO is required to disclose its policies and procedures for addressing and managing conflicts of interest in Exhibit 7 to Form NRSRO. An NRSRO submitting an application for an exemption from the new absolutely prohibited conflict may request that the application be afforded confidential treatment for a specified period of time, not exceeding 120 days from the date of the Commission's response.[2325] Otherwise, the application for an exemption must be made public as soon as practicable after the response has been sent or given to the NRSRO requesting it.[2326] If the Commission grants an exemption, the Commission order granting the exemption will be publicly available on the Commission's Web site.

The form and certifications an NRSRO must publish when taking certain rating actions under paragraph (a) of Rule 17g–7 must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating. An NRSRO must publicly disclose credit rating histories under paragraph (b) of Rule 17g–7 for free on an easily accessible portion of its Internet Web site.

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to its procedures and methodologies to determine credit ratings under paragraph (a) of Rule 17g–8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. These policies and procedures will be made public to the extent that an NRSRO is required to include them in Exhibit 2 to Form NRSRO, which requires a general description of the procedures and methodologies used by the NRSRO to determine credit ratings. In addition, under paragraph (a) of Rule 17g–8, an NRSRO must have policies and procedures reasonably designed to ensure that it promptly publishes on its Internet Web site material changes to the policies and procedures and notice of a significant error in a procedure or methodology that may result in a change to current credit ratings.

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to credit rating symbols under paragraph (b) of Rule 17g–8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. Under paragraph (b) of Rule 17g–8, an NRSRO must have policies and procedures reasonably designed to include definitions of its credit rating symbols in Exhibit 1 to Form NRSRO, which is publicly available.

[2320] 690 + 2,531 + 200 + 6,720 + 1,250 + 37,500 + 1,350 + 5,000 + 18,818 + 2.5 = 74,061.5, rounded to 74,062.

[2321] $400,000 + $5,000,000 + $2,508,800 = $7,908,800.

[2322] 690 + 1,015 + 50 + 1,650 + 695,347 + 450 + 1,250 + 3,914 + 21,090 = 725,456.

[2323] $4,000 + $200,000 + $521,600 = $725,600.

[2324] 119 + 715 = 834.

[2325] *See* 17 CFR 200.81(b).

[2326] *See* 17 CFR 200.81(a).

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to look-back reviews under paragraph (c) of Rule 17g–8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. If a look-back review determines that a credit rating was influenced by a conflict of interest, an NRSRO must promptly publish a revised credit rating or an affirmation of the credit rating, as appropriate, which must be published in the same manner as the credit rating that is the result or subject of the revision or affirmation and made available to the same persons who can receive or access the credit rating.

The standards of training, experience, and competence an NRSRO must establish, maintain, enforce, and document under Rule 17g–9 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

Forms ABS Due Diligence–15E that third-party due diligence providers must provide to an NRSRO that produces a credit rating of an Exchange Act-ABS to which the due diligence services relate and to the issuer or underwriter of the security that maintains the Rule 17g–5 Web site must be published by the NRSRO with certain rating actions, including initial credit ratings, in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating under paragraph (a) of Rule 17g–7.

G. Retention Period of Recordkeeping Requirements

The records that must be retained by an NRSRO under paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g–2 must be retained until three years after the date the record is replaced with an updated record. All other records that an NRSRO must retain under Rule 17g–2 must be retained for three years after the record is made or received.[2327]

There are no record retention requirements for providers of third-party due diligence services or for the records issuers and underwriters are required to make and furnish to the Commission pursuant to the requirements in Rule 15Ga–2 and the amendments to Form ABS–15G.

[2327] *See* paragraph (c) of Rule 17g–2 as adopted.

V. Implementation and Annual Compliance Considerations

The purpose of this section is to present the Commission's estimate of the costs of the PRA burdens attributable to the amendments and new rules being adopting today. As indicated in the discussion below, these costs include monitizations of PRA hour burdens and PRA external costs estimated in section IV.D. of this release. The costs included in this section are also noted and discussed in the focused economic analyses in section II of this release.[2328]

A. Internal Control Structure

The Commission is adding paragraph (a)(7) to Rule 17g–3. This paragraph requires an NRSRO to include an additional report—a report on the NRSRO's internal control structure established under section 15E(c)(3)(A) of the Exchange Act—with its annual submission of reports to the Commission pursuant to Rule 17g–3, and is amending paragraph (b) of Rule 17g–3 to require the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, to provide a signed statement that must be attached to the report.[2329] The Commission estimates that paragraph (a)(7) of Rule 17g–3 and the amendment to paragraph (b) of Rule 17g–3 will result in total industry-wide one-time costs for NRSROs to engage outside counsel to analyze the requirements for the internal controls report of approximately $400,000 [2330] and total industry-wide annual costs for NRSROs to prepare the internal controls report and to engage outside counsel to assist in the preparation of the report of approximately $667,000.[2331]

The Commission is adding paragraph (b)(12) to Rule 17g–2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document under section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.[2332] Under the amendments to paragraph (c) of Rule 17g–2, the record must be retained until three years after the date the record is replaced with an updated record. The Commission estimates that paragraph (b)(12) of Rule 17g– will result in total industry-wide one-time costs for NRSROs to update their record retention policies and procedures to incorporate the new record of approximately $12,000 [2333] and total industry-wide annual costs for NRSROs to retain the record of approximately $3,000.[2334]

B. Conflicts of Interest Relating to Sales and Marketing

The Commission is adding paragraph (c)(8) to Rule 17g–5. This paragraph prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[2335] The Commission is also adding paragraph (f) to Rule 17g–5, which provides that upon written application by an NRSRO the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) of Rule 17g–5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest.[2336]

[2328] The focused economic analyses are provided in sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release. These sections cross-reference the costs estimated in this section.

[2329] *See* section II.A.3. of this release (providing a more detailed discussion of this amendment); section II.A.4. of this release (providing a focused economic analysis for this amendment).

[2330] *See* section IV.D.4. of this release (PRA analysis providing cost and hour burden estimates). The internal cost to the NRSRO to prepare and file the first internal controls report is included in the annual cost.

[2331] 1,650 hours × $283 per hour for a compliance manager = $466,950 + $200,000 = $666,950, rounded to $667,000. *See* section IV.D.4. of this release (PRA analysis providing cost and hour burden estimates). As noted earlier, the salary figures provided in this release are from SIFMA's *Management & Professional Earnings in the Securities Industry 2013,* modified by Commission staff to account for a 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[2332] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment) section II.A.4. of this release (providing a focused economic analysis for this amendment).

[2333] 200 hours/5 records = 40 hours × $291 per hour for a senior systems analyst = $11,640, rounded to $12,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2334] 50 hours/5 records = 10 hours × $291 per hour for a senior systems analyst = $2,910, rounded to $3,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2335] *See* section II.B.1. of this release (providing a more detailed discussion of this amendment); section II.B.4. of this release (providing a focused economic analysis for this amendment).

[2336] *See* section II.B.2. of this release (providing a more detailed discussion of this provision); section II.B.4. of this release (providing a focused economic analysis for this amendment).

The Commission estimates that paragraph (c)(8) of Rule 17g–5 will impose total industry-wide one-time costs for NRSROs to update the NRSRO's conflicts of interest policies and procedures and to prepare and file an update of registration to account for the update of the written policies and procedures of approximately $354,000.[2337]

The Commission also estimates that the cost of drafting and submitting a written application to the Commission under paragraph (f) of Rule 17g–5, including the cost of engaging outside counsel to assist in drafting the application, would be approximately $62,000.[2338]

C. ''Look-Back'' Review

The Commission is adopting Rule 17g–8. Paragraph (c) of the rule contains requirements relating to the policies and procedures with respect to look-back reviews an NRSRO must establish, maintain, and enforce under section 15E(h)(4)(A) of the Exchange Act.[2339] The Commission is also adding paragraph (a)(9) to Rule 17g–2 to identify the policies and procedures of an NRSRO with respect to look-back reviews as a record that must be made and retained.[2340] The Commission estimates that paragraph (c) of Rule 17g–8 will result in total industry-wide one-time costs for NRSROs to establish and make a record of the policies and procedures of approximately $283,000 [2341] and total industry-wide annual costs for NRSROs of approximately $71,000 [2342] to review, to update (if necessary) the policies and procedures and the record documenting the policies and procedures, to maintain and enforce the policies and procedures, and to take steps pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict.

The Commission estimates that paragraph (a)(9) of Rule 17g–2 will result in total industry-wide one-time costs for an NRSRO to update its record retention policies and procedures to incorporate the new record of approximately $12,000 [2343] and total industry-wide annual costs for an NRSRO to retain the record of approximately $3,000.[2344]

D. Fines and Other Penalties

The Commission is amending the instructions for Form NRSRO by adding instruction A.10, which provides notice to credit rating agencies applying for registration as NRSROs and NRSROs that an NRSRO is subject to the fine and penalty provisions and other available sanctions in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act for violations of the securities laws.[2345] The Commission believes that this amendment will not result in additional regulatory obligations for NRSROs.

E. Enhancements to Disclosures of Performance Statistics

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.[2346] The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the Exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample ''Transition/Default Matrix.'' The amendments also will enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligor or obligation paid off or the credit rating was withdrawn for reasons other than a default or the obligor or obligation paying off.

The Commission estimates that the amendments to the instructions for Exhibit 1 requiring standardized ''Transition/Default Matrices'' and prescribing the method of calculating transition and default rates will result in total industry-wide one-time costs for NRSROs to establish systems for determining performance statistics according to the amended instructions of approximately $737,000 [2347] and total industry-wide annual costs for NRSROs to calculate and format the performance statistics according to the amended instructions for Exhibit 1 of approximately $295,000.[2348] The costs associated with calculating and presenting these performance statistics will depend in part on the number of obligors, securities, and money market instruments assigned credit ratings by the NRSRO.

Under the amendments to paragraph (i) of Rule 17g–1, NRSROs are required to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet Web site and to provide a paper copy of Exhibit 1 to individuals who request a paper copy.[2349] The Commission estimates that re-configuring a corporate Internet Web site for this purpose will result in total industry-wide one-time costs for NRSROs of approximately $10,000.[2350] The Commission estimates that the requirement to send a paper copy of Exhibit 1 on request will result in total industry-wide costs for NRSROs to establish procedures and protocols for receiving and processing requests for a paper copy of Exhibit 1 of approximately $140,000 [2351] and total industry-wide annual costs for NRSROs to process requests for a paper copy of Exhibit 1 and for postage costs to send the paper copy of approximately $121,000.[2352]

[2337] 1,250 hours × $283 per hour for a compliance manager = $353,750, rounded to $354,000. *See* section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

[2338] 150 hours × $283 per hour for a compliance manager = $42,450 + $20,000 to engage outside counsel = $62,450, rounded to $62,000. *See* section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

[2339] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph); section II.C.3. of this release (providing a focused economic analysis for the requirements of this paragraph).

[2340] *See* section II.C.2. of this release (providing a more detailed discussion of this amendment); section II.C.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g–2, the record must be retained until three years after the date it is replaced with an updated record.

[2341] 1,000 hours × $283 per hour for a compliance manager = $283,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2342] 250 hours × $283 per hour for a compliance manager = $70,750, rounded to $71,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2343] 200 hours/5 records = 40 hours × $291 per hour for a senior systems analyst = $11,640, rounded to $12,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2344] 50 hours/5 records = 10 hours × $291 per hour for a senior systems analyst = $2,910, rounded to $3,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2345] *See* section II.D. of this release (providing a more detailed discussion of this amendment).

[2346] *See* section II.E.1. of this release (providing a more detailed discussion of the amendments) section II.E.4. of this release (providing a focused economic analysis for these amendments).

[2347] 2,531 hours × $291 per hour for a senior systems analyst = $736,521, rounded to $737,000. *See* section IV.D.2. of this release (PRA analysis providing cost and hour burden estimates).

[2348] 1,015 hours × $291 per hour for a senior systems analyst = $295,365, rounded to $295,000. *See* section IV.D.2. of this release (PRA analysis providing cost and hour burden estimates).

[2349] *See* section II.E.2. of this release (providing a more detailed discussion of this amendment); section II.E.4. of this release (providing a focused economic analysis for this amendment).

[2350] 50 hours × $207 per hour for a webmaster = $10,350, rounded to $10,000. *See* section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

[2351] 480 hours × $291 per hour for a senior systems analyst = $139,680, rounded to $140,000. *See* section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

[2352] 670 hours × $175 per hour for a paralegal = $117,250, rounded to $117,000 + $4,000 for postage = $121,000. *See* section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

F. Enhancements to Rating Histories Disclosures

The Commission is amending Rule 17g–7 to recodify, in paragraph (b) of Rule 17g–7, the requirements for NRSROs to disclose credit rating histories formerly prescribed in paragraph (d)(3) of Rule 17g–2 and to substantially enhance the requirements.[2353] Paragraph (b) of Rule 17g–7 also increases the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.

The Commission estimates that the amendments will result in total industry-wide one-time costs for NRSROs registered with the Commission to program existing systems and initially add the ratings histories for all applicable outstanding credit ratings of approximately $393,000 [2354] and total industry-wide annual costs to comply with the increased requirements, including updating and administering the database, of approximately $131,000.[2355]

G. Credit Rating Methodologies

The Commission is adopting Rule 17g–8. Paragraph (a) of the rule requires an NRSRO to have policies and procedures with respect to the procedures and methodologies the NRSRO uses to determine credit ratings.[2356] The Commission estimates that this requirement will result in total industry-wide one-time costs for NRSROs of approximately $566,000 [2357] to establish and document the policies and procedures and total industry-wide annual costs for NRSROs to maintain, review, update (if necessary), and enforce the policies and procedures of approximately $142,000.[2358]

In addition, the Commission estimates that an NRSRO will spend an average of approximately $5,700 [2359] to promptly publish on an easily accessible portion of its Web site information about material changes to procedures and methodologies and the likelihood such changes will result in changes to any current ratings, or notice of significant errors identified in a procedure or methodology.

The Commission is adding paragraph (b)(13) to Rule 17g–2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO must establish, maintain, enforce and document pursuant to paragraph (a) of Rule 17g–8 as a record that must be retained.[2360] The Commission estimates that paragraph (b)(13) of Rule 17g–2 will result in total industry-wide one-time costs for an NRSRO to update its record retention policies and procedures to incorporate the new record of approximately $12,000 [2361] and total industry-wide annual costs for an NRSRO to retain the record of approximately $3,000.

H. Form and Certification to Accompany Credit Ratings

The Commission is amending paragraph (a) of Rule 17g–7 to require NRSROs, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action and any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[2362] The Commission estimates that the amendments will result in total industry-wide one-time costs for NRSROs of approximately $15,613,000 to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process, including the cost of engaging outside professionals (counsel and information technology consultants) to assist in developing the standardized disclosures and creating the systems, protocols, and procedures for populating the form with information generated and collected during the rating process,[2363] and total industry-wide annual costs for NRSROs of approximately $196,783,000 to update standardized disclosures, to tailor disclosures to particular rating actions and asset classes, and to generate and publish each form and attach the required certifications to the form.[2364]

I. New Rule 15Ga–2 and Amendments to Form ABS–15G

The Commission is adopting Rule 15Ga–2 and amendments to Form ABS–15G. Rule 15Ga–2 generally requires an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS–15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.[2365] The rule does not apply to issuers or underwriters of municipal Exchange Act-ABS but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

The Commission estimates that Rule 15Ga–2 and amendments to Form ABS–15G will result in total industry-wide one-time costs for issuers and underwriters to develop processes and protocols to provide the required information to comply with Rule 15Ga–2 and/or section 15E(s)(4)(A) of the Exchange Act, including modifying their existing Form ABS–15G processes and protocols to accommodate the requirements of Rule 15Ga–2, of

[2353] *See* section II.E.3. of this release (providing a more detailed discussion of this amendment); section II.E.4. of this release (providing a focused economic analysis for this amendment).

[2354] 1,350 hours × $291 per hour for a senior systems analyst = $392,850, rounded to $393,000. *See* section IV.D.6. of this release (PRA analysis providing for cost and hour burden estimates).

[2355] 450 hours × $291 per hour for a senior systems analyst = $130,950, rounded to $131,000. *See* section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

[2356] *See* section II.F.1. of this release (providing a more detailed discussion of this paragraph); section II.F.3. of this release (providing a focused economic analysis for the requirements of this paragraph).

[2357] 2,000 hours × $283 per hour for a compliance manager = $566,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2358] 500 hours × $273 per hour for a compliance manager = $136,500, rounded to $137,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2359] 20 hours × $283 per hour for a compliance manager = $5,660, rounded to $5,700. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2360] *See* section II.F.2. of this release (providing a more detailed discussion of this amendment) section II.F.3. of this release (providing a focused economic analysis for the requirements of this paragraph). Under the amendments to paragraph (c) of Rule 17g–2, the record must be retained until three years after it is replaced with an updated record.

[2361] 200 hours/5 records = 40 hours × $291 per hour for a senior systems analyst = $11,640, rounded to $12,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2362] *See* section II.G. of this release (providing a more detailed discussion of this amendment); section II.F.3. of this release (providing a focused economic analysis for the requirements of this amendment).

[2363] 37,500 hours × $283 per hour for a compliance manager = $10,612,500; $10,612,500 + $5,000,000 to engage outside professionals = $15,612,500, rounded to $15,613,000. *See* section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

[2364] 695,347 hours × $283 per hour for a compliance manager = $ 196,783,201, rounded to $196,783,000. *See* section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

[2365] *See* section II.H.1. of this release (providing a more detailed discussion of this rule and form); section II.H.4. of this release (providing a focused economic analysis for the requirements of this rule and form).

approximately $9,509,000 [2366] and total industry-wide annual costs for issuers and underwriters to make the disclosures as required by Rule 15Ga–2 and/or section 15E(s)(4)(A) of the Exchange Act of approximately $202,000.[2367]

J. New Rule 17g–10 and New Form ABS Due Diligence–15E

The Commission is adopting Rule 17g–10 and Form ABS Due Diligence–15E, which requires that the written certification a provider of third-party due diligence services must provide to an NRSRO be made on Form ABS Due Diligence–15E.[2368]

The Commission estimates that Rule 17g–10 and Form ABS Due Diligence–15E will result in total industry-wide one-time costs for providers of third-party due diligence services of approximately $1,405,000 [2369] to develop processes and protocols to provide the required information and submit the certifications and to hire outside counsel to provide legal advice on the requirements of the new rule and form and total industry-wide annual costs for providers of third-party due diligence services of approximately $67,000 [2370] to provide the required information and submit the certifications.

The Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g–5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security.[2371] This provision, which was not included in the proposal, may require redrafting of NRSRO agreement templates. In addition, issuers, sponsors and underwriters will incur recurring costs resulting from posting the certifications to the Rule 17g–5 Web site. The Commission estimates paragraph (a)(3)(iii)(E) of Rule 17g–5 will result in total industry-wide one-time costs for NRSROs of approximately $1,902,000 [2372] to redraft the agreement templates they use with respect to obtaining representations from issuers, sponsors, or underwriters as required under Rule 17g–5 and total industry-wide annual costs for issuers, sponsors, and underwriters of approximately $34,000 to upload each form and post it to the Web site.[2373]

K. Standards of Training, Experience, and Competence

The Commission is adopting Rule 17g–9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.[2374]

The Commission estimates that Rule 17g–9 will result in total industry-wide one-time costs for NRSROs to establish and document the standards of training, experience, and competence for their credit analysts required under the rule and to establish testing programs, including the cost to hire outside professionals to assist in setting up training and testing programs, of approximately $7,834,000 [2375] and total industry-wide annual costs for NRSROs of approximately $1,629,000 to maintain, review, update (if necessary), and enforce the standards and to administer the training and testing programs, including the cost to hire outside professionals to assist in reviewing and updating training and testing programs.[2376] In addition, the Commission estimates that Rule 17g–9 will result in total industry-wide annual costs for NRSROs to conduct periodic testing of their credit analysts of approximately $5,990,000.[2377]

The Commission is adding paragraph (b)(15) of Rule 17g–2 to identify the records documenting the standards of training, experience, and competence as a record that must be retained.[2378] The Commission estimates that paragraph (b)(15) of Rule 17g–2 will result in total industry-wide one-time costs for NRSROs of approximately $12,000 [2379] and total industry-wide annual costs for NRSROs of approximately $3,000.[2380]

L. Universal Rating Symbols

The Commission is adopting paragraph (b) of Rule 17g–8, which requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.[2381] The Commission estimates that paragraph (b) of Rule 17g–8 will result in total industry-wide one-time costs for NRSROs to establish and document the policies and procedures of approximately $566,000 [2382] and total industry-wide annual costs for NRSROs of approximately $142,000 to maintain, review, update (if necessary), and enforce the policies and procedures.[2383]

The Commission is adding paragraph (b)(14) to Rule 17g–2 to identify the

[2366] 33,600 hours × $283 per hour for a compliance manager = $9,508,800, rounded to $9,509,000. *See* section IV.D.10. of this release (PRA analysis providing cost and hour burden estimates).

[2367] 715 hours × $283 per hour for a compliance manager = $ 202,345, rounded to $202,000. *See* section IV.D.10. of this release (PRA analysis providing cost and hour burden estimates).

[2368] *See* section II.H.2. and section II.H.3. of this release (providing a more detailed discussion of this rule and form).

[2369] 3,375 hours × $283 per hour for a compliance manager = $955,125; $955,125 + $450,000 to engage outside counsel = $1,405,125, rounded to $1,405,000. *See* section IV.D.9. of this release (PRA analysis providing cost and hour burden estimates).

[2370] 238 hours × $283 per hour for a compliance manager = $67,354, rounded to $67,000. *See* section IV.D.9. of this release (PRA analysis providing cost and hour burden estimates).

[2371] *See* sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this provision).

[2372] 6,720 hours × $283 per hour for a compliance manager = $1,901,760, rounded to $1,902,000. *See* section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

[2373] 119 hours × $283 per hour for a compliance manager = $33,677, rounded to $34,000. *See* section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

[2374] *See* section II.I.1. of this release (providing a more detailed discussion of this rule); section II.I.3. of this release (providing a focused economic analysis for the requirements of this rule).

[2375] 18,818 hours × $283 per hour for a compliance manager = $5,325,494; $5,325,494 + $2,508,800 to engage outside professionals = $7,834,294, rounded to $7,834,000. *See* section IV.D.8. of this release (PRA analysis providing cost and hour burden estimates).

[2376] 3,914 hours × $283 per hour for a compliance manager = $1,107,662; $1,107,662 + $521,600 to engage outside professionals = $1,629,262, rounded to $1,629,000. *See* section IV.D.8. of this release (PRA analysis providing cost and hour burden estimates).

[2377] 21,090 hours × $284 per hour for a fixed income research analyst (intermediate) = $5,989,560, rounded to $5,990,000.

[2378] *See* section II.I.2. of this release (providing a more detailed discussion of this amendment); section II.I.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g–2, the record must be retained until three years after the date the record is replaced with an updated record.

[2379] 200 hours/5 records = 40 hours × $291 per hour for a senior systems analyst = $11,640, rounded to $12,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2380] 50 hours/5 records = 10 hours × $291 per hour for a senior systems analyst = $2,910, rounded to $3,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2381] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph); section II.I.3. of this release (providing a focused economic analysis for this the requirements of this paragraph).

[2382] 2,000 hours × $283 per hour for a compliance manager = $566,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

[2383] 500 hours × $283 per hour for a compliance manager = $141,500, rounded to $142,000. *See* section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document under paragraph (b) of Rule 17g–8 as a record that must be retained.[2384] The Commission estimates that paragraph (b)(14) of Rule 17g–2 will result in total industry-wide one-time costs for NRSROs of approximately $12,000 [2385] and total industry-wide annual costs for NRSROs of approximately $3,000.[2386]

M. Electronic Submission of Form NRSRO and the Rule 17G–3 Annual Reports

The Commission is amending Rule 17g–1, the Instructions to Form NRSRO, Rule 17g–3, and Regulation S–T to require that the annual reports under Rule 17g–3 and a Form NRSRO and Exhibits 1 through 9 to Form NRSRO under paragraph (e), (f), or (g) of Rule 17g–1 (an update of registration, an annual certification, or a withdrawal from registration, respectively) be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system.[2387]

The Commission estimates that these amendments will result in total industry-wide one-time costs for NRSROs of approximately $46,000 [2388] to become familiar with the EDGAR system and to file Form ID and total industry-wide annual costs for NRSROs of approximately $6,000 to monitor changes in EDGAR filing requirements.[2389]

[2384] *See* section II.J.2. of this release (providing a more detailed discussion of this amendment); section II.I.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g–2, the record must be retained until three years after the date the record is replaced with an updated record.

[2385] 200 hours/5 records = 40 hours × $291 per hour for a senior systems analyst = $11,640, rounded to $12,000. *See* the PRA analysis in section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2386] 50 hours/5 records = 10 hours × $291 per hour for a senior systems analyst = $2,910, rounded to $3,000. *See* section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

[2387] *See* section II.L. of this release (providing a more detailed discussion of these amendments) section II.L.2. of this release (providing a focused economic analysis for these amendments).

[2388] 160 hours + 2.5 hours = 162.5 hours × $283 per hour for a compliance manager = $45,987.50, rounded to $46,000. *See* sections IV.D.1. and IV.D.12 of this release (PRA analyses providing cost and hour burden estimates).

[2389] 20 hours × $283 per hour for a compliance manager = $5,660, rounded to $6,000. *See* section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

VI. Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act (''RFA'') [2390] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities.

The Commission proposed amendments to Rule 101 of Regulation S–T, Rule 201 of Regulation S–T, Rule 314 of Regulation S–T, Rule 17g–1, Rule 17g–2, Rule 17g–3, Rule 17g–5, Rule 17g–6, Rule 17g–7, Form ABS–15G, and Form NRSRO, and proposed new Rule 17g–8, new Rule 17g–9, new Rule 17g–10, new Rule 15Ga–2, and new Form ABS Due Diligence–15E. The Commission included an Initial Regulatory Flexibility Analysis (''IRFA'') in the proposing release.[2391] The Commission has prepared this Final Regulatory Flexibility Analysis in accordance with the provisions of the RFA.[2392]

A. Need for and Objectives of the Amendments and New Rules

Section II of this release describes the need for and objectives of the amendments and new rules. In addition, section IV.B. of this release describes the intended use of the collections of information that are required under the amendments and new rules. Moreover, as described in section II of this release, the amendments and new rules implement Title IX, Subtitle C of the Dodd-Frank Act.[2393] In section 931 of Title IX, Subtitle C of the Dodd-Frank Act, Congress made findings relating to the need for the amendments and new rules.[2394]

B. Significant Issues Raised by Public Comments

The Commission requested comment with regard to all matters discussed in the IRFA, including comments with respect to the number of small entities that may be affected by the proposed amendments and new rules and whether the effect on small entities would be economically significant.[2395]

One commenter addressed the IRFA stating that ''the majority of the proposed rules set forth in the Proposing Release are more appropriate for, and aimed at, large, established agencies and overall, insufficient consideration has been given to smaller agencies.'' [2396] The Commission is sensitive to the impact the amendments and new rules will have on small entities and has taken actions to address this issue. Specifically, the amendments and new rules contain certain modifications from the proposals designed to alleviate some of the concerns regarding small entities. The Commission believes that the amendments and new rules being adopted today, as modified from the proposal, strike an appropriate balance between minimizing the impact on small entities and implementing the policies and requirements addressed by Title IX, Subtitle C of the Dodd-Frank Act.

Moreover, in response to the commenter that specifically addressed the IRFA, the Commission believes the choices it has made in implementing Title IX, Subtitle C of the Dodd-Frank Act have resulted in amendments and new rules that are designed to be appropriate for entities of all sizes, while still implementing the policies and requirements addressed by the Dodd-Frank Act. For example, a number of the amendments and new rules are policies and procedures-based requirements and, consequently, a small NRSRO can comply with these requirements by tailoring and scaling its policies and procedures to its size and business activities. In addition, where feasible, the Commission has implemented Title IX, Subtitle C of the Dodd-Frank Act by enhancing existing requirements (most particularly with respect to performance statistics and rating histories) rather than establishing separate new requirements. Consequently, small NRSROs that currently are subject to the existing requirements can leverage their existing systems and procedures to comply with the new requirements and will not be subject to separate new requirements. Moreover, the Commission has implemented Title IX, Subtitle C of the Dodd-Frank Act, in large part, by designing amendments and new rules that are modeled closely on the statutory text mandating the rulemaking. Consequently, the Commission has sought to limit the cumulative impact on small NRSRO resulting from the amendments and new rules to that which is necessary to implement the policies and requirements addressed by Title IX, Subtitle C of the Dodd-Frank Act.

[2390] 5 U.S.C. 601 *et seq.*

[2391] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33533–33537.

[2392] *See* 5 U.S.C. 604(a).

[2393] *See* Public Law 111–203, 931 through 939H.

[2394] *See* Public Law 111–203, 931; section I.B.1. of this release (setting forth the findings).

[2395] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33537.

[2396] *See Trade Metrics Letter.* As noted below, other commenters addressed more generally issues related to the impact on small entities, which are discussed above in the relevant sections, as well as below in this analysis. *See, e.g., Kroll Letter.*

Finally, the Commission—as discussed in section III of this release—has prescribed differing dates for when the amendments and new rules will become effective, with the more technically complex amendments and rules having longer lead times before they become effective. This will provide all entities—including entities that are small NRSROs—with transition periods to prepare to comply with the new requirements, which may be particularly helpful to small NRSROs.

While the Commission has sought to limit the impact on small entities, the Commission acknowledges that Title IX, Subtitle C of the Dodd-Frank Act contains requirements—including those resulting from this substantial package of rulemaking—that collectively and, in many cases, individually will impose costs on NRSROs, including NRSROs that are small entities. The Commission recognizes that the consequences of these amendments and new rules may be the creation of barriers to entry and negative impacts on competition. The Commission has balanced these potential impacts with the rulemaking requirements and objectives of Title IX, Subtitle C of the Dodd-Frank Act (reflected in the findings in section 931 of the Dodd-Frank Act).

In addition to the comment discussed above that specifically addressed the IRFA, several commenters discussed the potential impact of the proposed amendments and new rules on small entities. These comments—and the Commission's response to the comments—are discussed in the various, relevant sections throughout this release, as well as below.

One commenter, with regard to the proposals relating to the internal control structure, stated that the Commission should ''avoid creating a regulatory environment for NRSROs that is so burdensome and complicated that only the large NRSROs, which have enormous resources at their disposal, can address the multitude of complex requirements'' and that the proposed amendments to Rule 17g–3 related to internal controls would compound barriers to entry because they are ''expensive and burdensome to implement,'' particularly for newer or smaller NRSROs.[2397] Commenters also stated, in response to a question in the proposing release, that the Commission should not prescribe factors for an internal control structure because this would place a heavy burden on small NRSROs.[2398] One commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, that the requirements are expensive, time consuming, and yield little benefit, and that documenting policies and procedures ''naturally coincide with the establishment of a properly functioning internal controls structure,'' which the NRSRO should be allowed to establish on its own, and the commenter urged the Commission to exclude ''extensive or overly-inclusive documentation requirements'' should it adopt paragraph (b)(12) of Rule 17g–2.[2399]

In response to these comments, the Commission notes that the approach it has taken with respect to section 15E(c)(3) of the Exchange Act—which contains a self-executing requirement that an NRSRO establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings—will reduce the impact on small NRSROs as compared to the proposal.[2400] First, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a specific factor be implemented. Consequently, while small NRSROs must consider the factors identified by the Commission, they can tailor and scale their internal control structures to their size and business activities. Second, the modifications to the amendments to Rule 17g–3 from the proposal (because they specify that management of the NRSRO cannot state in the internal controls report that the internal control structure was effective if it contained one or more material weaknesses and provide a description of when a material weakness exists) will provide better guidance to NRSROs on the statements and information that must be included in the report compared with the proposal. Consequently, modifications may result in modest reductions of the impact on small NRSROs associated with preparing the reports, as this guidance will provide more certainty as to the matters that must be specifically addressed in the reports and, therefore, reduce the effort needed to prepare them.[2401]

One commenter stated that the prohibited conflict of interest related to sales and marketing in proposed paragraph (c)(8) of Rule 17g–5 could make compliance ''a practical impossibility'' for all but the largest NRSROs because small NRSROs do not have the same resources or structure as larger NRSROs to comply with an absolute prohibition.[2402] Similarly, another commenter stated that the proposed rule regarding the prohibited conflict of interest related to sales and marketing is overly-restrictive, particularly for smaller NRSROs, and would result in ''grossly inefficient use of the [NRSRO's] resources and add a substantial amount of infrastructure costs, at little to no benefit.'' [2403]

In response to these comments, the Commission notes that, consistent with Exchange Act section 15E(h)(3)(B)(i), the final amendments provide a mechanism for small NRSROs to apply for an exemption from the rule's requirements.[2404] Under the final amendments, the Commission may grant an exemption if it finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[2405]

An NRSRO stated that complying with the amended instructions for Exhibit 1 to Form NRSRO regarding the production and presentation of performance statistics will require ''substantial technology resources'' and that smaller NRSROs' resources may be strained if sufficient time is not provided to comply.[2406] One commenter stated that the single cohort approach could lead to results that are ''significantly more volatile within the shorter time period, which will make interpreting those results more difficult.'' [2407] This commenter stated further that ''the volatility impact will be amplified for NRSROs with fewer ratings, which could lead to bias against smaller NRSROs.'' [2408]

In response to the first comment, the Commission notes—as discussed in section III. of this release—NRSROs will not be required to provide performance statistics in Exhibit 1 to Form NRSRO that adhere to the new requirements until they file their annual certifications in 2016. This will provide all NRSROs, including small NRSROs, with a substantial transition period to prepare to comply with the new requirements. In response to the second comment, the

[2397] *See Kroll Letter.*

[2398] *See A.M. Best Letter; Kroll Letter.*

[2399] *See A.M. Best Letter.*

[2400] *See* 15 U.S.C. 78o–7(c)(3). *See also* section II.A. of this release (discussing in detail the Commission's approach with respect to section 15E(c)(3)).

[2401] *See* section II.A.3. of this release (providing a more detailed discussion of the description of what constitutes a material weakness).

[2402] *See Kroll Letter.*

[2403] *See A.M. Best Letter.*

[2404] *See* paragraph (f) of Rule 17g–5.

[2405] *See id.*

[2406] *See Morningstar Letter.*

[2407] *See DBRS Letter.*

[2408] *See DBRS Letter.*

Commission—as discussed in section II.E.1.b. of this release—has balanced this concern with section (q)(2)(B) of the Exchange Act, which provides that the Commission's rules shall require that the performance measurement disclosures be clear and informative for investors having a wide range of sophistication).[2409] The single cohort approach involves simpler computations than other approaches for calculating the performance statistics. The requirements in the instructions for Exhibit 1 provide for very transparent disclosures about the number of credit ratings in the start date cohort and in the cohort for each notch in the credit rating scale of a given class or subclass. This transparency will provide persons reviewing the performance statistics with information to assess how the small number of credit rating ratings in a given cohort may have impacted the results.[2410] Further, the modifications to the instructions for Exhibit 1 to Form NRSRO permit an NRSRO, including a small NRSRO, to include in the exhibit a short statement describing the single cohort approach and any advantages or limitations to the single cohort approach the NRSRO believes would be appropriate to disclose.

The Commission also notes that it has modified the instructions for Exhibit 1 to Form NRSRO from the proposal in ways that will reduce the impact on small NRSROs.[2411] For example, the final amendments provide that, except for the issuers of asset-backed securities class of credit ratings, to determine the number of credit ratings outstanding as of the beginning of the applicable period, the NRSRO must include only credit ratings assigned to an obligor as an entity or, if there is no such rating, the rating of the obligor's senior unsecured debt, instead of the credit ratings of individual securities or money-market instruments issued by the obligor.[2412] Because the Commission has narrowed the scope of the credit ratings included in the performance statistics for four of the five classes of credit ratings, this is expected to substantially reduce the amount of historical information that an NRSRO is required to analyze. The Commission has also revised the standard definition of *paid off,* in response to comment,[2413] to eliminate the prong that applied to entity ratings of obligors. The Commission has clarified that the rule does not require an NRSRO to track the outcome of an obligor, security, or money market instrument after the credit rating has been withdrawn, in response to comments.[2414]

With respect to paragraph (a) of proposed Rule 17g–8, one NRSRO stated that to adopt policies mandating board approval of procedures and methodologies to determine credit ratings would be ''overly-burdensome for many smaller NRSROs and likely cost prohibitive for a small credit rating agency seeking to become an NRSRO.'' [2415] A second commenter stated that certain provisions of the proposal, including those related to credit rating methodologies, would compound barriers to entry, that many of the new provisions are ''expensive and burdensome to implement,'' especially for newer and smaller NRSROs, and do not appear to promote competition, and that the Commission should take into account the ''dominance'' of the larger players and expand small company exceptions that are ''needed to level the competitive field.'' [2416]

In response to comments about the board's role in approving the procedures and methodologies an NRSRO uses to determine credit ratings, the Commission notes—as discussed in section II.F.1. of this release—that section 15E(t)(3)(A) of the Exchange Act provides that the board of an NRSRO shall oversee the establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.[2417] Consequently, the self-executing requirement in the statute governs the responsibility of the board. Paragraph (a)(1) of Rule 17g–8 governs the responsibility of the NRSRO to have policies and procedures reasonably designed to ensure that board carries out this statutory responsibility. Therefore, the rule implements a policies and procedures-based requirement and, therefore, a small NRSRO can comply with the rule requirements by tailoring and scaling its policies and procedures to its size and business activities. Moreover, with respect to the self-executing requirement, section 15E(t)(5) of the Exchange Act provides exception authority under which the Commission may permit an NRSRO to delegate responsibilities required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small NRSRO.[2418] The ability to request an exception under section 15E(t)(5) provides a means for a small NRSRO to seek relief to delegate responsibilities to a committee if the Commission finds the costs and burdens associated with the requirements of section 15E(t) of the Exchange Act—including the requirement that the board oversee the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings—are an unreasonable burden.[2419]

In response to the more general comment on the impact of paragraph (a) of Rule 17g–8 on smaller NRSROs, all of the provisions in the paragraph establish policies and procedures-based requirements. Therefore, a small NRSRO can comply with the requirements by tailoring and scaling its policies and procedures to its size and business activities. This should result in lower impacts on smaller NRSROs as compared to large NRSROs because the smaller NRSROs issue substantially fewer credit ratings than the large NRSROs.[2420] Consequently, the number of credit analysts and credit ratings to which the policies and procedures will need to be applied will be significantly fewer than will be the case for a large NRSRO. Thus, the new rule should result in lower impacts for small NRSROs in terms of the scope of the activities to be addressed by the policies and procedures.

One NRSRO stated that the implementation of proposed paragraph (a) of Rule 17g–7 (requiring the publication of a form and any applicable due diligence certifications with the taking of a rating action) would result in an ''enormous technological undertaking'' that will require a lead time of at least one year to implement for all NRSROs and possibly longer for smaller NRSROs who may not have the same level of financial or technological resources as the larger NRSROs.[2421]

In response to this comment, the Commission notes—as discussed in section III of this release—that the

[2409] *See* 15 U.S.C. 78o–7(q)(2)(B).

[2410] *See* section II.E.1.b. of this release.

[2411] *See* section II.E.1.b. of this release (discussing the modifications in more detail).

[2412] *See* section II.E.1.b. of this release.

[2413] *See S&P Letter.*

[2414] *See, e.g., S&P Letter* (stating that that the Commission should not require that an NRSRO monitor an obligor, security, or money market instrument after withdrawal because of the lack of information available to the NRSRO to perform such monitoring).

[2415] *See A.M. Best Letter.*

[2416] *See Kroll Letter.*

[2417] *See* 15 U.S.C. 78o–7(t)(3)(A).

[2418] *See* 15 U.S.C. 78o–7(t)(5).

[2419] The Commission will handle such requests in a manner similar to requests for relief under section 36 of the Exchange Act. *See* 15 U.S.C. 78mm. Further information about requesting relief from the Commission under section 36 of the Exchange Act is available at *http://www.sec.gov/rules/exempt.shtml.*

[2420] *See* Table 4 in section I.B.2.a. of this release (showing the approximate number of credit ratings outstanding across the ten NRSROs).

[2421] *See Morningstar Letter.*

requirement will not be effective until nine months after this release is published in the **Federal Register**. This will provide small NRSROs with a substantial transition period to prepare to comply with the new requirements. Moreover, while the transition period is not as long as suggested by the commenter (at least one year), the Commission has modified the final amendments from the proposal in a number of ways that will reduce impacts on small NRSROs and, therefore, should make a nine month transition period sufficient for small NRSROs.[2422] All of these modifications were made, in part, in response to concerns about burdens raised by commenters. The modifications include narrowing the scope of rating actions that will trigger the disclosure requirement. In addition, the Commission has exempted certain rating actions involving credit ratings assigned to foreign obligors or securities or money market instruments issued overseas. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. These modifications should reduce the impact on all NRSROs, including small NRSROs, as compared with the proposal.

While commenters may not have specifically addressed the impact on small entities of other amendments and new rules being adopted today, as discussed in detail in Section II of this release, the Commission has made modifications from the proposals that will reduce the impact on small entities.

For example, the Commission has modified the requirement to submit certain Forms NRSRO and annual reports under Rule 17g–3 to the Commission electronically.[2423] In response to a comment from an NRSRO that the Commission's proposed cost estimate for the proposal ''accounts for only a small fraction of the expected cost of compliance'' and that instead PDF copies of the required submissions should be used,[2424] the Commission has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents, which another NRSRO described as ''the most preferred and simplest'' way to provide the information.[2425] This will mitigate the costs for all NRSROs, including small NRSROs, to file the forms and report.

Further, the Commission has modified proposed paragraph (b) of Rule 17g–7 (the 100% Rule) in a number of ways that will reduce the impact on small NRSROs.[2426] To focus the disclosure of rating histories on the rating actions that are most relevant to evaluating performance, the final rule eliminates the proposed requirement to include placements on watch and affirmations (and the required data associated with these actions) in the rating histories. The final rule also significantly shortens from the proposal the time horizon of historical information that must be retrieved for inclusion in the rating histories. In particular, the proposed requirement to include information for all credit ratings outstanding on or after June 26, 2007 has been replaced with a standard three-year backward looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This, together with the elimination of two proposed types of rating actions that would trigger a requirement to add information to a credit rating's history—placements of the security on credit watch or review and affirmations of the credit rating—is expected to significantly mitigate the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures. The modifications from the proposal also should mitigate concerns about having to obtain information that was not traditionally retained by the NRSRO because it will significantly narrow the scope of such information that will need to be included in the rating histories. Further, the modifications from the proposal are expected to reduce the cost of updating the XBRL data file with new information.[2427] The final amendments also specify a standard for updating the file—no less frequently than monthly. This will mitigate costs that would result if the Commission had not established a minimum requirement for how often the file must be updated and NRSROs updated the file more frequently than monthly as a result. Finally, the final rule modifies the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This is expected to reduce to some degree the data retention and maintenance costs associated with the final rule as compared to the proposed rule. Overall, these modifications are expected to reduce the impact on NRSROs, including small NRSROs, as compared with the proposal.

The Commission also has modified proposed Rule 17g–10 and Form ABS Due Diligence–15E in ways that will reduce the impact on small entities.[2428] In particular, Rule 17g–10, as adopted, establishes a ''safe harbor'' to provide certainty to providers of third-party due diligence services with respect to how they can meet their obligation under section 15E(s)(4)(B) of the Exchange Act to provide Form ABS Due Diligence–15E to any NRSRO that produces a credit rating to which the due diligence services relate. Consequently, small third-party due diligence providers will not be required to identify every NRSRO that is producing a credit rating.

Finally, the amendments being adopted today eliminate the 10% Rule.[2429] This will eliminate the costs for all NRSROs, including small NRSROs, to produce and disclose rating histories to comply with the 10% Rule.

C. Small Entities Subject to the Rules

1. NRSROs and Providers of Third-Party Due Diligence Services

Paragraph (a) of Rule 0–10 provides that, for purposes of the RFA, a small entity ''[w]hen used with reference to an 'issuer' or a 'person' other than an investment company'' means ''an 'issuer' or 'person' that, on the last day of its most recent fiscal year, had total assets of $5 million or less.''[2430] The Commission has stated in the past that an NRSRO with total assets of $5 million or less would qualify as a ''small'' entity for purposes of the RFA.[2431] The Commission continues to believe this threshold of total assets of $5 million or less qualifies an NRSRO as ''small'' for purposes of the RFA. In addition, the Commission believes this is an appropriate threshold for determining whether a provider of third-party due diligence services is ''small'' for purposes of the RFA. Currently, there are ten credit rating agencies registered with the

[2422] *See* section II.G. of this release (providing a more detailed discussion of these modifications).

[2423] *See* section II.E.2. of this release.

[2424] *See DBRS Letter.*

[2425] *See S&P Letter.*

[2426] *See* section II.E.3. of this release (providing a more detailed discussion of these modifications).

[2427] *See* section II.E.3.b. of this release (discussing how the modifications narrow the types of rating actions that must be included in a rating history).

[2428] *See* section II.H.2. of this release.

[2429] See section II.E.3. of this release (discussing the 10% Rule and reasons for its elimination).

[2430] 17 CFR 240.0–10(a).

[2431] *See, e.g., Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations,* 72 FR 33618; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 6481; *Amendments to Rules for Nationally Recognized Statistical Rating Organizations,* 74 FR at 63863.

Commission as NRSROs.[2432] Based on their annual reports under Rule 17g–3 for the 2013 fiscal year, two NRSROs are small entities under the above definition.

The Commission stated in the proposing release that it believed that there were approximately ten firms that provide, or would begin providing, third-party due diligence services to issuers and underwriters of Exchange Act-ABS and that all would be small entities for purposes of the RFA.[2433] However, based on further analysis, the Commission estimates that there are approximately fifteen providers of third-party due diligence services.[2434] The Commission believes that all of these firms will be small entities for purposes of the RFA.

2. Issuers

As noted above, Rule 0–10(a)[2435] defines an issuer be a *small business* or *small organization* if it had total assets of $5 million or less on the last day of its most recent fiscal year. In the proposing release, the Commission estimated that there were 270 issuers and certified pursuant to 5 U.S.C. 605(b) that Rule 15Ga–2 and the amendments to Form ABS–15G, if adopted, would not have a significant economic impact on a substantial number of small entities.[2436] The Commission requested comment on this certification.[2437] However, no commenters responded to that request or indicated that the proposed rules would have a significant economic impact on a substantial number of small entities.

The Commission estimates that there will be 336 unique issuers subject to Rule 15Ga–2 and the amendments to Form ABS–15G.[2438] The Commission's data indicate that only one issuer would be small for purposes of the RFA.[2439] Because only one out of 336 unique issuers is small and because commenters did not indicate that the proposed rules would have a significant economic impact on a substantial number of small issuers, the Commission certifies that Rule 15Ga–2 and the amendments to Form ABS–15G will not have a significant economic impact on a substantial number of small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

In accordance with the Dodd-Frank Act and to enhance oversight of NRSROs, the Commission is adopting amendments to existing rules and new rules that apply to NRSROs, providers of third-party due diligence services for asset-backed securities, and issuers and underwriters of asset-backed securities.

The Commission is amending Rule 17g–1. First, the Commission is amending paragraph (i) of Rule 17g–1.[2440] The amendments require an NRSRO to make Form NRSRO and Exhibits 1 through 9 of the form publicly and freely available on an easily accessible portion of its corporate Internet Web site (eliminating an option to make the form and exhibits available ''through another comparable, readily accessible means'') and to make its most recent Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit.

Second, the Commission is amending paragraphs (e), (f), and (g) of Rule 17g–1 to require NRSROs to use the Commission's EDGAR system to electronically submit Form NRSRO and required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.[2441]

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.[2442] The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the Exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample ''Transition/Default Matrix.'' The amendments also enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

The Commission is amending Rule 17g–2. First, the Commission is adding paragraph (a)(9) to Rule 17g–2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g–8 as a record that must be made and retained.[2443] Second, the Commission is adding paragraph (b)(12) to Rule 17g–2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.[2444] Third, the Commission is adding paragraph (b)(13) to Rule 17g–2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g–8 as a record that must be retained.[2445] Fourth, the Commission is adding paragraph (b)(14) to Rule 17g–2 to identify the policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g–8 as a record that must be retained.[2446] Fifth, the Commission is adding paragraph (b)(15) to Rule 17g–2 to identify the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g–9 as a record that must be retained.[2447] In addition, the Commission is amending paragraph (c) of Rule 17g–2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g–2 must be retained until three years after the date the record is replaced with an updated record, instead of three years after the record is made or received, which is the retention period for other

[2432] *See* section I.B.2.a. of this release (discussing the economic baseline with respect to NRSROs); *see also* section IV.C. of this release (stating that there are ten NRSRO respondents for purposes of the PRA).

[2433] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33534.

[2434] *See* section I.B.2.b. of this release (discussing the economic baseline with respect to providers of third-party due diligence services and the analysis upon which the Commission bases this estimate); *see also* section IV.C. of this release (stating that there are fifteen respondents that are providers of third-party due diligence services for purposes of the PRA).

[2435] 17 CFR 240.0–10(a).

[2436] *See Nationally Recognized Statistical Rating Organizations,* 76 FR at 33534.

[2437] *See id.* at 33537.

[2438] *See* section I.B.2.b. of this release (discussing the economic baseline with respect to issuers); *see also* section IV.C. of this release (stating that there are 336 issuer respondents for purposes of the PRA).

[2439] This is based on data from Asset-Backed Alert, which is available at *http://www.abalert.com/ranks.php.*

[2440] *See* section II.E.2. of this release (providing a more detailed discussion of the amendments).

[2441] *See* section II.L. of this release (providing a more detailed discussion of the amendments).

[2442] *See* section II.E.1. of this release (providing a more detailed discussion of the amendments).

[2443] *See* section II.C.2. of this release (providing a more detailed discussion of this amendment).

[2444] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment).

[2445] *See* section II.F.2. of this release (providing a more detailed discussion of this amendment).

[2446] *See* section II.J.2. of this release (providing a more detailed discussion of this amendment).

[2447] *See* section II.I.2. of this release (providing a more detailed discussion of this amendment).

records identified in paragraphs (a) and (b) of Rule 17g–2.[2448] The Commission also repealed paragraph (d)(2) of Rule 17g–2 (the 10% Rule) and has re-codified (with significant amendments) the requirements in paragraph (d)(3) of Rule 17g–2 (the 100% Rule) in paragraph (b) of Rule 17g–7.[2449]

The Commission is amending Rule 17g–3. First, the Commission is amending paragraphs (a) and (b) of Rule 17g–3.[2450] The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an additional unaudited report—a report on the NRSRO's internal control structure—with its annual submission of reports to the Commission pursuant to Rule 17g–3.[2451] The amendment to paragraph (b) of Rule 17g–3 requires that the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report.[2452]

Second, the Commission is adding paragraph (d) to Rule 17g–3 to require that the annual reports required to be submitted to the Commission pursuant to Rule 17g–3 be submitted electronically through the Commission's EDGAR system as PDF documents.[2453]

Third, the Commission is adding paragraph (a)(8) to Rule 17g–3 to identify the report of the NRSRO's designated compliance officer that an NRSRO is required to file with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other annual reports.[2454] This aspect of the requirement will not result in a collection of information requirement because the requirement to file the report with the other annual reports required under Rule 17g–3 is pursuant to section 15E(j)(5)(B) of the Exchange Act.[2455] Moreover, the Commission is not adding any requirements with respect to the filing other than the requirement that this report be filed with the other annual reports. However, as discussed in more detail below, this report and the other annual reports must be submitted through the EDGAR system.[2456]

The Commission is amending Rule 17g–5. First, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g–5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g–5 Web site, promptly after receipt, any executed Form ABS Due Diligence–15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.[2457]

Second, the Commission is adding paragraph (c)(8) to Rule 17g–5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) Participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.[2458]

Third, the Commission is adding paragraph (f) of Rule 17g–5, which provides that upon written application by an NRSRO the Commission may exempt, either conditionally or unconditionally, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.[2459]

Fourth, the Commission is adding paragraph (g) of Rule 17g–5 to establish a finding that must be made in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F) of the Exchange Act.[2460]

The Commission is amending Rule 17g–7. First, the Commission is incorporating the disclosure requirement in Rule 17g–7 relating to representations, warranties, and enforcement mechanisms available to investors in asset-backed securities before today's amendments into paragraph (a) of the rule and is adding disclosure provisions that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.[2461] The amendments prescribe: (1) The types of rating actions that trigger the requirement to publish the form and, if applicable, any due diligence certifications;[2462] (2) the format of the form;[2463] (3) the content of the form (which must include certain qualitative and quantitative information relating to the credit rating);[2464] and (4) an attestation requirement for the form.[2465]

Second, the Commission is re-codifying in paragraph (b) of Rule 17g–7 the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g–2 before today's amendments (the 100% Rule).[2466] The amendments to Rule 17g–7 also expand the scope of the credit ratings that must be included in the histories and add additional data elements that must be disclosed in the rating history for a particular credit rating.

The Commission is adopting Rule 17g–8, which requires an NRSRO to establish, maintain, enforce, and document certain types of policies and procedures or to address certain matters in policies and procedures the NRSRO is required to establish, maintain, and enforce pursuant to the Exchange Act.

Specifically, paragraph (a) of Rule 17g–8 requires an NRSRO to establish,

[2448] *See* section II.A.2. of this release (providing a more detailed discussion of this amendment).

[2449] *See* section II.E.3. of this release (providing a more detailed discussion of this amendment).

[2450] *See* section II.A.3. of this release (providing a more detailed discussion of these amendments).

[2451] *See* paragraph (a)(7) of Rule 17g–3.

[2452] *See* paragraph (b)(2) of Rule 17g–3.

[2453] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2454] *See* section II.K. of this release (providing a more detailed discussion of this amendment).

[2455] *See* 15 U.S.C. 78o–7(j)(5)(B).

[2456] *See* section IV.D.11. of this release (discussing the initial and annual recordkeeping and reporting burdens resulting from the requirement to submit the annual reports to the Commission using the EDGAR system).

[2457] *See* sections II.G.5. and II.H.2. of this release (providing more detailed discussions of this amendment).

[2458] *See* section II.B.1. of this release (providing a more detailed discussion of this amendment).

[2459] *See* section II.B.2. of this release (providing a more detailed discussion of this amendment).

[2460] *See* section II.B.3. of this release (providing a more detailed discussion of this amendment).

[2461] *See* section II.G. of this release (providing a more detailed discussion of these amendments).

[2462] The Commission is adopting an exemption for certain non-U.S. rating actions from the requirements of paragraph (a). *See* section II.G.1. of this release (providing a more detailed discussion of these amendments).

[2463] *See* section II.G.2. of this release (providing a more detailed discussion of these amendments).

[2464] *See* section II.G.3. of this release (providing a more detailed discussion of these amendments).

[2465] *See* section II.G.4. of this release (providing a more detailed discussion of these amendments).

[2466] *See* section II.E.3. of this release (providing a more detailed discussion of these amendments). The Commission is also repealing paragraph (d)(2) of Rule 17g–2 (the 10% Rule). As stated above in section II.E.3. of this release, in light of the amendments to the instructions for Exhibit 1 to Form NRSRO and the amendments to the 100% Rule, retaining the 10% Rule would provide little, if any, incremental benefit.

maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.[2467] The required policies and procedures include policies and procedures relating to: (1) Board approval of the procedures and methodologies for determining credit ratings;[2468] (2) the development and modification of the procedures and methodologies for determining credit ratings;[2469] (3) applying material changes to the procedures and methodologies for determining credit ratings;[2470] (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;[2471] and (5) disclosing the version of a credit rating procedure or methodology used with respect to a particular credit rating.[2472]

Paragraph (b) of Rule 17g–8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.[2473] The required policies and procedures include policies and procedures relating to: (1) Assessing the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or money market instrument;[2474] (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO;[2475] and (3) applying any symbol, number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.[2476]

Paragraph (c) of Rule 17g–8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.[2477]

Paragraph (d) of Rule 17g–8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act.[2478]

The Commission is adopting Rule 17g–9. Rule 17g–9 requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.[2479] Paragraph (b) identifies four factors the NRSRO must consider when designing the standards.[2480] Paragraph (c)(1) requires NRSROs to include a requirement for periodic testing in its standards.[2481] Paragraph (c)(2) provides that the standards must include a requirement that at least one individual with an ''appropriate level of experience in performing credit analysis, but not less than three years'' must participate in the determination of a credit rating.[2482]

The Commission is adopting Rule 17g–10 and Form ABS Due Diligence–15E.[2483] Paragraph (a) of Rule 17g–10 provides that the written certification providers of third-party due diligence services must provide to NRSROs pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence–15E.[2484] Paragraph (b) of Rule 17g–10 provides that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.[2485] Paragraph (c) of Rule 17g–10 provides a ''safe harbor'' for a provider of third-party due diligence services to meet its obligation under section 15E(s)(4)(B).[2486] Paragraph (d) of Rule 17g–10 contains four definitions to be used for the purposes of section 15E(s)(4)(B) and Rule 17g–10; namely, definitions of *due diligence services,*[2487] *issuer,*[2488] *originator,*[2489] and *securitizer.*[2490]

Form ABS Due Diligence–15E contains five line items identifying information the provider of third-party due diligence services must provide.[2491] It also contains a signature line with a corresponding representation.[2492] Item 1 elicits the identity and address of the provider of third-party due diligence services.[2493] Item 2 elicits the identity and address of the issuer, underwriter, or NRSRO that paid the provider to provide the services.[2494] Item 3 requires the provider of the due diligence services to identify each NRSRO whose published criteria for performing due diligence the provider of third-party due diligence services intended to satisfy in performing the due diligence review.[2495] Item 4 requires the provider of third-party due diligence services to describe the scope and manner of the due diligence performed.[2496] Item 5 requires the provider of third-party due diligence services to describe the findings and conclusions resulting from the review.[2497]

The Commission is adopting Rule 15Ga–2 and amendments to Form ABS–15G.[2498] Rule 15Ga–2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish a Form ABS–15G on the Commission's EDGAR system containing the findings and conclusions

[2467] *See* section II.F.1. of this release (providing a more detailed discussion of this paragraph).

[2468] *See* paragraph (a)(1) of Rule 17g–8.

[2469] *See* paragraph (a)(2) of Rule 17g–8.

[2470] *See* paragraph (a)(3) of Rule 17g–8.

[2471] *See* paragraph (a)(4) of Rule 17g–8.

[2472] *See* paragraph (a)(5) of Rule 17g–8.

[2473] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph).

[2474] *See* paragraph (b)(1) of Rule 17g–8.

[2475] *See* paragraph (b)(2) of Rule 17g–8.

[2476] *See* paragraph (b)(3) of Rule 17g–8.

[2477] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph).

[2478] *See* section II.A.1. of this release (providing a more detailed discussion of this paragraph).

[2479] *See* section II.I.1.a. of this release (providing a more detailed discussion of this paragraph).

[2480] *See* section II.I.1.b. of this release (providing a more detailed discussion of this paragraph).

[2481] *See* section II.I.1.c. of this release (providing a more detailed discussion of this paragraph).

[2482] *See* section II.I.1.c. of this release (providing a more detailed discussion of this paragraph).

[2483] *See* section II.H.2. of this release (providing a more detailed discussion of Rule 17g–10); section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence–15E).

[2484] *See* paragraph (a) of Rule 17g–10.

[2485] *See* paragraph (b) of Rule 17g–10.

[2486] *See* paragraphs (c)(1) and (2) of Rule 17g–10. *See also* paragraph (a)(3)(iii)(E) of Rule 17g–5 (provisions under which the issuer or underwriter must promptly post the form on the Rule 17g–5 Web site).

[2487] *See* paragraph (d)(1) of Rule 17g–10.

[2488] *See* paragraph (d)(2) of Rule 17g–10.

[2489] *See* paragraph (d)(3) of Rule 17g–10.

[2490] *See* paragraph (d)(4) of Rule 17g–10.

[2491] *See* section II.H.3. of this release (providing a more detailed discussion of the information to be reported in the form).

[2492] *See* Form ABS Due Diligence–15E.

[2493] *See* Item 1 of Form ABS Due Diligence–15E.

[2494] *See* Item 2 of Form ABS Due Diligence–15E.

[2495] *See* Item 3 of Form ABS Due Diligence–15E.

[2496] *See* Item 4 of Form ABS Due Diligence–15E.

[2497] *See* Item 5 of Form ABS Due Diligence–15E.

[2498] *See* section II.H.1. of this release (providing a more detailed discussion of the rule and form).

of any third-party ''due diligence report'' obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. The rule defines *due diligence report* as any report containing findings and conclusions relating to *due diligence services* as defined in Rule 17g–10.[2499] Under the rule, the disclosure must be furnished using Form ABS–15G for both registered and unregistered offerings of Exchange Act-ABS. However, if the disclosure required by Rule 15Ga–2 has been made in the applicable prospectus, the issuer or underwriter may refer to that section of the prospectus in Form ABS–15G rather than providing the findings and conclusions directly on the form.[2500] Also, Rule 15Ga–2 provides an exemption for certain offshore issuances of Exchange Act-ABS. Further, the final rule does not apply to municipal Exchange Act-ABS, but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

As stated above, the Commission is requiring that certain Forms NRSRO and all Rule 17g–3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system as PDF documents.[2501] In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S–T to require that Forms NRSRO and Exhibits 1 through 9 submitted pursuant to paragraphs (e), (f), and (g) of Rule 17g–1 and the annual reports submitted pursuant Rule 17g–3 be submitted through the EDGAR system as PDF documents.[2502]

NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to make electronic submissions to the Commission.[2503]

Issuers and underwriters of Exchange Act-ABS also will need to furnish Form ABS–15G to the Commission through the EDGAR system pursuant to Rule 15Ga–2. The Commission believes that these issuers and underwriters already have access to the EDGAR system because, for example, they need such access for purposes of Rule 15Ga–1. Consequently, the new rule and amendments will not require them to file a Form ID to gain access to the EDGAR system.

E. Agency Action To Minimize Effect on Small Entities

Pursuant to section 604(a)(6) of the RFA, the Commission must describe the steps it has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes.[2504] In connection with adopting the amendments and new rules, the Commission considered the following alternatives: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rules, or any part of the rules, for small entities.

As discussed throughout this release, as well as in section VI.B. of this release, the Commission is sensitive to the costs and burdens the amendments and new rules will have on all entities, including small entities. Consequently, the amendments and new rules contain certain modifications from the proposals designed to alleviate as appropriate some of the concerns regarding small entities. The Commission believes that the amendments and new rules being adopted today, as modified from the proposal, strike an appropriate balance between minimizing the costs and burdens on small entities, and implementing the policies and requirements addressed by Title IX, Subtitle C of the Dodd-Frank Act. Moreover, the Commission believes the choices it has made in implementing Title IX, Subtitle C of the Dodd-Frank Act have resulted in amendments and new rules that are appropriate for entities of all sizes.

Consistent with Exchange Act section 15E(h)(3)(B)(i), the Commission has provided for a process for small NRSROs to seek exemptions with respect to the sales and marketing conflict of interest provisions.[2505] The Commission does not otherwise believe it is appropriate to establish different compliance or reporting requirements or timetables; to clarify, consolidate, or simplify compliance and reporting requirements under the amendments to existing rules and new rules for small entities; or summarily exempt small entities from coverage of the rules, or any part of the rules. As discussed throughout this release, the amendments and new rules being adopted today are designed to improve the governance of NRSROs with respect to their procedures and methodologies for determining credit ratings, increase the transparency of NRSRO activities, and improve the quality of NRSRO credit ratings. These measures will benefit NRSROs, investors, and other users of credit ratings. Moreover, the objectives of governance, transparency, and quality are as relevant to small NRSROs as they are to large NRSROs insomuch as investors and others use the credit ratings of all NRSROs.

However, where possible in the adopted amendments and new rules and as discussed throughout this release, the Commission has used performance standards. Policies and procedures requirements allow for tailoring by the small NRSROs to their particular business models. As noted in section VI.B. of this release, a number of the amendments and new rules are policies and procedures-based requirements and, consequently, a small NRSRO can comply with these requirements by tailoring and scaling its policies and procedures to its size and business activities. For example, the Commission has established policies and procedures-based requirements in Rule 17g–8 to implement provisions in Title IX, Subtitle C of the Dodd-Frank Act that address: (1) The procedures and methodologies an NRSRO uses to determine credit ratings;[2506] (2) the symbols, numbers, or scores an NRSRO uses to denote credit ratings;[2507] and (3) look-back reviews.[2508] In addition, the new rule requiring an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings provides the NRSRO with flexibility to design the standards subject to certain minimum requirements.[2509]

Moreover, as noted in section VI.B. of this release, the Commission has modified the amendments and new rules from the proposal in ways that will reduce costs on, and burdens for, all NRSROs subject to the amendments and new rules, including small entities.

[2499] *See* paragraph (d)(1) of Rule 17g–10.

[2500] *See* section II.H.1. of this release (providing a more detailed discussion of this rule).

[2501] *See* section II.L. of this release (providing a more detailed discussion of this amendment).

[2502] *See* paragraph (a)(xiv) of Rule 101 of Regulation S–T.

[2503] *See* section II.L. of this release (providing a more detailed discussion of these requirements).

[2504] *See* 5 U.S.C. 604(a)(6).

[2505] *See* section II.B.2. of this release (providing a more detailed discussion of this provision).

[2506] *See* section II.F.1. of this release (providing a more detailed discussion of these requirements).

[2507] *See* section II.J.1. of this release (providing a more detailed discussion of this paragraph).

[2508] *See* section II.C.1. of this release (providing a more detailed discussion of this paragraph).

[2509] *See* section II.I.1. of this release (providing a more detailed discussion of this rule).

For example, the Commission has modified the provisions from the proposal regarding the disclosure of performance statistics to narrow the scope of the credit ratings included in the statistics, which will make producing them less costly and burdensome.[2510] In addition, the Commission has significantly shortened from the proposal the time horizon of historical information that must be retrieved for inclusion in the rating histories.[2511] Furthermore, the Commission has narrowed from the proposal the scope of rating actions that will trigger the requirement that an NRSRO publish a form and any due diligence certifications when taking a rating action and has exempted from this requirement certain rating actions involving credit ratings assigned to foreign obligors or securities or money market instruments issued overseas.[2512] These modifications and the other modifications discussed throughout this release, as well as in section VI.B. of this release, will reduce the cumulative cost and burden of the amendments and new rules as compared with the proposals.

Finally, the amendments and new rules being adopted today will make additional information about third-party due diligence services provided for Exchange Act-ABS available to market participants and others.[2513] This will benefit NRSROs, the users of credit ratings, and investors and other Exchange Act-ABS market participants who may or may not be users of credit ratings.[2514] As discussed in section VI.C. of this release, the Commission estimates that all fifteen providers of third-party due diligence services subject to the new requirements are small entities and that the new requirements applicable to issuers will not have a significant economic impact on a substantial number of small entities.

As noted above, the Commission included its view that the requirements applicable to issuers will not have a significant economic impact on a substantial number of small entities in the proposing release and received no comments on its conclusion and the Commission estimates that only one of the estimated 336 unique issuers is small for purposes of the PRA. For these reasons, the Commission does not believe it is appropriate to establish different compliance or reporting requirements or timetables; to clarify, consolidate, or simplify compliance and reporting requirements under the amendments to existing rules and new rules for small entities; or summarily exempt small entities from coverage of the rules, or any part of the rules.

[2510] *See* section II.E.1.b. of this release (providing a more detailed discussion of these modifications).

[2511] *See* section II.E.3. of this release (providing a more detailed discussion of these modifications).

[2512] *See* section II.G. of this release (providing a more detailed discussion of these modifications).

[2513] *See* section II.H. of this release (providing a more detailed discussion of the final amendments and new rules relating to third-party due diligence services).

[2514] *See, e.g.,* section II.H.4. of this release (providing a more detailed discussion of the benefits of the final amendments and new rules relating to third-party due diligence services).

VII. Statutory Authority

The Commission is adopting amendments to §§ 232.101, 240.17g–1, 240.17g–2, 240.17g–3, 240.17g–5, 240.17g–6, 240.17g–7, Form NRSRO, and Form ABS–15G and is adopting §§ 240.15Ga–2, 240.17g–8, 240.17g–9, 240.17g–10, and Form ABS Due Diligence–15E pursuant to the authority conferred by the Exchange Act, including sections 15E, 17(a), and 36 (15 U.S.C. 78o–7, 78q, and 78mm), and pursuant to authority in sections 936, 938, and 943 of the Dodd-Frank Act (Pub. L. 111–203 §§ 936, 938, and 943).

List of Subjects in 17 CFR Parts 232, 240, 249, and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

Text of Final Rules

In accordance with the foregoing, the Commission is amending Title 17, Chapter II of the Code of Federal Regulation as follows.

PART 232—REGULATION S–T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

■ 1. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78*l,* 78m, 78n, 78o(d), 78w(a), 78*ll,* 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 *et seq.;* and 18 U.S.C. 1350.

* * * * *

■ 2. Section 232.101 is amended by adding paragraph (a)(1)(xiv) to read as follows:

§ 232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(xiv) Form NRSRO (§ 249b.300 of this chapter), and the information and documents in Exhibits 1 through 9 to Form NRSRO, filed with or furnished to, as applicable, the Commission under § 240.17g–1(e), (f), and (g) of this chapter and the annual reports filed with or furnished to, as applicable, the Commission under § 240.17g–3 of this chapter. The filings or furnishings must be made on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T (§ 232.11). Notwithstanding Rule 104 of Regulation S–T (§ 232.104), the PDF documents filed or furnished under this paragraph will be considered as officially filed with or furnished to, as applicable, the Commission.

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PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 3. The authority citation for part 240 is amended by adding sectional authorities for §§ 240.15Ga–2, 240.17g–8, and 240.17g–9 to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.,* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); and 18 U.S.C. 1350 unless otherwise noted.

* * * * *

Section 240.15Ga–2 is also issued under sec. 943, Pub. L. 111–203, 124 Stat. 1376.

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Section 240.17g–8 is also issued under sec. 938, Pub. L. 111–203, 124 Stat. 1376.

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Section 240.17g–9 is also issued under sec. 936, Pub. L. 111–203, 124 Stat. 1376.

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■ 4. Section 240.15Ga–2 is added to read as follows:

§ 240.15Ga–2 Findings and conclusions of third-party due diligence reports.

(a) The issuer or underwriter of an offering of any asset-backed security (as that term is defined in Section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)) that is to be rated by a nationally recognized statistical rating organization must furnish Form ABS–15G (§ 249.1400 of this chapter) to the Commission containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.

Instruction to paragraph (a): Disclosure of the findings and conclusions includes, but is not limited to, disclosure of the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those criteria. This disclosure is only required

for an initial rating and does not need to be furnished in connection with any subsequent rating actions. For purposes of this rule, the date of first sale is the date on which the first investor is irrevocably contractually committed to invest, which, depending on the terms and conditions of the contract, could be the date on which the issuer receives the investor's subscription agreement or check.

(b) In the case where the issuer and one or more underwriters have obtained the same third-party due diligence report related to a particular asset-backed securities transaction, if any one such party has furnished all the disclosures required in order to meet the obligations under paragraph (a) of this section, the other party or parties are not required to separately furnish the same disclosures related to such third-party due diligence report.

(c) If the disclosure required by this rule has been made in the prospectus (including an attribution to the third-party that provided the third-party due diligence report), the issuer or underwriter may refer to that section of the prospectus in Form ABS–15G rather than providing the findings and conclusions itself directly in Form ABS–15G.

(d) For purposes of paragraphs (a) and (b) of this section, *issuer* is defined in Rule 17g–10(d)(2) (§ 240.17g–10(d)(2) of this chapter) and *third-party due diligence report* means any report containing findings and conclusions of any *due diligence services* as defined in Rule 17g–10(d)(1) (§ 240.17g–10(d)(1) of this chapter) performed by a third party.

(e) The requirements of this rule would not apply to an offering of an asset-backed security if certain conditions are met, including:

(i) The offering is not required to be, and is not, registered under the Securities Act of 1933;

(ii) The issuer of the rated security is not a U.S. person (as defined under Securities Act Rule 902(k)); and

(iii) the security issued by the issuer will be offered and sold upon issuance, and any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States.

(f) The requirements of this rule would not apply to an offering of an asset-backed security if certain conditions are met, including:

(i) The issuer of the rated security is a municipal issuer; and

(ii) The offering is not required to be, and is not, registered under the Securities Act of 1933.

(g) For purposes of paragraph (f) of this section, a municipal issuer is an *issuer* (as that term is defined in Rule 17g–10(d)(2) (§ 240.17g–10(d)(2) of this chapter)) that is any State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory or the District of Columbia, or any public instrumentality of one or more States, Territories or the District of Columbia.

(h) An offering of an asset-backed security that is exempted from the requirements of this rule pursuant to paragraph (f) of this section remains subject to the requirements of Section 15E(s)(4)(A) of the Act (15 U.S.C. 78o–7(s)(4)(A)), which requires that the issuer or underwriter of any asset-backed security shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

■ 5. Section 240.17g–1 is amended:

■ a. In paragraphs (a), (b), and (c), by removing the phase ''furnish the Commission with'' and its place adding the phrase ''file with the Commission two paper copies of'';

■ b. In paragraph (d), by adding the phrase ''two paper copies of'' after the phrase ''the applicant must furnish the Commission with''; and

■ c. By revising paragraphs (e), (f), (g), (h), and (i).

The revisions read as follows:

§ 240.17g–1 Application for registration as a nationally recognized statistical rating organization.

* * * * *

(e) *Update of registration.* A nationally recognized statistical rating organization amending materially inaccurate information in its application for registration pursuant to section 15E(b)(1) of the Act (15 U.S.C. 78o–7(b)(1)) must promptly file with the Commission an update of its registration on Form NRSRO that follows all applicable instructions for the Form. A Form NRSRO and the information and documents in Exhibits 2 through 9 to Form NRSRO, as applicable, filed under this paragraph must be filed electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T (§ 232.11 of this chapter).

(f) *Annual certification.* A nationally recognized statistical rating organization amending its application for registration pursuant to section 15E(b)(2) of the Act (15 U.S.C. 78o–7(b)(2)) must file with the Commission an annual certification on Form NRSRO that follows all applicable instructions for the Form not later than 90 days after the end of each calendar year. A Form NRSRO and the information and documents in Exhibits 1 through 9 to Form NRSRO filed under this paragraph must be filed electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.

(g) *Withdrawal from registration.* A nationally recognized statistical rating organization withdrawing from registration pursuant to section 15E(e)(1) of the Act (15 U.S.C. 78o–7(e)(1)) must furnish the Commission with a notice of withdrawal from registration on Form NRSRO that follows all applicable instructions for the Form. The withdrawal from registration will become effective 45 calendar days after the notice is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors. A Form NRSRO furnished under this paragraph must be furnished electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.

(h) *Filing or furnishing Form NRSRO.* A Form NRSRO filed or furnished, as applicable, under any paragraph of this section will be considered filed with or furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form. Information filed or furnished, as applicable, on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law.

(i) *Public availability of Form NRSRO.* A nationally recognized statistical rating organization must make its current Form NRSRO and information and documents in Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet Web site within 10 business days after the date of the Commission order granting an initial application for registration as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings and within 10 business days after filing with or furnishing to, as applicable, the Commission a Form NRSRO under paragraph (e), (f), or (g) of this section. In addition, a nationally recognized statistical rating organization must make

its most recently filed Exhibit 1 to Form NRSRO freely available in writing to any individual who requests a copy of the Exhibit.

■ 6. Section 240.17g–2 is amended:

■ a. In paragraphs (a)(2)(iii) and (a)(7), by removing the words ''or mortgage-backed'';

■ b. By adding paragraph (a)(9);

■ c. By revising paragraph (b)(1);

■ d. In paragraph (b)(9), by removing the words ''or mortgage-backed'';

■ e. By revising paragraph (b)(11);

■ f. By adding paragraphs (b)(12) through (15);

■ g. By revising paragraph (c);

■ h. By redesignating paragraph (d)(1) as paragraph (d); and

■ i. By removing paragraphs (d)(2) and (d)(3);

The additions and revisions read as follows:

§ 240.17g–2 Records to be made and retained by nationally recognized statistical rating organizations.

(a) * * *

(9) A record documenting the policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o–7(h)(4)(A)) and § 240.17g–8(c).

* * * * *

(b) * * *

(1) Significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports the nationally recognized statistical rating organization filed with or furnished to, as applicable, the Commission pursuant to § 240.17g–3.

* * * * *

(11) Forms NRSRO (including Exhibits and accompanying information and documents) the nationally recognized statistical rating organization filed with or furnished to, as applicable, the Commission.

(12) The internal control structure the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Act (15 U.S.C. 78o–7(c)(3)(A)).

(13) The policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g–8(a).

(14) The policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g–8(b).

(15) The standards of training, experience, and competence for credit analysts the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g–9.

(c) *Record retention periods.* The records required to be retained pursuant to paragraphs (a) and (b) of this section must be retained for three years after the date the record is made or received, except that a record identified in paragraph (a)(9), (b)(12), (b)(13), (b)(14), or (b)(15) of this section must be retained until three years after the date the record is replaced with an updated record.

* * * * *

■ 7. Section 240.17g–3 is amended:

■ a. By revising the section heading;

■ b. By revising paragraph (a) introductory text;

■ c. In paragraph (a)(1) introductory text, by removing the first word ''Audited'' and in its place adding the phrase ''File with the Commission a financial report, as of the end of the fiscal year, containing audited'';

■ d. In paragraph (a)(2) introductory text, by removing the first word ''If'' and in its place adding the phrase ''File with the Commission a financial report, as of the end of the fiscal year, containing, if'';

■ e. In the Note to paragraph (a)(2), by removing the word ''furnished'' and in its place adding the word ''filed'';

■ f. In paragraphs (a)(3) introductory text, (a)(4) introductory text, and (a)(5) introductory text, by removing the first word ''An'' and in its place adding the phrase ''File with the Commission an unaudited financial report, as of the end of the fiscal year,'';

■ g. In paragraph (a)(6) introductory text, by removing the first word ''An'' and in its place adding the phrase ''Furnish the Commission with an unaudited report, as of the end of the fiscal year,'';

■ h. In the Note to paragraph (a)(6), by removing the words ''or mortgage-backed'';

■ i. By adding paragraphs (a)(7) and (8);

■ j. By redesignating paragraph (b) as paragraph (b)(1) and revising it;

■ k. By adding paragraphs (b)(2), (d), and (e).

The additions and revisions read as follows:

§ 240.17g–3 Annual financial and other reports to be filed or furnished by nationally recognized statistical rating organizations.

(a) A nationally recognized statistical rating organization must annually, not more than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO):

* * * * *

(7)(i) File with the Commission an unaudited report containing an assessment by management of the effectiveness during the fiscal year of the internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Act (15 U.S.C. 78o–7(c)(3)(A)) that includes:

(A) A description of the responsibility of management in establishing and maintaining an effective internal control structure;

(B) A description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and

(C) A statement as to whether the internal control structure was effective as of the end of the fiscal year.

(ii) Management is not permitted to conclude that the internal control structure of the nationally recognized statistical rating organization was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.

(iii) For purposes of this paragraph (a)(7), a deficiency in the internal control structure exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect a failure of the nationally recognized statistical rating organization to:

(A) Implement a policy, procedure, or methodology for determining credit ratings in accordance with the policies and procedures of the nationally recognized statistical rating organization; or

(B) Adhere to an implemented policy, procedure, or methodology for determining credit ratings.

(iv) For purposes of this paragraph (a)(7), a material weakness exists if a deficiency, or a combination of deficiencies, in the design or operation of the internal control structure creates a reasonable possibility that a failure identified in paragraph (a)(7)(iii) of this section that is material will not be prevented or detected on a timely basis.

(8) File with the Commission an unaudited annual report on the compliance of the nationally recognized statistical rating organization with the securities laws and the policies and procedures of the nationally recognized statistical rating organization pursuant

to section 15E(j)(5)(B) of the Act (15 U.S.C. 78o–7(j)(5)(B)).

(b)(1) The nationally recognized statistical rating organization must attach to the reports filed or furnished, as applicable, pursuant to paragraphs (a)(1) through (6) of this section a signed statement by a duly authorized person associated with the nationally recognized statistical rating organization stating that the person has responsibility for the reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the financial condition, results of operations, cash flows, revenues, analyst compensation, and credit rating actions of the nationally recognized statistical rating organization for the period presented; and

(2) The nationally recognized statistical rating organization must attach to the report filed pursuant to paragraph (a)(7) of this section a signed statement by the chief executive officer of the nationally recognized statistical rating organization or, if the nationally recognized statistical rating organization does not have a chief executive officer, an individual performing similar functions, stating that the chief executive officer or equivalent individual has responsibility for the report and, to the best knowledge of the chief executive officer or equivalent individual, the report fairly presents, in all material respects: an assessment by management of the effectiveness of the internal control structure during the fiscal year that includes a description of the responsibility of management in establishing and maintaining an effective internal control structure; a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.

* * * * *

(d) *Electronic filing.* The reports must be filed with or furnished to, as applicable, the Commission electronically on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S–T.

(e) *Confidential treatment.* Information in a report filed or furnished, as applicable, on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law. Confidential treatment may be requested by marking each page ''Confidential Treatment Requested'' and by complying with Commission rules governing confidential treatment.

■ 8. Section 240.17g–5 is amended:

■ a. In paragraph (a)(3) introductory text, by removing the words ''or mortgaged-backed'';

■ b. In paragraphs (a)(3)(i), (a)(3)(ii) introductory text, (a)(3)(iii)(A), (a)(3)(iii)(B) introductory text, and (a)(3)(iii)(C) and (D), by removing the words ''Web site'' and in their place adding the word ''website'';

■ c. In paragraphs (a)(3)(i) and (a)(3)(iii)(A), by removing the citation ''(a)(3)(iii)(C) and (a)(3)(iii)(D)'' and in their place adding the words ''(a)(3)(iii)(C) through (E)'';

■ d. By adding paragraph (a)(3)(iii)(E);

■ e. In paragraph (b)(9), by removing the words ''or mortgaged-backed'';

■ f. In paragraph (c)(6), by removing the word ''or'' at the end of the paragraph after the semicolon;

■ g. In paragraph (c)(7), by adding the word ''or'' at the end of the paragraph after the semicolon;

■ f. By adding paragraph (c)(8);

■ h. In paragraph (e) introductory text, by removing the words ''Web site'' and in their place adding the word ''Web site'' and in the undesignated certification paragraph, removing the words ''websites'' and in their place adding the word ''Web sites''; and

■ i. By adding paragraphs (f) and (g).

The additions read as follows:

§ 240.17g–5 Conflicts of interest.

(a) * * *

(3) * * *

(iii) * * *

(E) Post on such password-protected Internet Web site, promptly after receipt, any executed Form ABS Due Diligence–15E (§ 249b.500 of this chapter) containing information about the security or money market instrument delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.

* * * * *

(c) * * *

(8) The nationally recognized statistical rating organization issues or maintains a credit rating where a person within the nationally recognized statistical rating organization who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also:

(i) Participates in sales or marketing of a product or service of the nationally recognized statistical rating organization or a product or service of an affiliate of the nationally recognized statistical rating organization; or

(ii) Is influenced by sales or marketing considerations.

* * * * *

(f) Upon written application by a nationally recognized statistical rating organization, the Commission may exempt, either unconditionally or on specified terms and conditions, such nationally recognized statistical rating organization from the provisions of paragraph (c)(8) of this section if the Commission finds that due to the small size of the nationally recognized statistical rating organization it is not appropriate to require the separation within the nationally recognized statistical rating organization of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.

(g) In a proceeding pursuant to section 15E(d)(1) of the Act (15 U.S.C. 78o–7(d)(1)), the Commission shall suspend or revoke the registration of a nationally recognized statistical rating organization if the Commission finds, in lieu of a finding specified under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F) of the Act (15 U.S.C. 78o–7(d)(1)(A) through (F)), that the nationally recognized statistical rating organization has violated a rule issued under section 15E(h) of the Act (15 U.S.C. 78o–7(h)) and that the violation affected a credit rating.

§ 240.17g–6 [Amended]

■ 9. Section 240.17g–6 is amended in paragraph (a)(4) by removing the words ''or mortgage-backed''.

■ 10. Section 240.17g–7 is revised to read as follows:

§ 240.17g–7 Disclosure requirements.

(a) *Disclosures to be made when taking a rating action.* Except as provided in paragraph (a)(3) of this section, a nationally recognized statistical rating organization must publish the items described in paragraphs (a)(1) and (2) of this section, as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the nationally recognized statistical rating organization is registered. For purposes of this section, the term *rating action* means any of the following: the publication of an expected or preliminary credit rating assigned to an obligor, security, or

money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); and an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the nationally recognized statistical rating organization using applicable procedures and methodologies for determining credit ratings. The items described in paragraphs (a)(1) and (2) of this section must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.

(1) *Information disclosure form.* A form generated by the nationally recognized statistical rating organization that meets the requirements of paragraphs (a)(1)(i) through (iii) of this section.

(i) *Format.* The form generated by the nationally recognized statistical rating organization must be in a format that:

(A) Organizes the information into numbered items that are identified by the type of information being disclosed and a reference to the paragraph in this section that specifies the disclosure of the information, and are in the order that the paragraphs specifying the information to be disclosed are codified in this section;

Note to paragraph (a)(1)(i)(A): A given item in the form should be identified by a title that identifies the type of information and references paragraph (a)(1)(ii)(A), (B), (C), (D), (E), (F), (G), (H), (I), (J), (K), (L), (M), (N), or (a)(2) of this section based on the information being disclosed in the item. For example, the information specified in paragraph (a)(1)(ii)(C) of this section should be identified with the caption ''Main Assumptions and Principles Used to Construct the Rating Methodology used to Determine the Credit Rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g–7''). The form must organize the items of information in the following order: items 1 through 14 must contain the information specified in paragraphs (a)(1)(ii)(A) through (N) of this section, respectively, and item 15 must contain the certifications specified in paragraph (a)(2) of this section (the information specified in each paragraph comprising a separate item). For example, item 3 must contain the information specified in paragraph (a)(1)(ii)(C) of this section.

(B) Is easy to use and helpful for users of credit ratings to understand the information contained in the form; and

(C) Provides the content described in paragraphs (a)(1)(ii)(K) through (M) of this section in a manner that is directly comparable across types of obligors, securities, and money market instruments.

(ii) *Content.* The form generated by the nationally recognized statistical rating organization must contain the following information about the credit rating:

(A) The symbol, number, or score in the rating scale used by the nationally recognized statistical rating organization to denote credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and, as applicable, the identity of the obligor or the identity and a description of the security or money market instrument;

(B) The version of the procedure or methodology used to determine the credit rating;

(C) The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets;

(D) The potential limitations of the credit rating, including the types of risks excluded from the credit rating that the nationally recognized statistical rating organization does not comment on, including, as applicable, liquidity, market, and other risks;

(E) Information on the uncertainty of the credit rating including:

(*1*) Information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and

(*2*) A statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including:

(*i*) Any limits on the scope of historical data; and

(*ii*) Any limits on accessibility to certain documents or other types of information that would have better informed the credit rating;

(F) Whether and to what extent the nationally recognized statistical rating organization used due diligence services of a third party in taking the rating action, and, if the nationally recognized statistical rating organization used such services, either:

(*1*) A description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party; or

(*2*) A cross-reference to a Form ABS Due Diligence–15E executed by the third party that is published with the form, provided the cross-referenced Form ABS Due Diligence–15E (§ 249b.500 of this chapter) contains a description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party;

(G) If applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating;

(H) A description of the types of data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating;

(I) A statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the nationally recognized statistical rating organization in rating similar obligors, securities, or money market instruments;

(J) Information relating to conflicts of interest of the nationally recognized statistical rating organization, which must include:

(*1*) As applicable, a statement that the nationally recognized statistical rating organization was:

(*i*) Paid to determine the credit rating by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated;

(*ii*) Paid to determine the credit rating by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; or

(*iii*) Not paid to determine the credit rating;

(*2*) If applicable, in a statement required under paragraph (a)(1)(ii)(J)(*1*)(*i*) or (*ii*) of this section, a statement that the nationally recognized statistical rating organization also was paid for services other than determining credit ratings during the most recently ended fiscal year by the person that paid the nationally recognized statistical rating organization to determine the credit rating; and

(*3*) If the rating action results from a review conducted pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o–7(h)(4)(A)) and § 240.17g–8(c), the following information (as applicable):

(*i*) If the rating action is a revision of a credit rating pursuant to § 240.17g–8(c)(2)(i)(A), an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, including a description of the nature of the conflict, the date and associated credit rating of each prior rating action that the nationally recognized statistical rating organization has determined was influenced by the conflict, and a description of the impact the conflict had on the prior rating action or actions; or

(*ii*) If the rating action is an affirmation of a credit rating pursuant to § 240.17g–8(c)(2)(i)(B), an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, including a description of the nature of the conflict, an explanation of why no rating action was taken to revise the credit rating notwithstanding the presence of the conflict, the date and associated credit rating of each prior rating action the nationally recognized statistical rating organization has determined was influenced by the conflict, and a description of the impact the conflict had on the prior rating action or actions.

(K) An explanation or measure of the potential volatility of the credit rating, including:

(*1*) Any factors that are reasonably likely to lead to a change in the credit rating; and

(*2*) The magnitude of the change that could occur under different market conditions determined by the nationally recognized statistical rating organization to be relevant to the rating;

(L) Information on the content of the credit rating, including:

(*1*) If applicable, the historical performance of the credit rating; and

(*2*) The expected probability of default and the expected loss in the event of default;

(M) Information on the sensitivity of the credit rating to assumptions made by the nationally recognized statistical rating organization, including:

(*1*) Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if the assumptions were proven false or inaccurate; provided that, if the nationally recognized statistical rating organization has made fewer than five such assumptions, it need only disclose information on the assumptions that would have an impact on the credit rating; and

(*2*) An analysis, using specific examples, of how each of the assumptions identified in paragraph (a)(1)(ii)(M)(*1*) of this section impacts the credit rating;

(N)(*1*) If the credit rating is assigned to an asset-backed security as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)), information on:

(*i*) The representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security; and

(*ii*) How they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities;

(*2*) A nationally recognized statistical rating organization must include the information required under paragraph (a)(1)(ii)(N)(*1*) of this section only if the rating action is a preliminary credit rating, an initial credit rating, or, in the case of a rating action other than a preliminary credit rating or initial credit rating, the rating action is the first rating action taken after a material change in the representations, warranties, or enforcement mechanisms described in paragraph (a)(1)(ii)(N)(*1*) of this section and the rating action involves an asset-backed security that was initially rated by the nationally recognized statistical rating organization on or after September 26, 2011.

(iii) *Attestation.* The nationally recognized statistical rating organization must attach to the form a signed statement by a person within the nationally recognized statistical rating organization stating that the person has responsibility for the rating action and, to the best knowledge of the person:

(A) No part of the credit rating was influenced by any other business activities;

(B) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and

(C) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

(2) *Third-party due diligence certification.* Any executed Form ABS Due Diligence–15E (§ 249b.500 of this chapter) containing information about the security or money market instrument subject to the rating action that is received by the nationally recognized statistical rating organization or obtained by the nationally recognized statistical rating organization through an Internet Web site maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to § 240.17g–5(a)(3).

(3) *Exemption.* The provisions of paragraphs (a)(1) and (a)(2) do not apply to a rating action if:

(i) The rated obligor or issuer of the rated security or money market instrument is not a U.S. person (as defined in § 230.902(k) of this chapter); and

(ii) The nationally recognized statistical rating organization has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument after issuance, only in transactions that occur outside the United States.

(b) *Disclosure of credit rating histories*—(1) *Credit ratings subject to the disclosure requirement.* A nationally recognized statistical rating organization must publicly disclose for free on an easily accessible portion of its corporate Internet Web site:

(i) For a class of credit rating in which the nationally recognized statistical rating organization is registered with the Commission as of the effective date of paragraph (b) of this section, the credit rating assigned to each obligor, security, and money market instrument in the class that was outstanding as of, or initially determined on or after, the date three years prior to the effective date of this rule, and any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), and a withdrawal of the credit rating; and

(ii) For a class of credit rating in which the nationally recognized statistical rating organization is registered with the Commission after the effective date of paragraph (b) of this section, the credit rating assigned to each obligor, security, and money market instrument in the class that was outstanding as of, or initially determined on or after, the date three years prior to the date the nationally recognized statistical rating organization is registered in the class, and any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), and a withdrawal of the credit rating.

(2) *Information.* A nationally recognized statistical rating organization must include, at a minimum, the

following information with each credit rating disclosed pursuant to paragraph (b)(1) of this section:

(i) The identity of the nationally recognized statistical rating organization disclosing the rating action;

(ii) The date of the rating action;

(iii) If the rating action is taken with respect to a credit rating of an obligor as an entity, the following identifying information about the obligor, as applicable:

(A) The Legal Entity Identifier issued by a utility endorsed or otherwise governed by the Global LEI Regulatory Oversight Committee or the Global LEI Foundation (LEI) of the obligor, if available, or, if an LEI is not available, the Central Index Key (CIK) number of the obligor, if available; and

(B) The name of the obligor.

(iv) If the rating action is taken with respect to a credit rating of a security or money market instrument, as applicable:

(A) The LEI of the issuer of the security or money market instrument, if available, or, if an LEI is not available, the CIK number of the issuer of the security or money market instrument, if available;

(B) The name of the issuer of the security or money market instrument; and

(C) The CUSIP of the security or money market instrument;

(v) A classification of the rating action as either:

(A) An addition to the rating history disclosure because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in paragraph (b) of this section or because the credit rating was outstanding as of the date three years prior to the nationally recognized statistical rating organization becoming registered in the class of credit ratings;

(B) An initial credit rating;

(C) An upgrade of an existing credit rating;

(D) A downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable; or

(E) A withdrawal of an existing credit rating and, if the classification is withdrawal, the nationally recognized statistical rating organization also must classify the reason for the withdrawal as either:

(*1*) The obligor defaulted, or the security or money market instrument went into default;

(*2*) The obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or

(*3*) The credit rating was withdrawn for reasons other than those set forth in paragraph (b)(2)(v)(E)(*1*) or (*2*) of this section; and

(vi) The classification of the class or subclass that applies to the credit rating as either:

(A) Financial institutions, brokers, or dealers;

(B) Insurance companies;

(C) Corporate issuers; or

(D) Issuers of structured finance products in one of the following subclasses:

(*1*) Residential mortgage backed securities (''RMBS'') (for purposes of this subclass, RMBS means a securitization primarily of residential mortgages);

(*2*) Commercial mortgage backed securities (''CMBS'') (for purposes of this subclass, CMBS means a securitization primarily of commercial mortgages);

(*3*) Collateralized loan obligations (''CLOs'') (for purposes of this subclass, a CLO means a securitization primarily of commercial loans);

(*4*) Collateralized debt obligations (''CDOs'') (for purposes of this subclass, a CDO means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds);

(*5*) Asset-backed commercial paper conduits (''ABCP'') (for purposes of this subclass, ABCP means short term notes issued by a structure that securitizes a variety of financial assets, such as trade receivables or credit card receivables, which secure the notes);

(*6*) Other asset-backed securities (''other ABS'') (for purposes of this subclass, other ABS means a securitization primarily of auto loans, auto leases, floor plans, credit card receivables, student loans, consumer loans, or equipment leases); or

(*7*) Other structured finance products (''other SFPs'') (for purposes of this subclass, other SFPs means any structured finance product not identified in paragraphs (b)(2)(iv)(D)(*1*) through (*6*)) of this section; or

(E) Issuers of government securities, municipal securities, or securities issued by a foreign government in one of the following subclasses:

(*1*) Sovereign issuers;

(*2*) U.S. public finance; or

(*3*) International public finance; and

(vii) The credit rating symbol, number, or score in the applicable rating scale of the nationally recognized statistical rating organization assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the action, the credit rating symbol, number, or score in the applicable rating scale of the nationally recognized statistical rating organization assigned to the obligor, security, or money market instrument as of the date of the rating action (in either case, include a credit rating in a default category, if applicable).

(3) *Format and frequency of updating.* The information identified in paragraph (b)(2) of this section must be disclosed in an interactive data file that uses an XBRL (eXtensible Business Reporting Language) format and the List of XBRL Tags for nationally recognized statistical rating organizations as published on the Internet Web site of the Commission, and must be updated no less frequently than monthly.

(4) *Timing.* The nationally recognized statistical rating organization must disclose the information required in paragraph (b)(2) of this section:

(i) Within twelve months from the date the rating action is taken, if the credit rating subject to the action was paid for by the obligor being rated or by the issuer, underwriter, depositor, or sponsor of the security being rated; or

(ii) Within twenty-four months from the date the rating action is taken, if the credit rating subject to the action is not a credit rating described in paragraph (b)(4)(i) of this section.

(5) *Removal of a credit rating history.* The nationally recognized statistical rating organization may cease disclosing a rating history of an obligor, security, or money market instrument if at least 15 years have elapsed since a rating action classified as a withdrawal of a credit rating pursuant to paragraph (b)(2)(v)(E) of this section was disclosed in the rating history of the obligor, security, or money market instrument.

11. Section 240.17g–8 is added to read as follows:

§ 240.17g–8 Policies, procedures, and internal controls.

(a) *Policies and procedures with respect to the procedures and methodologies used to determine credit ratings.* A nationally recognized statistical rating organization must establish, maintain, enforce, and document policies and procedures reasonably designed to ensure:

(1) That the procedures and methodologies, including qualitative and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.

(2) That the procedures and methodologies, including qualitative

and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit ratings are developed and modified in accordance with the policies and procedures of the nationally recognized statistical rating organization.

(3) That material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit ratings are:

(i) Applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply; and

(ii) To the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.

(4) That the nationally recognized statistical rating organization promptly publishes on an easily accessible portion of its corporate Internet Web site:

(i) Material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the nationally recognized statistical rating organization uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings; and

(ii) Notice of the existence of a significant error identified in a procedure or methodology, including a qualitative or quantitative model, the nationally recognized statistical rating organization uses to determine credit ratings that may result in a change to current credit ratings.

(5) That the nationally recognized statistical rating organization discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.

(b) *Policies and procedures with respect to credit rating symbols, numbers, or scores.* A nationally recognized statistical rating organization must establish, maintain, enforce, and document policies and procedures that are reasonably designed to:

(1) Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.

(2) Clearly define each symbol, number, or score in the rating scale used by the nationally recognized statistical rating organization to denote a credit rating category and notches within a category for each class of credit ratings for which the nationally recognized statistical rating organization is registered (including subclasses within each class) and to include such definitions in Exhibit 1 to Form NRSRO (§ 249b.300 of this chapter).

(3) Apply any symbol, number, or score defined pursuant to paragraph (b)(2) of this section in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.

(c) *Policies and procedures with respect to look-back reviews.* The policies and procedures a nationally recognized statistical rating organization is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o–7(h)(4)(A)) must address instances in which a review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or money market instrument by including, at a minimum, procedures that are reasonably designed to ensure that the nationally recognized statistical rating organization will:

(1) Promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the nationally recognized statistical rating organization uses to determine credit ratings; and

(2)(i) Promptly publish, based on the determination of whether a current credit rating referred to in paragraph (c)(1) of this section must be revised (as applicable):

(A) A revised credit rating, if appropriate, and include with the publication of the revised credit rating the information required by § 240.17g–7(a)(1)(ii)(J)(*3*)(*i*); or

(B) An affirmation of the credit rating, if appropriate, and include with the publication of the affirmation the information required by § 240.17g–7(a)(1)(ii)(J)(*3*)(*ii*).

(ii) If the credit rating is not revised or affirmed pursuant to paragraph (c)(2)(i) of this section within fifteen calendar days of the date of the discovery that the credit rating was influenced by a conflict of interest, publish a rating action placing the credit rating on watch or review and include with the publication an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest.

(d) *Internal control structures.* A nationally recognized statistical rating organization must take into consideration the factors identified in paragraphs (d)(1) through (4) of this section when establishing, maintaining, enforcing, and documenting an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Act.

(1) With respect to establishing the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) Controls reasonably designed to ensure that a newly developed methodology or proposed update to an in-use methodology for determining credit ratings is subject to an appropriate review process (for example, by persons who are independent from the persons that developed the methodology or methodology update) and to management approval prior to the new or updated methodology being employed by the nationally recognized statistical rating organization to determine credit ratings;

(ii) Controls reasonably designed to ensure that a newly developed methodology or update to an in-use methodology for determining credit ratings is disclosed to the public for consultation prior to the new or updated methodology being employed by the nationally recognized statistical rating organization to determine credit ratings, that the nationally recognized statistical rating organization makes comments received as part of the consultation publicly available, and that the nationally recognized statistical rating organization considers the comments before implementing the methodology;

(iii) Controls reasonably designed to ensure that in-use methodologies for determining credit ratings are periodically reviewed (for example, by persons who are independent from the persons who developed and/or use the methodology) in order to analyze whether the methodology should be updated;

(iv) Controls reasonably designed to ensure that market participants have an opportunity to provide comment on whether in-use methodologies for

determining credit ratings should be updated, that the nationally recognized statistical rating organization makes any such comments received publicly available, and that the nationally recognized statistical rating organization considers the comments;

(v) Controls reasonably designed to ensure that newly developed or updated quantitative models proposed to be incorporated into a credit rating methodology are evaluated and validated prior to being put into use;

(vi) Controls reasonably designed to ensure that quantitative models incorporated into in-use credit rating methodologies are periodically reviewed and back-tested;

(vii) Controls reasonably designed to ensure that a nationally recognized statistical rating organization engages in analysis before commencing the rating of a class of obligors, securities, or money market instruments the nationally recognized statistical rating organization has not previously rated to determine whether the nationally recognized statistical rating organization has sufficient competency, access to necessary information, and resources to rate the type of obligor, security, or money market instrument;

(viii) Controls reasonably designed to ensure that a nationally recognized statistical rating organization engages in analysis before commencing the rating of an ''exotic'' or ''bespoke'' type of obligor, security, or money market instrument to review the feasibility of determining a credit rating;

(ix) Controls reasonably designed to ensure that measures (for example, statistics) are used to evaluate the performance of credit ratings as part of the review of in-use methodologies for determining credit ratings to analyze whether the methodologies should be updated or the work of the analysts employing the methodologies should be reviewed;

(x) Controls reasonably designed to ensure that, with respect to determining credit ratings, the work and conclusions of the lead credit analyst developing an initial credit rating or conducting surveillance on an existing credit rating is reviewed by other analysts, supervisors, or senior managers before a rating action is formally taken (for example, having the work reviewed through a rating committee process);

(xi) Controls reasonably designed to ensure that a credit analyst documents the steps taken in developing an initial credit rating or conducting surveillance on an existing credit rating with sufficient detail to permit an after-the-fact review or internal audit of the rating file to analyze whether the analyst adhered to the nationally recognized statistical rating organization's procedures and methodologies for determining credit ratings;

(xii) Controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews or internal audits of rating files to analyze whether analysts adhere to the nationally recognized statistical rating organization's procedures and methodologies for determining credit ratings; and

(xiii) Any other controls necessary to establish an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(2) With respect to maintaining the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) Controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews of whether it has devoted sufficient resources to implement and operate the documented internal control structure as designed;

(ii) Controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews or ongoing monitoring to evaluate the effectiveness of the internal control structure and whether it should be updated;

(iii) Controls reasonably designed to ensure that any identified deficiencies in the internal control structure are assessed and addressed on a timely basis;

(iv) Any other controls necessary to maintain an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(3) With respect to enforcing the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) Controls designed to ensure that additional training is provided or discipline taken with respect to employees who fail to adhere to requirements imposed by the internal control structure;

(ii) Controls designed to ensure that a process is in place for employees to report failures to adhere to the internal control structure; and

(iii) Any other controls necessary to enforce an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(4) With respect to documenting the internal control structure, the nationally recognized statistical rating organization must take into consideration any controls necessary to document an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

■ 12. Section 240.17g–9 is added to read as follows:

§ 240.17g–9 Standards of training, experience, and competence for credit analysts.

(a) A nationally recognized statistical rating organization must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the nationally recognized statistical rating organization produces accurate credit ratings in the classes of credit ratings for which the nationally recognized statistical rating organization is registered.

(b) The nationally recognized statistical rating organization must consider the following when establishing the standards required under paragraph (a) of this section:

(1) If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated;

(2) If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies;

(3) The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses; and

(4) The complexity of the obligors, securities, or money market instruments

for which the individual participates in determining credit ratings.

(c) The nationally recognized statistical rating organization must include the following in the standards required under paragraph (a) of this section:

(1) A requirement for periodic testing of the individuals employed by the nationally recognized statistical rating organization to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings; and

(2) A requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating.

■ 13. Section 240.17g–10 is added to read as follows:

§ 240.17g–10 Certification of providers of third-party due diligence services in connection with asset-backed securities.

(a) The written certification that a person employed to provide third-party due diligence services is required to provide to a nationally recognized statistical rating organization pursuant to section 15E(s)(4)(B) of the Act (15 U.S.C. 78o–7(s)(4)(B)) must be on Form ABS Due Diligence–15E (§ 249b.500 of this chapter).

(b) The written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.

(c) A person employed to provide third-party due diligence services will be deemed to have satisfied its obligations under section 15E(s)(4)(B) of the Act (15 U.S.C. 78o–7(s)(4)(B)) if the person promptly delivers an executed Form ABS Due Diligence–15E (§ 249b.500 of this chapter) after completion of the due diligence services to:

(1) A nationally recognized statistical rating organization that provided a written request for the Form prior to the completion of the due diligence services stating that the services relate to a credit rating the nationally recognized statistical rating organization is producing;

(2) A nationally recognized statistical rating organization that provides a written request for the Form after the completion of the due diligence services stating that the services relate to a credit rating the nationally recognized statistical rating organization is producing; and

(3) The issuer or underwriter of the asset-backed security for which the due diligence services relate that maintains the Internet Web site with respect to the asset-backed security pursuant to § 240.17g–5(a)(3).

(d) For purposes of section 15E(s)(4)(B) of the Act (15 U.S.C. 78o–7(s)(4)(B)) and this section:

(1) The term *due diligence services* means a review of the assets underlying an asset-backed security, as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)) for the purpose of making findings with respect to:

(i) The accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets;

(ii) Whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements;

(iii) The value of collateral securing the assets;

(iv) Whether the originator of the assets complied with federal, state, or local laws or regulations; or

(v) Any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the asset-backed security will pay interest and principal in accordance with applicable terms and conditions.

(2) The term *issuer* includes a sponsor, as defined in § 229.1101 of this chapter, or depositor, as defined in § 229.1101 of this chapter, that participates in the issuance of an asset-backed security, as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)).

(3) The term *originator* has the same meaning as in section 15G(a)(4) of the Act (15 U.S.C. 78o–9(a)(4)).

(4) The term *securitizer* has the same meaning as in section 15G(a)(3) of the Act (15 U.S.C. 78o–9(a)(3)).

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 14. The authority citation for part 249 continues to read as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

■ 15. Subpart O and Form ABS–15G (referenced in § 249.1400) to Part 249 are revised to read as follows:

Note: The text of Form ABS–15G does not, and this amendment will not, appear in the Code of Federal Regulations.

Subpart O—Forms for Securitizers of Asset-Backed Securities

§ 249.1400 Form ABS–15G, Asset-backed securitizer report pursuant to Section 15G of the Securities Exchange Act of 1934.

This form shall be used for reports of information required by Rule 15Ga–1 (§ 240.15Ga–1 of this chapter) and Rule 15Ga–2 (§ 240.15Ga–2 of this chapter).

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS-15G

ASSET-BACKED SECURITIZER
REPORT PURSUANT TO SECTION 15G OF
THE SECURITIES EXCHANGE ACT OF 1934

Check the appropriate box to indicate the filing obligation which this form is intended to satisfy:

____ Rule 15Ga-1 under the Exchange Act (17 CFR 240.15Ga-1) for the reporting period _____ to _____

Date of Report (Date of earliest event reported)_____

Commission File Number of securitizer: _____

Central Index Key Number of securitizer: _____

_____
Name and telephone number, including area code, of the person to contact in connection with this filing

Indicate by check mark whether the securitizer has no activity to report for the initial period pursuant to Rule 15Ga-1(c)(1) [ ]

Indicate by check mark whether the securitizer has no activity to report for the quarterly period pursuant to Rule 15Ga-1(c)(2)(i) [ ]

Indicate by check mark whether the securitizer has no activity to report for the annual period pursuant to Rule 15Ga-1(c)(2)(ii) [ ]

____ Rule 15Ga-2 under the Exchange Act (17 CFR 240.15Ga-2)

Central Index Key Number of depositor: _____

_____
(Exact name of issuing entity as specified in its charter)

Central Index Key Number of issuing entity (if applicable): _____

Central Index Key Number of underwriter (if applicable): _____

_____
Name and telephone number, including area code, of the person to contact in connection with this filing

GENERAL INSTRUCTIONS

A. Rule as to Use of Form ABS-15G.

This form shall be used to comply with the requirements of Rule 15Ga-1 (17 CFR 240.15Ga-1) and Rule 15Ga-2 (17 CFR 240.15Ga-2) under the Exchange Act.

B. Events to be Reported and Time for Filing of Reports.

Forms filed under Rule 15Ga-1. In accordance with Rule 15Ga-1, file the information required by Part I in accordance with Item 1.01, Item 1.02, or Item 1.03, as applicable. If the filing deadline for the information occurs on a Saturday, Sunday, or holiday on which the Commission is not open for business, then the filing deadline shall be the first business day thereafter.

Forms furnished under Rule 15Ga-2. In accordance with Rule 15Ga-2, furnish the information required by Part II no later than five business days prior to the first sale of securities in the offering.

C. Preparation of Report.

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report on paper meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

D. Signature an d Filing of Report.

1. Forms filed under Rule 15Ga-1. Any form filed for the purpose of meeting the requirements in Rule 15Ga-1 must be signed by the senior officer in charge of securitization of the securitizer.
2. Forms furnished under Rule 15Ga-2. Any form furnished for the purpose of meeting the requirements in Rule 15Ga-2 must be signed by a senior officer in charge of securitization of the depositor if information required by Item 2.01 is required to be provided and must be signed by a duly authorized officer of the underwriter if information required by Item 2.02 is required to be provided.
3. Copies of report. If paper filing is permitted, three complete copies of the report shall be filed with, or furnished to, the Commission, as applicable.

INFORMATION TO BE INCLUDED IN THE REPORT

PART I: REPRESENTATION AND WARRANTY INFORMATION

Item 1.01 Initial Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) according to the filing requirements of Rule 15Ga-1(c)(1).

Item 1.02 Periodic Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) according to the filing requirements of Rule 15Ga-1(c)(2).

Item 1.03 Notice of Termination of Duty to File Reports under Rule 15Ga-1

If a securitizer terminates its reporting obligation pursuant to Rule 15Ga-1(c)(3), provide the date of the last payment on the last asset-backed security outstanding that was issued by or issued by an affiliate of the securitizer.

PART II – FINDINGS AND CONCLUSIONS OF THIRD-PARTY DUE DILIGENCE REPORTS

Item 2.01 Findings and Conclusions of a Third Party Due Diligence Report Obtained by the Issuer

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party due diligence report obtained by the issuer.

Item 2.02 Findings and Conclusions of a Third-Party Due Diligence Report Obtained by the Underwriter

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party due diligence report obtained by the underwriter.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the reporting entity has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

_____ (Securitizer, Depositor or Underwriter)

Date _____

_____ (Signature)*

*Print name and title of the signing officer under his or her signature.

PART 249b—FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934

16. The authority citation for part 249b continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., unless otherwise noted;

* * * * *

17. Form (referenced in § 249b.300) is amended to read as follows:

Note: The text of Form NRSRO does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM NRSRO

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

SEC 1541 (4-09)

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

☐ INITIAL APPLICATION

☐ APPLICATION TO ADD CLASS OF CREDIT RATINGS

☐ APPLICATION SUPPLEMENT
Items and/or Exhibits Supplemented:

_____

☐ ANNUAL CERTIFICATION

☐ UPDATE OF REGISTRATION
Items and/or Exhibits Amended:

_____

☐ WITHDRAWAL FROM REGISTRATION

Important: Refer to Form NRSRO Instructions for General Instructions, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO). "You" and "your" mean the person filing or furnishing, as applicable, this Form NRSRO. "Applicant" and "NRSRO" mean the person filing or furnishing, as applicable, this Form NRSRO and any credit rating affiliate identified in Item 3.

1. **A.** Your full name:

_____

B. (i) Name under which your credit rating business is primarily conducted, if different from Item 1A:

_____

(ii) Any other name under which your credit rating business is conducted and where it is used (other than the name of a credit rating affiliate identified in Item 3):

_____

C. Address of your principal office (do not use a P.O. Box):

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (See Instructions):

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form NRSRO on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including Exhibits and attachments, all of which are part of this Form, are accurate in all significant respects. If

this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate in all significant respects.

_____ _____
(Date) (Name of the Applicant/NRSRO)

By: _____
(Signature) (Print Name and Title)

2. **A**. Your legal status:

☐ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) _____

B. Month and day of your fiscal year end: _____

C. Place and date of your formation (i.e., state or country where you were incorporated, where your partnership agreement was filed, or where you otherwise were formed):

State/Country of formation: _____ Date of formation: _____

3. Your credit rating affiliates (See Instructions):

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

4. The designated compliance officer of the Applicant/NRSRO (See Instructions):

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail how this Form NRSRO and Exhibits 1 through 9 to this Form NRSRO will be made publicly and freely available on an easily accessible portion of the corporate Internet website of the Applicant/NRSRO (See Instructions):

_____

_____

_____

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION, APPLICATION SUPPLEMENT, OR APPLICATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. For each class, indicate the approximate number of obligors, securities, and money market instruments in that class as of the date of this application for which the Applicant/NRSRO has an outstanding credit rating and the approximate date the Applicant/NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit ratings	Applying for registration	Approximate number currently outstanding	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

_____

C. Check the applicable box and attach certifications from qualified institutional buyers, if required (See Instructions):

☐ The Applicant/NRSRO is attaching _____ certifications from qualified institutional buyers to this application. Each is marked "Certification from Qualified Institutional Buyer."

☐ The Applicant/NRSRO is exempt from the requirement to file certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: You are not required to make a Certification from a Qualified Institutional Buyer filed with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the certifications confidential upon request to the extent permitted by law.

7. DO NOT COMPLETE ITEM 7 IF THIS IS AN INITIAL APPLICATION.

A. Indicate below the classes of credit ratings for which the NRSRO is currently registered. For each class, indicate the approximate number of obligors, securities, and money market instruments in that class for which the NRSRO had an outstanding credit rating as of the most recent calendar year end and the approximate date the NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit rating	Currently registered	Approximate number outstanding as of the most recent calendar year end	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

_____

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and submit the Disclosure Reporting Page with this Form NRSRO (See Instructions). You are not required to make any disclosure reporting pages submitted with this Form publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.	

	YES	NO
A. Has the Applicant/NRSRO or any person within the Applicant/NRSRO committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934 in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the Applicant/NRSRO or any person within the Applicant/NRSRO been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
C. Is any person within the Applicant/NRSRO subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐	☐

9. Exhibits (See Instructions).

Exhibit 1. Credit ratings performance measurement statistics. ☐ Exhibit 1 is attached and made a part of this Form NRSRO.
Exhibit 2. A description of the procedures and methodologies used in determining credit ratings. ☐ Exhibit 2 is attached and made a part of Form NRSRO.
Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information. ☐ Exhibit 3 is attached and made a part of this Form NRSRO.
Exhibit 4. Organizational structure. ☐ Exhibit 4 is attached to and made a part of this Form NRSRO.
Exhibit 5. The code of ethics or a statement of the reasons why a code of ethics is not in effect. ☐ Exhibit 5 is attached to and made a part of this Form NRSRO.
Exhibit 6. Identification of conflicts of interests relating to the issuance of credit ratings. ☐ Exhibit 6 is attached to and made a part of this Form NRSRO.
Exhibit 7. Policies and procedures to address and manage conflicts of interest. ☐ Exhibit 7 is attached to and made a part of this Form NRSRO.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached to and made a part of this Form NRSRO.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer.

☐ Exhibit 9 is attached to and made a part of this Form NRSRO.

Exhibit 10. A list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application.

☐ Exhibit 10 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application.

☐ Exhibit 11 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application.

☐ Exhibit 12 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

FORM NRSRO INSTRUCTIONS

A. GENERAL INSTRUCTIONS.

1. Form NRSRO is the Application for Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO") under Section 15E of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 17g-1. Exchange Act Rule 17g-1 requires an Applicant/NRSRO to use Form NRSRO to:

   - File an initial application to be registered as an NRSRO with the U.S. Securities and Exchange Commission ("Commission");
   - File an application to register for an additional class of credit ratings with the Commission;
   - File an application supplement with the Commission;
   - File an update of registration pursuant to Section 15E(b)(1) of the Exchange Act with the Commission;
   - File an annual certification pursuant to Section 15E(b)(2) of the Exchange Act with the Commission; and
   - Furnish a withdrawal of registration pursuant to Section 15E(e) of the Exchange Act to the Commission.

2. Exchange Act Rule 17g-1(c) requires that an Applicant/NRSRO promptly file with the Commission a written notice if information filed with the Commission in an initial application for registration or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must identify the information found to be materially inaccurate. The Applicant/NRSRO must also promptly file with the Commission accurate and complete information as an application supplement on Form NRSRO.

3. Pursuant to Exchange Act Rule 17g-1(i), an NRSRO must make its current Form NRSRO and information and documents filed in Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet website within 10 business days after the date of the Commission Order granting an initial application for registration as an

NRSRO or an application to register for an additional class of credit ratings and within 10 business days after filing with or furnishing to, as applicable, the Commission an update of registration, annual certification, or withdrawal from registration on Form NRSRO.

The certifications from qualified institutional buyers, disclosure reporting pages, and Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Rule 17g-1(i). An Applicant/NRSRO may request that the Commission keep confidential the certifications from qualified institutional buyers, the disclosure reporting pages, and the information and documents in Exhibits 10 – 13 filed with the Commission. An Applicant/NRSRO seeking confidential treatment for these submissions should mark each page "Confidential Treatment" and comply with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep this information confidential to the extent permitted by law.

4. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny an initial application for registration as an NRSRO. These time periods also apply to an application to register for an additional class of credit ratings.

5. Type or clearly print all information. Use only the current version of Form NRSRO or a reproduction of it.

6. Section 15E of the Exchange Act (15 U.S.C. 78o-7) authorizes the Commission to collect the Information on Form NRSRO from an Applicant/NRSRO. The principal purposes of Form NRSRO are to determine whether an Applicant should be granted registration as an NRSRO, whether an NRSRO should be granted registration in an additional class of credit ratings, whether an NRSRO continues to meet the criteria for registration as an NRSRO, for an NRSRO to withdraw from registration, and to provide information about an NRSRO to users of credit ratings. Intentional misstatements or omissions may constitute federal criminal violations under 18 U.S.C. 1001.

The information collection is in accordance with the clearance requirements of Section 3507 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). The Commission may not conduct or sponsor, and you are not required to respond to, a collection of information unless it displays a

valid Office of Management and Budget (OMB) control number. The time required to complete and file or furnish, as applicable, this form, will vary depending on individual circumstances. The estimated average time to complete an initial application is displayed on the facing page of this Form. Send comments regarding this burden estimate or suggestions for reducing the burden to Chief Information Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549 or PRA Mailbox@sec.gov.

7. Under Exchange Act Rule 17g-2(b)(10), an NRSRO must retain copies of all Forms NRSRO (including Exhibits, accompanying information, and documents) filed with or furnished to, as applicable, the Commission. Exchange Act Rule 17g-2(c) requires that these records be retained for three years after the date the record is made.

8. An Applicant must file with the Commission at the address indicated below two paper copies of an initial application for registration as an NRSRO under Exchange Act Rule 17g-1(a), an application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(b), a supplement to an initial application or application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(c), or a withdrawal of an initial application or an application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(d).

ADDRESS - The mailing address for Form NRSRO is:

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

After registration, an NRSRO must file with or furnish to, as applicable, the Commission electronically on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T, an update of registration under Exchange Act Rule 17g-1(e), an annual certification under Exchange Act Rule 17g-1(f), or a withdrawal from registration under Exchange Act Rule 17g-1(g).

9. A Form NRSRO will be considered filed with or furnished to, as applicable, the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows

all applicable instructions for the Form, including the instructions in Item A.8 with respect to how a Form NRSRO must be filed with or furnished to the Commission.

10. An NRSRO is subject to applicable fines, penalties, and other available sanctions set forth in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act (15 U.S.C. 78o-7, 78u, 78u-1, 78u-2, 78u-3, and 78ff, respectively) for violations of the securities laws.

B. INSTRUCTIONS FOR AN INITIAL APPLICATION

An Applicant applying to be registered with the Commission as an NRSRO must file with the Commission an initial application on Form NRSRO. To complete an initial application:

- Check the "INITIAL APPLICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, and 8. (See Instructions below for each Item). Enter "None" or "N/A" where appropriate.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers, marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- Attach Exhibits 1 through 13 (See Instructions below for each Exhibit).
- Execute the Form.

The Applicant must promptly file with the Commission a written notice if information submitted to the Commission in an initial application is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly file with the Commission an application supplement on Form NRSRO (See instructions below for an application supplement).

C. INSTRUCTIONS FOR AN APPLICATION TO ADD A CLASS OF CREDIT RATINGS

An NRSRO applying to register for an additional class of credit ratings must file with the Commission an application on Form NRSRO. To complete an application to register for an additional class of credit ratings:

- Check the "APPLICATION TO ADD CLASS OF CREDIT RATINGS" box at the top of Form NRSRO.

- Complete Items 1, 2, 3, 4, 5, 6, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on a previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers for the additional class of credit ratings marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- If any information in an Exhibit previously submitted is materially inaccurate, update that information.
- Execute the Form.

The Applicant must promptly file with the Commission a written notice if information submitted to the Commission in an application to add a class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly file with the Commission an application supplement on Form NRSRO (See instructions below for an application supplement).

D. INSTRUCTIONS FOR AN APPLICATION SUPPLEMENT

An Applicant must file an application supplement with the Commission on Form NRSRO if information submitted to the Commission in a pending initial application for registration as an NRSRO or a pending application to register for an additional class of credit ratings is found to be or becomes materially inaccurate. To complete an application supplement:

- Check the "APPLICATION SUPPLEMENT" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being supplemented.
- Complete Items 1, 2, 3, 4, 5 and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If supplementing an initial application, also complete Item 6. If supplementing an application for registration in an additional class of credit ratings, also complete Items 6 and 7. If any information in an Item on a

previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.

- If a certification from a qualified institutional buyer is being updated or a new certification is being added, attach the updated or new certification.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

E. INSTRUCTIONS FOR AN UPDATE OF REGISTRATION

After registration is granted, section 15E(b)(1) of the Exchange Act requires that an NRSRO must promptly amend its application for registration if information or documents provided in a previously submitted Form NRSRO become materially inaccurate. This requirement does not apply to Item 7 and Exhibit 1, which only are required to be updated annually with the annual certification. It also does not apply to Exhibits 10 – 13 and the certifications from qualified institutional buyers, which are not required to be updated on Form NRSRO after registration. An NRSRO amending its application for registration must file with the Commission an update of its registration on Form NRSRO. To complete an update of registration:

- Check the "UPDATE OF REGISTRATION" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being updated.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on a previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

F. INSTRUCTIONS FOR ANNUAL CERTIFICATIONS

After registration is granted, section 15E(b)(2) of the Exchange Act requires that an NRSRO file with the Commission an annual certification not later than 90 days after the end of each calendar

year. The annual certification must be filed with the Commission on Form NRSRO and must include an update of the information in Item 7 and the credit rating transition and default rates submitted in Exhibit 1, a certification that the information and documents on or with Form NRSRO continue to be accurate (use the certification on the Form), and a list of material changes to the application for registration that occurred during the previous calendar year. To complete an annual certification:

- Check the "ANNUAL CERTIFICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If any information in a non-confidential Exhibit previously submitted is materially inaccurate, update that information. (Note: After registration, Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Exchange Act Rule 17g-1(i) and they should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year under Exchange Act Rule 17g-3.).
- Attach a list of all material changes made to the information or documents in the application for registration of the NRSRO that occurred during the previous calendar year.
- Execute the Form.

G. INSTRUCTIONS FOR A WITHDRAWAL FROM REGISTRATION

Section 15E(e)(1) of the Exchange Act provides that an NRSRO may voluntarily withdraw its registration with the Commission. Under Exchange Act Rule, 17g-1(g), to withdraw from registration, an NRSRO must furnish the Commission with a notice of withdrawal from registration on Form NRSRO. The withdrawal from registration will become effective 45 calendar days after the withdrawal from registration is furnished to the Commission upon such terms and conditions

as the Commission may establish as necessary in the public interest or for the protection of investors. To complete a withdrawal from registration:

- Check the "WITHDRAWAL FROM REGISTRATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information on a previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- Execute the Form.

H. INSTRUCTIONS FOR SPECIFIC LINE ITEMS

Item 1A. Provide the name of the person (e.g., XYZ Corporation) that is filing or furnishing, as applicable, the Form NRSRO. This means the name of the person that is applying for registration as an NRSRO or is registered as an NRSRO and not the name of the individual that is executing the Form.

Item 1E. The individual listed as the contact person must be authorized to receive all communications and papers from the Commission and must be responsible for their dissemination within the Applicant/NRSRO.

Certification. The certification must be executed by the Chief Executive Officer or the President of the person that is filing or furnishing, as applicable, the Form NRSRO or an individual with similar responsibilities.

Item 3. Identify credit rating affiliates that issue credit ratings on behalf of the person filing or furnishing, as applicable, the Form NRSRO in one or more of the classes of credit ratings identified in Item 6 or Item 7. A "credit rating affiliate" is a separate legal entity or a separately identifiable department or division thereof that determines credit ratings that are credit ratings of the person filing or furnishing, as applicable, the Form NRSRO. The information in Items 4 – 8 and all the Exhibits must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, personnel, and organizational structure of each credit rating affiliate identified in Item 3, as applicable. Any credit rating determined by a credit rating affiliate identified in Item 3 will be treated as a credit rating issued by the person filing or furnishing, as applicable, the Form NRSRO for purposes of section 15E of the Exchange Act and the Commission's rules thereunder. The terms "Applicant" and

"NRSRO" as used on Form NRSRO and the Instructions for the Form mean the person filing or furnishing, as applicable, the Form NRSRO and any credit rating affiliate identified in Item 3.

Item 4. Section 15E(j)(1) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the NRSRO established pursuant to sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations.

Item 5. Section 15E(a)(3) of the Exchange Act and Exchange Act Rule 17g-1(i) require an NRSRO to make Form NRSRO and Exhibits 1 – 9 to Form NRSRO filed with the Commission publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website within 10 business days after the date of the Commission order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after filing with or furnishing to, as applicable, the Commission an amendment, annual certification, or withdrawal from registration on Form NRSRO. The certifications from qualified institutional investors, Disclosure Reporting Pages, and Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's corporate Internet website. Describe how the current Form NRSRO and Exhibits 1 – 9 will be made publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website by providing the Internet address and link to the Form and Exhibits.

Item 6. Complete Item 6 only if filing an initial application for registration, an application to be registered in an additional class of credit ratings, or an application supplement.

Item 6A. Pursuant to section 15E(a)(1)(B)(vii) of the Exchange Act, an Applicant applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. Indicate these classes by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments in that class for which the Applicant/NRSRO presently has a credit rating outstanding as of the date of the application. In determining this amount, the Applicant/NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other

unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer. The Applicant/NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating. An Applicant/NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction. For each class of credit ratings, also provide in the appropriate box the approximate date the Applicant/NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in section 3(a)(61) of the Exchange Act. If there was a period when the Applicant/NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the Applicant/NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency" in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the Applicant/NRSRO began operating as a "credit rating agency."

Item 6B. To meet the definition of "credit rating agency" pursuant to section 3(a)(61)(A) of the Exchange Act, the Applicant must, among other things, issue "credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee." Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the Applicant/NRSRO, provide a fee schedule or describe the price(s) charged.

Item 6C. If the Applicant/NRSRO is required to file qualified institutional buyer certifications under section 15E(a)(1)(C) of the Exchange Act file a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the Applicant/NRSRO. Each certification may address more than one class of credit ratings. To be registered as an NRSRO for a class of credit ratings identified in Item 6A under "Applying for Registration," the Applicant/NRSRO must file at least two certifications that address the class of credit ratings. If this is an application of an NRSRO to be registered in one or more additional classes of credit ratings, file at least two certifications that address each additional class of credit ratings.

The required certifications must be signed by a person duly authorized by the certifying entity, must be notarized, must be marked "Certification from Qualified Institutional Buyer," and must be in substantially the following form:

"I, [Executing official], am authorized by [Certifying entity] to execute this certification on behalf of [Certifying entity]. I certify that all actions by stockholders, directors, general partners, and other bodies necessary to authorize me to execute this certification have been taken and that [Certifying entity]:

(i) Meets the definition of a 'qualified institutional buyer' as set forth in section 3(a)(64) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(64)) pursuant to the following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];

(ii) Has seriously considered the credit ratings of [the Applicant/NRSRO] in the course of making some of its investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings: [Insert applicable classes of credit ratings]; and

(iii) Has not received compensation either directly or indirectly from [the Applicant/NRSRO] for executing this certification.

[Signature]

Print Name and Title"

You are not required to make a Certification from a Qualified Institutional Buyer filed with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the certifications confidential upon request to the extent permitted by law.

Item 7. An Applicant filing Form NRSRO to apply for registration as an NRSRO should not complete Item 7. An NRSRO filing or furnishing, as applicable, Form NRSRO for any other reason must complete Item 7. The information in Item 7 must be updated on an annual basis with the filing of the annual certification.

Item 7A. Indicate the classes of credit ratings for which the NRSRO is currently registered by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments in that class for which the NRSRO had a credit rating outstanding as of the end of the most recently ended calendar year. In determining this amount, NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer. The NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating. An NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction. For each class of credit ratings, also provide in the appropriate box the approximate date the NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in section 3(a)(61) of the Exchange Act. If there was a period when the NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency" in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the NRSRO began operating as a "credit rating agency."

Item 7B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the NRSRO, provide a fee schedule or describe the price(s) charged.

Item 8. Answer each question by checking the appropriate box. Refer to the definition of "person within an Applicant/NRSRO" set forth below to determine the persons to which the questions apply. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and filed with Form NRSRO. Submit a separate Disclosure Reporting Page (NRSRO) for each person that:

(a) has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions. Note: the definition of "person within an Applicant/NRSRO" is narrower than the definition of "person associated with a nationally recognized statistical rating organization" in Section 3(a)(63) of the Exchange Act. You are not required to make any disclosure reporting pages submitted with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires a credit rating agency's application for registration as an NRSRO to contain certain specific information and documents and, pursuant to section 15E(a)(1)(B)(x), any other information and documents concerning the applicant and any person associated with the applicant that the Commission requires as necessary or appropriate in the public interest or for the protection of investors. If any information or document required to be included with any Exhibit is maintained in a language other than English, file a copy of the original document and a version of the document translated into English. Attach a certification by an authorized person that the translated version is a true, accurate, and complete English translation of the information or document. Attach the Exhibits to Form NRSRO in numerical order. Bind each Exhibit separately, and mark each Exhibit or bound volume of the Exhibit with the appropriate Exhibit number. The information in the Exhibits must be sufficiently detailed to allow for verification. The information and documents in Exhibits 1 through 9 must

be made publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website pursuant to Exchange Act Rule 17g-1(i). The information and documents in Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's corporate Internet website pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep these Exhibits confidential by marking each page of them "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in these Exhibits confidential upon request to the extent permitted by law. (Note: After registration, Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Exchange Act Rule 17g-1(i) and they should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3.)

Exhibit 1. (1) An Applicant/NRSRO must provide in this Exhibit performance measurement statistics consisting of transition and default rates for each class (and applicable subclass of credit ratings as listed below) for which it is seeking registration as an NRSRO or for which it is registered as an NRSRO. For each applicable class and subclass of credit ratings, an Applicant/NRSRO must provide transition and default rates for 1-year, 3-year, and 10-year time periods through the most recent calendar year end. The transition and default rates for each time period must be presented together in tabular form ("Transition/Default Matrix"). The Transition/Default Matrices must be presented on a calendar year basis even if the Applicant/NRSRO has a fiscal year end other than December 31. Exhibit 1 must be updated annually with the filing of the NRSRO's Annual Certification pursuant to Exchange Act Rule 17g-1(f). Pursuant to Exchange Act Rule 17g-1(i), an NRSRO must make the Annual Certification publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website within 10 business days after the filing and must make its most recently filed Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit. The classes and subclasses of credit ratings for which an Applicant/NRSRO must provide Transition/Default Matrices are (as applicable):

(A) The class of credit ratings described in section 3(a)(62)(B)(i) of the Exchange Act (financial institutions, brokers, or dealers).

(B) The class of credit ratings described in section 3(a)(62)(B)(ii) of the Exchange Act (insurance companies);

(C) The class of credit ratings described in section 3(a)(62)(B)(iii) of the Exchange Act (corporate issuers);

(D) The following subclasses of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) and, to the extent not described in section 3(a)(62)(B)(iv), any security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction:

(i) Residential mortgage backed securities ("RMBS") (for the purposes of Exhibit 1, RMBS means a securitization primarily of residential mortgages);

(ii) Commercial mortgage backed securities ("CMBS") (for the purposes of Exhibit 1, CMBS means a securitization primarily of commercial mortgages);

(iii) Collateralized loan obligations ("CLOs") (for the purposes of Exhibit 1, a CLO means a securitization primarily of commercial loans);

(iv) Collateralized debt obligations ("CDOs") (for the purposes of Exhibit 1, a CDO means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds);

(v) Asset-backed commercial paper ("ABCP") (for the purposes of Exhibit 1, ABCP means short term notes issued by a structure that securitizes a variety of financial assets (e.g., trade receivables or credit card receivables), which secure the notes);

(vi) other asset-backed securities ("other ABS") (for the purposes of Exhibit 1, other ABS means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, or equipment leases); and

(vii) other structured finance products ("other SFPs") (for the purposes of Exhibit 1, other SFPs means any structured finance product not identified in subparagraphs (i) through (vi) above -- the Applicant/NRSRO must provide a description of the products in this subclass); and

(E) The following subclasses of credit ratings described in section 3(a)(62)(B)(v) of the Exchange Act (issuers of government securities, municipal securities, or securities issued by a foreign government):

(i) Sovereign issuers;

(ii) U.S. public finance; and

(iii) International public finance.

(2) The Transition/Default Matrices for applicable classes and subclasses of credit ratings must be presented in the same order that the classes and subclasses of credit ratings are identified in paragraphs (1)(A) through (E) above. For a given class or subclass, Transition/Default Matrices must be presented in the following order: 1-year matrix, 3-year matrix, and then 10-year matrix. If the Applicant/NRSRO has not been determining credit ratings in the applicable class or subclass for the length of time necessary to produce a 1-year, 3-year, and/or 10-year Transition/Default Matrix, it must explain that fact in the location where the Transition/Default Matrix would have been presented in the Exhibit. The Applicant/NRSRO must clearly define, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit. In, addition the Applicant/NRSRO must clearly explain the conditions under which it classifies obligors, securities, or money market instruments as being in default. Next, the Applicant/NRSRO must provide the uniform resource locator (URL) of its corporate Internet website where the credit rating histories required to be disclosed pursuant to 17 CFR 17g-7(b) will be located (in the case of an Applicant) or are located (in the case of an NRSRO). Exhibit 1 must contain no performance measurement statistics or information other than as described in, and required by, these Instructions for Exhibit 1; except that the Applicant/NRSRO may provide after the presentation of all required Transition/Default Matrices and other disclosures: (1) a short statement describing the required method of calculating the performance measurement statistics in Exhibit 1 (the single cohort approach) and any advantages or limitations to the single cohort approach the Applicant/NRSRO believes would be appropriate to disclose; (2) a short statement that the Applicant/NRSRO has calculated and published on an Internet website performance measurement statistics using the average cohort approach (if applicable), a description of the differences between the single cohort approach and the average cohort approach used to calculate the performance measurement statistics, and the Internet website URL where the performance measurements statistics calculated using the average cohort approach are located; and

(3) the Internet website URLs where any other information relating to performance measurement statistics of the Applicant/NRSRO is located.

(3) The Transition/Default Matrices must be presented using the format of the sample matrix ("Sample Matrix") below. The first row of a Transition/Default Matrix must contain the column headings: "Credit Ratings as of [insert the period start date]"; "Credit Ratings as of [insert the period end date] percent"; and "Other Outcomes During [insert the period start date and end date] (percent)". The second row must contain column headings that are grouped under the three top row headings. The first and second columns in Transition/Default Matrix are for entering information about the credit ratings as of the period start date and must be grouped under the first heading in the first row. The cells in the second row for the first two columns must contain the headings, respectively: "Credit Rating Scale" and "Number of Ratings Outstanding." The applicable date is the date 1, 3, or 10 years prior to the most recent calendar year end depending on whether the Transition/Default Matrix is for a 1-year, 3-year, or 10-year period. The next sequence of columns are for entering information about the credit ratings as of the period end date and must be grouped under the second heading in the first row. The cells in the second row for this series of columns must contain, from left to right, each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for the applicable class or subclass of credit ratings in descending order from the highest to the lowest notch. The Applicant/NRSRO must not include a "default" category if its rating scale has such a category. The final three columns in the header row are for entering information about credit ratings that were classified as in default or paid off during the period, or were withdrawn during the period for reasons other than default or having been paid off (see explanations below). These columns must grouped under the third heading in the top row. The cells in the header rows for these columns must have the following headings from left to right, "Default", "Paid Off", and "Withdrawn (other)". The first column of a Transition/Default Matrix must have a separate cell containing each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for the applicable class or subclass of credit ratings in descending order from the highest to the lowest notch. The Applicant/NRSRO must not include a "default" category in the column if its rating scale has such a category. The last cell of the first column must contain the word "Total." The cells representing no

change in the credit rating as of the period end date must be highlighted. Finally, the Transition/Default Matrix must have a title identifying the applicable class or subclass of credit ratings, the period covered, and the start date and end date of the period.

The Transition/Default Matrix must resemble the Sample Matrix below except that the number of credit rating symbols depicted in the cells of the first column and header row of a matrix will depend on the number of notches in the applicable rating scale of the Applicant/NRSRO (excluding a "default" category).

Corporate Issuers – 10-Year Transition and Default Rates
(December 31, 2000 through December 31, 2010)

Credit Ratings as of 12/31/2000		Credit Ratings as of 12/31/2010 (Percent)									Other Outcomes During 12/31/2000-12/31/2010 (Percent)		
Credit Rating	Number of Ratings Outstanding	AAA	AA	A	BBB	BB	B	CCC	CC	C	Default	Paid Off	Withdrawn (other)
AAA	10	50%	10%									40%	
AA	2000	1%	39%	12%	10%	8%	5%	4%			1%	19%	1%
A	4000		6%	34%	15%	10%	6%	4%	3%		2%	18%	2%
BBB	3600		2%	9%	28%	15%	10%	6%	5%	1%	4%	17%	3%
BB	1000			2%	4%	20%	14%	5%			2%	16%	37%
B	500			1%	3%	6%	20%	20%	15%		15%	15%	5%
CCC	300					4%	6%	15%	25%	20%	20%	4%	6%
CC	200						2%	8%	10%	38%	30%	2%	10%
C	160							2%	8%	10%	67%	1%	12%
Total	11,770												

(4) An Applicant/NRSRO must complete a Transition/Default Matrix as follows:

(A) *Second Column Showing Number of Ratings Outstanding as of the Period Start Date*. To determine the number of credit ratings outstanding as of the period start date (the "start-date cohort") for all classes of credit ratings other than the class of issuers of asset-backed securities, the Applicant/NRSRO must: (1) identify each obligor that the Applicant/NRSRO assigned a credit rating to as an entity where the credit rating was outstanding as of the period start date; (2) identify each additional obligor that issued securities or money market instruments that the Applicant/NRSRO assigned credit ratings to where the credit ratings were outstanding as of the period start date; and (3) include in the start-date cohort only credit ratings assigned to an obligor as an entity, or, if the obligor is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt. All other credit ratings outstanding as of the period start date assigned to securities or money market instruments issued by the obligor must be excluded from the start-date cohort. For the class of issuers of asset-backed securities, the start-date cohort

must consist of credit ratings that the Applicant/NRSRO assigned to all securities or money market instruments in the class where the credit ratings were outstanding as of the period start date, excluding expected or preliminary credit ratings.

In determining the start-date cohort for all classes of credit ratings, the Applicant/NRSRO must exclude credit ratings that the Applicant/NRSRO classified as in default as of the period start date or that were expected or preliminary credit ratings.

The Applicant/NRSRO must next determine the number of credit ratings in the start-date cohort in each notch in the "Credit Rating Scale" column as of the period start date and enter this number in the appropriate cell. The Applicant/NRSRO must enter the total number of credit ratings in the start-date cohort in the last cell of the column.

(B) *Rows Representing Credit Rating Notches*. Each row representing a credit rating notch must contain percents indicating the credit rating outcomes as of the period end date of all the credit ratings at that notch as of the period start date. The percents in a row must add up to 100%. To compute the percents for each row in the Transition/Default Matrix representing a notch in the rating scale:

(i) The Applicant/NRSRO must determine the number of credit ratings in the start-date cohort at that notch as of the period start date that were assigned a credit rating at the same notch as of the period end date. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the column representing the same notch. The cell must be highlighted. To determine this percent, the Applicant/NRSRO must use the credit rating as of the period end date and not a credit rating assigned between the period start date and the period end date.

(ii) The Applicant/NRSRO must determine the number credit ratings at that notch as of the period start date at each other notch as of the period end date. These numbers must be expressed as percents of the total number of credit ratings at that notch as of the period start date and the percents must be entered in the columns representing each notch. To determine these percents, the Applicant/NRSRO must use the credit rating as of the period

end date and not a credit rating assigned between the period start date and the period end date.

(iii) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date that went into *Default* (see explanation below) at any time during the applicable time period. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Default* column. The Applicant/NRSRO must classify a credit rating as a *Default* if any of the following conditions are met*:*

(a) The obligor failed to timely pay principal or interest due according to the terms of an obligation during the applicable period or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument during the applicable period;

(b) The security or money market instrument was subject to a write-down, applied loss, or other realized deficiency of the outstanding principal amount during the applicable period; or

(c) The Applicant/NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of "default" during the applicable period.

A credit rating that goes into in *Default* as defined in this paragraph (4)(B)(iii) must be classified as in *Default* even if the Applicant/NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of *Default* or withdrew the credit rating on or after the event of *Default*.

(iv) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date that were *Paid Off* (see explanation below) at any time during the applicable time period. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Paid Off* column. To determine this percent, the Applicant/NRSRO must classify a credit rating as *Paid Off* if the issuer of the security or money market instrument assigned the credit rating

extinguished its obligation with respect to the security or money market instrument during the applicable time period by paying in full all outstanding principal and interest due according to the terms of the security or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid); and the Applicant/NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.

(v) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date for which the Applicant/NRSRO withdrew a credit rating at any time during the applicable time period for a reason other than *Default* (as described in paragraph (4)(B)(iii)) or *Paid-Off* (as described in paragraph (4)(B)(iv)). This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Withdrawn (other)* column. The Applicant/NRSRO must classify the credit rating as *Withdrawn (other)* even if the Applicant/NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing its credit rating.

Exhibit 2. Provide in this Exhibit a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the Applicant/NRSRO is seeking registration or is registered. The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings, including, as applicable, descriptions of: policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or securities transaction is relied on in determining credit ratings; the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or securities transaction factor into the determination of credit ratings; the

methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating. An Applicant/NRSRO may provide in Exhibit 2 the location on its corporate Internet website where additional information about the procedures and methodologies is located.

Exhibit 3. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to prevent the misuse of material, nonpublic information pursuant to section 15E(g) of the Exchange Act and 17 CFR 240.17g-4. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 4. Provide in this Exhibit information about the organizational structure of the Applicant/NRSRO, including, as applicable, an organizational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the Applicant/NRSRO; an organizational chart showing the divisions, departments, and business units of the Applicant/NRSRO; and an organizational chart showing the managerial structure of the Applicant/NRSRO, including the designated compliance officer identified in Item 4.

Exhibit 5. Provide in this Exhibit a copy of the written code of ethics the Applicant/NRSRO has in effect or a statement of the reasons why the Applicant/NRSRO does not have a written code of ethics in effect.

Exhibit 6. Identify in this Exhibit the types of conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO that are material to the Applicant/NRSRO. First, identify the conflicts described in the list below that apply to the Applicant/NRSRO. The Applicant/NRSRO may use the descriptions below to identify an applicable conflict of interest and is not required to provide any further details. Second, briefly describe any other type of conflict of interest relating to the issuance of credit ratings by the Applicant/NRSRO that is not covered in the descriptions below that is material to the Applicant/NRSRO (for example, one the Applicant/NRSRO has established specific policies and procedures to address):

The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.
- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term “nationally recognized statistical rating organization.”
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:

- Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
- Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.

- A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).
- The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

Exhibit 7. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to address and manage conflicts of interest pursuant to section 15E(h) of the Exchange Act. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 8. Provide in this Exhibit the following information about the Applicant/NRSRO's credit analysts and the persons who supervise the credit analysts:

- The total number of credit analysts (including credit analyst supervisors).
- The total number of credit analyst supervisors.
- A general description of the minimum qualifications required of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).
- A general description of the minimum qualifications required of the credit analyst supervisors, including education level and work experience.

Exhibit 9. Provide in this Exhibit the following information about the designated compliance officer (identified in Item 4) of the Applicant/NRSRO:

- Name.
- Employment history.
- Post secondary education.

- Whether employed by the Applicant/NRSRO full-time or part-time.

Exhibit 10. Provide in this Exhibit a list of the largest users of credit rating services of the Applicant by the amount of net revenue earned by the Applicant attributable to the person during the fiscal year ending immediately before the date of the initial application. First, determine and list the 20 largest issuers and subscribers in terms of net revenue. Next, add to the list any obligor or underwriter that, in terms of net revenue during the fiscal year, equaled or exceeded the 20th largest issuer or subscriber. In making the list, rank the persons in terms of net revenue from largest to smallest and include the net revenue amount for each person. For purposes of this Exhibit:

Net revenue means revenue earned by the Applicant for any type of service or product provided to the person, regardless of whether related to credit rating services, and net of any rebates and allowances the Applicant paid or owes to the person; and

Credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 10 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 11. Provide in this Exhibit the financial statements of the Applicant, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date of the Applicant's initial application to the Commission, subject to the following:

- If the Applicant is a division, unit, or subsidiary of a parent company, the Applicant may provide audited consolidated financial statements of its parent company.

- If the Applicant does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date of the initial application, the Applicant may provide unaudited financial statements for the applicable year or years, but must provide audited financial statements for the fiscal or calendar year ending immediately before the date of the initial application.

Attach to the unaudited financial statements a certification by a person duly authorized by the Applicant to make the certification that the person has responsibility for the financial statements and that to the best knowledge of the person making the certification the financial statements fairly present, in all material respects, the Applicant's financial condition, results of operations, and cash flows for the period presented.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 11 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 12. Provide in this Exhibit the following information, as applicable, and which is not required to be audited, regarding the Applicant's aggregate revenues for the fiscal or calendar year ending immediately before the date of the initial application:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings; and

- Revenue from all other services and products offered by your credit rating organization (include descriptions of any major sources of revenue).

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 12 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 13. Provide in this Exhibit the approximate total and median annual compensation of the Applicant's credit analysts for the fiscal or calendar year ending immediately before the date of this initial application. In calculating total and median annual compensation, the Applicant may exclude deferred compensation, provided such exclusion is noted in the Exhibit.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 13 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3.)

I. EXPLANATION OF TERMS.

1. COMMISSION - The U.S. Securities and Exchange Commission.
2. CREDIT RATING [Section 3(a)(60) of the Exchange Act] - An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.
3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act] - Any person:

- engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
- employing either a quantitative or qualitative model, or both to determine credit ratings; and
- receiving fees from either issuers, investors, other market participants, or a combination thereof.

4. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act] - A credit rating agency that:

- issues credit ratings certified by qualified institutional buyers in accordance with section 15(a)(1)(B)(ix) of the Exchange Act with respect to:
    - financial institutions, brokers, or dealers;
    - insurance companies;
    - corporate issuers;
    - issuers of asset-backed securities;
    - issuers of government securities, municipal securities, or securities issued by a foreign government; or
    - a combination of one or more of the above; and
- is registered as an NRSRO.

6. PERSON - An individual, partnership, corporation, trust, company, limited liability company, or other organization (including a separately identifiable department or division).

7. PERSON WITHIN AN APPLICANT/NRSRO – The person filing or furnishing, as applicable, Form NRSRO identified in Item 1, any credit rating affiliates identified in Item 3, and any partner, officer, director, branch manager, or employee of the person or the credit rating affiliates (or any person occupying a similar status or performing similar functions).

8. SEPARATELY IDENTIFIABLE DEPARTMENT OR DIVISION - A unit of a corporation or company:

- that is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities; and
- for which all of the records relating to its credit rating activities are separately created or maintained in or extractable from such unit's own facilities or the facilities of the corporation, and such records are so maintained or otherwise accessible as to permit independent examination and enforcement by the Commission of the Exchange Act and rules and regulations promulgated thereunder.

8. QUALIFIED INSTITUTIONAL BUYER [Section 3(a)(64) of the Exchange Act] - An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency.

DISCLOSURE REPORTING PAGE (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to provide information concerning affirmative responses to **Item 8** of Form NRSRO.

Submit a separate DRP for each person that: (a) has committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.

Name of Applicant/NRSRO Date

_____ _____

Check Item being responded to:

☐ Item 8A

☐ Item 8B

☐ Item 8C

Full name of the person for whom this DRP is being submitted:

_____

If this DRP provides information relating to a "Yes" answer to Item 8A, describe the act(s) that was (were) committed or omitted; or the order(s) or finding(s); or the injunction(s) (provide the relevant statute(s) or regulation(s)) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8B, describe the crime(s) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8C, attach the relevant Commission order(s) and provide the date(s):

_____

18. Section 249b.500 and Form ABS Due Diligence-15E are added to read as follows:

Note: The text of Form ABS Due Diligence-15E will not appear in the Code of Federal Regulations.

§ 249b.500 Form ABS Due Diligence-15E, Certification of third-party provider of due diligence services for asset-backed securities

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS DUE DILIGENCE-15E

CERTIFICATION OF PROVIDER OF THIRD-PARTY DUE DILIGENCE SERVICES FOR ASSET-BACKED SECURITIES

Pursuant 17 CFR 240.17g-10, this Form must be used by a person providing third-party due diligence services in connection with an asset-backed security to comply with section 15E(s)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7(s)(4)(B)). Section 15E(s)(4)(B) of the Securities Exchange Act of 1934 requires a person providing the due diligence services to provide a written certification to any nationally recognized statistical rating organization that produces a credit rating to which such due diligence services relate.

Item 1. Identity of the person providing third-party due diligence services

Legal Name: _____

Business Name (if Different): _____

Principal Business Address: _____

_____

Item 2. Identity of the person who paid the person to provide third-party due diligence services

Legal Name: _____

Business Name (if Different): _____

Principal Business Address: _____

_____

Item 3. Credit rating criteria

If the due diligence performed by the third party is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization, identify the nationally recognized statistical rating organization and the title and date of the published criteria (more than one nationally recognized statistical rating organization may be identified).

Identity of NRSRO	Title and Date of Criteria

Item 4. Description of the due diligence performed

Provide a description of the scope and manner of the due diligence services performed in connection with the review of assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review. Include in the description: (1) the type of assets that were reviewed; (2) the sample size of the assets reviewed; (3) how the sample size was determined and, if applicable, computed; (4) whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; (5) whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria or other requirements was reviewed and, if so, how the review was conducted; (6) whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted; (7) whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and (8) any other type of review that was part of the due diligence services conducted by the person executing this Form. This description should be attached to the Form and contain the heading “Item 4.” Provide this description regardless of whether the due diligence performed is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization.

Item 5. Summary of findings and conclusions of review

Provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2. This summary should be attached to the Form and contain the heading “Item 5.”

CERTIFICATION

The undersigned has executed this Form ABS Due Diligence 15E on behalf of, and on the authority of, the person identified in Item 1 of the Form. The undersigned, on behalf of the person, represents that the person identified in Item 1 of the Form conducted a thorough review in performing the due diligence described in Item 4 attached to this Form and that the information and statements contained in this Form, including Items 4 and 5 attached to this Form, which are part of this Form, are accurate in all significant respects on and as of the date hereof.

Name of Person Identified in Item 1: _____

By: _____ _____
(Print name of duly authorized person) (Signature)

Date: _____

By the Commission.

Dated: August 27, 2014.

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2014–20890 Filed 9–12–14; 8:45 am]

BILLING CODE 8011–01–P