

111TH CONGRESS
1ST SESSION

S. 1073

To provide for credit rating reforms, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 19, 2009

Mr. REED introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To provide for credit rating reforms, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Rating Accountability
5 and Transparency Enhancement Act of 2009” or the
6 “RATE Act”.

7 **SEC. 2. FINDINGS.**

8 Congress finds that—

9 (1) because of the systemic importance of credit
10 ratings and the reliance placed on them by indi-
11 vidual and institutional investors and financial regu-
12 lators, the activities and performances of credit rat-

1 ing agencies, including nationally recognized statis-
2 tical rating organizations, are the subject of national
3 public interest, as they are central to capital forma-
4 tion, investor confidence, and the efficient perform-
5 ance of the United States economy;

6 (2) credit rating agencies, including nationally
7 recognized statistical rating organizations, play a
8 critical “gatekeeper” role that is functionally similar
9 to that of securities analysts, who evaluate the qual-
10 ity of securities, and auditors, who review the finan-
11 cial statements of firms, and such role justifies a
12 similar level of public oversight and accountability;

13 (3) because credit rating agencies perform eval-
14 uative and analytical services on behalf of clients,
15 their activities are fundamentally commercial in
16 character and should be subject to the same stand-
17 ards of liability and oversight as apply to auditors
18 and securities analysts;

19 (4) in certain of their roles, particularly in ad-
20 vising arrangers of structured financial products on
21 potential ratings of such products, credit rating
22 agencies face conflicts of interest that need to be
23 carefully monitored and that therefore should be ad-
24 dressed explicitly in legislation in order to give clear

1 authority to the Securities and Exchange Commis-
2 sion;

3 (5) in the recent credit crisis, the ratings of
4 structured financial products have proven to be inac-
5 curate, and have contributed to the mismanagement
6 of risks by financial institutions and investors, which
7 impacts the health of the economy in the United
8 States and around the world; and

9 (6) credit rating agencies should determine
10 their ratings independently, without regulatory ap-
11 proval of methodologies, in order to avoid overreli-
12 ance on ratings and to ensure that the rating agen-
13 cies, rather than the Securities and Exchange Com-
14 mission, are accountable for such methodologies, ex-
15 cept that regulators should have strong authority to
16 ensure that all other aspects of rating agency activi-
17 ties are designed to ensure the highest quality rat-
18 ings and accountability for those creating them.

19 **SEC. 3. ENHANCED REGULATION OF NATIONALLY RECOG-**
20 **NIZED STATISTICAL RATING ORGANIZA-**
21 **TIONS.**

22 Section 15E of the Securities Exchange Act of 1934
23 (15 U.S.C. 78o-7) is amended—

24 (1) in subsection (c)—

1 (A) in the second sentence of paragraph
2 (2), by inserting “including the requirements of
3 this section,” after “Notwithstanding any other
4 provision of law,”; and

5 (B) by adding at the end the following:

6 “(3) REVIEW OF INTERNAL CONTROLS FOR DE-
7 TERMINING CREDIT RATINGS.—

8 “(A) IN GENERAL.—Credit ratings by, and
9 the policies, procedures, and methodologies em-
10 ployed by, each nationally recognized statistical
11 rating organization shall be reviewed by the
12 Commission to ensure that—

13 “(i) the nationally recognized statis-
14 tical rating organization has established
15 and documented a system of internal con-
16 trols for determining credit ratings, taking
17 into consideration such factors as the Com-
18 mission may prescribe by rule; and

19 “(ii) the nationally recognized statis-
20 tical rating organization adheres to such
21 system; and

22 “(iii) the public disclosures of the na-
23 tionally recognized statistical rating orga-
24 nization required under this section about

1 its ratings, methodologies, and procedures
2 are consistent with such system.

3 “(B) SCOPE OF REVIEWS.—The Commis-
4 sion shall conduct the reviews required by this
5 paragraph—

6 “(i) for all types of credit ratings; and

7 “(ii) for new credit ratings, in a time-
8 ly manner.

9 “(C) MANNER AND FREQUENCY.—The
10 Commission shall conduct reviews required by
11 this paragraph in a manner and with a fre-
12 quency to be determined by the Commission.

13 “(4) PROVISION OF INFORMATION TO THE COM-
14 MISSION.—Each nationally recognized statistical rat-
15 ing organization shall make available and maintain
16 such records and information, for such a period of
17 time, as the Commission may prescribe, by rule, as
18 necessary for the Commission to conduct the reviews
19 under this subsection;”;

20 (2) in subsection (d)—

21 (A) by inserting “fine,” after “censure,”
22 each place that term appears;

23 (B) in the subsection heading, by inserting
24 “FINE,” after “CENSURE,”;

1 (C) in paragraph (4), by striking “or” at
2 the end;

3 (D) in paragraph (5), by striking the pe-
4 riod at the end and inserting “; or”; and

5 (E) by adding at the end the following:

6 “(6) fails to conduct sufficient surveillance to
7 ensure that credit ratings remain current, accurate,
8 and reliable.”;

9 (3) by amending subsection (h) to read as fol-
10 lows:

11 “(h) MANAGEMENT OF CONFLICTS OF INTEREST.—

12 “(1) ORGANIZATION POLICIES AND PROCE-
13 DURES.—Each nationally recognized statistical rat-
14 ing organization shall establish, maintain, and en-
15 force written policies and procedures reasonably de-
16 signed, taking into consideration the nature of the
17 business of such nationally recognized statistical rat-
18 ing organization and affiliated persons and affiliated
19 companies thereof, to address, manage, and disclose
20 any conflicts of interest that can arise from such
21 business.

22 “(2) GOVERNANCE IMPROVEMENTS AT
23 NRSRO.—Each nationally recognized statistical rat-
24 ing organization shall establish governance proce-
25 dures to manage conflicts of interest, consistent with

1 the protection of users of credit ratings, in accord-
2 ance with rules issued by the Commission pursuant
3 to paragraph (3).

4 “(3) COMMISSION AUTHORITY.—The Commis-
5 sion shall issue final rules to prohibit, or require the
6 management and disclosure of, any conflicts of inter-
7 est relating to the issuance of credit ratings by a na-
8 tionally recognized statistical rating organization, in-
9 cluding—

10 “(A) conflicts of interest relating to the
11 manner in which a nationally recognized statis-
12 tical rating organization is compensated by the
13 obligor, or any affiliate of the obligor, for
14 issuing credit ratings or providing related serv-
15 ices;

16 “(B) conflicts of interest relating to the
17 provision of consulting, advisory, or other serv-
18 ices by a nationally recognized statistical rating
19 organization, or any person associated with
20 such nationally recognized statistical rating or-
21 ganization, and the obligor, or any affiliate of
22 the obligor;

23 “(C) disclosure of business relationships,
24 ownership interests, affiliations of nationally
25 recognized statistical rating organization board

1 members with obligors, or any other financial or
2 personal interests between a nationally recog-
3 nized statistical rating organization, or any per-
4 son associated with such nationally recognized
5 statistical rating organization, and the obligor,
6 or any affiliate of the obligor;

7 “(D) disclosure of any affiliation of a na-
8 tionally recognized statistical rating organiza-
9 tion, or any person associated with such nation-
10 ally recognized statistical rating organization,
11 with any person that underwrites securities, en-
12 tities, or other instruments that are the subject
13 of a credit rating; and

14 “(E) any other potential conflict of inter-
15 est, as the Commission deems necessary or ap-
16 propriate in the public interest or for the pro-
17 tection of users of credit ratings.

18 “(4) COMMISSION RULES.—The rules issued by
19 the Commission under paragraph (3) shall include—

20 “(A) the establishment of a system of pay-
21 ment for each nationally recognized statistical
22 rating organization that requires that payments
23 are structured to ensure that the nationally rec-
24 ognized statistical rating organization conducts
25 accurate and reliable surveillance of ratings

1 over time, and that incentives for accurate rat-
2 ings are in place;

3 “(B) a prohibition on providing credit rat-
4 ings for structured products that it advised on,
5 in the form of assistance, advice, consultation,
6 or other aid that preceded its retention by any
7 issuer, underwriter, or placement agent to pro-
8 vide a rating for the securities in question (or
9 any assistance provided after such point for
10 which additional compensation is paid directly
11 or indirectly);

12 “(C) requirements that a nationally recog-
13 nized statistical rating organization disclose any
14 relationship or affiliation described in subpara-
15 graphs (C) and (D) of paragraph (3);

16 “(D) a requirement that, in each credit
17 rating report issued to the public, a nationally
18 recognized statistical rating organization dis-
19 close the type and number of ratings it has pro-
20 vided to the obligor or affiliates of the obligor,
21 including the fees it has billed for the credit
22 rating and aggregate amount of fees in the pre-
23 ceding 2 years that it has billed to the par-
24 ticular obligor or its affiliates; and

1 “(E) any other requirement as the Com-
2 mission deems necessary or appropriate in the
3 public interest, or for the protection of users of
4 credit ratings.

5 “(5) LOOK-BACK REQUIREMENT.—

6 “(A) REVIEW BY NRSRO.—In any case in
7 which an employee of an obligor or an issuer or
8 underwriter of a security or money market in-
9 strument was employed by a nationally recog-
10 nized statistical rating organization and partici-
11 pated in any capacity in determining credit rat-
12 ings for the obligor or the securities or money
13 market instruments of the issuer during the 1-
14 year period preceding the date of the issuance
15 of the credit rating, the nationally recognized
16 statistical rating organization shall—

17 “(i) conduct a review to determine
18 whether any conflicts of interest of such
19 employee influenced the credit rating; and

20 “(ii) take action to revise the rating if
21 appropriate, in accordance with such rules
22 as the Commission shall prescribe.

23 “(B) REVIEW BY COMMISSION.—The Com-
24 mission shall conduct periodic reviews of the
25 look-back policies described in subparagraph

1 (A) and the implementation of such policies at
2 each nationally recognized statistical rating or-
3 ganization to ensure they are appropriately de-
4 signed and implemented to most effectively
5 eliminate conflicts of interest in this area.

6 “(6) PERIODIC REVIEWS.—

7 “(A) REVIEWS REQUIRED.—The Commis-
8 sion shall conduct periodic reviews of govern-
9 ance and conflict of interest procedures estab-
10 lished under this subsection to determine the ef-
11 fectiveness of such procedures.

12 “(B) TIMING OF REVIEWS.—The Commis-
13 sion shall review and make available to the pub-
14 lic the code of ethics and conflict of interest
15 policy of each nationally recognized statistical
16 rating organization—

17 “(i) not less frequently than once
18 every 3 years; and

19 “(ii) whenever such policies are mate-
20 rially modified or amended.”;

21 (4) by amending subsection (j) to read as fol-
22 lows:

23 “(j) DESIGNATION OF COMPLIANCE OFFICER.—

1 “(1) IN GENERAL.—Each nationally recognized
2 statistical rating organization shall designate an in-
3 dividual to serve as a compliance officer.

4 “(2) DUTIES.—The compliance officer shall—

5 “(A) report directly to the board of the na-
6 tionally recognized statistical rating organiza-
7 tion (or the equivalent thereof) or to the senior
8 officer of the nationally recognized statistical
9 rating organization; and

10 “(B) shall—

11 “(i) review compliance with policies
12 and procedures to manage conflicts of in-
13 terest and assess the risk that such compli-
14 ance (or lack of such compliance) may
15 compromise the integrity of the credit rat-
16 ing process;

17 “(ii) review compliance with internal
18 controls with respect to the procedures and
19 methodologies for determining credit rat-
20 ings, including quantitative and qualitative
21 models used in the rating process, and as-
22 sess the risk that such compliance with the
23 internal controls (or lack of such compli-
24 ance) may compromise the integrity and
25 quality of the credit rating process;

1 “(iii) in consultation with the board of
2 the nationally recognized statistical rating
3 organization, a body performing a function
4 similar to that of a board, or the senior of-
5 ficer of the nationally recognized statistical
6 rating organization, resolve any conflicts of
7 interest that may arise;

8 “(C) be responsible for administering the
9 policies and procedures required to be estab-
10 lished pursuant to this section; and

11 “(D) ensure compliance with securities
12 laws and the rules and regulations issued there-
13 under, including rules promulgated by the Com-
14 mission pursuant to this section.

15 “(3) LIMITATIONS.—No compliance officer des-
16 ignated under paragraph (1), may, while serving in
17 such capacity—

18 “(A) perform credit ratings;

19 “(B) participate in the development of rat-
20 ing methodologies or models;

21 “(C) perform marketing or sales functions;

22 or

23 “(D) participate in establishing compensa-
24 tion levels, other than for employees working
25 for such officer.

1 “(4) OTHER DUTIES.—The compliance officer
2 shall establish procedures for the receipt, retention,
3 and treatment of—

4 “(A) complaints regarding credit ratings,
5 models, methodologies, and compliance with the
6 securities laws and the policies and procedures
7 required under this section; and

8 “(B) confidential, anonymous complaints
9 by employees or users of credit ratings.

10 “(5) ANNUAL REPORTS REQUIRED.—The com-
11 pliance officer shall annually prepare and sign a re-
12 port on the compliance of the nationally recognized
13 statistical rating organization with the securities
14 laws and its policies and procedures, including its
15 code of ethics and conflict of interest policies, in ac-
16 cordance with rules prescribed by the Commission.
17 Such compliance report shall accompany the finan-
18 cial reports of the nationally recognized statistical
19 rating organization that are required to be furnished
20 to the Commission pursuant to this section.”;

21 (5) in subsection (k)—

22 (A) by striking “, on a confidential basis,”;

23 (B) by striking “Each nationally” and in-
24 serting the following:

25 “(1) IN GENERAL.—Each nationally”; and

1 (C) by adding at the end the following:

2 “(2) EXCEPTION.—The Commission may treat
3 as confidential any item furnished to the Commis-
4 sion under paragraph (1), the publication of which
5 the Commission determines may have a harmful ef-
6 fect on a nationally recognized statistical rating or-
7 ganization.”;

8 (6) by amending subsection (p) to read as fol-
9 lows:

10 “(p) NRSRO REGULATION.—

11 “(1) IN GENERAL.—The Commission shall es-
12 tablish an office that administers the rules of the
13 Commission with respect to the practices of nation-
14 ally recognized statistical rating organizations in de-
15 termining ratings, for the protection of users of
16 credit ratings and in the public interest, and to en-
17 sure that credit ratings issued by such registrants
18 are accurate and not unduly influenced by conflicts
19 of interest.

20 “(2) STAFFING.—The office of the Commission
21 established under this subsection shall be staffed
22 sufficiently to carry out fully the requirements of
23 this section.

24 “(3) RULEMAKING AUTHORITY.—The Commis-
25 sion shall—

1 “(A) establish by rule fines and other pen-
2 alties for any nationally recognized statistical
3 rating organization that violates the applicable
4 requirements of this title; and

5 “(B) issue such rules as may be necessary
6 to carry out this section with respect to nation-
7 ally recognized statistical rating organizations.

8 “(q) TRANSPARENCY OF RATINGS PERFORMANCE.—

9 “(1) RULEMAKING REQUIRED.—The Commis-
10 sion shall, by rule, require that each nationally rec-
11 ognized statistical rating organization shall disclose
12 publicly information on initial ratings and subse-
13 quent changes to such ratings for the purpose of
14 providing a gauge of the accuracy of ratings and al-
15 lowing users of credit ratings to compare perform-
16 ance of ratings by different nationally recognized
17 statistical rating organizations.

18 “(2) CONTENT.—The rules of the Commission
19 under this subsection shall require, at a minimum,
20 disclosures that—

21 “(A) are comparable among nationally rec-
22 ognized statistical rating organizations, so that
23 users can compare rating performance across
24 rating organizations;

1 “(B) are clear and informative for a wide
2 range of investor sophistication;

3 “(C) include performance information over
4 a range of years and for a variety of classes of
5 credit ratings, as determined by the Commis-
6 sion; and

7 “(D) are published and made freely avail-
8 able by the nationally recognized statistical rat-
9 ing organization, on an easily accessible portion
10 of its website and in written form when re-
11 quested by users.

12 “(r) CREDIT RATINGS METHODOLOGIES.—The Com-
13 mission shall promulgate rules, for the protection of users
14 of credit ratings and in the public interest, with respect
15 to the procedures and methodologies, including qualitative
16 and quantitative models, used by nationally recognized
17 statistical rating organizations that require each nation-
18 ally recognized statistical rating organization to—

19 “(1) ensure that credit ratings are determined
20 using procedures and methodologies, including quali-
21 tative and quantitative models, that are approved by
22 the board of the nationally recognized statistical rat-
23 ing organization, a body performing a function simi-
24 lar to that of a board, or the senior officer of the
25 nationally recognized statistical rating organization,

1 and in accordance with the policies and procedures
2 of the nationally recognized statistical rating organi-
3 zation for developing and modifying credit rating
4 procedures and methodologies;

5 “(2) ensure that when major changes to credit
6 rating procedures and methodologies, including to
7 qualitative and quantitative models, are made, that
8 the changes are applied consistently to all credit rat-
9 ings to which such changed procedures and meth-
10 odologies apply and, to the extent the changes are
11 made to credit rating surveillance procedures and
12 methodologies, they are applied to current credit rat-
13 ings within a time period to be determined by the
14 Commission by rule, and that the reason for the
15 change is disclosed publicly;

16 “(3) notify users of credit ratings of the version
17 of a procedure or methodology, including a quali-
18 tative or quantitative model, used with respect to a
19 particular credit rating; and

20 “(4) notify users of credit ratings when a
21 change is made to a procedure or methodology, in-
22 cluding to a qualitative or quantitative model, or an
23 error is identified in a procedure or methodology
24 that may result in credit rating actions, and the like-

1 likelihood of the change resulting in current credit rat-
2 ings being subject to rating actions.

3 “(s) TRANSPARENCY OF CREDIT RATING METH-
4 ODOLOGIES AND INFORMATION REVIEWED.—

5 “(1) IN GENERAL.—The Commission shall es-
6 tablish a form, to accompany each rating issued by
7 a nationally recognized statistical rating organiza-
8 tion—

9 “(A) to disclose information about assump-
10 tions underlying credit rating procedures and
11 methodologies, the data that was relied on to
12 determine the credit rating and, where applica-
13 ble, how the nationally recognized statistical
14 rating organization used servicer or remittance
15 reports, and with what frequency, to conduct
16 surveillance of the credit rating; and

17 “(B) that can be made public and used by
18 investors and other users to better understand
19 credit ratings issued in each class of credit rat-
20 ing issued by the nationally recognized statis-
21 tical rating organization.

22 “(2) FORMAT.—The Commission shall ensure
23 that the form established under paragraph (1)—

24 “(A) is designed in a user-friendly and
25 helpful manner for users of credit ratings to

1 understand the information contained in the re-
2 port; and

3 “(B) requires the nationally recognized
4 statistical rating organization to provide the ap-
5 propriate content, as required by paragraph (3).

6 “(3) CONTENT.—Each nationally recognized
7 statistical rating organization shall include on the
8 form established under this subsection, along with
9 its ratings—

10 “(A) the main assumptions included in
11 constructing procedures and methodologies, in-
12 cluding qualitative and quantitative models;

13 “(B) the potential shortcomings of the
14 credit ratings, and the types of risks excluded
15 from the credit ratings that the registrant is
16 not commenting on (such as liquidity, market,
17 and other risks);

18 “(C) information on the reliability, accu-
19 racy, and quality of the data relied on in deter-
20 mining the ultimate credit rating and a state-
21 ment on the extent to which key data inputs for
22 the credit rating were reliable or limited (in-
23 cluding, any limits on the reach of historical
24 data, limits in accessibility to certain documents
25 or other forms of information that would have

1 better informed the credit rating, and the com-
2 pleteness of certain information considered);

3 “(D) whether and to what extent third
4 party due diligence services have been utilized,
5 and a description of the information that such
6 third party reviewed in conducting due diligence
7 services;

8 “(E) a description of relevant data about
9 any obligor, issuer, security, or money market
10 instrument that was used and relied on for the
11 purpose of determining the credit rating;

12 “(F) an explanation or measure of the po-
13 tential volatility for the rating, including any
14 factors that might lead to a change in the rat-
15 ing, and the extent of the change that might be
16 anticipated under different conditions; and

17 “(G) additional information, including con-
18 flict of interest information, as may be required
19 by the Commission.

20 “(4) DUE DILIGENCE SERVICES.—

21 “(A) CERTIFICATION REQUIRED.—In any
22 case in which third party due diligence services
23 are employed by a nationally recognized statis-
24 tical rating organization or an issuer or under-
25 writer, the firm providing the due diligence

1 services shall provide to the nationally recog-
2 nized statistical rating organization written cer-
3 tification of such due diligence, which shall be
4 subject to review by the Commission.

5 “(B) FORMAT AND CONTENT.—The na-
6 tionally recognized statistical rating organiza-
7 tions shall establish the appropriate format and
8 content for written certifications required under
9 subparagraph (A), to ensure that providers of
10 due diligence services have conducted a thor-
11 ough review of data, documentation, and other
12 relevant information necessary for the nation-
13 ally recognized statistical rating organization to
14 provide an accurate rating.”; and

15 (7) by amending subsection (m) to read as fol-
16 lows:

17 “(m) ACCOUNTABILITY.—

18 “(1) IN GENERAL.—The enforcement and pen-
19 alty provisions of this title shall apply to a nationally
20 recognized statistical rating organization in the same
21 manner and to the same extent as such provisions
22 apply to a registered public accounting firm or a se-
23 curities analyst under the Federal securities laws for
24 statements made by them, and such statements shall

1 not be deemed forward-looking statements for pur-
2 poses of section 21E.

3 “(2) RULEMAKING.—The Commission shall
4 issue such rules as may be necessary to carry out
5 this subsection.”.

6 **SEC. 4. STATE OF MIND IN PRIVATE ACTIONS.**

7 Section 21D(b)(2) of the Securities Exchange Act of
8 1934 (15 U.S.C. 78u-4(b)(2)) is amended by inserting be-
9 fore the period at the end the following: “, except that
10 in the case of an action brought under this title for money
11 damages against a nationally recognized statistical rating
12 organization, it shall be sufficient, for purposes of pleading
13 any required state of mind for purposes of such action,
14 that the complaint shall state with particularity facts giv-
15 ing rise to a strong inference that the nationally recog-
16 nized statistical rating organization knowingly or reck-
17 lessly failed either to conduct a reasonable investigation
18 of the rated security with respect to the factual elements
19 relied upon by its own methodology for evaluating credit
20 risk, or to obtain reasonable verification of such factual
21 elements (which verification may be based on a sampling
22 technique that does not amount to an audit) from other
23 sources that it considered to be competent and that were
24 independent of the issuer and underwriter”.

1 **SEC. 5. REGULATIONS.**

2 The Securities and Exchange Commission shall issue
3 final rules and regulations, as required by the amend-
4 ments made by this Act, not later than 365 days after
5 the date of enactment of this Act.

6 **SEC. 6. STUDY AND REPORT.**

7 (a) **STUDY.**—The Comptroller General of the United
8 States shall undertake a study of—

9 (1) the extent to which rulemaking the Securi-
10 ties and Exchange Commission has carried out the
11 provisions of this Act;

12 (2) the appropriateness of relying on ratings for
13 use in Federal, State, and local securities and bank-
14 ing regulations, including for determining capital re-
15 quirements;

16 (3) the effect of liability in private actions aris-
17 ing under the Securities Exchange Act of 1934 and
18 the exception added by section 4 of this Act; and

19 (4) alternative means for compensating credit
20 rating agencies that would create incentives for ac-
21 curate credit ratings and what, if any, statutory
22 changes would be required to permit or facilitate the
23 use of such alternative means of compensation.

24 (b) **REPORT.**—Not later than 30 months after the
25 date of enactment of this Act, the Comptroller General
26 shall submit to Congress and the Securities Exchange

- 1 Commission, a report containing the findings under the
- 2 study required by subsection (a).

○