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Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249b

[Release No. 34–55231; File No. S7–04–07]

RIN 3235–AJ78

Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations

AGENCY: Securities and Exchange Commission (''Commission'').

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for comment rules to implement provisions of the Credit Rating Agency Reform Act of 2006 (the ''Act''), enacted on September 29, 2006. The Act defines the term ''nationally recognized statistical rating organization,'' provides authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue final implementing rules no later than 270 days after its enactment (or by June 26, 2007).

DATES: Comments should be received on or before March 12, 2007.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7–04–07 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–04–07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551–5525; Thomas K. McGowan, Assistant Director, at (202) 551–5521; Randall W. Roy, Branch Chief, at (202) 551–5522; Rose Russo Wells, Attorney, at (202) 551–5527; Sheila Swartz, Attorney, at (202) 551–5545, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–6628.

SUPPLEMENTARY INFORMATION:

I. Background

The credit rating business has expanded significantly over the last 100 years. Credit rating agencies now issue credit ratings for debt securities of public companies, sovereign governments, and municipalities, and for structured products such as asset backed securities. They also issue ratings on money market instruments such as commercial paper and with respect to obligors (that is, a credit assessment of an entity as opposed to the entity's securities). Obligor ratings are issued on, among other entities, public companies, sovereign governments, and non-public companies such as banks and insurance companies.

The scope of the credit rating business reflects the importance of credit ratings to securities market participants and other creditors. Investors use credit ratings to make investment decisions. Large public institutions, such as pension funds, also use credit ratings to prescribe the types of securities the institution is permitted to hold. Creditors, such as commercial and investment banks, use credit ratings to manage credit risk and govern transactional agreements. For example, credit agreements frequently contain trigger provisions requiring more collateral if the creditor's credit rating drops.

In addition, regulatory bodies have come to rely on credit ratings. In 1975, the Commission adopted the term ''nationally recognized statistical rating organization'' or ''NRSRO'' as part of amendments to its broker-dealer net capital rule [1] under the Securities Exchange Act of 1934 (''Exchange Act'').[2] The net capital rule requires a broker-dealer to maintain a level of net capital generally defined as net worth plus subordinated debt less illiquid assets and less percentage deductions on proprietary securities.[3] The net capital rule prescribes specific percentage deductions for various classes of securities based on the liquidity and volatility of the type of security.[4] These deductions, known as ''haircuts,'' are intended to provide a financial buffer against risks arising from the broker-dealer's business activities, including potential losses arising from market fluctuations in the prices of, or lack of liquidity in, the securities.

The Commission's incorporation of the term ''nationally recognized statistical rating organization'' into the net capital rule provided a means to distinguish between different classes of debt securities for the purpose of prescribing applicable haircuts.[5] Thus, the net capital rule permits a broker-dealer to apply lower haircuts to certain types of debt securities that are rated in one of the four highest categories (known as the ''investment grade'' categories) by at least two NRSROs.[6]

Although the Commission used the term ''nationally recognized statistical rating organization'' in the net capital rule, it did not provide a definition. The Commission staff has identified NRSROs through no-action letters.[7] In response to a request for a no-action letter from a credit rating agency, the Commission staff would review information and documents submitted by the credit rating agency concerning its financial and managerial resources, methodologies for determining ratings, policies for managing activities that could impact the impartiality of the credit ratings, and recognition in the marketplace. Based on this review, the Commission staff would determine whether the credit rating agency had the financial and managerial resources and appropriate policies and procedures to consistently issue credible and reliable credit ratings. The Commission staff also would determine whether the predominant users of credit ratings considered the credit rating agency to be credible and reliable.

[1] *See* Adoption of Amendments to Rule 15c3–1 and Adoption of Alternative Net Capital Requirement for Certain Brokers and Dealers, Exchange Act Release No. 11497 (June 26, 1975), 40 FR 29795 (July 16, 1975) and 17 CFR 240.15c3–1.

[2] 15 U.S.C. 78a *et seq.*

[3] *See* 17 CFR 240.15c3–1(c)(2).

[4] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[5] *See, e.g.*, 17 CFR 240.15c3–1(c)(2)(vi)(E), (F), and (H).

[6] *See Id.*

[7] *See, e.g.*, Letter from Gregory C. Yadley, Staff Attorney, Division of Market Regulation, SEC, to Ralph L. Gosselin, Treasurer, Coughlin & Co., Inc. (November 24, 1975).

If these assessments were both positive, the Commission staff, after seeking the advice of the Commission, would issue a no-action letter informing broker-dealers that they could treat the credit rating agency as an NRSRO for purposes of the net capital rule.[8] Since 1975, the Commission staff has identified nine credit rating agencies as NRSROs. However, as a result of consolidation, only five credit rating agencies currently are identified as NRSROs—Moody's Investors Service, Inc., Fitch, Inc., the Standard and Poor's Division of the McGraw-Hill Companies Inc., A.M. Best Company, Inc., and Dominion Bond Rating Service Limited.[9]

Over time, the Commission has imported the NRSRO concept into a number of other rules.[10] For example, definitions in Commission Rule 2a–7 under the Investment Company Act of 1940 include the term NRSRO to prescribe the type of securities a money market fund can hold.[11] In addition, regulations adopted by the Commission under the Securities Act of 1933 permit offerings of certain nonconvertible debt, preferred, and asset-backed securities that are rated investment grade by at least one NRSRO to be registered on Form S–3—the Commission's ''short-form'' registration statement—without the issuer satisfying a minimum public float test.[12]

The term ''NRSRO'' also has been incorporated into a wide range of federal legislation.[13] For example, when Congress defined the term ''mortgage related security'' in Section 3(a)(41) of the Exchange Act as part of the Secondary Mortgage Market Enhancement Act of 1984,[14] it required, among other things, that such securities be rated in one of the two highest rating categories by at least one NRSRO.[15]

Further, a number of other federal, state, and foreign laws and regulations have incorporated the term ''NRSRO.'' For example, the U.S. Department of Education uses ratings from NRSROs to set standards of financial responsibility for institutions seeking to participate in student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended.[16] Several state insurance codes rely, directly or indirectly, on NRSRO ratings in determining appropriate investments for insurance companies.[17] Canada and El Salvador also have employed the concept.[18]

II. The Credit Rating Agency Reform Act of 2006

The Act[19] seeks to address two important issues that have arisen with respect to credit rating agencies.[20] First, the practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier to entry for credit rating agencies seeking wider recognition and market share.[21] Second, the importance of credit ratings to the financial markets has raised the question of whether greater supervision of credit rating agencies is warranted.[22] The failures of Enron and WorldCom—which led to new laws and regulations governing a host of market participants including public companies, securities analysts, and accountants[23]—increased concerns that credit rating agencies were operating outside the scope of any meaningful regulatory supervision.[24]

Over the years, the Commission has made attempts to address these issues[25] and has participated in international initiatives to address similar issues.[26]

[8] *See* Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, Commission, to John T. Anderson, Esquire, of Lord, Bissell & Brook, on behalf of Duff & Phelps, Inc. (February 24, 1982); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Paul McCarthy, President, McCarthy, Crisanti & Maffei, Inc. (September 13, 1983); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Robin Monro-Davies, President, IBCA Limited (November 27, 1990) and Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to David L. Lloyd, Jr., Dewey Ballentine, Bushby, Palmer & Wood (October 1, 1990); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Gregory A. Root, President, Thomson BankWatch, Inc. (August 6, 1991) and Letter from Michael A. Macchiaroli Assistant Director, Division of Market Regulation, Commission, to Lee Pickard, Pickard and Djinis LLP (January 25, 1999); Letter from Annette L. Nazareth, Director, Division of Market Regulation, Commission, to Mari-Anne Pisarri, Pickard and Djinis LLP (February 24, 2003); and Letter from Mark M. Attar, Special Counsel, Division of Market Regulation, Commission, to Arthur Snyder, President, A.M. Best Company, Inc. (March 3, 2005).

[9] Moody's and Standard and Poors represent over 80% of the industry market share as measured by revenues according to the *Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[10] *See* Commission rules 17 CFR 228.10(e), 229.10(c), 230.134(a)(14), 230.436(g), 239.13, 239.32, 239.33, 240.3a1–1(b)(3), 240.10b–10(a)(8), 240.15c3–1(c)(2)(vi)(E), (F), and (H), 240.15c3–1a(b)(1)(i)(C), 240.15c3–1f(d), 240.15c3–3a, Item 14, Note G, 242.101(c)(2), 242.102(d), 242.300(k)(3) and (l)(3), 270.2a–7(a)(10), 270.3a–7(a)(2), 270.5b–3(c), and 270.10f–3(a)(3).

[11] 17 CFR 270.2a–7.

[12] Form S–3 (17 CFR 239.13).

[13] *See, e.g.*, 15 U.S.C. 78c(a)(41) (defining the term ''mortgage related security''); 15 U.S.C. 78c(a)(53)(A) (defining the term ''small business related security''); and 15 U.S.C. 80a–6(a)(5)(A)(iv)(I) (exempting certain companies from the provisions of the Investment Company Act of 1940''); Gramm-Leach-Bliley Act, Pub. L. No. 106–102 (1999); Transportation Equity Act for the 21st Century, Pub. L. No. 105–178 (1998); Reigle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103–325 (1994); Department of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations Act, FY2001, Pub. L. No. 106–553 (2000); Higher Education Amendments of 1992, Pub. L. No. 102–325 (1992); Housing and Community Development Act of 1992, Pub. L. No. 102–550 (1992); Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102–242 (1991); and Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101–72 (1989).

[14] Pub. L. No. 98–440, § 101, 98 Stat. 1689 (1984).

[15] 15 U.S.C. 78c(a)(41).

[16] 20 U.S.C. 1070 *et seq.* and 42 U.S.C. 2751 *et seq.*, 34 CFR 668.15(b)(7)(ii) and (8)(ii).

[17] For example, the California Insurance Code relies on NRSRO ratings in allowing California-incorporated insurers to invest excess funds in certain types of investments. *See* Cal. Ins. Code 1192.10.

[18] *See, e.g.*, National Instrument 71–101, The Multi-jurisdictional Disclosure System (Oct. 1, 1998) (Can.) and Law of the Securities Market, El Salvador, Title VI, Chapter II, Section 88(a). D.L. Not. 374, Published in the Official Newspaper No. 149, Volume 340 of August 14, 1998.

[19] Pub. L. No. 109–291 (2006).

[20] *See* Section 2 of the Act and the Senate Report.

[21] *See* Senate Report.

[22] *Id.*

[23] *See e.g.*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (2002).

[24] *See* Senate Report.

[25] *See e.g., Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 34616 (August 31, 1994), 59 FR 46314 (September 7, 1994); *Capital Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934,* Exchange Act Release No. 39457 (December 17, 1997), 62 FR 68018 (December 30, 1997); *Order In the Matter of the Role of Rating Agencies in the U.S. Securities Markets Directing Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, and Designating Officers for Such Designation* (March 19, 2002); *The Current Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, Hearings Before the U.S. Securities and Exchange Commission* (Nov. 15 and 21, 2002) (''Commission 2002 CRA Hearings'') (Transcripts available on the Commission's Web site at *http://www.sec.gov/spotlight/ratingagency.htm);* Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, As Required by Section 702(b) of the Sarbanes-Oxley Act of 2002, U.S. Securities and Exchange Commission, January 2003 (''Commission CRA Report''); *Concept Release: Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws,* Securities Act Release No. 8236, 68 FR 35258 (June 12, 2003) (''Commission CRA Concept Release''); and *Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization,* Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005).

[26] *See Statement of Principles Regarding the Activities of Credit Rating Agencies,* Technical Committee, International Organization of Securities Commissions (''IOSCO'') (September 25, 2003); *Report on the Activities of Credit Rating Agencies,* The Technical Committee, IOSCO (September 2003); and *Code of Conduct Fundamentals for Credit Rating Agencies,* Technical Committee of IOSCO (December 2004).

However, the Commission's efforts have been hindered by limitations to its authority.[27] Congress ultimately found that legislation was necessary and enacted the Act to provide for voluntary registration and oversight of NRSROs.[28]

In overview, the Act adds definitions to Section 3 of the Exchange Act,[29] creates a new Section 15E of the Exchange Act,[30] and amends Section 17 of the Exchange Act.[31] These new statutory provisions, and the grants of Commission rulemaking authority under these provisions, establish a registration and regulatory program for credit rating agencies opting to have their credit ratings qualify for purposes of laws and rules using the term ''nationally recognized statistical rating organization.'' These credit rating agencies would be required to register with the Commission, make public certain information to help persons assess their credibility, make and retain certain records, furnish the Commission with certain financial reports, implement policies to manage the handling of material non-public information and conflicts of interest, and abide by certain prohibitions against unfair, coercive, or abusive practices. The Commission notes that international standards, such as those promulgated by the Technical Committee of the International Organization of Securities Commissions (''IOSCO''), are generally consistent with the Act and the rules the Commission is proposing.[32]

The statutory provisions of the Act prohibit reliance on Commission staff no-action letters identifying NRSROs.[33] These statutory provisions become effective on the earlier of June 26, 2007 (270 days after the date of enactment of the Act) or the date the Commission issues final rules under the Act.[34] However, as a transitional measure, no-action letters issued before the effective date may continue to be relied upon by regulatory users of credit ratings after the effective date if the credit rating agency identified in the letter has a pending application for registration before the Commission.[35] In this case, the letter becomes void after the Commission has acted on the application.[36]

III. Description of the Proposed Rules

A. Overview

The Act mandates that the rules adopted to implement its provisions be ''narrowly tailored'' to meet the Act's requirements.[37] Moreover, it provides that the rules adopted by the Commission may not ''regulate the substance of credit ratings or the procedures or methodologies by which an NRSRO determines credit ratings.''[38]

Under the proposed rules,[39] in conjunction with the statutory provisions of the Act, a credit rating agency seeking to register as an NRSRO would need to apply to the Commission using Form NRSRO.[40] The information furnished to the Commission in the form would fall broadly into two categories. First, the form would elicit information the credit rating agency would need to make public upon registration and thereafter update to keep the information current.[41] As the Senate Report noted, making this information public would ''facilitate informed decisions by giving investors the ratings quality of different firms.''[42] The second category of information would be submitted on a confidential basis to the extent permitted by law and the credit rating agency would not need to make it public or update it on the form (but would have to keep it current through proposed financial reporting requirements).[43]

After registration, the credit rating agency (now an NRSRO under the Act) would need to promptly update the information on its Form NRSRO to the extent an item or exhibit becomes materially inaccurate, with certain exceptions.[44] In addition, on a calendar year basis, the credit rating agency would need to furnish the Commission with an annual certification on Form NRSRO that the information and documents in the form continues to be accurate and listing any material changes that occurred during the year.[45] The most recently furnished Form NRSRO (initial, amended, or annual certification) and public exhibits would be the operative registration application and would need to be made public by the NRSRO (with exceptions for certain confidential information).

After registration, the NRSRO would be subject to several substantive rules. First, the NRSRO would be subject to a recordkeeping rule, under which the NRSRO would be required to make and retain certain records relating to the business of issuing credit ratings.[46] These records would assist the Commission, through its examination process, in monitoring whether the NRSRO complies with the requirements of the Act. Other required records would assist the Commission in monitoring whether the NRSRO follows its established policies and procedures.

On an annual fiscal year basis, an NRSRO would be required to furnish the Commission with audited financial statements.[47] This requirement is designed to assist the Commission in monitoring whether the credit rating agency continues to maintain adequate financial resources to consistently produce credit ratings with integrity. The financial reports also would include a schedule of the NRSRO's largest customers. This would assist the Commission in monitoring for potential conflicts of interest arising from

[27] *See* Testimony of Commissioner Annette L. Nazareth, then Director, Division of Market Regulation, Commission, Before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Regarding Credit Rating Agencies (April 12, 2005) (Available on the Commission's Web site at *http://www.sec.gov/news/testimony/ts041205aln.htm).*

[28] *See* Section 2 of the Act and Senate Report.

[29] 15 U.S.C. 78c.

[30] 15 U.S.C. 78o–7.

[31] 15 U.S.C. 78q.

[32] *See e.g., IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies,* September 25, 2003; *Code of Conduct Fundamentals for Credit Rating Agencies* (IOSCO Technical Committee), December 2004.

[33] *See* Section 15E(*l*) of the Exchange Act (15 U.S.C. 78o–7(*l*)). This provision of the Act renders moot the Commission's earlier proposals to define the term ''NRSRO'' by rule and, consequently, they are withdrawn. *See Capital Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934,* Exchange Act Release No. 39457 (December 17, 1997), 62 FR 68018 (December 30, 1997); *Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization,* Securities Act Release No. 8570, (April 22, 2005), 70 FR 21306 (April 25, 2005).

[34] Section 15E(p) of the Exchange Act (15 U.S.C. 78o–7(p)). The Act was enacted on September 29, 2006 and June 26, 2007 is 270 days after that date.

[35] Section 15E(*l*)(2) of the Exchange Act (15 U.S.C. 78o–7(*l*)(2)).

[36] *Id.*

[37] Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o–7(c)(2)).

[38] *Id.*

[39] The proposed rules would be codified respectively at 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–4 (''Rule 17g–4''); 17 CFR 240.17g–5 (''Rule 17g–5''); and 17 CFR 240.17g–6 (''Rule 17g–6''). Further specifics of this proposed regulatory program—including citations to provisions in the proposed rules and statutory provisions of the Act—are provided in the following sections describing the proposed rules individually.

[40] Proposed Rule 17g–1.

[41] *See* Sections 15E(a)(1)(B) and (b)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B) and (b)(1)), Proposed Rule 17g–1, Form NRSRO, and instructions for the form.

[42] *See* Senate Report.

[43] *See* Sections 15E(a)(1)(B)(viii) and (ix) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(viii) and (ix)), proposed Rule 17g–3, Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b–2, 17 CFR 200.80, and 17 CFR 200.83.

[44] *See* Section 15E(b)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B) and (b)(1)), proposed Rule 17g–1, Form NRSRO, and instructions for the form.

[45] Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o–7(b)(2)), proposed Rule 17g–1, Form NRSRO, and instructions for the form.

[46] Proposed Rule 17g–2.

[47] Proposed Rule 17g–3.

dealings with the NRSRO's largest customers.

Finally, all NRSROs would be subject to requirements designed to protect their impartiality with respect to issuing credit ratings. First, they would be required to establish, maintain, and enforce specific written policies designed to prevent the misuse of material non-public information.[48] Second, they would be subject to requirements to avoid, manage, and disclose conflicts of interest.[49] Third, NRSROs would be prohibited from engaging in certain unfair, coercive, or abusive practices.[50]

B. Proposed Rule 17g–1—Registration Requirements

The provisions of proposed Rule 17g–1 would implement rulemaking authority under the Act with respect to how a credit rating agency must apply to be registered as an NRSRO, make the non-confidential information in its application public, apply to add an additional category of credit ratings to its registration, update its application, furnish the annual certification, and withdraw its registration.

1. Entities Eligible To Apply for Registration

The Act, by adding definitions to Section 3 of the Exchange Act,[51] identifies the types of entities that may apply for registration with the Commission as an NRSRO.[52] First, it defines a ''nationally recognized statistical rating organization'' as a credit rating agency that:

(A) Has been in business as a credit rating agency for at least the three consecutive years immediately preceding the date of its application for registration under section 15E [of the Exchange Act];

(B) Issues credit ratings certified by qualified institutional buyers, in accordance with section 15E(a)(1)(B)(ix) [of the Exchange Act], with respect to

(i) Financial institutions, brokers, or dealers;

(ii) Insurance companies;

(iii) Corporate issuers;

(iv) Issuers of asset-backed securities (as that term is defined in [17 CFR 229.1101(c)]);

(v) Issuers of government securities, municipal securities, or securities issued by a foreign government; or

(vi) A combination of one or more categories of obligors described in any of clauses (i) through (v); and

(C) Is registered under section 15E [of the Exchange Act].[53]

Section 3 of the Exchange Act also defines the term ''credit rating agency'' as any person:

(A) Engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;

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

(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.[54]

Finally, Section 3 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.'' [55]

Taken together, these three definitions limit the type of entity eligible to be registered with the Commission as an NRSRO. First, the entity must meet the definition of ''credit rating agency'' in Section 3 of the Exchange Act, which means, among other things, it must issue ''credit ratings'' as that term is defined in the act. Thus, an entity that issues ''credit ratings'' but does not receive compensation from issuers, investors, or other market participants would not be eligible for registration as an NRSRO because it would not meet the third prong of the definition of ''credit rating agency.'' [56] Similarly, an entity would not be eligible for registration based solely on the fact that it has issued recommendations with respect to equity securities (for example, buy, sell, or hold) or ratings with respect to the quality of a company's management. In either case, the entity would not have been issuing ''credit ratings'' as the term is defined because the recommendations and ratings are not assessments of the creditworthiness of an obligor or of specific securities or money market instruments.[57]

Another component of the first prong in the definition of ''credit rating agency'' is that the entity must be engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[58] The statute does not define ''reasonable fee.'' As a preliminary matter, the Commission believes that the fees contemplated by the definition are those charged by a credit rating agency, if any, for a customer to access or receive the credit ratings of the credit rating agency. The fees a credit rating agency charges for other services are not part of the definition, since regulatory users of credit ratings would not need access to these other services to comply with statutes and regulations using the term ''NRSRO.'' These other fees would include fees charged to issuers, obligors, or underwriters to determine or maintain a credit rating, fees charged to subscribers for credit analysis reports, and fees charged for consulting or other services.

Additionally, the Commission preliminarily believes that the determination of whether a fee for accessing or obtaining credit ratings is reasonable would depend on the facts and circumstances. The Commission requests comment on the issue of determination of the reasonableness of fees charged by NRSROs for accessing or obtaining their credit ratings; in particular, the Commission requests comment on this issue in the context of users of credit ratings for regulatory purposes.

Finally, if an entity meets the definition of ''credit rating agency,'' the entity must have been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration to be eligible to apply to register with the Commission as an NRSRO.

2. Description of Proposed Registration Rule (Rule 17g–1)

A credit rating agency that elects to be treated as an NRSRO must apply to the Commission to be registered as an NRSRO. Section 15E(a)(1)(A) of the Exchange Act provides that a credit rating agency applying for registration must furnish the Commission with an application in a form prescribed by Commission rule.[59] In addition, Section 15E(a)(1)(B) of the Exchange Act prescribes certain minimum information the credit rating agency must provide in

[48] Section 15E(g) of the Exchange Act (15 U.S.C. 78o–7(g)), proposed Rule 17g–4.

[49] Section 15E(h) of the Exchange Act (15 U.S.C. 78o–7(h)), proposed Rule 17g–5.

[50] Section 15E(i) of the Exchange Act (15 U.S.C. 78o–7(i)), proposed Rule 17g–6.

[51] 15 U.S.C. 78c.

[52] *See* Section 3 of the Act.

[53] Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)). Section 3(a)(64) of the Exchange Act defines the ''qualified institutional buyer'' (''QIB'') as having the ''meaning given such term in [17 CFR 230.144A(a)] or any successor thereto.'' 15 U.S.C. 78c(a)(62).

[54] Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

[55] Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

[56] *See* Section 3(a)(61)(C) of the Exchange Act (15 U.S.C. 78c(a)(61)(C)).

[57] *See* Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

[58] *See* Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A).

[59] 15 U.S.C. 78o–7(a)(1)(A).

the application.[60] This includes information regarding the categories of credit ratings set forth in the definition of ''NRSRO'' in Section 3(a)(62)(B) of the Exchange Act with respect to which the credit rating agency ''intends to apply for registration.''[61]

Paragraph (a) of proposed Rule 17g–1 would implement these provisions by providing that a credit rating agency applying to be registered with the Commission as an NRSRO would be required to furnish the Commission with an application on Form NRSRO. As discussed below, a credit rating agency would be able to apply to be registered for less than all five of the categories of credit ratings identified in Section 3(a)(62)(B) of the Exchange Act.[62] For example, the credit rating agency might not meet the definitional thresholds discussed above with respect to a particular category of credit rating because it has not issued credit ratings in that category for the three years preceding the date of its application.[63]

Paragraph (b)(1) of proposed Rule 17g–1 provides that an application would be considered furnished to the Commission on the date that the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the form.[64] The requirement that an application must be accurate and complete comports with the requirements imposed on other classes of registrants under the Exchange Act.[65] In addition, Section15E(a)(2)(A) of the Exchange Act requires the Commission to grant the application for registration or commence proceedings on whether to deny it within 90 days from the date the application is furnished to the Commission or a longer period if the applicant consents.[66] Moreover, if proceedings are commenced, Section 15E(a)(2)(B) of the Exchange Act[67] requires the Commission to conclude them within 120 days of the date the application was furnished to the Commission.[68] As a result, the Commission must have a complete application before the 90-day and 120-day periods begin to run.

Paragraph (b)(1) of proposed Rule 17g–1 also provides that information submitted with the application on a confidential basis would be accorded confidential treatment to the extent permitted by law. As discussed in detail below, the information proposed to be required in Form NRSRO includes information which an NRSRO would need to make public after registration and information that is submitted on a confidential basis to the extent permitted by law. Some of the confidential information is required by Section 15E(a)(1)(B) of the Exchange Act.[69] The Commission also would require certain additional information under authority conferred by Section 15E(a)(1)(B)(x) of the Exchange Act.[70] The Commission believes that it would be appropriate to provide confidential treatment to some of this information as well. Because the statute does not specifically grant confidential treatment to the additional information, the Commission would provide it through paragraph (b)(1) of proposed Rule 17g–1 to the extent permitted by law.

Paragraph (b)(2) of proposed Rule 17g–1 would provide a mechanism for a credit rating agency to withdraw its application before the Commission takes final action on it.[71] Specifically, it would require the credit rating agency to furnish the Commission with a written notice of withdrawal executed by a duly authorized person. The proposed requirement for execution by a duly authorized person is designed to ensure that the withdrawal notice reflects the intent of the credit rating agency.

Paragraph (c) of proposed Rule 17g–1 would provide that if information on the application becomes materially inaccurate before the Commission has granted or denied the application, the credit rating agency must promptly notify the Commission and amend the application with accurate and complete information by submitting an amended initial application on proposed Form NRSRO.[72] Because preparing and furnishing an amended form may take time, this proposed notification provision is designed to alert the Commission as soon as possible that the application before it is materially inaccurate or incomplete. The intent is to avoid situations where the Commission continues to review an application that is no longer materially accurate.

Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, shall require an NRSRO, after registration, to make the information submitted in its completed application and any amendments publicly available on its Web site or through another comparable, readily accessible means.[73] It also permits the Commission to determine by rule the information that shall be made publicly available.[74]

Paragraph (d) of proposed Rule 17g–1 would require that the information be made publicly available within five business days of the NRSRO being registered or furnishing an amendment or annual certification. The five business-day period is intended to provide the NRSRO with sufficient time to make the information public while also designed to ensure that users of credit ratings would have access to information within a reasonably short timeframe. Under the proposed rule, certain additional information submitted pursuant to Commission rulemaking authority also would not need to be made publicly available after registration.[75] In addition, an applicant could seek confidential treatment for information in the application under existing law and rules governing confidential treatment.[76] The Commission would accord this information confidential treatment to the extent permitted by law.

While Section 15E(a)(3) of the Exchange Act[77] does not require an applicant to make the public information in its application publicly available until after registration, this information typically would be made available by the Commission to

[60] 15 U.S.C. 78o–7(a)(1)(B).

[61] *See* Section 15E(a)(1)(B)(vii) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(vii)).

[62] 15 U.S.C. 78c(a)(62)(B).

[63] *See* definition of ''NRSRO'' in Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)).

[64] This provision would be implemented under the Commission's authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o–7(a)(1)(A)).

[65] *See e.g.*, 17 CFR 240.15b1–1 and 17 CFR 240.15b3–1 (broker-dealers); 17 CFR 240.15Ba2–1 (municipal securities dealers); 17 CFR 240.17Ab2–1 (clearing agencies); and 17 CFR 240.17Ac2–1 (transfer agents).

[66] 15 U.S.C. 78o–7(a)(2)(A).

[67] 15 U.S.C. 78o–7(a)(2)(B).

[68] Under Section 15E(a)(2)(B)(iii) of the Exchange Act, the Commission can extend this period for an additional 90 days for good cause or for such other period as the applicant consents (15 U.S.C. 78o–7(a)(2)(B)(iii)). Practically, an applicant would need to consent to extend both the period for the Commission to make the initial determination and the 120-day period to conclude proceedings, since the 120-day period begins when the application is furnished to the Commission, not when the Commission determines to commence proceedings.

[69] *See* Sections 15E(a)(1)(B)(viii) and (ix) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(viii) and (ix)).

[70] 15 U.S.C. 78o–7(a)(1)(B)(x).

[71] The withdrawal of a granted registration is discussed separately below.

[72] This provision would be implemented under the Commission's authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o–7(a)(1)(A)).

[73] 15 U.S.C. 78o–7(a)(3).

[74] Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o–7(a)(3)). As discussed below, the Commission proposes not to require an NRSRO to make public certain information required in the application, including the information about the applicant's 20 largest issuer and subscriber customers and the QIB certifications.

[75] *See* discussion below with respect to Exhibits 10 through 13 of proposed Form NRSRO.

[76] *See* 17 CFR 200.80 and 17 CFR 200.80a.

[77] 15 U.S.C. 78o–7(a)(3).

members of the public before the application is acted on by the Commission. As noted above, an applicant could seek confidential treatment for information in the application under existing laws and rules governing confidential treatment.[78] This would be consistent with how the Commission treats applications of other entities.

As noted, a credit rating agency may apply to be registered for fewer than all five categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act.[79] Paragraph (e) of proposed Rule 17g–1 would create a mechanism for an NRSRO registered for fewer than the five categories to apply to be registered with respect to an additional category.[80] The proposed rule provides that the NRSRO would need to furnish an amended Form NRSRO and indicate where appropriate on the form the additional category for which it is applying to be registered.[81] The proposed rule also provides that the application to register for an additional category would be subject to the requirements in proposed Rule 17g–1 and Section 15E of the Exchange Act[82] applicable to an initial application. For example, the provisions of paragraph (b)(1) of proposed Rule 17g–1 regarding when an application is deemed to have been furnished to the Commission would apply, as would the provisions of paragraph (c) with respect to amending the application prior to registration being granted. The time periods for the Commission to act on the application set forth in Sections 15E(a)(2)(A) and (B) of the Exchange Act also would apply to the amended form.[83]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if, after registration, any information or document provided as part of the application becomes materially inaccurate.[84] The statute further provides that the information on credit ratings performance statistics (discussed more fully below) need only be updated on an annual basis and that the QIB certifications need not be updated.[85] Paragraph (f) of proposed Rule 17g–1 provides that an NRSRO would need to meet the statutory requirement to amend an application if information becomes materially inaccurate by promptly furnishing the amendment to the Commission on Form NRSRO.[86] The Act does not define the term ''promptly.'' The Commission believes the amendment should be furnished as soon as reasonably practicable after the NRSRO determines the information has become materially inaccurate. In most cases, the Commission believes that completing Form NRSRO, attaching any amended information and documents, and submitting the amendment package to the Commission should not take more than two days

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish the Commission with an amendment to its registration not later than 90 days after the end of each calendar year in a form prescribed by Commission rule.[87] This section further provides that the amendment must (1) Certify that the information and documents provided in the application for registration (except the QIB certifications) continue to be accurate and (2) list any material change to the information and documents during the previous calendar year.[88] Paragraph (g) of proposed Rule 17g–1 would implement these statutory provisions by requiring an NRSRO to furnish the amendment on Form NRSRO.

Finally, Section 15E(e)(1) of the Exchange Act provides that an NRSRO may withdraw from registration, subject to terms and conditions the Commission may establish as necessary in the public interest or for the protection of investors, by furnishing the Commission with a written notice of withdrawal.[89] Paragraph (h) of proposed Rule 17g–1 would provide that the notice must be executed by a person duly authorized by the NRSRO. The proposed requirement for execution by a duly authorized person is designed to ensure that the registration withdrawal notice reflects the intent of the credit rating agency. Section 15E(e)(1) of the Exchange Act also provides the Commission with the authority to establish additional terms and conditions with respect to the withdrawal of a credit rating agency's NRSRO registration as necessary in the public interest or for the protection of investors.[90] Such conditions potentially could include a requirement that the NRSRO provide public notice that its credit ratings will cease to be eligible for regulatory use.

The Commission generally requests comment on all aspects of this proposed rule. The Commission also seeks comment on whether the five-day time limit for making the non-confidential information in the application publicly available should be longer or shorter. For example, the Commission seeks comment on whether five days is a sufficient amount of time to make an initial application public, given the volume of information that may need to be posted on a Web site or made public through another comparable means. Additionally, the Commission requests comment on ways other than the Internet that the information could be made public that would be comparable to posting the information on a Web site, particularly in terms of ensuring that users of credit ratings would have a comparable ease of access to the information. Further, the Commission seeks comment on whether it should define the term ''promptly'' in section 15E(b)(1) of the Exchange Act[91] to mean a specific time period such as two, five, or ten business days or some other period.

C. Proposed Form NRSRO

1. Overview of How the Form Would Be Used

The Commission is proposing a new form, ''Form NRSRO,'' the ''Application for Registration as a Nationally Recognized Statistical Rating Organization.'' The form is designed to serve four functions: To apply for initial registration, to amend the scope of registration, to amend public information required by the form, and to make an annual certification. Instructions for the form describe how an applicant, and after registration, an NRSRO, should complete the form in each of these circumstances. The Commission construes the Act's requirement that implementing rules be ''narrowly tailored'' to also apply to proposed Form NRSRO.[92]

The Commission believes that having just one form (and one set of instructions) would reduce the burden on applicants, NRSROs, and

[78] *See* Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b–2, 17 CFR 200.80 and 17 CFR 200.83.

[79] Section 15E(a)(1)(B)(vii) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(vii)) provides that a credit rating agency must submit information with its application regarding the categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)) for which it ''intends to apply for registration.''

[80] This provision further implements Section 15E(a)(1) of the Exchange Act, which requires the Commission, by rule, to prescribe the form of an application for registration (15 U.S.C. 78o–7(a)(1)).

[81] The specific requirements for completing the Form NRSRO in this circumstance are described in the next section.

[82] 15 U.S.C. 78o–7.

[83] 15 U.S.C. 78o–7(a)(2)(A) and (B).

[84] 15 U.S.C. 78o–7(b)(1).

[85] *Id.*

[86] This provision further implements Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)), which requires the Commission, by rule, to prescribe the form of an application for registration.

[87] 15 U.S.C. 78o–7(b)(2).

[88] *Id.*

[89] 15 U.S.C. 78o–7(e)(1).

[90] 15 U.S.C. 78o–7(e)(1).

[91] 15 U.S.C. 78o–7(b)(1).

[92] Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o–7(c)(2)).

Commission staff. For example, it would reduce the complexity of having different forms for the application, amendments, and annual certification. Using one form also would allow NRSROs to more quickly become familiar with the form and its instructions, which would reduce the potential for making mistakes in completing the form. It also would assist users of credit ratings in understanding the form and public exhibits and where to look on the form for specific information.

A credit rating agency applying for registration as an NRSRO would need to complete the form by providing the required information in all the items (except Item 7) [93] and attaching all exhibits. The credit rating agency also would need to attach a minimum of 10 certifications from QIBs (with at least two addressing each category for which registration is sought), and a non-resident credit rating agency would need to attach the undertaking required under proposed Rule 17g–2 (discussed below).

The Commission would use the information provided on the form to make the threshold determination whether the applicant is a ''credit rating agency'' as defined in section 3(a)(61) of the Exchange Act and would meet the definition of ''NRSRO'' in section 3(a)(62) of the Exchange Act.[94] The Commission also would use the information on the form to determine whether the applicant meets the statutory requirements for registration.[95] Specifically, the Commission would use the information to determine whether the applicant has adequate financial and managerial resources to consistently produce credit ratings with integrity and to comply with its established policies and methodologies (*e.g.*, policies for determining credit ratings, managing material non-public information and conflicts of interest, and complying with applicable laws and regulations).[96] The Commission also would use the information to determine whether the credit rating agency, if granted registration, would not be subject to having its registration suspended or revoked under section 15E(d) of the Exchange Act.[97]

After registration, an NRSRO would use Form NRSRO if it sought to apply for registration with respect to an additional category of credit ratings. In this case, the NRSRO would not need to update the non-public exhibits, and it also would not need to update the public exhibits to the extent that information or documents previously provided remained materially accurate. However, the fact that the NRSRO was seeking to expand the scope of its registration to an additional category of credit ratings likely would mean certain information provided in the public exhibits would no longer be materially accurate. For example, the NRSRO may have established new or additional methodologies to determine credit ratings in the category for which it was seeking registration. These would need to be provided as an update to Exhibit 2.[98] Finally, the NRSRO would need to provide two QIB certifications for each category of credit rating for which it is applying to be registered.[99]

An NRSRO also would use Form NRSRO to amend the information on the form and in the public exhibits after registration.[100] The need to amend the form would arise whenever there was a material change to information in one of the items on the form (except for Items 6 and 7) [101] or to information or a document provided in a public exhibit. For example, if the NRSRO materially changed its procedures for preventing the misuse of material non-public information, the NRSRO would be required to furnish the Commission with an amendment on Form NRSRO and include the new procedures as an update to Exhibit 3.[102] It would not need to update the other public exhibits if the information in them remained materially accurate.

Finally, an NRSRO would use Form NRSRO to furnish the annual certification required by Section 15E(b)(2) of the Exchange Act.[103] This section requires the NRSRO to certify on an annual calendar-year basis that the information and documents provided in its application continue to be materially accurate (other than the QIB certifications).[104] It also requires the NRSRO to identify any material change to the information or documents that occurred during the previous calendar year.[105] In addition, Section 15E(b)(1) of the Exchange Act provides that the performance statistics about the NRSRO's credit ratings need only be updated on a yearly basis with the annual certification.[106]

The proposed Form NRSRO is designed to meet these statutory requirements. First, the certification on the facing page would include the representations needed for the annual certification; namely, that the NRSRO's application on Form NRSRO, as amended, continues to be accurate.[107] Second, Exhibit 1 would require information on credit rating performance statistics. The instructions would require this information to be provided in the initial application and, thereafter, updated with the annual certification (as opposed to the other public exhibits that would need to be updated promptly whenever they become materially inaccurate). The instructions also would require the NRSRO to include with the annual certification a list of each material change made during the previous calendar year.[108]

2. Items on the Form

Checkboxes indicating nature of submission. The first entry an applicant or NRSRO would make on Form NRSRO

[93] As discussed below, an NRSRO would need to complete Item 7 when furnishing an amendment to the form or the annual certification required under Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o–7(b)(2)).

[94] *See* 15 U.S.C. 78c(a)(61) and 15 U.S.C. 78c(a)(62).

[95] *See* Section 15E(a)(2)(C) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C)).

[96] *See* Section 15E(a)(2)(C)(ii)(I) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C)(ii)(I)).

[97] Section 15E(a)(2)(C)(ii)(II) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C)(ii)(II)) directs the Commission to deny a credit rating agency's application for registration as an NRSRO if the Commission finds that the applicant, if granted registration, would be subject to suspension or revocation of its registration under Section 15E(d) of the Exchange Act (15 U.S.C. 78o–7(d)).

[98] As discussed below, Exhibit 2 would elicit the methodologies used by the credit rating agency to determine credit ratings.

[99] Section 15E(a)(1)(C)(ii) of the Exchange Act requires an applicant to provide at least 2 QIB certifications for each category of credit rating for which the credit rating agency seeks to be registered (78o–7(a)(1)(C)(iii)).

[100] *See* Section 15E(b)(1) of the Exchange Act, which requires an NRSRO to update certain information provided in its application for registration (15 U.S.C. 78o–7(b)(1)).

[101] As explained below, Item 6 only would be used to provide information relating to the categories of credit ratings for which a credit rating agency was applying for registration. Therefore, unless the amendment is furnished to apply for registration in an additional category, Item 6 would not need to be completed or updated after registration. Item 7 requires information relating to current credit ratings, including information that could change relatively often such as the number of credit ratings currently issued. Therefore, this item would not need to be updated when information in the item materially changed. Instead, an NRSRO would be required to update it when furnishing a Form NRSRO for another reason.

[102] As discussed below, Exhibit 3 requires policies and procedures implemented by the NRSRO to prevent the misuse of material non-public information.

[103] 15 U.S.C. 78o–7(b)(2).

[104] Section 15E(b)(2)(A) of the Exchange Act (15 U.S.C. 78o–7(b)(2)(A)).

[105] Section 15E(b)(2)(B) of the Exchange Act (15 U.S.C. 78o–7(b)(2)(B)).

[106] 15 U.S.C. 78o–7(b)(1)(A).

[107] *See* Section 15E(b)(2)(A) of the Exchange Act (15 U.S.C. 78o–7(b)(2)(A)).

[108] *See* Section 15E(b)(2)(B) of the Exchange Act (15 U.S.C. 78o–7(b)(2)(B)).

would be to indicate, by checking the appropriate box, the reason the form is being furnished: initial application, amendment, or annual certification. If an amendment, the NRSRO also would need to briefly describe the amendment on lines under the amendment check box. For example, if an NRSRO was filing the amendment because its address and organizational structure changed, the description of the amendments should be as brief as ''Item 1C (address change)'' and ''Exhibit 4 (new organizational structure).''

Item 1 (Identifying information). Item 1 of proposed Form NRSRO would elicit the name and address of the credit rating agency, and the name and address of the contact person for the credit rating agency. The instructions for proposed Form NRSRO would provide that the individual listed as the contact person must be authorized to receive all communications and papers from the Commission and would be responsible for their dissemination within the credit rating agency.

Item 2 (Legal status, place of formation, fiscal year end). Item 2 of proposed Form NRSRO would elicit the legal status of the credit rating agency (for example, corporation or partnership), the place and date of formation of the entity, and the fiscal year end of the credit rating agency. The information with respect to the fiscal year end of the applicant or NRSRO is relevant because Form NRSRO would require applicants to submit audited financial statements with the application. Proposed Rule 17g–3 would require NRSROs to annually furnish the Commission with audited financial statements covering the previous fiscal year.

Item 3 (Undertaking by non-resident NRSRO). Paragraph (f) of proposed Rule 17g–2 would require an NRSRO that does not reside in the United States to execute a written undertaking, in substantially the form provided in the proposed rule, to promptly provide books and records to the Commission in a form requested by the Commission, including translation into English. The proposed undertaking is designed to provide a means for the Commission to promptly obtain records subject to its examination authority located outside the U.S. without requiring that Commission staff travel to the location. In addition, because some non-resident NRSROs may maintain original records in a language other than English, the proposed undertaking would require a translation if the Commission requested it.

Item 3 of proposed Form NRSRO would require a non-resident applicant to attach the required undertaking to its initial application. If the application is granted, the undertaking would be in place when the applicant becomes an NRSRO and is subject to the proposed recordkeeping requirements. The prescribed form of the undertaking would make it applicable only to books and records a credit rating agency is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Exchange Act [109] or any regulation under the Exchange Act.[110] An applicant becomes subject to these recordkeeping requirements only after registration is granted and the applicant becomes an NRSRO.

Item 4 (Compliance officer). Section 15E(j) of the Exchange Act requires every NRSRO to designate an individual responsible for administering the policies and procedures of the credit rating agency to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.[111] Item 4 of proposed Form NRSRO would elicit the name of and contact information for this person.

Item 5 (Method of making form and public exhibits readily accessible). Section 15E(a)(3) of the Exchange Act provides that the Commission shall, by rule, require an NRSRO, upon the granting of registration, to make the non-confidential information and documents submitted to the Commission in the initial application, amendments, or annual certifications publicly available on the NRSRO's Web site or through another comparable, readily accessible means.[112] Item 5 of proposed Form NRSRO would elicit information on how the applicant would make the public information readily accessible. Providing this information on proposed Form NRSRO would assist the Commission in verifying that the NRSRO is complying with this requirement and assist the public in locating the information to assess the credibility and integrity of the NRSRO.

Item 6 (Categories of credit ratings for which registration is sought and QIB certifications). Item 6 of proposed Form NRSRO would only need to be completed when a credit rating agency was furnishing an initial application to be registered as an NRSRO and when an NRSRO was applying to expand the scope of its registration by adding an additional class of credit ratings. This item would elicit information about the categories of credit ratings for which the applicant was applying for registration. It also would require the applicant to attach the QIB certifications to the application (unless the applicant was exempt from this requirement under Section 15E(a)(1)(D) of the Exchange Act).[113]

Section 15E(a)(1)(B)(vii) of the Exchange Act requires an applicant for NRSRO registration to provide information with respect to the categories of credit ratings for which it is applying to be registered.[114] Item 6 of proposed Form NRSRO would require a credit rating agency applying for registration, and an NRSRO applying to add a category of credit ratings to its registration, to indicate the categories of credit ratings for which registration was being sought.

Item 6 also would elicit the approximate number of credit ratings issued in each category as of the date of the application, and the number of consecutive years preceding the date of the application that the credit rating agency has issued credit ratings with respect to each category indicated. This information would be used by the Commission in verifying that the credit rating agency meets the definitional thresholds for registration as NRSRO, including that the entity has been in business as a credit rating agency for the three consecutive years preceding the date of its application.[115]

Item 6 also would elicit a brief description of how the credit rating agency makes its credit ratings readily accessible. The Commission would use this information to verify that the applicant meets another definitional threshold for registration eligibility; namely, that the applicant issues credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[116] The Act does not define ''readily accessible'' other than to specify that the method must be comparable to the Internet in terms of accessibility.[117] Moreover, as discussed above, the Act does not define ''reasonable fee.'' However, the Commission believes the ''fee''

[109] 15 U.S.C. 78a *et seq.*

[110] This would include the records required to be retained in proposed Rule 17g–2.

[111] 15 U.S.C. 78o–7(j).

[112] 15 U.S.C. 78o–7(a)(3). Paragraph (d) of proposed Rule 17g–1 (discussed above) would implement this rulemaking authority.

[113] 15 U.S.C. 78o–7(a)(1)(D).

[114] 15 U.S.C. 78o–7(a)(1)(B)(vii).

[115] As discussed above, the definitions of ''credit rating,'' ''credit rating agency,'' and NRSRO in, respectively, Sections 3(a)(60), (61) and (62) of the Exchange Act prescribe the type of entity that is eligible for registration as an NRSRO (15 U.S.C. 78c(a)(60), (61) and (62)).

[116] Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A)).

[117] *Id.*

contemplated by the statute is the fee charged to access or receive the credit ratings of the credit rating agency (*i.e.*, not the fees charged for other services). This information elicited in Item 6 (and after registration in Item 7) would assist the Commission in monitoring the cost to regulatory users of credit ratings of accessing or obtaining NRSRO credit ratings.

Finally, Item 6 would require the applicant to provide QIB certifications. Section 15E(a)(1)(B)(ix) of the Exchange Act requires an applicant to submit a minimum of ten QIB certifications with the application.[118] Sections 15E(a)(1)(C)(i), (ii), and (iii) further provide, respectively, that: (1) The certifying QIB must not be affiliated with the applicant; (2) the certification may address more than one of the categories of credit ratings for which the applicant is seeking registration; and (3) at least two of the certifications must address each category of credit ratings for which the applicant is seeking registration.[119] Section 15E(a)(1)(C)(iv) provides that the QIB must state in the certification that it meets the definition of a ''QIB'' in Section 3(a)(64) of the Exchange Act[120] and that the QIB has used the credit ratings of the applicant for at least three years immediately preceding the date of the application in the subject category or categories of subscribers.[121] The Senate Report explained that the term ''used'' was intended to mean the QIB ''seriously considered the ratings in some of [its] investment decisions.''[122]

The proposed instructions to Item 6 would prescribe the form of the QIB certification. For example, consistent with Section 15E(a)(1)(C)(i)(I) of the Exchange Act[123] and the Senate Report explaining that section, the QIB certification would be required to include a representation that the QIB ''has seriously considered the credit ratings of [the credit rating agency] in the course of making investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings.''[124] The QIB certification also would be required to be executed by a person duly authorized by the QIB to make the certification on behalf of the QIB.[125] This is designed to ensure that the certification is that of the QIB and not an employee of the QIB who may have an interest (distinct from that of the QIB) in providing the certification to the applicant. In addition, as a measure designed to ensure the impartiality of the QIB's assessment, the QIB would need to certify that it had not received compensation for providing the certification.

Item 6 of proposed Form NRSRO also would require the applicant to indicate whether it was submitting the QIB certifications and, if so, how many certifications were being submitted or that the applicant was exempt from the requirement to provide the certifications. Under Section 15E(a)(1)(D) of the Exchange Act, a credit rating agency is not required to submit the QIB certifications if it was identified as an NRSRO in a Commission staff no-action letter issued before August 2, 2006.[126]

The Commission requests comment on whether there should be a requirement for an NRSRO to notify the Commission if a QIB withdraws its certification.

Item 7 (Categories of credit ratings covered by current registration). Item 7 would solicit information about the categories of credit ratings for which the NRSRO was currently registered, the approximate number of credit ratings currently outstanding in each category, and the number of years the NRSRO has issued credit ratings in that category. It also would elicit information about how the NRSRO makes its credit ratings readily accessible to users of credit ratings.

Because some of the information in Item 7 may change fairly regularly, this Item would need to be updated if it became materially inaccurate only when the NRSRO furnishes the next Form NRSRO either as an amendment or as an annual certification. Thus, if the information in Item 7 became materially inaccurate, it would be updated on an annual basis at a minimum.

The information requested in Item 7 would allow users of credit ratings to assess the NRSRO with respect to the number of credit ratings it has issued and the number of years it has issued credit ratings in each category for which it is registered.[127]

Item 8 (Potential statutory disqualifications). Section 15E(a)(2)(C)(ii)(II) of the Exchange Act[128] directs the Commission to deny a credit rating agency's application for registration as an NRSRO if the Commission finds that the applicant, if granted registration, would be subject to suspension or revocation of its registration under Section 15E(d) of the Exchange Act.[129] Section 15E(d) of the Exchange Act[130] provides that the Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO, if the Commission finds that the NRSRO or a person associated with the NRSRO has committed certain acts described in Sections 15(b)(4)(A), (D), (E), (G), or (H) of the Exchange Act,[131] been convicted of certain offenses described in Section 15(b)(4)(B) of the Exchange Act,[132] been convicted of certain other offenses, or if a person associated with the NRSRO is subject to a Commission order suspending or barring the person from being associated with an NRSRO. Item 8 of proposed Form NRSRO would ask whether the acts, convictions or orders described in Section 15E(d) of the Exchange Act[133] applied to the credit rating agency or any person associated with the credit rating agency.

If a question in Item 8 was answered ''yes,'' the credit ratingagency would be required to provide additional information on a Disclosure Reporting Page (DRP) NRSRO as set forth in the instructions for Form NRSRO. The Commission would then need to evaluate whether an applicant's registration could be granted in light of the disclosure. After registration, an NRSRO would need to update the information in Item 8 if there was a change. The Commission would then evaluate whether it would be appropriate to issue an order censuring,

[118] 15 U.S.C. 78o–7(a)(1)(B)(ix).

[119] *See* 15 U.S.C. 78o–7(a)(1)(C)(i), (ii) and (iii), respectively.

[120] 15 U.S.C. 78c(a)(64).

[121] 15 U.S.C. 78o–7(a)(1)(C)(iv).

[122] The Senate Report further explained that ''a QIB whose analysts regularly read and consider [a credit rating agency's] ratings in the course of making investment decisions would have ''used'' them under the meaning of the bill. A QIB whose employees subscribe to or regularly receive the ratings but do not read them or, if they read them, rarely or never consider them in making their investment decisions would not be deemed to have ''used'' the ratings.''

[123] 15 U.S.C. 78o–7(a)(1)(C)(i)(I).

[124] Instructions to Item 6D of proposed Form NRSRO.

[125] *Id.*

[126] 15 U.S.C. 78o–7(a)(1)(D).

[127] Because Item 7 would not have been filled out when the NRSRO applied for registration, it would remain blank for a period of time between the granting of an initial registration and the time when the NRSRO furnishes a new Form NRSRO either as an amendment or annual certification. Item 6, however, would have been filled out as part of the application for registration. This item requires the same information as Item 7. Therefore, users of credit ratings would have the access to the information through Item 6 until the NRSRO furnished a new Form NRSRO. Thereafter, the information would be located in Item 7.

[128] 15 U.S.C. 78o–7(a)(2)(C)(ii)(II).

[129] 15 U.S.C. 78o–7(d).

[130] 15 U.S.C. 78o–7(d).

[131] 15 U.S.C. 78o–7(b)(4)(A), (D), (E), (G) and (H).

[132] 15 U.S.C. 78o(b)(4).

[133] 15 U.S.C. 78o–7(d).

placing limitations on the activities, functions, or operations of, suspending for a period not exceeding 12 months, or revoking the registration of the NRSRO as provided for under Section 15E(d) of the Exchange Act.[134]

Certification. Proposed Form NRSRO would require the signature of an authorized person of the credit rating agency representing that the information and statements contained in the form are current, accurate, and complete or, if the NRSRO is submitting an annual certification, that the application, as amended, is current, accurate, and complete.

3. Exhibits to the Form

Proposed Form NRSRO would have 13 exhibits. Sections 15E(a)(1)(B)(i), (ii), (iii), (iv), (v), (vi), and (viii) of the Exchange Act require the furnishing of some of this information.[135] The Commission is proposing to require the furnishing of the remainder of the information pursuant to its authority under Section 15E(a)(1)(B)(x) of the Exchange Act.[136] The proposed exhibits are an important part of the program for NRSRO oversight. Therefore, the information and documents proposed to be provided in the exhibits must be sufficiently detailed to allow the Commission to evaluate and verify the information and, with respect to the public exhibits, assist users of credit ratings in understanding how the NRSRO manages its activities.

Exhibits 1 through 9 would be public exhibits that the NRSRO would be required to keep current through furnishing updated information and make readily accessible to the public. The information in these public exhibits would be useful to the users of credit ratings in assessing the ratings quality of the NRSRO and in comparing the NRSRO to other NRSROs.

Exhibits 10 through 13 would be accorded confidential treatment by the Commission, to the extent permitted by law, under provisions of Section 15E of the Exchange Act[137] in conjunction with proposed Rule 17g–1.[138] The information in the public and confidential exhibits would be used by the Commission to make the determination whether the credit rating agency has adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with the methodologies, policies, and procedures it discloses in the public exhibits.[139]

The information in Exhibits 10 through 13 would not need to be updated by furnishing amendments on proposed Form NRSRO after registration is granted. Instead, this information would be updated through the proposed financial reporting rule (proposed Rule 17g–3). Section 15E(b)(1) of the Exchange Act[140] provides that information submitted with an application must be updated promptly when the information becomes materially inaccurate, except information submitted under Sections 15E(a)(1)(B)(i) and (ix) of the Exchange Act (respectively, the performance statistics, which must be updated annually, and the QIB certifications, which need not be updated).[141] Thus, under the statute, the information provided in Exhibits 10 through 13 would need to be updated promptly if it became materially inaccurate. However, the Commission is not proposing that an NRSRO update these exhibits by furnishing the information to the Commission in Form NRSRO amendments. Rather, the Commission is proposing that the NRSRO would update this information as part of the financial statements that would be required to be furnished under proposed Rule 17g–3.

Exhibit 1 (Public). Section 15E(a)(1)(B)(i) of the Exchange Act requires that an application for registration as an NRSRO contain credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable).[142] This information would be required as Exhibit 1 to proposed Form NRSRO. The Exchange Act does not otherwise define or identify the particular credit rating performance statistics to be provided with the application. The Commission believes credit rating agencies typically generate statistical reports showing historical default and downgrade rates within each credit rating notch or grade.[143] Further, the Commission believes these types of statistics are important indicators of the performance of a credit rating agency in terms of its ability to assess the creditworthiness of issuers and obligors and, consequently, would be useful to users of credit ratings in evaluating an NRSRO.

In addition to historical default and downgrade rates, the instructions to proposed Form NRSRO also would provide that an applicant or NRSRO include in the exhibit definitions of the credit ratings (*i.e.*, an explanation of each grade or notch) and explanations of the performance measurement statistics, including the metrics used to derive the statistics. The Commission believes that requiring this information would be necessary or appropriate in the public interest or for the protection of investors because it would assist users of credit ratings in understanding how the measurements were derived and in making comparisons with the measurement statistics of other NRSROs.[144]

The definitions of the notches and grades also would assist the Commission in assessing whether the NRSRO's ratings, as a practical matter, can be used for certain Commission rules. For example, paragraph(c)(2)(vi)(F) of Commission Rule 15c3–1 specifies lower haircuts for debt securities that are rated in one of the ''four highest rating categories'' (*i.e.*, notches) of at least two NRSROs.[145] The current NRSROs generally have at least eight notches for their debt securities with the top four commonly referred to as ''investment grade.'' If an NRSRO decided to use less than eight notches, the Commission would need to evaluate whether, based on the NRSRO's definitions, securities that would be included in the top four notches would be suitable for the lower haircuts specified in paragraph(c)(2)(vi)(F) of Rule 15c3–1.[146]

The Commission generally requests comment on Exhibit 1. The Commission also requests comment on whether the performance measurement statistics should use standardized inputs, time horizons and metrics to allow for greater comparability. Commenters are requested to provide specific details as to how these statistical measures could

[134] 15 U.S.C. 78o–7(d).

[135] 15 U.S.C. 78o–7(a)(1)(B)(i), (ii), (iii), (iv), (v), (vi), and (viii).

[136] 15 U.S.C. 78o–7(a)(1)(B)(x).

[137] *See* Sections 15E(a)(1)(B)(viii), (a)(1)(B)(ix), and (k) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(viii), (a)(1)(B)(ix), and (k).

[138] *See also* Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b–2, 17 CFR 200.80 and 17 CFR 200.83.

[139] *See* Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[140] 15 U.S.C. 78o–7(b)(1).

[141] 15 U.S.C. 78o–7(a)(1)(B)(i) and (ix).

[142] 15 U.S.C. 78o–7(a)(1)(B)(i).

[143] The credit rating notches or grades of a credit rating agency generally are represented by symbols, numbers or other designations that are used to distinguish the creditworthiness of the obligors, securities and money market instruments the credit rating agency rates. For example, some credit rating agencies use symbols such as AAA, AA, A, BBB, BB, B, CCC, and CC to distinguish the creditworthiness of corporate debt securities. AAA would be the highest rating and CC would be the lowest rating above the default or regulatory supervision of the issuer.

[144] Section 15E(a)(1)(B)(x) of the Exchange Act provides that the Commission can require additional information that it finds is necessary or appropriate in the public interest or for the protection of investors (15 U.S.C. 78o–7(a)(1)(B)(x)).

[145] 17 CFR 240.15c3–1(c)(2)(vi)(F).

[146] *Id.*

be standardized. The Commission further requests comment on whether credit rating agencies or other persons currently use other performance measurement statistics or whether other performance measurement statistics would be appropriate as an alternative, or in addition, to historical default and downgrade rates. For example, the Commission requests comment on whether Exhibit 1 should require measurement of the performance of a given credit rating by comparing or mapping it to the market value of the rated security or to extreme declines in the market value of the security after the rating. The Commission additionally requests comment on whether the requirement to include definitions and explanations in Exhibit 1 would achieve its stated purpose.

Exhibit 2 (Public). Section 15E(a)(1)(B)(ii) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding the procedures and methodologies used by the credit rating agency to determine credit ratings.[147] This information would be required as Exhibit 2 to proposed Form NRSRO. The Exchange Act does not otherwise define or identify the procedures and methodologies that must be provided under this section.[148] However, the definition of ''credit rating agency'' in Section 3(a)(61) of the Exchange Act provides that a ''credit rating agency'' is an entity that, among other things, ''employ[s] either a quantitative or qualitative model, or both, to determine credit ratings.'' [149]

The Commission believes that entities meeting the definition of ''credit rating agency'' in Section 3(a)(61) of the Exchange Act [150] generally establish procedures and methodologies for determining credit ratings in the following areas: the determination of whether to initiate a credit rating; the use of public and non-public sources of information to perform credit rating analysis, including information and analysis provided by third-party vendors; the use of quantitative and qualitative models and metrics to determine credit ratings; the interaction with the management of a rated obligor or issuer of rated securities; the establishment of the structure and voting process of committees that review or approve credit ratings; the notification of rated obligors or issuers of rated securities about credit rating decisions and for appeals of final or pending credit rating decisions; monitoring, reviewing, and updating of credit ratings; and the withdrawal, or suspension of the maintenance, of a credit rating.

This list identifies areas where a credit rating agency could establish procedures and methodologies for determining credit ratings. The applicability of certain areas to a particular credit rating agency may depend on whether it uses subjective qualitative analysis, purely quantitative models or a combination of both.[151] Consequently, an applicant and NRSRO may not establish a procedure or methodology in a given area because doing so would not be relevant to how the credit rating agency determines credit ratings.

In addition, credit rating agencies that issue ''unsolicited'' credit ratings may establish procedures and methodologies in the areas described above that are unique to such ratings. An ''unsolicited'' credit rating is one the credit rating agency decides to initiate without being requested to do so by an issuer, obligor, underwriter, or other interested party. Credit rating agencies that use a subscription fee based business model may only issue unsolicited ratings because that business model does not rely on fees from issuers, obligors, and underwriters to determine specific credit ratings (issuers, obligors, and underwriters, however, may subscribe to receive the credit ratings of such credit rating agencies). The procedures and methodologies these credit rating agencies employ, in some respects, may be unique to this business model.

Credit rating agencies that are paid by issuers, obligors, and underwriters to determine specific credit ratings sometimes also issue unsolicited ratings. As discussed below with regard to proposed Rule 17g–6, this practice has led to concerns that unsolicited ratings may be used to coerce issuers and obligors into ultimately paying the credit rating agency to determine and maintain the credit rating. Consequently, the Commission believes that credit rating agencies that rely on fees from issuers, obligors, and underwriters to determine specific credit ratings, but also issue unsolicited ratings, often have established procedures and methodologies for determining unsolicited credit ratings that are designed to address this concern and the fact that the issuer or obligor may not have participated in the determination of the credit rating (as is frequently the case with a solicited credit rating).

The Commission believes that information regarding the procedures and methodologies established by an NRSRO in the areas described above, including those with respect to unsolicited credit ratings, as applicable, would be useful to users of credit ratings. The information would provide an understanding of the nature of the credit rating agency (*i.e.*, a user of quantitative models, qualitative analysis, or a combination of both) and how the credit rating agency produces credit ratings. This would provide a basis for comparing NRSROs. The disclosure also would provide the Commission with an understanding of the managerial and financial resources required to produce the credit ratings. This would assist the Commission in evaluating whether an applicant or NRSRO has adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[152]

The Commission generally requests comment on Exhibit 2, as proposed. The Commission also requests comment on whether the areas identified above are the areas where credit rating agencies establish procedures and methodologies for determining credit ratings. A commenter that believes one or more of the areas identified above is not one where any type of credit rating agency establishes procedures and methodologies should identify each area and explain the reason for such conclusion. The Commission also requests comment on whether there are additional areas where credit rating agencies establish procedures and methodologies for determining credit ratings and, if so, requests that commenters identify them.

Exhibit 3 (Public). Section 15E(a)(1)(B)(iii) of the Exchange Act [153] requires that an application for registration as an NRSRO contain information regarding policies or procedures adopted and implemented by the credit rating agency to prevent the misuse, in violation of Exchange Act [154] provisions and rules, of material, non-public information. Exhibit 3 would require an applicant and NRSRO to furnish its policies and procedures to prevent the misuse of material, nonpublic information established

[147] 15 U.S.C. 78o–7(a)(1)(B)(ii).

[148] *See* 15 U.S.C. 78a *et seq.*

[149] *See* particularly, Section 3(a)(61)(B) of the Exchange Act (15 U.S.C. 78c(a)(61)(B)).

[150] 15 U.S.C. 78c(a)(61).

[151] *See* Section 3(a)(61) of the Exchange Act defining the term ''credit rating agency'' (15 U.S.C. 78c(a)(61)).

[152] *See* Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[153] 15 U.S.C. 78o–7(a)(1)(B)(iii).

[154] 15 U.S.C. 78a *et seq.*

under Section 15E(g) of the Exchange Act [155] and proposed Rule 17g–4.

Section 15E(g)(1) of the Exchange Act [156] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[157] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[158] As discussed below, proposed Rule 17g–4 would implement this statutory provision by requiring an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act [159] to include certain specific types of procedures.

The Commission generally requests comment on Exhibit 3, as proposed.

Exhibit 4 (Public). Section 15E(a)(1)(B)(iv) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding the organizational structure of the applicant.[160] This information would be required as Exhibit 4 to proposed Form NRSRO. The Exchange Act does not otherwise define or identify the specific type of organizational information that should be provided under Section 15E(a)(1)(B)(iv) of the Exchange Act.[161] The Commission believes that companies typically create, as applicable, an organizational chart showing ultimate and sub-holding companies, subsidiaries, and material affiliates; an organizational chart showing divisions, departments, and business units within the entity; and an organizational chart showing the management structure and senior management reporting lines within the entity.

The Commission believes that, if a credit rating agency is part of a holding company structure, users of credit ratings and the Commission would benefit from an organizational chart showing the entity's ultimate and sub-holding companies, subsidiaries, and material affiliates. This chart would provide an understanding of where potential conflicts of interest relating to the business activities of related companies might arise. Also, the fact that a credit rating agency has a holding company that potentially could provide financial support would be relevant to the Commission's evaluation of whether an applicant or NRSRO has adequate financial resources as required under the Exchange Act.[162]

The Commission further believes that, if a credit rating agency engages in business activities in addition to determining credit ratings, users of credit ratings and the Commission would benefit from an organizational chart showing the entity's divisions, departments, and business units. This chart would provide an understanding of where potential conflicts of interest relating to ancillary business activities might arise.

Finally, the Commission believes that users of credit ratings and the Commission would benefit from an organizational chart showing an NRSRO's management structure and senior management reporting lines. This chart would assist the Commission in evaluating whether an applicant and NRSRO has adequate managerial resources as required under the Exchange Act.[163] Users of credit ratings also would be able to use this information to compare the managerial resources of different NRSROs.

Additionally, the instructions to proposed Form NRSRO would provide that this managerial chart include the compliance officer designated by the NRSRO pursuant to Section 15E(j) of the Exchange Act.[164] The Commission believes that including the compliance officer in the chart would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission and users of credit ratings in understanding the degree of the compliance officer's independence from the business managers.[165] The Commission believes users of credit ratings would find the compliance officer's reporting lines relevant in assessing the integrity of the credit rating process of a particular NRSRO, since the officer is responsible for administering the credit rating agency's policies and procedures required by Sections 15E(g) and (h) of the Exchange Act [166] and for ensuring the NRSRO's compliance with the securities laws and rules and regulations thereunder.[167] In carrying out these responsibilities, a compliance officer would need to review activities overseen by senior business managers. The ability of the compliance officer to objectively review an area could be impacted by whether the officer reported to the senior manager responsible for the area. Thus, the relative independence of the compliance officer would be relevant to assessing the NRSRO's ability to ensure compliance with its policies and procedures.

For these reasons, Exhibit 4 would provide that the information about the organizational structure of the applicant or NRSRO required to be furnished and made public under Section 15E(a)(1)(B)(iv) of the Exchange Act [168] consist of charts showing the managerial structure and senior management reporting lines, and, if applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the entity, and the divisions, departments, and business units within the entity. The exhibit also would require that the management chart include the designated compliance officer.

The Commission generally requests comment on Exhibit 4, as proposed. The Commission specifically also requests comment on whether including the compliance officer in the chart would achieve the stated purpose of the requirement. The Commission further requests comment on whether other organizational information should be provided, or whether some of the information proposed to be required should be eliminated or modified. Commenters who believe that other information should be provided are asked to describe the information and explain why it would be appropriate under Section 15E of the Exchange Act.[169]

Exhibit 5 (Public). Section 15E(a)(1)(B)(v) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding whether the applicant has a code of ethics in effect or an explanation of why the applicant has not established a code of ethics.[170] Exhibit 5 to proposed Form NRSRO would elicit this information by requiring an applicant and NRSRO to attach its code of ethics or an explanation of why it does not have a code of ethics. The Exchange Act does not otherwise define or identify the ''code of ethics'' that should be provided under Section

[155] 15 U.S.C. 78o–7(g).

[156] 15 U.S.C. 78o–7(g)(1).

[157] 15 U.S.C. 78a *et seq.*

[158] 15 U.S.C. 78o–7(g)(2).

[159] 15 U.S.C. 78o–7(g)(1).

[160] 15 U.S.C. 78o–7(a)(1)(B)(iv).

[161] *Id, see also,* 15 U.S.C. 78a *et seq.*

[162] *See* Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[163] *See* Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[164] 15 U.S.C. 78o–7(j).

[165] *See* Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(x)).

[166] 15 U.S.C. 78o–7(g) and (h).

[167] Section 15E(j) of the Exchange Act (15 U.S.C. 78o–7(j)).

[168] *Id.*

[169] 15 U.S.C. 78o–7.

[170] 15 U.S.C. 78o–7(a)(1)(B)(v).

15E(a)(1)(B)(v).[171] The Commission believes credit rating agencies should have the flexibility to establish a code of ethics appropriate for their business model and organizational structure and, consequently, is not proposing any specific elements that should be in the code of ethics, if any, furnished in this exhibit.

The Commission generally requests comment on Exhibit 5, as proposed. The Commission also requests comment on whether it should propose specific elements to be included in the code of ethics provided in Exhibit 5. Commenters who believe the Commission should propose specific elements are asked to describe them. The Commission further seeks comment on whether it should require in Exhibit 5 that NRSROs disclose whether they comply with international principles and codes of conduct related to credit rating agencies.

Exhibit 6 (Public). Section 15E(a)(1)(B)(vi) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding any conflict of interest relating to the issuance of credit ratings by the applicant and NRSRO.[172] Exhibit 6 to proposed Form NRSRO would require an applicant and NRSRO to identify, in general terms, the types of conflicts of interest that arise from its business as a credit rating agency.

The Exchange Act does not otherwise define or identify the types of conflicts of interest that should be disclosed under Section 15E(a)(1)(B)(vi) of the Exchange Act.[173] The Commission believes that credit rating agencies that rely on fees from issuers, obligors and underwriters to determine specific credit ratings are exposed to a unique set of conflicts, as are credit rating agencies that operate under a subscriber fee based business model. Moreover, certain conflicts, such as those arising from owning securities of a rated entity, can arise under either business model.

The Commission believes that the types of conflicts of interest arising from the activities of credit rating agencies include, as applicable: receiving compensation from rated obligors, issuers of rated securities and money market instruments, and underwriters of rated securities and money market instruments to determine or maintain a credit rating and for other services; owning securities of, or having any other form of ownership interest in, a rated obligor, issuer of rated securities and money market instruments, or underwriter of rated securities and money market instruments; receiving compensation for any service from subscribers that use credit ratings for regulatory purposes; owning securities of, or having any other form of ownership interest in, a subscriber that uses credit ratings for regulatory purposes; and having another material business relationship (*e.g.*, a loan) or affiliation (*e.g.*, being an officer or director) with a rated obligor, issuer of rated securities and money market instruments, underwriter of rated securities and money market instruments, or entity that uses credit ratings for regulatory purposes.

The Commission believes the above list covers the range of general conflicts of interest that arise from the activities of credit rating agencies.[174] However, as noted, based on a particular credit rating agency's business model, some of these conflicts would not be evident. The Commission further believes that an applicant and NRSRO subject to any of these types of conflicts would need to disclose that fact in a general manner in order to comply with Section 15E(a)(1)(B)(vi) of the Exchange Act.[175] Furthermore, the disclosure would assist the Commission in evaluating whether an applicant has sufficient financial and managerial resources to comply with the procedures for managing conflicts of interest required under Section 15E(h) of the Exchange Act,[176] given the conflicts of interest identified by the applicant.[177] The information also would be useful to users of credit ratings in assessing an NRSRO by, for example, comparing the types of conflicts disclosed by the entity in Exhibit 6 with the procedures for managing conflicts of interest disclosed by the entity in Exhibit 7 (discussed next). As noted above, the disclosure of the type of conflict only would need to be general in nature. For example, an NRSRO that receives compensation from issuers for rating their securities would only need to disclose that fact. It would not need to disclose separately each time it was compensated by an issuer or the identity of each such issuer.

The instructions to Form NRSRO also would provide that an applicant and NRSRO include in Exhibit 6 the identity of any affiliated entity that acts as an underwriter or uses credit ratings for regulatory purposes.[178] The Commission believes that requiring a credit rating agency to disclose this information would be necessary or appropriate in the public interest or for the protection of investors because it would apprise users of credit ratings to a potential conflict of interest arising from the fact that the affiliate could exercise undue influence on the credit rating agency to issue a credit rating that assists in the marketing of the security or that provides a regulatory benefit.[179] Users of credit ratings would be able to review the NRSRO's procedures made public in Exhibit 7 to understand how the credit rating agency addresses these potential conflicts.

The Commission generally requests comment on Exhibit 6, as proposed. The Commission also requests comment on whether there are conflicts of interest that should be disclosed in addition to those identified above, or whether some of the information proposed to be required should be eliminated or modified. Commenters who believe that other conflicts exist should describe how they arise from the business of credit rating agencies. The Commission further requests specific comment on whether requiring the identification of affiliates that are underwriters and regulatory users of credit ratings would achieve the stated purpose of the requirement.

Exhibit 7 (Public). Section 15E(h) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures to address and manage conflicts of interest.[180] These policies and procedures would be required as Exhibit 7 to proposed Form NRSRO. The Commission believes that requiring these policies and procedures would be necessary or appropriate in the public interest or for the protection of investors.[181] First, their disclosure would assist the Commission in monitoring whether an NRSRO is complying with Section 15E(h) of the Exchange Act.[182] Second, the disclosure would assist the Commission in evaluating whether an applicant or NRSRO has sufficient financial and managerial resources to manage the conflicts of interest disclosed by the

[171] *Id.*

[172] 15 U.S.C. 78o–7(a)(1)(B)(vi).

[173] *Id, see also* 15 U.S.C. 78a *et seq.*

[174] The section below describing proposed Rule 17g–5 provides a further discussion of conflicts of interest generally and how the types of activities described in this list can give rise to conflicts of interest.

[175] 15 U.S.C. 78o–7(a)(1)(B)(vi).

[176] 15 U.S.C. 78o–7(h).

[177] *See* Section 15E(a)(2)(C) Exchange Act (15 U.S.C. 78o–7(a)(2)(C)).

[178] As discussed below, proposed Rule 17g–5 would prohibit an NRSRO from having a conflict with respect to issuing or maintaining a credit rating with respect to an affiliate. Thus, this type of conflict would need to be avoided rather than disclosed and managed.

[179] *See* Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(x)).

[180] 15 U.S.C. 78o–7(h).

[181] *See* Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(x)).

[182] 15 U.S.C. 78o–7(h).

credit rating agency in Exhibit 6. Third, the disclosure would allow users of credit ratings to compare an NRSRO's policies and procedures for managing conflicts of interest with the types of conflicts disclosed in Exhibit 7.

The Commission requests general comment on Exhibit 7, as proposed, including on whether including this information would achieve the stated purpose of the requirement.

Exhibits 8 (Public). The ability of a credit rating agency to assess the credit worthiness of an issuer and obligor depends on the competence of the personnel responsible for determining the entity's credit ratings (''credit analysts''). This is true regardless of whether the credit rating agency uses quantitative models or qualitative analysis or a combination of both. A credit rating agency that solely uses quantitative models would be relying on credit analysts to understand the model inputs and metrics and back test the model's results to judge whether the model is producing credible credit ratings. A credit rating agency that uses qualitative analysis would be relying on credit analysts to understand and interpret relevant information about an obligor or issuer and use the information to render a credible assessment of the issuer or obligor's creditworthiness.

The Commission believes that requiring an applicant and NRSRO to disclose information about the responsibilities, experience and employment history of its credit analysts and supervisors would be necessary or appropriate in the public interest or for the protection of investors.[183] First, it would assist users of credit ratings in assessing the competence of an NRSRO's credit analysts and, thereby, provide a means for users to compare NRSROs. Second, this information would assist the Commission in evaluating whether the applicant has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[184]

The Commission requests comment on Exhibit 8, as proposed. Comment is specifically sought on whether the information would be helpful to users of credit ratings in comparing the NRSRO to other NRSROs. The Commission also requests comment on whether other information should be provided, or whether some of the information proposed to be required should be eliminated or modified. For example, comment is sought on whether Exhibit 8 should be limited to eliciting information about the supervisors of the credit analysts. Commenters who believe other information should be provided should describe the information and explain why it would be appropriate.

Exhibit 9 (Public). As discussed above, Section 15E(j) of the Exchange Act requires every NRSRO to designate an individual responsible for administering the policies and procedures of the credit rating agency to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.[185] The ability of the compliance officer to carry out these statutorily mandated responsibilities would depend, in part, on the officer's experience and qualifications. Additionally, based on the size of the credit rating agency, it may depend also on the experience and qualifications of persons who assist the designated compliance officer in these responsibilities.

The Commission believes that requiring information about the experience and employment history of the designated compliance officer and persons assisting the officer would be necessary or appropriate in the public interest or for the protection of investors. It would assist the Commission in evaluating whether the applicant has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[186] It also would be useful to users of credit ratings because it would provide information regarding the resources an NRSRO devotes to ensuring, among other things, that credit ratings are determined in accordance with the procedures and methodologies the NRSRO makes public in Exhibit 1.

The Commission requests comment on Exhibit 9, as proposed. The Commission also requests comment on whether other information should be provided, or whether some of the information proposed to be required should be eliminated or modified. Commenters should describe the additional information and why it would be appropriate.

Exhibit 10 (Confidential). Section 15E(a)(1)(B)(viii) of the Exchange Act requires that an application for registration as an NRSRO include, on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services provided by the credit rating agency by amount of net revenue received by the credit rating agency in the fiscal year immediately preceding the date of submission of the application.[187] This information would be required as Exhibit 10 to proposed Form NRSRO. An NRSRO would not be required to make this information public (to the extent permitted by law) or update the exhibit after registration. However, an NRSRO would be required to update this information in the audited financial statements provided to the Commission under proposed Rule 17g–3.

The statute refers to the ''20 largest issuers and subscribers.'' The instructions to Exhibit 10 would provide that an applicant add certain large obligors (*i.e.*, persons who are rated as an entity as opposed to having their securities rated) and underwriters to the list. Specifically, these types of customers would need to be added to the list if they are determined to have provided at least as much net revenue as the 20th largest issuer or subscriber. Consequently, a credit rating agency would be required to identify the 20 largest issuers and subscribers as required by Section 15E(a)(1)(B)(viii) of the Exchange Act[188] and add any obligor and underwriter customers that met the above criteria.

The Commission believes that adding large obligor and underwriter customers to the list of the 20 largest issuer and subscriber customers would be necessary or appropriate in the public interest or for the protection of investors.[189] The Commission views the list as a means to identify customers that could potentially have undue influence on an NRSRO given the amount of revenue the customer provides the NRSRO. Obligors and securities underwriters would have as much of an interest in potentially influencing a credit rating as issuers and subscribers.

Section 15E(a)(1)(B)(viii) of the Exchange Act limits the customers required to be included in the list to users of the ''credit rating services'' of the applicant and NRSRO.[190] The Exchange Act[191] does not define the term ''credit rating services.'' The Commission would interpret this term to mean any of the following: Rating an

[183] *See* Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o–7(a)(1)(B)(x)).

[184] *See* Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[185] 15 U.S.C. 78o–7(j).

[186] *See* Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o–7(a)(2)(C) and (d)).

[187] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[188] *Id.*

[189] 15 U.S.C. 78o–7(a)(1)(B)(x).

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

[191] 15 U.S.C. 78a *et seq.*

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 to a subscriber. The intent of this interpretation is to include—along with customers that pay for credit ratings and subscriptions—customers that are rated, or whose securities or money market instruments are rated, but that did not pay for the credit rating. Even though these customers may not have paid for the credit rating, they potentially could have undue influence on the credit rating agency if they provide substantial net revenue for other services or products.

Section 15E(a)(1)(B)(viii) of the Exchange Act provides that the determination of the 20 largest issuers and subscribers is to be based on ''net revenue'' received from the issuer or subscriber.[192] The Exchange Act[193] does not define the term ''net revenue.'' The Commission proposes to interpret the term ''net revenue'' for the purposes of Section 15E(a)(1)(B)(viii) of the Exchange Act[194] to mean all fees, sales proceeds, commissions, and other revenue received by the applicant and its affiliates for any type of service or product, regardless of whether related to credit ratings, and net of any fees, sales proceeds, rebates, commissions, and other monies paid to the customer by the credit rating agency and its affiliates. The risk is that a large customer may be in a position to influence the determination of the credit rating. Limiting the interpretation of net revenue to revenues relating to ''credit rating services'' may not capture the largest customers of the NRSRO or its affiliates as these customers may use credit rating services of the NRSRO and other services of the NRSRO and its affiliates. The instructions for proposed Form NRSRO would implement this proposed interpretation by providing that the calculation of net revenue should include all revenue received from the customer.

The Commission requests comment on Exhibit 10, as proposed. The Commission specifically requests comment on its proposal to include large obligor and underwriter customers in the list. The Commission further requests comment on the proposed interpretations of ''credit rating services'' and ''net revenue.'' Specifically, the Commission requests comment on how these interpretations affect the determination of large customers. If a commenter believes they are not practicable, the commenter should provide alternative interpretations and explain how they would achieve the goal of identifying large customers that could potentially exercise undue influence on the NRSRO.

Exhibit 11 (Confidential). Exhibit 11 would require the applicant to furnish audited financial statements for the past three fiscal or calendar years immediately preceding the date of the application. An NRSRO would not need to make the information in Exhibit 11 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to provide audited financial statements to the Commission annually under proposed Rule 17g–3.

The Commission believes this financial information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding required by Section 15E(a)(2)(C) of the Exchange Act.[195] This section directs the Commission to grant a credit rating agency's application for registration as an NRSRO unless, among other things, the Commission finds that the applicant does not have adequate financial and managerial resources to consistently issue ratings with integrity and to materially comply with its procedures and methodologies furnished in the public exhibits and with the requirements in Sections 15E(g), (h), (i) and (j) of the Exchange Act.[196] The financial statements would provide the Commission with information as to the applicant's net worth and income, which would assist it in determining whether the applicant has sufficient financial resources. Financial statements for three years would provide information that would assist the Commission in verifying that the applicant has been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration. An applicant must have been in the business of issuing credit ratings for the three years preceding the application to be eligible for registration with the Commission as an NRSRO.[197] The information also would alert the Commission to a significant downward trend in the applicant's financial condition, which could be relevant to whether it has adequate financial resources.

The proposed requirement that the financial statements be audited would provide the Commission with an independent verification of the information in the statements. However, the Commission anticipates that some applicants may not have been audited in the past. In this case, the applicant would only need to provide an audited financial statement for the fiscal year immediately preceding the date of the application. The other years could be covered by unaudited statements. The applicant would need to attach to the unaudited financial statements a statement by a duly authorized person of the applicant that the financial statements present fairly, in all respects, the financial condition, results of operations, and the cash flows of the applicant. This would provide a level of assurance that the information in the financial statements had been reviewed and verified by the applicant.

In addition, the Commission also anticipates that some applicants would be subsidiaries of holding companies. In this case, the applicant would be able to provide consolidated and consolidating financial statements of the parent company. This would diminish the burden on applicants that have a holding company audit but not an audit of the subsidiary credit rating agency. Consolidated and consolidating financial statements would provide sufficient information about the subsidiary credit rating agency for the Commission to evaluate whether its financial resources meet the requirements of Section 15E(a)(2)(C)(ii)(I) of the Exchange Act.[198]

The Commission requests comment on whether the furnishing of audited financial statements would achieve the stated purposes of the requirement.

Exhibit 12 (Confidential). Exhibit 12 would require an applicant to provide information as to the amount of revenue generated from various credit rating services and a separate computation of total revenue from all other services. The information would be for the most recently completed fiscal or calendar year and would not have to be audited. An NRSRO would not need to make the information in Exhibit 12 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to update this information with the annual audited financial statements provided to

[192] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[193] 15 U.S.C. 78a *et seq.*

[194] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[195] *See* 15 U.S.C. 78o–7(a)(2)(C).

[196] *See* 15 U.S.C. 78o–7(a)(2)(C)(ii)(I).

[197] *See* Section 3(a)(62)(A) of the Exchange Act (15 U.S.C. 78c(a)(62)(A)).

[198] *Id.*

the Commission under proposed Rule 17g–3.

As described in the instructions for proposed Form NRSRO, the specific revenue items would be, as applicable:

- Revenue from determining and maintaining credit ratings.
- Revenue from subscribers.
- Revenue from granting licenses or rights to publish credit ratings.
- Revenue from determining credit ratings that are not made readily accessible (private ratings).
- Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue).

The Commission believes this revenue information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act.[199] This information would augment the financial statements that would be required under proposed Exhibit 11 in that it would provide detail as to the revenues generated by different types of services.

The Commission requests comment on whether the furnishing of this revenue information would achieve the stated purposes of the requirement, or whether any additions, deletions or modifications should be made. The Commission also requests comment on any difficulties a credit rating agency may confront in determining its revenues from these various sources. If a commenter believes it would not be practicable to do so, the commenter should explain why.

Exhibit 13 (Confidential). Exhibit 13 would require an applicant to provide the amount of total aggregate annual compensation paid to its credit analysts and the median compensation. The information would be for the most recently completed fiscal or calendar year and would not have to be audited. An NRSRO would not need to make the information in Exhibit 13 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to update this information with the annual audited financial statements provided to the Commission under proposed Rule 17g–3.

The Commission believes this compensation information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act.[200] Similar to the revenue information, this information would augment the financial statements that would be required under Exhibit 11 because it provides detail on the expenses necessary to retain the credit rating agency's credit analysts.

The Commission requests comment on Exhibit 13, as proposed. The Commission also requests comment on any difficulties a credit rating agency would have in determining these compensation amounts. If a commenter believes it would not be practicable to do so, the commenter should explain why.

Request for comment. In addition to the specific requests for comment above, the Commission requests comment on all aspects of proposed Form NRSRO and the proposed instructions to the form, including whether the proposals could be more narrowly tailored and still meet the stated goals. Further, the Commission solicits comment about whether other requirements should be added, or whether items and exhibits proposed should be eliminated or modified. Commenters are asked to explain their conclusions.

D. Proposed Rule 17g–2—Recordkeeping

The Act amends Section 17(a)(1) of the Exchange Act to add NRSROs to the list of entities required 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.[201] The inclusion of NRSROs on the list also provides the Commission with authority under Section 17(b)(1) of the Exchange Act to examine all the records of an NRSRO.[202]

Proposed Rule 17g–2, ''Records to be made and retained by nationally recognized statistical rating organizations,'' would implement the Commission's recordkeeping rulemaking authority under Section 17(a) of the Exchange Act.[203] The proposed rule would require an NRSRO to make and retain certain records relating to its business and to retain certain other business records, if such records are made. The rule also would prescribe the time periods and manner in which all these records must be retained.

With respect to other regulated entities, the Commission has made clear that books and records rules are ''integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.'' [204] Proposed Rule 17g–2 is designed to ensure that an NRSRO makes and retains records that would assist the Commission in monitoring, through its examination authority, whether an NRSRO was complying with the provisions of Section 15E of the Exchange Act [205] and the rules thereunder. For example, examiners would use the records to monitor whether an NRSRO was following its disclosed procedures and methodologies for determining credit ratings, its disclosed policies and procedures for preventing the misuse of material non-public information, and managing conflicts of interest, and whether it was complying with proposed Rules 17g–4, 17g–5 and 17g–6 discussed below.

1. Paragraph (a): Records To Be Made and Retained

Paragraph (a) of proposed Rule 17g–2 would require an NRSRO to make and retain certain books and records. Under the proposed rule, the records required in paragraph (a) must be complete and current. Consequently, it would be a violation of the proposed rule to falsify a record or fail to update a record when the information on the record becomes stale or incomplete. The Commission believes the records required to be made and retained under paragraph (a) of proposed Rule 17g–2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the Commission in monitoring whether an NRSRO was complying with Section

[199] *See* 15 U.S.C. 78o–7(a)(2)(C).

[200] *See* 1 U.S.C. 78o–7(a)(2)(C).

[201] *See* Section 5 of the Act and 15 U.S.C. 78q(a)(1).

[202] *See* 15 U.S.C. 78q(b)(1).

[203] 203 15 U.S.C. 78q.

[204] *See Electronic Storage of Broker-Dealer Records,* Exchange Act Release No. 47806 (May 7, 2003), 68 FR 25281 (May 12, 2003); *see also* Commission order in *Matter of Deutsche Bank Securities, Inc. et al,* Exchange Act Release No. 46937 (December 3, 2002) (''The record keeping rules are 'a keystone of the surveillance of broker-dealers' '') (citations omitted); Commission order in *Matter of J.P. Morgan Securities Inc.,* Exchange Act Release No. 51200 (February 14, 2005); *Electronic Recordkeeping by Investment Companies and Investment Advisers,* Investment Company Act Release No. 24991 (May 24, 2001) (''The recordkeeping requirements are a key part of the Commission's regulatory program for funds and advisers, as they allow [the Commission] to monitor fund and adviser operations, and to evaluate their compliance with federal securities laws.'').

[205] 15 U.S.C. 78o–7.

15E of the Exchange Act and the rules thereunder.[206] The Commission does not intend that these provisions of proposed Rule 17g–2 require a specific form of record. An NRSRO would have the flexibility to implement a recordkeeping system that captured the following information in a manner that conformed to the NRSRO's internal processes.

Paragraph (a)(1). Paragraph (a)(1) of proposed Rule 17g–2 would require an NRSRO to make records of original entry into the rating organization's accounting system, and records reflecting entries to and balances in all general ledger accounts of the rating organization for each fiscal year. These are fundamental business records and necessary for the preparation of the audited financial statements and schedules that would need to be prepared under proposed Rule 17g–3.

Paragraph (a)(2). Paragraph (a)(2) of proposed Rule 17g–2 would require an NRSRO to make and retain the following records with respect to each of the NRSRO's current credit ratings, as applicable: the identity of any credit analyst(s) that determined the credit rating; the identity of the person(s) who approved the credit rating before it was issued; the procedures and methodologies used to determine the credit rating; the method by which the credit rating was made readily accessible; whether the credit rating was solicited or unsolicited; and the date the credit rating action was taken. As noted above, the NRSRO would not be required to make a single record containing all this information for each current credit rating. Rather, the NRSRO would have the flexibility to implement a recordkeeping system that captured this information in different records in a manner that conformed to the NRSRO's internal processes.

The information in these records about the identity of the credit analysts, the persons who approved the credit rating, the methodology used to determine the credit rating, and whether the credit rating was solicited or unsolicited, collectively would assist the Commission in monitoring whether the NRSRO was following its procedures and methodologies for determining credit ratings. The information about the identity of the credit analysts, and the persons who approved the credit rating, also would assist the Commission in monitoring whether the NRSRO was complying with procedures designed to prevent the misuse of material nonpublic information.

Paragraph (a)(3). Paragraph (a)(3) of proposed Rule 17g–2 would require a record identifying each person that solicits the NRSRO to determine or maintain a credit rating (*e.g.*, an obligor, issuer, or underwriter) and the credit ratings determined for the person. This information would assist the Commission in monitoring whether the NRSRO was complying with procedures for addressing and managing conflicts of interest as well as complying with the requirements in proposed Rule 17g–5 prohibiting certain conflicts of interest.

Paragraph (a)(4). Paragraph (a)(4) of proposed Rule 17g–2 would require a record for each person that subscribes to receive the credit ratings of the NRSRO. Similar to the records that would be required under paragraph (a)(3), this information would assist the Commission in monitoring whether the NRSRO was complying with procedures for addressing and managing conflicts of interest as well as complying with the requirements in proposed Rule 17g–5 prohibiting certain conflicts of interest.

Paragraph (a)(5). Paragraph (a)(5) of proposed Rule 17g–2 would require a record describing each type of service and product offered by the NRSRO. This record would provide the Commission with details of the ancillary business activities of the credit rating agency and, therefore, would be useful in identifying potential conflicts of interest that arise from such activities. Commission examiners would then be able to review whether the NRSRO had implemented procedures to manage these potential conflicts.

Request for comment. The Commission requests comment on whether the records that would be required to be made and retained under paragraph (a) of proposed Rule 17g–2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to each type of record. The Commission also requests comment on whether there are other types of records that should be required, or whether any of the proposed requirements should be modified or omitted. Commenters that believe additional records should be required are asked to describe the record and explain why the Commission should require that it be made and retained.

2. Records To Be Retained if Made

There are certain records an NRSRO may make or receive as a matter of business practice. The Commission does not believe an NRSRO should be required, by rule, to make these records. However, the Commission believes an NRSRO should be required to retain these records for a period of time because the records would assist the Commission's oversight of NRSROs. Accordingly, paragraph (b) of proposed Rule 17g–2 would require that an NRSRO retain certain records, if they are made or received by the NRSRO. Since these are not records that are required to be made, they would not need to be updated under the requirements of proposed Rule 17g–2. Rather, the rule would require that the NRSRO retain the original record in an unaltered form or a true copy of the original record for the prescribed retention period. The Commission notes, however, that, under Section 15E(b)(1) of the Exchange Act,[207] an NRSRO must update, as provided in that section, the forms and exhibits (Form NRSRO) that would be required to be retained under paragraph (b)(9) of proposed Rule 17g–2 (discussed below).

The Commission believes the records required to be retained under paragraph (b) of proposed Rule 17g–2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the Commission in monitoring whether an NRSRO was complying with Section 15E of the Exchange Act[208] and the rules thereunder.[209]

Paragraph (b)(1). Paragraph (b)(1) of proposed Rule 17g–2 would require an NRSRO to retain all significant records underlying the information included in the credit rating agency's annual audited financial statements and schedules required under proposed Rule 17g–3. This would require the NRSRO to retain records such as bank statements, bills payable and receivable, trial balances and records relating to the determination of the largest customers for the list required under paragraph (b)(iii) of proposed Rule 17g–3. These records would assist Commission examiners in understanding and verifying the basis for information provided in the audited financial statements and schedules the NRSRO would be required to annually furnish to the Commission. For example, examiners could use the records relating to the list of the largest customers to verify that the NRSRO had identified such customers in accordance with proposed Rule 17g–3.

Paragraph (b)(2). Paragraph (b)(2) of proposed Rule 17g–2 would require an NRSRO to retain internal records, including non-public information and

[206] *See* 15 U.S.C. 78q(a)(1).

[207] *See* 15 U.S.C. 78o–7(b)(1).

[208] 15 U.S.C. 78o–7.

[209] *See* 15 U.S.C 78q(a)(1).

work papers, used to determine a credit rating. These records would include, for example, notes of conversations with the management of an issuer or obligor that was the subject of the credit rating and the inputs and raw results of a quantitative model used to determine the credit rating. The retention of this information, and other internal records used to determine a credit rating, would assist the Commission in verifying whether an NRSRO was complying with its procedures and methodologies for determining credit ratings and for preventing the misuse of material nonpublic information.

Paragraph (b)(3). Paragraph (b)(3) of proposed Rule 17g–2 would require an NRSRO to retain credit analysis reports, credit assessment reports, and private credit rating reports and internal records, including nonpublic information and work papers, used to form the basis for the opinions expressed in these reports. These reports—which credit rating agencies commonly create and sell as an ancillary service to the issuance of credit ratings—generally provide a detailed analysis of the information and assumptions underlying a credit rating. In developing these reports, the credit analyst may receive material nonpublic information about an issuer or obligor. For example, an issuer may request a private credit rating report to understand how a contemplated transaction would impact the current publicly available credit rating of its debt securities. Consequently, the retention of these reports and internal records used to form the basis of the reports would assist the Commission in monitoring whether the NRSRO was complying with its policies and procedures for preventing the misuse of material nonpublic information.

Paragraph (b)(4). Paragraph (b)(4) of proposed Rule 17g–2 would require an NRSRO to retain all compliance reports and exception reports relating to the business of operating as credit rating agency. The retention of these reports would identify activities of the NRSRO that its designated compliance officer had determined raised, or did not raise, compliance and control issues. Examiners would then be able to review how the NRSRO addressed the compliance issues. This could lead to more focused examinations, which also would decrease the burden on the NRSRO. The reports also would provide information as to whether the NRSRO was complying with its rating credit ratings methodologies, procedures, and policies.

Paragraph (b)(5). Paragraph (b)(5) of proposed Rule 17g–2 would require an NRSRO to retain all internal audit plans, internal audit reports, and documents relating to internal audit follow-up measures relating to the business of operating as credit rating agency and all records identified by the NRSRO's internal auditors as necessary to perform the audit of an activity relating to the business of operating as credit rating agency. Similar to the compliance reports, the retention of these records would identify activities of the NRSRO that its internal auditors determined raised, or did not raise, compliance or control issues. They also would assist the Commission in verifying whether the NRSRO was complying with its stated methods, procedures, and policies.

Paragraph (b)(6). Paragraph (b)(6) of proposed Rule 17g–2 would require an NRSRO to retain all marketing materials relating to the business of operating as credit rating agency. Section 15E(f) of the Exchange Act prohibits an NRSRO from representing that it has been designated, recommended, or approved, or that its abilities or qualifications have been passed upon by any federal agency or officer.[210] The retention of marketing materials would assist the Commission in verifying that the NRSRO was complying with this statutory provision.

Paragraph (b)(7). Paragraph (b)(7) of proposed Rule 17g–2 would require an NRSRO to retain all external and internal written communications, including electronic communications, received and sent by the NRSRO and its employees relating to initiating, determining, maintaining, changing or withdrawing a credit rating. The retention of written communications has played an important role in assisting the Commission in identifying legal violations and compliance issues with respect to other regulated entities.[211]

Paragraph (b)(8). Paragraph (b)(8) of proposed Rule 17g–2 would require an NRSRO to retain the record that must be made under paragraph (b) of proposed Rule 17g–6 with respect to declining to determine or withdrawing a credit rating with respect to a structured product. The retention of this record would assist the Commission in understanding the reason behind an NRSRO's decision to take one of these actions and, therefore, to monitor its compliance with the prohibitions in proposed Rule 17g–6.

Paragraph (b)(9). Paragraph (b)(9) of proposed Rule 17g–2 would require an NRSRO to retain the forms and exhibits (Form NRSRO) furnished to the Commission under proposed Rule 17g–1. This would make the forms and exhibits subject to the retention and production requirements in proposed Rule 17g–2. For example, they would need to be retained in a manner that makes them easily accessible to the NRSRO's principal office. This would assist Commission examiners, particularly examiners in regional and district offices, in accessing the records on site during an examination.

Request for comment. The Commission requests comment on whether the retention of the records under paragraph (b) of proposed Rule 17g–2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to each type of record. The Commission also requests comment on whether there are other standards or criteria that could be used to further tailor these requirements. The Commission further requests comment on whether there are other types of records that should be required to be retained, or whether any proposed requirements should be eliminated or modified. Commenters that believe additional records should be retained are asked to describe the record and explain why requiring its retention would be necessary.

3. Remaining Provisions

Proposed Rule 17g–2 has additional provisions that would prescribe how long the records in paragraphs (a) and (b) would need to be retained, the manner in which they would need to be retained and the manner in which they, and any other records subject to the Commission's examination authority, would need to be produced. The Commission believes the additional provisions of proposed Rule 17g–2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the Commission in monitoring whether an NRSRO was complying with Section 15E of the Exchange Act and the rules thereunder.[212]

Paragraph (c). Paragraph (c) of proposed Rule 17g–2 would prescribe how long the records identified in paragraphs (a) and (b) would need to be

[210] 15 U.S.C. 78o–7(f).

[211] *See e.g.*, Commission complaint in *Commission* v. *Citigroup Global Markets Inc.*, 03 CV 2945 (WHP) (S.D.N.Y.) (April 28, 2003); Commission complaint in *Commission* v. *Merrill, Lynch, Pierce, Fenner & Smith*, 03 CV 2941 (WHP) (S.D.N.Y) (April 28, 2003); Commission Order in *Matter of Columbia Management Advisers, Inc. and Columbia Funds Distributor, Inc.*, Securities Act Release No. 8534 (February 9, 2005).

[212] *See* 15 U.S.C 78q(a)(1).

retained by an NRSRO. Specifically, the records required to be made pursuant to paragraph (a) would need to be retained for three years after the record is replaced with an updated record, except that the records with respect to customers would need to be retained for three years after the NRSRO's business relationship with the customer ended. The records required to be retained under paragraph (b) would need to be retained for three years after the record is made or received by the NRSRO. The three year retention periods are designed to ensure that the records are preserved for at least one internal audit or Commission exam cycle.

Paragraph (d). Paragraph (d) of proposed Rule 17g–2 would provide that records retained pursuant to paragraphs (a) and (b) must be retained in a manner that makes them easily accessible to the principal office and any other office that conducted activities causing the record to be made or received. This provision is designed to facilitate Commission examination of the NRSRO and to avoid delays in obtaining the records during an on-site examination. The proposed rule does not specify the format in which the records must be retained. NRSROs could retain them in, for example, paper form, on microfilm or microfiche, and electronically.

Paragraph (e). Paragraph (e) of proposed Rule 17g–2 would provide that records identified in paragraphs (a) and (b) could be made or retained by a third-party record custodian, provided the NRSRO furnishes the Commission with a written undertaking of the custodian. The proposed form of the undertaking is designed to ensure that storing the records with a third-party does not make them less accessible than records stored at an NRSRO's offices. Thus, the third-party would undertake that the records are the exclusive property of the NRSRO, will be produced promptly to the NRSRO or the Commission and its representatives at the request of the NRSRO, and will be available for inspection by the Commission and its representatives. The proposed rule also would provide that an NRSRO would remain responsible for complying with the Commission's books and records rules, notwithstanding the fact that a third-party was making and/or storing the records.

Paragraph (f). Paragraph (f) of proposed Rule 17g–2 would provide that a non-resident NRSRO (defined in paragraph (h)) must undertake to send books and records to the Commission and its representatives upon request. The undertaking would need to be attached to an initial application for registration as an NRSRO (see Item 3 of proposed Form NRSRO). This proposed requirement is designed to provide a mechanism for the Commission examination staff to inspect records maintained overseas without having to travel to the location. In addition, because some non-resident NRSROs may maintain original records in a language other than English, the proposed undertaking would require a translation if the Commission requested it.

Paragraph (g). Paragraph (g) of proposed Rule 17g–2 would require an NRSRO to promptly furnish the Commission with copies of the records that it would have to retain under proposed Rule 17g–2 and any other records of the NRSRO that are subject to examination by the Commission under Section 17(b) of the Exchange Act [213] that are requested by the Commission and its staff. Similar to the ''easily accessible'' requirement of paragraph (d), this proposed requirement is designed to facilitate Commission examinations of NRSROs by requiring an NRSRO to promptly produce requested records.

Paragraph (h). Paragraph (h) of proposed Rule 17g–2 would define the term *non-resident rating organization* to mean an NRSRO that is located or has its principal office in a location outside the U.S., its territories, or possessions. This definition is similar to definitions of non-resident entities in other Commission rules.[214]

Request for comment. The Commission requests comment on whether the additional provisions of proposed Rule 17g–2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to a provision. The Commission also requests comment on whether there are other provisions that should be required, or whether any proposed requirements should be modified or omitted. Commenters that believe additional provisions would be appropriate are asked to describe the nature of the provision and explain why it should be required.

More broadly, the Commission requests comment on all aspects of proposed Rule 17g–2, including whether the proposals could be more narrowly tailored and still meet the stated goals, or whether items should be added, eliminated, or modified. Commenters are asked to explain their conclusions.

E. Proposed Rule 17g–3 Annual Audit

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[215] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[216] For the reasons discussed below, the Commission believes proposed Rule 17g–3 requiring annual financial statements and schedules would be necessary or appropriate in the public interest or for the protection of investors.[217]

First, Section 15E(d) of the Exchange Act provides that the Commission shall, by order, censure, place limitations on the activities, functions or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO if, among other things, the NRSRO fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.[218] The audited financial statements and schedules required to be furnished by an NRSRO on an annual basis under proposed Rule 17g–3 would assist the Commission in monitoring the NRSRO's financial resources and whether the resources were at a level that would necessitate the Commission taking action under Section 15(d) of the Exchange Act.[219]

Second, Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration, as prescribed in that section, if any information or document provided in the application becomes materially inaccurate.[220] As discussed above, the application (proposed Form NRSRO) would require the following financial information: a list of large customers in terms of net revenues, audited financial statements, information about revenues, and information about credit analyst compensation. This information would need to be as of, or for, the previous fiscal year. Accordingly, information

[213] *See* 15 U.S.C 78q(b).

[214] *See e.g.,* 17 CFR 240.17a–7 and 17 CFR 275.0 –2.

[215] 15 U.S.C. 78o–7(k).

[216] *Id.*

[217] *See* 15 U.S.C. 78o–7(k).

[218] 15 U.S.C. 78o–7(d).

[219] *Id.*

[220] 15 U.S.C. 78o–7(b)(1).

only would become materially inaccurate and, therefore, need to be updated on an annual basis. In addition, the information would be furnished in the application on a confidential basis and, to the extent permitted by law, would not need to be made public. Therefore, because the information only would be disclosed to the Commission, it would be more appropriate to update this information by furnishing an annual financial statement and schedules than by furnishing an amended Form NRSRO.

Paragraph (a). Paragraph (a) of proposed Rule 17g–3 would require an NRSRO to furnish the audited financial statements to the Commission annually, as of the fiscal year end indicated on the NRSRO's current Form NRSRO, within 90 calendar days after the end of such fiscal year. The financial statements would include the schedules discussed below. The requirement that the financial statements be audited, therefore, would provide the Commission with an independent verification that the information in the financial statements is presented fairly, in all material respects, and that the schedules are presented fairly, in all material respects, based on the financial statements taken as a whole. The 90 day time period would be consistent with the time period for furnishing the annual certification with respect to NRSROs whose fiscal year-end is the end of the calendar year. These NRSROs could furnish both the annual audited financial statements and the annual certification to the Commission at the same time.

Paragraph (a) also would provide that the financial statements be prepared according to generally accepted accounting principles and comply with applicable provisions of the Commission's Regulation S–X.[221] These requirements are designed to ensure that the financial statements comport with accounting standards and Commission rules.

Paragraph (b). Paragraph (b) of proposed Rule 17g–3 would require an NRSRO to include three supporting schedules in the audited financial statements. These schedules would be the mechanism by which an NRSRO would update the list of large customers, information about revenues, and information about total aggregate credit analyst compensation and median compensation originally furnished in the NRSRO's initial application for registration.

As discussed above with respect to Exhibit 10, the list of the largest customers would assist the Commission in identifying customers of an NRSRO that could potentially have undue influence on the NRSRO given the amount of revenue they provide the credit rating agency. The largest customers would be determined using the same definitions of ''net revenues'' and ''credit rating services'' discussed with respect to Exhibit 10. In addition, just as with Exhibit 10, obligor and underwriter customers would be added to the list to the extent they were as large as, or larger than, the 20th largest issuer or subscriber customer.

The information on revenue sources and analyst compensation that would be required in the schedule would be the same as the information that would be required in Exhibits 12 and 13, respectively. The information on revenue sources and credit analyst compensation would augment the financial statements by providing detail as to the revenues generated specifically from credit rating services and the expenses necessary to retain the credit rating agency's credit analysts. This information collectively would assist the Commission in monitoring whether an NRSRO maintains adequate financial resources to consistently produce credit ratings with integrity.[222]

Paragraph (c). Paragraph (c)(1) of proposed Rule 17g–3 would require that the financial statements be certified by an independent public accountant in accordance with the provisions the Commission's Regulation S–X. These provisions are designed to ensure that auditors are independent of their audit clients.[223]

Paragraph (c)(2) of proposed Rule 17g–3 would require that the NRSRO attach to the financial statements a statement by a duly authorized person of the NRSRO that the financial statements present fairly, in all respects, the financial condition, results of operations, and the cash flows of the NRSRO. This would provide a level of assurance that the information in the financial statements had been reviewed and verified by the NRSRO. This proposed requirement parallels Commission Rule 17a–5(e)(2), which requires a duly authorized officer of a broker-dealer (or, in the case of a general partnership, the general partner) to attach an oath or affirmation stating the financial statements and schedules required under that rule are true and correct.[224]

Finally, Paragraph (d) of proposed Rule 17g–3 would provide that the Commission may grant an extension of time from any requirements in the proposed rule either unconditionally or on specified terms and conditions on the written request of an NRSRO, if the Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. The Commission believes the 90-day period after the end of the fiscal year to prepare and furnish the financial statements and schedules required under proposed Rule 17g–3 would be a sufficient amount of time to fulfill these requirements. However, there may be situations where an NRSRO would require more time. In such cases, the NRSRO would be required to request an extension in writing and the Commission could grant it unconditionally or subject to certain specified terms and conditions.

Request for comment. The Commission requests comment on all aspects of proposed Rule 17g–3, including whether the proposed requirements could be more narrowly tailored and still meet the stated goals. Further, the Commission solicits comment on whether any additional requirements should be added, or whether any of the proposed requirements should be omitted or modified. The Commission also requests comment on the 90-day time period to provide the audited financial statements and, in particular, whether that time frame is too long or too short. The Commission further requests comment on whether the requirement that the schedules to the financial statements be audited is practicable, given the information to be included in them. Commenters that believe it would not be practicable should explain the reasons for their conclusion.

F. Proposed Rule 17g–4—Procedures to Prevent the Misuse of Material Non-Public Information

Section 15E(g)(1) of the Exchange Act[225] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[226] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[227]

[221] 17 CFR 210.1–01 *et seq.*

[222] 15 U.S.C. 78o–7(d).

[223] *See Final Rule: Strengthening the Commission's Rules Regarding Auditor Independence,* Securities Act Release No. 8183 (January 28, 2003), 68 FR 6005 (February 5, 2003).

[224] 17 CFR 240.17a–5(e)(2).

[225] 15 U.S.C. 78o–7(g)(1).

[226] 15 U.S.C. 78a *et seq.*

[227] 15 U.S.C. 78o–7(g)(2).

Proposed Rule 17g–4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act [228] include three specific types of procedures.

First, paragraph (a) of proposed Rule 17g–4 would require procedures designed to prevent the inappropriate dissemination within and outside the NRSRO of material nonpublic information obtained for the purpose of developing a credit rating. Some credit rating agencies, as part of their analysis, contact senior management of the obligors and issuers subject to their credit ratings. In the course of these contacts, an issuer or obligor may provide the credit rating agency with nonpublic information including contemplated business transactions or estimated financial projections.[229] Credit rating agencies have commented that this confidential information greatly assists them in issuing credible and reliable ratings.[230] In fact, the Commission's Regulation FD, which governs the disclosure of material non-public information by issuers, contains an exception that permits issuers to intentionally disclose material non-public information to a credit rating agency without making a simultaneous public disclosure of the information.[231] The selective disclosure to the credit rating agency, however, must be solely for the purpose of developing a publicly available credit rating.[232]

Under paragraph (a) of proposed Rule 17g–4, a credit rating agency that permits its credit analysts to contact an issuer or obligor in the process of determining or maintaining a credit rating would be required to, for example, have procedures reasonably designed to prevent material, non-public information obtained by the credit analyst from being shared with or made readily accessible to any person outside the NRSRO or to persons employed by the NRSRO who do not need to know the information because they are not involved in determining or approving the credit rating. One concern that has been raised in the past is that subscribers to a credit rating agency's more detailed credit reports also may be granted direct access to the credit analysts.[233] If the credit analyst is in possession of material non-public information, there is a risk the information may be inappropriately disclosed to the subscriber during the course of communications with the credit analyst.[234]

The Commission believes NRSROs should have flexibility to develop procedures tailored to their specific organizational structures and business models and, consequently, is not proposing to prescribe specific procedures. Nonetheless, as applicable to the business model of the NRSRO, an NRSRO could have procedures requiring credit analysts to receive training in the laws governing the misuse of material non-public information; defining the persons within the NRSRO with whom the credit analyst can share the information; prohibiting the credit analyst from disclosing the information to any other persons; and requiring the credit analyst to take steps to safeguard documents containing the information. An NRSRO that does not use management contacts as part of its methodology for determining credit ratings could prohibit credit analysts from contacting rated issuers or obligors.

Paragraph (b) of proposed Rule 17g–4 would require an NRSRO to implement specific procedures designed to prevent an associated person or member of an associated person's household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material nonpublic information obtained for the purpose of developing a credit rating. This proposed rule recognizes the risk that individuals in possession of, or with access to, material nonpublic information about an issuer or obligor may trade securities or money market instruments on the information.[235] Again, the Commission does not intend to prescribe exact procedures. However, as applicable to the business model of the NRSRO, an NRSRO could have policies prohibiting associated persons from purchasing or selling a security or money market instrument that is subject to a pending rating action; requiring associated persons to obtain pre-approval before purchasing or selling a security or money market instrument; and requiring associated persons to be notified of securities or money market instruments that are on a ''do not trade'' list.

Paragraph (c) of proposed Rule 17g–4 would require an NRSRO to implement specific procedures designed to prevent the inappropriate dissemination within and outside the NRSRO of a credit rating action prior to making the action readily accessible. This provision recognizes that a credit rating action of an NRSRO that is not yet public may be material, non-public information. Consequently, an NRSRO should have policies designed to ensure that its pending credit rating actions are not disclosed in a manner that allows a person to trade on the information before the action is widely disseminated to the market. Once again, the Commission does not intend to prescribe specific procedures. However, as applicable to the business model of the NRSRO, these policies could include procedures designed to ensure that a credit rating action is issued in a way that makes it readily accessible to the market place, such as posting the credit rating or an announcement of the credit rating action on the NRSRO's Web site or through a news or information service used by market participants. The policies also could include procedures prohibiting credit analysts from selectively disclosing the pending action to persons outside the NRSRO and to persons inside the NRSRO who do not need to know of the pending action.

At the same time, the Commission understands that some credit rating agencies, as part of their methodologies for determining credit ratings, will discuss a proposed credit rating action with the management of the issuer or obligor being rated to solicit their views or provide an opportunity to appeal the decision. NRSROs engaging in this practice should have procedures designed to ensure that the discussions with the issuer or obligor do not lead to the selective disclosure of the information to persons other than those persons within the issuer or obligor who are authorized to receive the information.

The Commission requests comment on all aspects of this proposed rule, including whether the proposals could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether other types of specific procedures should be

[228] 15 U.S.C. 78o–7(g)(1).

[229] *See Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization,* Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005).

[230] *See Id.*

[231] *See* 17 CFR 243.100.

[232] 17 CFR 243.100(b)(2)(iii).

[233] *See* Commission 2003 CRA Report and Commission 2003 Concept Release, Securities Act Release No. 8236 (June 4, 2003), 68 FR 35258 (June 12, 2003), noting the concern raised by some that subscribers may have preferential access to credit analysts and, as a result, may inappropriately learn material non-public information in the possession of a credit analyst.

[234] *Id.*

[235] *See e.g.,* Commission complaint in *Commission* v. *Rick A. Marano, William Marano and Carl Loizzi,* 04 CV 5828 (Judge Kimba Wood) (S.D.N.Y.); *see also* Commission Litigation Release No. 18799 (July 27, 2004).

required, or whether any of the proposed requirements should be omitted or modified.

G. Proposed Rule 17g–5—Management of Conflicts of Interest

Section 15E(h)(1) of the Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest.[236] Section 15E(h)(2) of the Act requires the Commission to adopt rules to prohibit or require the management and disclosure of conflicts of interest relating to the issuance of credit ratings.[237] Proposed Rule 17g–5 would implement this statutory provision by requiring an NRSRO to disclose and manage certain conflicts of interest and prohibiting other conflicts of interest.

Paragraph (a) of proposed Rule 17g–5 would make it unlawful for an NRSRO to have a conflict of interest relating to the issuance of a credit rating that is identified in paragraph (b) of the proposed rule *unless* the NRSRO has publicly disclosed the type of conflict of interest in compliance with Rule 17g–1 and has implemented policies and procedures to address and manage such conflict of interest in accordance with Section 15E(h)(1) of the Exchange Act. As discussed, Rule 17g–1 would require an NRSRO to apply for registration and update its registration using Form NRSRO. Exhibit 6 to proposed Form NRSRO would require the NRSRO to identify and publicly disclose the types of conflicts of interest that arise from its business activities as required by Section 15E(a)(1)(B)(vi) of the Exchange Act.[238] As mentioned above, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures to address conflicts of interest.[239] Accordingly, under proposed Rule 17g–5, it would be unlawful for an NRSRO to have a conflict of interest identified in paragraph (b) of the rule if it had not complied with its regulatory and statutory requirements with respect to disclosing and managing types of conflicts of interest. The Commission believes that these requirements in proposed Rule 17g–5 would be appropriate in the public interest and for the protection of investors because they are designed to ensure that users of credit ratings are made aware of the potential conflicts of interest that arise from an NRSRO's business activities and that an NRSRO establishes policies and procedures for managing the specific conflicts.

The types of conflicts identified in paragraph (b) of proposed Rule 17g–5 are those that a credit rating agency commonly faces, depending on its business model. Consequently, prohibiting them outright could adversely impact the ability of an NRSRO to operate as a credit rating agency. Nonetheless, the conflicts should be managed through policies and procedures and disclosed so that users of the credit ratings can assess whether the conflict impacts the NRSRO's judgment.

The first type of conflict identified in paragraph (b) of proposed Rule 17g–5 involves receiving compensation from a rated person for a service or product of the NRSRO or its affiliates.[240] This type of conflict arises from a common business model in the credit rating industry; namely, charging issuers and obligors to determine and maintain a credit rating of the issuer or obligor. A related conflict may arise when the credit rating agency offers other services and products of its own and its affiliates to rated issuers and obligors, including credit assessment and risk management consulting.[241] Furthermore, an NRSRO could potentially issue a credit rating that the rated issuer or obligor uses for regulatory purposes. For example, an issuer may rely on the credit rating to qualify for Form S–3—the Commission's ''short-form'' registration statement.[242]

The second type of conflict identified in paragraph (b) of proposed rule 17g–5 involves having an ownership interest (securities or otherwise) in an issuer or obligor subject to a credit rating of the NRSRO.[243] As discussed below, this conflict would be prohibited under paragraph (c) of proposed Rule 17g–5 if the NRSRO, credit analyst, or an associated person approving the credit rating had the ownership interest.[244] However, it may be appropriate for an NRSRO to permit employees that have no involvement in determining or approving the credit rating of an obligor or issuer to own securities of the entity.[245] For example, a prohibition for all employees could be a particular hardship if the NRSRO issued credit ratings with respect to most public companies.

The third type of conflict identified in paragraph (b) of proposed rule 17g–5 involves receiving compensation from subscribers that use the credit ratings of the NRSRO for regulatory purposes.[246] As discussed in section I, numerous federal and state statutes and regulations use the term ''NRSRO.'' A subscriber potentially could be subject to one or more of these statutes and regulations and, consequently, benefit depending on how the NRSRO rates securities held by the subscriber. For example, a broker-dealer subscriber holding debt securities would be able to apply lower haircuts when computing its net capital under Exchange Act Rule 15c3–1, if the securities are rated investment grade by two NRSROs.[247] Regulatory users of credit ratings such as broker-dealers likely also would be subscribers to an NRSRO's credit ratings or credit analysis. Therefore, prohibiting this conflict could be impractical, particularly for NRSROs that rely solely on a subscription-based business model.

The fourth type of conflict identified in paragraph (b) of proposed rule 17g–5 involves having an ownership interest in a subscriber that uses the NRSRO's credit ratings for regulatory purposes.[248] This potentially could create an incentive for the credit rating agency or an associated person to issue a credit rating that allows the subscriber to take advantage of a benefit in a statute or regulation using the NRSRO concept.

The fifth type of conflict identified in paragraph (b) of proposed rule 17g–5 involves having a business or personal

[236] 15 U.S.C. 78o–7(h)(1).

[237] 15 U.S.C. 78o–7(h)(2).

[238] 15 U.S.C. 78o–7(a)(1)(B)(vi).

[239] *Id.*

[240] Paragraph (b)(1) of proposed Rule 17g–5. *See* 15 U.S.C. 78o–7(h)(2)(A).

[241] *See* Commission 2003 CRA Report noting concerns of some that conflicts in this area could become much greater if these ancillary services were to become a substantial portion of an NRSRO's business. *See also* Commission 2003 CRA Concept Release, Securities Act Release No. 8236 (June 4, 2003), 68 FR 35258 (June 12, 2003), noting concerns of some that greater concerns about conflicts of interest arise when a credit rating agency offers consulting or other advisory services to issuers it rates.

[242] Form S–3 (17 CFR § 239.13).

[243] Paragraph (b)(2) of proposed Rule 17g–5. *See* 15 U.S.C. 78o–7(h)(1)(C); *see also Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization,* Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005), which noted that conflicts may arise when a person associated with a credit rating agency also is associated with, or has an interest in, an issuer that is being rated.

[244] Several commenters to the 2005 proposing release recommended prohibiting a credit rating agency and its analysts from owning securities in the companies they rate. Letters from Charles D. Brown, General Counsel, Fitch, Inc., dated June 9, 2005; Marjorie E. Gross, Senior Vice President and Regulatory Counsel, The Bond Market Association and Frank A. Fernandez, Senior Vice President and Chief Economist, Securities Industry Association, dated June 9, 2005; and Larry G. Mayewski, Executive Vice President & Chief Rating Officer, A.M. Best Company, Inc., dated June 9, 2005.

[245] *Cf.* 17 CFR 275.204A–1(e)(1) (defining ''access person'' for purposes of requiring investment advisers to establish procedures requiring access persons to report their personal securities holdings).

[246] Paragraph (b)(3) of proposed Rule 17g–5.

[247] *See,* 17 CFR 240.15c3–1(c)(2)(vi)(E), (F), and (H).

[248] Paragraph (b)(4) of proposed Rule 17g–5.

relationship or affiliation with a rated issuer or obligor, underwriter of a rated issuer's securities, or a subscriber that uses the credit ratings for regulatory purposes.[249] An example of this conflict would include a person associated with the NRSRO having a relative or spouse who worked for a rated issuer, obligor, or underwriter of a rated issuer's securities. It also would include a person associated with the NRSRO having a business relationship with one of these types of entities, for example, receiving a loan from a bank that is rated.[250] The Commission believes, however, that prohibiting these types of relationships outright may be unnecessary or could prove impractical. However, an NRSRO should have robust policies and procedures to manage conflicts arising from these relationships. Moreover, paragraph (c) of proposed Rule 17g–5 would not prohibit a credit analyst or associated person approving the credit rating from having these types of relationships with the rated issuer or obligor or underwriter of the rated issuer's securities.[251] However, there may be circumstances where an NRSRO, as part of its policies and procedures, should prohibit the conflict. One potential example would be if the credit analyst's spouse or close family member works for the rated issuer or obligor.

The sixth type of conflict identified in paragraph (b) of proposed rule 17g–5 involves being an officer or director of a rated issuer or obligor, underwriter of a rated issuer's securities, or subscriber that uses the NRSRO's credit ratings for regulatory purposes.[252] As discussed below, this type of conflict would be prohibited under paragraph (c) of proposed Rule 17g–5 if the credit analyst or associated person responsible for approving the credit rating was an officer or director of one of these entities. However, it may be appropriate, subject to adequate policies and procedures, for other employees of the NRSRO and its affiliates to serve in these roles, since they would have no direct role in determining the credit rating.

The seventh type of conflict identified in paragraph (b) of proposed rule 17g–5 would be any other type of conflict that the NRSRO identifies on proposed Form NRSRO in compliance with Section 15E(a)(1)(B)(vi) of the Exchange Act[253] and proposed Rule 17g–1. This catchall provision would capture conflict types not specifically listed in paragraph (b) of Rule 17g–5 that the NRSRO has identified on Exhibit 6 to proposed Form NRSRO as arising from its business activities.[254]

Paragraph (c) of proposed Rule 17g–5 would specifically prohibit four types of conflicts of interest. The Commission preliminarily believes that prohibiting such conflicts of interest would be appropriate in the public interest and for the protection of investors.

The first proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the person soliciting the credit rating was the source of 10% or more of the total net revenue of the NRSRO and its affiliates in the most recently ended fiscal year.[255] Such a person would be in a position to exercise substantial influence on the NRSRO.[256] It would be difficult for the NRSRO to remain impartial, given the impact on the NRSRO's income if the issuer, obligor or underwriter withdrew its business. Given our understanding that fees from a single entity generally compose a very small percentage of the revenues of entities currently identified as NRSROs, the Commission preliminarily believes that a 10% threshold is a reasonable benchmark for registered NRSROs.[257]

The second proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the NRSRO, a credit analyst responsible for the credit rating, or a person associated with the NRSRO responsible for approving the credit rating, owns securities of, or has any other ownership interest in the rated person, or is a borrower or lender with respect to the rated person.[258] The Commission preliminarily believes that the NRSRO, credit analyst responsible for determining the credit rating, and person responsible for approving the credit rating should not have a direct financial interest in the rated issuer or obligor. The Commission preliminarily believes an NRSRO or associated person having such a financial interest could not remain impartial and issue an objective credit rating in these circumstances.[259]

The third proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the rated entity is a person associated with the NRSRO.[260] The Commission preliminary believes an NRSRO would not be able to maintain an appropriate level of impartiality when issuing a credit rating with respect to an affiliated entity.

The fourth proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the credit analyst responsible for the credit rating, or a person associated with the NRSRO responsible for approving the credit rating, also is an officer or director of the person that is the subject of the credit rating.[261] Again the Commission preliminarily believes that an NRSRO or person associated with the NRSRO having such a position could not issue an objective credit rating in these circumstances.

The Commission requests comment on all aspects of proposed Rule 17g–5, including whether the proposals could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether paragraph (b) of proposed Rule 17g–5 captures all the types of conflicts that arise from the activities of a credit rating agency. Comment also is sought on whether proposed Rule 17g–5 should contain materiality thresholds insomuch as some conflicts may be inconsequential. The Commission seeks comment on whether the focus of the proposal on the ''type'' of conflict of interest would appropriately capture the conflicts that arise from the business of a credit rating agency. In addition, the Commission requests comment on the prohibited conflicts and whether these conflicts should be permitted if a credit rating agency discloses them and has procedures in place to manage such conflicts. If so, what specific disclosures should be required? Alternatively, should the rule prohibit other types of

[249] Paragraph (b)(5) of proposed Rule 17g–5.

[250] *See* 15 U.S.C. 78o–7(h)(2)(C).

[251] *See* 15 U.S.C. 78o–7(h)(2)(D).

[252] Paragraph (b)(5) of proposed Rule 17g–5.

[253] 15 U.S.C. 78o–7(a)(1)(B)(vi).

[254] *See* 15 U.S.C. 78o–7(h)(2)(E).

[255] Paragraph (c)(1) of proposed Rule 17g–5. The determination of ''net revenue'' would be same as the determination of net revenue for purposes of Form NRSRO and proposed Rule 17g–3.

[256] As noted in the Commission 2003 CRA Report, some participants in the Commission 2002 CRA Hearings expressed concern that ancillary services could become much greater in the future and suggestions were made that their percentage contribution to total revenue be capped.

[257] As noted in the Commission 2003 CRA Report, fees from any single issuer typically comprise a very small percentage—less than 1%—of a credit rating agency's total revenue.

[258] Paragraph (c)(2) of proposed Rule 17g–5.

[259] The Senate Report notes that rating agencies argue that although the pay-for-rating business model presents inherent conflicts of interest, the conflict is effectively managed inasmuch as credit analysts do not benefit financially from any of their ratings decisions. The Senate Report further notes that credit analysts are not permitted to own any of the securities they follow.

[260] Paragraph (c)(3) of proposed Rule 17g–5.

[261] Paragraph (c)(4) of proposed Rule 17g–5. *Cf.* Rule 2711 of the National Association of Securities Dealers, Inc. (''NASD'') allowing a securities research analyst to be an officer or director of a subject company if proper disclosure is made.

conflicts of interest, or should some of the proposed requirements be eliminated or modified? The Commission further requests comment on whether there should be specific exceptions to the proposed prohibitions. For example, should the prohibition against ownership of securities in a rated company apply to indirect ownership of securities such as through a mutual fund. The Commission also requests comment on whether the 10% net revenue threshold in proposed Rule 17g–5(c)(1) is appropriate, or should a higher or lower threshold be applied.

H. Proposed Rule 17g–6—Prohibited Unfair, Coercive, or Abusive Practices

Section 15E(i)(1) of the Exchange Act [262] provides that the Commission shall adopt rules prohibiting any act or practice by an NRSRO that the Commission determines is unfair, abusive, or coercive, including certain acts and practices set forth in paragraphs (i)(1)(A)–(C) of Section 15E of the Exchange Act.[263] In explaining this statutory provision, the Senate Report stated that ''the Commission, as a threshold consideration, must determine that the practices subject to prohibition under this section are unfair, coercive or abusive before adopting rules prohibiting such practices.'' The Commission has made a preliminary determination that the acts and practices described in paragraphs (i)(1)(A)–(C) of Section 15E of the Exchange Act [264] would be unfair, coercive, or abusive. Consequently, the Commission is proposing to prohibit them in proposed Rule 17g–6, with one conditional exception. Further, the Commission also has made a preliminary determination that an additional act and practice relating to unsolicited credit ratings (as noted above, these are credit ratings that are not initiated at the request of the issuer, obligor or underwriter) would be unfair, coercive, or abusive and, consequently, is proposing to use its authority under Section 15E(i)(1) of the Exchange Act [265] to prohibit such act and practice.[266]

Section 15E(i)(1)(A) of the Exchange Act provides that the Commission shall prohibit the following practice if the Commission determines it is unfair, coercive, or abusive:

> Conditioning or threatening to condition the issuance of a credit rating on the purchase by the obligor or an affiliate thereof of other services or products, including pre-credit rating assessment products of the nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization[.] [267]

The Commission has preliminarily determined that this practice would be unfair, coercive, or abusive and proposes to prohibit it. Paragraph (a)(1) of Proposed Rule 17g–6 would prohibit an NRSRO from conditioning or threatening to condition the issuance of a credit rating on the purchase of other products or services, including pre-credit rating assessment products.[268]

Credit ratings play an important role in financial markets. Market participants use them in making financial decisions whether to buy or sell debt securities and extend credit to rated entities. Moreover, credit ratings of NRSROs are used in federal and state laws and regulations to establish limits or confer exemptions or privileges. Consequently, an entity may benefit from having an NRSRO credit rating because it makes its securities more marketable or the rating would qualify the entity for an exemption or privilege in one of these rules or statutes or make holding the entity's debt securities or transacting with the entity more attractive to other regulated entities. An NRSRO could abuse this incentive by using it to coerce an issuer or obligor to purchase services from the NRSRO or its affiliates. Accordingly, the Commission is proposing to prohibit this potential practice.

An NRSRO would be allowed to condition the issuance and maintenance of a credit rating on the issuer or obligor paying for the service of determining and monitoring the credit rating. As noted above, this is a longstanding business model in the credit rating industry.[269] However, as discussed, the NRSRO could not condition the issuance of the credit rating on the purchase of any other service or product offered by the NRSRO and its affiliates. This practice would violate paragraph (a)(1) of proposed Rule 17g–6 even if the NRSRO agreed to issue or did issue a credit rating that otherwise was determined in accordance with its methodologies for issuing credit ratings.

Section 15E(i)(1)(C) of the Exchange Act provides that the Commission shall prohibit the following practices if the Commissions determines they are unfair, coercive, or abusive:

> Modifying or threatening to modify a credit rating or otherwise departing from systematic procedures and methodologies in determining credit ratings, based on whether the obligor, or an affiliate of the obligor, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with such organization.[270]

The Commission has preliminarily determined that these practices would be unfair, coercive, or abusive and, consequently, proposes to prohibit them through paragraphs (a)(2) and (a)(3) of proposed Rule 17g–6. Paragraph (a)(2) would prohibit an NRSRO from issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures for determining credit ratings based on whether the rated person purchases or will purchase the credit rating or another product or service.[271] Thus, an NRSRO would be prohibited from issuing or threatening to issue a credit rating that is lower than would result from using its methodology for determining credit ratings based on whether the issuer or obligor pays for the credit rating or any other service or product of the NRSRO and its affiliates. The NRSRO also would be prohibited from issuing or promising to issue a higher credit rating in these circumstances.[272]

The practice proposed to be prohibited in this paragraph is distinguishable from the practice proposed to be prohibited in Paragraph (a)(1). Paragraph (a)(1) addresses the situation where an NRSRO conditions the issuance of a credit rating on the purchase of another service or product. Paragraph (a)(2) addresses the situation where an NRSRO conditions the conclusion reached in the credit rating on the purchase of the credit rating or

[262] 15 U.S.C. 78o–7(i)(1).

[263] 15 U.S.C. 78o–7(i)(1)(A), (B) and (C).

[264] Id.

[265] 15 U.S.C. 78o–7(i)(1).

[266] *See* Commission 2003 CRA Report, which noted that some participants in the Commission 2002 CRA Hearings questioned the appropriateness of unsolicited credit ratings because they could used to engage in ''strong-arm'' tactics to induce payment for a credit rating an issuer did not request.

[267] 15 U.S.C. 78o–7(i)(1)(A).

[268] *See* Commission 2003 CRA Report, which noted that some participants in the Commission's 2002 CRA Hearings worried that issuers could be unduly pressured to purchase advisory services, particularly in cases where they were solicited by the credit rating analyst.

[269] *See* Commission 2003 CRA Report, which noted that by the mid-1970s credit rating agencies began charging issuers for ratings, due to difficulties in limiting access to their credit ratings to subscribers, as well as to respond to the demand for more comprehensive and resource-intensive analysis of issuers.

[270] 15 U.S.C. 78o–7(i)(1)(C).

[271] Paragraph (a)(2) of proposed Rule 17g–6.

[272] Presumably, an issuer or obligor would not agree to compensate an NRSRO for a credit rating that was lower than would result from applying the NRSRO's methodologies. Nonetheless, if an NRSRO agreed to issue a lower than warranted credit rating in return for compensation, the NRSRO would violate paragraph (a)(2) as well.

another service.[273] Thus, unlike paragraph (a)(1), an NRSRO would violate paragraph (a)(2) if it conditioned the issuance of the credit rating on the obligor or issuer paying for the credit rating. This is because the NRSRO would not be agreeing to determine a credit rating that reflected the NRSRO's assessment of the creditworthiness of the issuer or obligor as determined by its methodologies (including, as applicable, quantitative and qualitative models). Rather, the NRSRO would be agreeing to skew the rating higher based on the issuer or obligor agreeing to pay for it.

Paragraph (a)(3) of proposed Rule 17g–6 would prohibit an NRSRO from modifying, or offering or threatening to modify, a credit rating in a manner contrary to its procedures for modifying a credit rating 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 and its affiliates. The prohibition in paragraph (a)(2) of proposed Rule 17g–6, as discussed, would apply to threats or promises with respect to the issuance of a credit rating. Paragraph (a)(3) would extend this prohibition to threats or promises with respect to changing an existing credit rating.

The potential for an NRSRO to use the threat of a lower or the promise of a higher credit rating to obtain business arises from the fact that an entity's cost of credit and, in some cases, ability to obtain credit, generally depends on its credit rating. Entities with lower credit ratings must pay higher interest rates to borrow funds or issue debt. In some cases, a low credit rating could block an entity's access to credit. Thus, it is in a borrower's economic interest to have a high credit rating. This creates the potential for an NRSRO to have inappropriate leverage over an issuer or obligor. The NRSRO could use this leverage to obtain business by threatening to issue or modify a credit rating in a manner that results in a lower rating than would have resulted from using its established methodologies. The NRSRO also could issue a lower rating or lower an existing rating to punish an issuer or obligor for not purchasing the credit rating or another service or product of the NRSRO and its affiliates. Conversely, the NRSRO could promise to issue or modify a credit rating in a manner that results in a higher rating than would have resulted from using its established methodologies as a reward for purchasing the credit rating or other services or products. Proposed Rule 17g–6 would provide a check on the potential inappropriate influence an NRSRO may have over issuers and obligors by prohibiting an NRSRO from using this leverage to coerce an issuer or obligor into purchasing a credit rating or other services and products of the NRSRO and its affiliates.

A second reason to prohibit these practices is that they would lead to credit ratings that could mislead the marketplace and undermine the regulatory use of NRSRO credit ratings. An NRSRO that follows through on a threat to issue a low credit rating or promise to issue a high credit rating would be issuing a credit rating that does not accurately reflect the credit rating agency's true assessment of the creditworthiness of the issuer or obligor. The credibility and reliability of an NRSRO and its credit ratings depends on the NRSRO developing and implementing sound methodologies for determining credit ratings and following those methodologies. The fact that an issuer or obligor agrees or refuses to purchase a credit rating or other service or product from the NRSRO and its affiliates should have no bearing on the NRSRO's credit assessment of the issuer or obligor.[274]

Section 15E(i)(1)(B) of the Exchange Act provides that the Commission by rule shall prohibit the following practices if the Commission determines they are unfair, coercive, or abusive:

> 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 nationally recognized statistical rating organization[.] [275]

In explaining this statutory provision, the Senate Report stated that ''there may be instances when a rating agency may refuse to rate securities or money market instruments for reasons that are not intended to be anti-competitive.'' The Senate Report further stated that ''the Commission * * * should prohibit only those ratings refusals that occur as part of unfair, coercive or abusive conduct.''

This provision in the statute is seeking to address a practice, sometimes referred to as ''notching,'' where a credit rating agency refuses to rate securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction (collectively, a ''structured product'') or discounts the rating for a structured product because it has not rated all of the underlying assets. Critics of this practice argue that it forces issuers of structured products to obtain credit ratings from the same credit rating agencies that rated the underlying assets.[276] They argue this makes it difficult for other credit rating agencies to develop a market in rating structured products. On the other hand, credit rating agencies that rate structured products argue that their rating of the structured product necessarily must involve assessments of the creditworthiness of the underlying assets. They do not believe it would be appropriate to rely on credit ratings of the underlying assets issued by another credit rating agency because those ratings may have been determined using different methodologies and may reflect different assessments of the creditworthiness of the asset.[277]

The Commission preliminarily determines that it would be unfair, coercive, or abusive for an NRSRO to issue or threaten to issue a lower credit rating, lower or threaten to lower an existing credit rating, refuse to issue a credit rating, or to withdraw a credit rating with respect to a structured product unless a portion of the assets underlying the structured product also are rated by the NRSRO. Consequently, the Commission proposes to prohibit these practices in paragraph (a)(4) of Proposed Rule 17g–6.

[273] *See* Commission 2003 CRA Report, which noted that some participants in the Commission 2002 CRA Hearings believed that, even if the purchase of ancillary services did not impact the credit rating decision, issuers may be pressured into using the services out of fear that their failure to do so may adversely impact their credit rating.

[274] The Commission is mindful of the limitation in Section 15E(c)(2) of the Exchange Act that the rules the Commission adopts under the Exchange Act not regulate the substance of credit ratings (15 U.S.C. 78o–7(c)(2)). The Commission does not believe that this prohibition would interfere with the process by which an NRSRO assesses the creditworthiness of a security, money market instrument or obligor. An issuer's or obligor's agreement or refusal to pay the NRSRO or its affiliate for a service or product is not, necessarily of itself, relevant to a credit assessment of the issuer or obligor. Moreover, this is a practice that Congress specifically identified in Section 15E(i)(1)(C) of the Exchange Act as potentially unfair, coercive, or abusive (15 U.S.C. 78o–7(i)(1)(C)).

[275] 15 U.S.C. 78o–7(i)(1)(A).

[276] *See* Commission 2003 CRA Report, which noted that one credit rating agency that participated in the Commission 2002 CRA Hearings complained that other credit rating agencies were attempting to squeeze it out of certain structured finance markets by engaging in the practice of ''notching.''

[277] The Commission 2003 CRA Report noted that the credit rating agency that raised the concern about ''notching'' in Commission 2002 Hearings suggested, as a possible solution, that NRSROs be required to recognize the credit ratings of other NRSROs as their own for purposes of rating these asset pools.

At the same time, the Commission believes there could be legitimate reasons for an NRSRO to refuse to rate a structured product where the NRSRO has not rated the underlying assets. Therefore, the Commission is proposing that an NRSRO could refuse to initiate a rating or withdraw an existing rating in certain circumstances. This exception only would apply to the prohibition in paragraph (a)(4) against refusing to rate the security or withdrawing a rating. It would not apply to issuing or threatening to issue a lower credit rating or lowering or threatening to lower an existing credit rating.

Under the exception to the prohibition, an NRSRO could refuse to issue the rating or withdraw the rating if the NRSRO has rated less than 85% of the market value of the assets underlying the structured product. This is designed to address the concern that an NRSRO when assessing the credit worthiness of the structured product would be forced to issue a rating either when a portion of the underlying assets are not rated or when the underlying assets have been rated by another credit rating agency. If the underlying assets were unrated, the NRSRO may not have sufficient information for issuing a rating on the structured product. In cases where the underlying assets were rated by another credit rating agency, the other credit rating agency may have used different methodologies to assess the creditworthiness of the asset and may have determined a credit rating that is different than the credit rating the NRSRO would issue, if it had rated the asset. The Commission preliminarily does not believe it would be appropriate to require the NRSRO to issue or maintain a rating when the NRSRO has rated less than 85% of the market value of the underlying assets.[278]

Finally, the Commission is proposing to prohibit a practice that is not specifically identified in Section 15E(i)(1) of the Exchange Act[279] but is related to the practices described in the statute. Specifically, the Commission has preliminarily determined that it would be unfair, coercive or abusive to issue an unsolicited credit rating and communicate with the rated person to induce or attempt to induce the rated person to pay for the rating or another product or service of the NRSRO or its affiliates. Consequently, paragraph (a)(5) of proposed Rule 17g–6 would prohibit this practice.

It may be appropriate for an NRSRO that operates under a business model where issuers or obligors pay for the credit ratings to issue a credit rating that the issuer or obligor has not requested. For example, an NRSRO may want to have an active credit rating for every major issuer in a given industry.

It would not be appropriate, however, to determine an unsolicited credit rating and then to contact the issuer or obligor to solicit them to pay for the rating.[280] As discussed, an NRSRO may yield a degree of influence on issuers and obligors, given the impact a credit rating can have on the issuer's or obligor's access to credit and cost of credit. Thus, an issuer or obligor may agree to pay for an unsolicited credit rating to placate the NRSRO, rather than because they want to be rated. For example, the issuer or obligor may already be paying other credit rating agencies for a credit rating and, therefore, would derive no additional benefit from having an additional credit rating.

The Commission requests comment on all aspects of proposed Rule 17g–6, particularly on whether the proposed rule's requirements that prohibit certain acts and practices could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether there are any other unfair, coercive, or abusive practices which should be prohibited under the proposed rules, or whether any of the practices proposed to be prohibited should not be subject to prohibition. The Commission further requests comment on whether any of the proposed prohibitions should be modified. With respect to the exception to the prohibition in paragraph (a)(4) of the Rule 17g–6, the Commission requests comment on whether the proposed exception permitting an NRSRO to refuse to issue a credit rating or withdraw a credit rating of structured product when it has not rated all the underlying assets should be modified or deleted and whether the 85% threshold in that exception should be higher or lower.

IV. Paperwork Reduction Act

Certain provisions of the proposed rules contain a ''collection of information'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[281] The Commission has submitted the proposed rules to the Office of Management and Budget (''OMB'') for review in accordance with the PRA. 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 control number. The titles for the collections of information are:

(1) Rule 17g–1, Application for registration as a nationally recognized statistical rating agency; Form NRSRO and the Instructions for Form NRSRO;

(2) Rule 17g–2, Records to be made and retained by national recognized statistical rating organizations;

(3) Rule 17g–3, Annual audited financial statements to be furnished by nationally recognized statistical rating organizations;

(4) Rule 17g–4, Prevention of Misuse of Material Nonpublic Information; and

(5) Rule 17g–6, Prohibited Acts and Practices.

A. Collections of Information Under the Proposed Amendments

The Commission is proposing for comment rules to implement registration, recordkeeping, financial reporting, and oversight rules under the Credit Rating Agency Reform Act of 2006 (the ''Act'').[282] The proposed rules contain recordkeeping and disclosure requirements that are subject to the PRA. The collection of information obligations imposed by the proposed rules would be mandatory. The proposed rules, however, would apply only to credit rating agencies that are registered with the Commission as NRSROs and registration is voluntary.[283]

In summary, the proposed rules would require an NRSRO to: (1) Complete an initial application for registration on Form NRSRO;[284] (2) provide written notice to the Commission if information submitted on the application is materially inaccurate, as well as furnishing an updated Form NRSRO to the Commission, prior to final action by the Commission;[285] (3) if applicable, provide a written notice of withdrawal of the application prior to final action

[278] Anecdotally, the Commission understands that several of the credit rating agencies currently subject to a staff no-action letter have procedures under which they will undertake to issue a credit rating for a structured product where they have rated approximately 80% to 90% of the market value of the underlying assets.

[279] 15 U.S.C. 78o–7(i)(1).

[280] As discussed above, some participants in the Commission 2002 CRA Hearings questioned the appropriateness of unsolicited credit ratings because they could be used to engage in ''strong-arm'' tactics to induce payment for a credit rating an issuer did not request. Potential tactics identified included sending a bill for an unsolicited rating or sending a fee schedule and encouraging payment. *See* Commission 2003 CRA Report.

[281] 44 U.S.C. 3501 *et seq.* 5 CFR 1320.11.

[282] Pub. L. No. 109–291 (2006).

[283] *See* Section 15E of the Exchange Act (15 U.S.C. 78o–7)).

[284] Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)) and proposed Rule 17g–1(a).

[285] Proposed Rule 17g–1(c); *see also* Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)).

by the Commission;[286] (4) make the current Form NRSRO, including non-confidential exhibits, publicly available on its Web site or through another comparable, readily accessible means;[287] (5) if applicable, apply to be registered for an additional category of credit ratings by furnishing an amended Form NRSRO;[288] (6) update its Form NRSRO after registration with the Commission;[289] (7) furnish an annual certification to the Commission with respect to Form NRSRO;[290] (8) if applicable, provide a written notice of withdrawal of registration;[291] (9) make, keep and preserve certain records;[292] (10) if applicable, furnish the Commission with an undertaking from a third-party custodian;[293] (11) if applicable, provide an undertaking with respect to producing records to the Commission;[294] (12) furnish the Commission with annual audited financial statements;[295] (13) develop procedures to prevent the misuse of material nonpublic information;[296] and (14) if applicable, document, in writing, the reason for refusing to initiate a rating, or withdrawing an existing rating, with respect to an asset-backed or mortgaged-backed security.[297] Many of these requirements are prescribed in Section 15E of the Exchange Act.[298]

B. Proposed Use of Information

Proposed Rules 17g–1 through 17g–6, Form NRSRO, and the Instructions for Form NRSRO, would create a framework for Commission oversight of NRSROs. The collections of information in the proposed rules are designed to allow the Commission to determine whether an entity should be registered as an NRSRO. Further, they would assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E of the Exchange Act[299] and the rules thereunder. These proposed rules also are designed to assist users of credit ratings by requiring the disclosure of information with respect to an NRSRO that could be used to compare the credit ratings quality of different NRSROs. The information would include methods for determining credit ratings, organizational structure, policies for managing material, non-public information, information regarding conflicts of interest, policies for managing conflicts of interest, credit analyst experience, and management experience. As noted in the Senate Report accompanying the Act, the information that NRSROs would have to make public ''will facilitate informed decisions by giving investors the opportunity to compare ratings quality of different firms.''[300]

C. Respondents

The number of respondents that would be subject to the proposed rules would depend, in part, on the number of entities that meet the statutory requirements to be eligible for registration. The Act, by adding definitions to Section 3 of the Exchange Act,[301] identifies the types of entities that may apply for registration with the Commission as an NRSRO.[302] First, it defines an ''NRSRO'' as a ''credit rating agency'' that, in pertinent part, has been in business as a credit rating agency for at least three consecutive years immediately preceding the date of its application for registration; issues credit ratings certified by 10 QIBs (unless exempted from that requirement) with respect to financial institutions, brokers, dealers, insurance companies, corporate issuers, issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)), issuers of government securities, issuers of municipal securities, or issuers of foreign government securities; and is registered with the Commission.[303]

Section 3 of the Exchange Act also defines the term ''credit rating agency'' as, in pertinent part, 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; employing either a quantitative or qualitative model, or both, to determine credit ratings; and receiving fees from either issuers, investors, or other market participants, or a combination of these persons.[304] The definition specifically excludes a commercial credit reporting company.[305] Finally, Section 3 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.''[306]

These definitions create threshold eligibility requirements with respect to the entities that would be eligible to apply for registration as an NRSRO. Because NRSROs have not previously been supervised as such, and because credit rating agencies include publicly and privately held companies located throughout the world, it is difficult to estimate the number of entities that would be eligible to register as NRSROs.

In 2000, a working group of the Basel Committee on Banking Supervision[307] issued a report on credit rating agencies that was based, in part, on surveys of 28 credit rating agencies located around the world, including the five credit rating agencies currently identified as NRSROs through the Commission's no-action letter process.[308] In its report, the working group estimated that there were approximately 150 credit rating agencies located world-wide.[309] The working group also noted that there was a wide disparity in size among credit rating agencies in terms of number of employees and credit ratings issued.[310] In addition, the working group noted

[286] Proposed Rule 17g–1(b)(2); *see also* Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1)).

[287] Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o–7(a)(3)) and proposed Rule 17g–1(d).

[288] Proposed Rule 17g–1(e).

[289] Section 15E(b)(1) of the Exchange Act (15 U.S.C. 78o–7(b)(1)) and proposed Rule 17g–1(f).

[290] Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o–7(b)(2)) and proposed Rule 17g–1(g).

[291] Section 15E(e)(1) of the Exchange Act (15 U.S.C. 78o–7(e)(1)) and proposed Rule 17g–1(h).

[292] Proposed Rule 17g–2 under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

[293] Proposed Rule 17g–2(e) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

[294] Proposed Rule 17g–2(f) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

[295] Section 15E(k) of the Exchange Act (15 U.S.C. 78o–7(k)) and Proposed Rule 17g–3.

[296] Section 15E(g) of the Exchange Act (15 U.S.C. 78o–7(g)) and proposed Rule 17g–4.

[297] *See* Proposed Rule 17g–6(b)(2) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

[298] *See* 15 U.S.C. 78o–7.

[299] 15 U.S.C. 78o–7.

[300] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[301] 15 U.S.C. 78c.

[302] *See* Section 3 of the Act.

[303] Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)). Section 3(a)(64) of the Exchange Act defines the ''qualified institutional buyer'' (''QIB'') as having the ''meaning given such term in [17 CFR 230.144A(a)] or any successor thereto.'' 15 U.S.C. 78c(a)(62).

[304] Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

[305] Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A)).

[306] Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

[307] The Basel Committee on Banking Supervision is comprised of members from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. Countries are represented by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business where this is not the central bank. More information about the Basel Committee for Banking Supervision can be found at: *http://www.bis.org/.*

[308] *Credit Ratings and Complementary Sources of Credit Quality Information*, Working group of the Basel Committee on Banking Supervision, No. 3—August 2000 (''*Basel Report*'').

[309] *Id.*

[310] *Id.*

that some credit rating agencies focus exclusively on issuers in the countries where they are located.[311] More recently, the Web site *http://www.DefaultRisk.com* has tracked the number of credit rating agencies. This site identifies 57 credit rating agencies as of February 2006 and indicates that this count reflects a decrease from a previous count of 74.[312] The Web site attributed the decrease to smaller firms either being consolidated into larger firms or ceasing operations.[313]

The Commission believes the estimates in the 2000 *Basel Report* and by *DefaultRisk.Com* provide some basis upon which to estimate the number of entities engaging in the business of issuing credit ratings. The Commission, however, cannot determine whether the entities included in these estimates would meet the statutory requirements to apply for, and be registered as, an NRSRO.

In addition, the Commission cannot estimate with certitude how many credit rating agencies ultimately would opt to be registered as NRSROs. Section 15E(a)(1) of the Exchange Act makes registration voluntary.[314] Some credit rating agencies may decide not to seek registration because, for example, they do not believe that being an NRSRO would benefit them based on their business model. The Commission staff's experience with the current no-action letter process of identifying NRSROs provides some support for the conclusion that a substantial number of credit rating agencies may not apply for registration. Specifically, assuming the number of credit rating agencies has fluctuated over the years from between approximately 150 as of 2000 (*Basel Report*) and 57 as of February 2006 (*DefaultRisk.com*), then a large majority of these firms have not applied to the Commission to be identified as NRSROs under the current no-action letter process. It is possible that certain firms that did not seek NRSRO status previously would seek it under Section 15E of the Exchange Act[315] and any rules adopted thereunder. In addition, the use of QIB certifications as a prerequisite to registration (as opposed to the no-action letter process which evaluated national recognition) also may increase the number of credit rating agencies that would be eligible for registration as an NRSRO.

For all these reasons, the Commission estimates that the number of credit rating agencies applying for registration would be larger than the sum of the number of credit rating agencies currently identified as NRSROs plus the handful of entities with pending requests for no-action letters. At the same time, the Commission does not believe that all of the 57 credit rating agencies identified by *DefaultRisk.Com* would apply for, or be granted, registration. Consequently, the Commission estimates that approximately 30 credit rating agencies would be registered as NRSROs under Section 15E of the Exchange Act.[316]

The Commission requests comment on this estimate and whether more or fewer credit rating agencies would be registered as NRSROs. The Commission also requests comment on whether the sources of industry information used in arriving at the estimate (the *Basel Report* and the *DefaultRisk.Com* Web site) provide a reasonable basis for arriving at the estimate of 30 NRSROs. The Commission further requests comment on whether there are other industry sources that could provide credible statistics that could be used to determine the number of credit rating agencies that would be registered as NRSROs. Commenters should identify any such sources and explain how a given source would be used to either support the Commission's estimate of 30 NRSROs or arrive at a different estimate.

D. Total Annual Recordkeeping and Reporting Burden

As discussed in further detail below, the Commission estimates the total recordkeeping burden resulting from these proposed rules would be approximately 16,021 hours[316a] on an annual basis and 21,825 hours[316b] on a one-time basis.

The total annual and one-time hour burden estimates described below are averages across all types of expected NRSROs. The size and complexity of NRSROs would range from small entities to entities that are part of complex global organizations employing thousands of credit analysts. The Commission believes that larger NRSROs generally would have established written policies and procedures and recordkeeping systems that would comply with a substantial portion of the requirements in the proposed rules. For example, many of the requirements in the proposed rules are consistent with the IOSCO Code, which a number of credit rating agencies have adopted. These firms might only be required to augment or modify existing policies and procedures and recordkeeping systems to comply with the proposed rules.

Some smaller entities also would have implemented the policies, procedures, and recordkeeping systems necessary to comply with the proposed rules. Moreover, given their smaller size and simpler structure, smaller entities would require significantly fewer hours to comply with a substantial portion of the requirements in the proposed rules. Consequently, the burden hour estimates represent the average time across all NRSROs (regardless of size) and taking into account that many firms would only need to augment existing policies, procedures, and recordkeeping systems and processes to comply with the proposed rules. The Commission further notes that, given the significant variance in size between the largest credit rating agencies and the smaller firms, the burden estimates, as averages across all NRSROs, are skewed higher by the largest firms. Furthermore, because the Commission is proposing to require additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act,[317] the burden estimates for proposed Rule 17g–1 include estimates that arise from requirements imposed by Section 15E of the Exchange Act.[318] The intent is to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that would be required under proposed Rule 17g–1. Thus, the estimates do not seek to capture paperwork burden that would be solely attributable to requirements in Section 15E of the Exchange Act.[319]

The Commission seeks comment on whether these factors have been reasonably incorporated into the burden estimates.

1. Proposed Rule 17g–1, Form NRSRO and Instructions for Form NRSRO

Section 15E(a)(1) of the Exchange Act requires a credit rating agency applying for registration with the Commission to furnish an application containing certain specified information and such other information as the Commission prescribes as necessary or appropriate in

[311] *Id.*

[312] *See http://www.defaultrisk.com* (''*DefaultRisk.com*'').

[313] *Id.*

[314] 15 U.S.C. 78o–7(a)(1).

[315] 15 U.S.C. 78o–7.

[316] 15 U.S.C. 78o–7.

[316a] This total is derived from the total annual hours set forth in the order that the totals appear in the text: 1 + 1,500 + 300 + 300 + 7,620 + 6,000 + 300 = 16,021 hours.

[316b] This total is derived from the total one-time hours set forth in the order that the totals appear in the text: 9,000 + 125 + 900 + 9,000 + 100 + 1,500 = 21,825 hours.

[317] 15 U.S.C. 78o–7(a)(1)(B).

[318] 15 U.S.C. 78o–7.

[319] *Id.*

the public interest or for the protection of investors.[320] Proposed Rule 17g–1 would implement this statutory provision by requiring a credit rating agency to furnish an initial application on Form NRSRO to the Commission to apply to be registered under Section 15E of the Exchange Act.[321] The Commission estimates that the average time necessary to complete the initial Form NRSRO, and compile the various attachments, would be approximately 300 hours per applicant. This estimate is based on staff experience with the current NRSRO no-action letter process.[322] The Commission, therefore, estimates that the total one-time burden to the industry as a result of this requirement would be approximately 9,000 hours.[323]

The Commission also anticipates that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average, an outside counsel would spend approximately 40 hours assisting an NRSRO in preparing its application for registration for a one-time aggregate burden to the industry of 1,200 hours. The Commission further estimates that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimates that the average hourly cost for an outside counsel would be approximately $400 per hour. For reasons, the Commission estimates that the average one-time cost to an NRSRO would be $16,000[324] and the one-time cost to the industry would be $480,000.[325]

As noted, proposed Rule 17g–1 would require a credit rating agency to provide the Commission with a written notice if it intends to withdraw its application prior to final Commission action. Based on staff experience, the Commission estimates that one credit rating agency per year would withdraw a Form NRSRO prior to final Commission action on the application and, consequently, would furnish a notice of its intent to withdraw the application. Based on the Commission's current estimates for a broker-dealer to file a notice with the Commission under Rule 17a–11, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal would be one hour.[326] Thus, the Commission estimates that the aggregate annual burden to the industry of providing a notice of withdrawal prior to final Commission action would be one hour per year.[327]

Proposed Rule 17g–1 also would require that an NRSRO registered for fewer than the five categories of credit ratings listed in Section 3(a)(62)(B) of the Exchange Act would apply to be registered for an additional category by furnishing an amendment on Form NRSRO.[328] The Commission estimates that it would take an NRSRO substantially less time to update the Form NRSRO for this purpose than to prepare the initial application. For example, much of the information on the form and many of the exhibits would still be current and not have to be updated. Based on the Commission's estimate of the burden to complete a Form ADV, the Commission estimates that filing an amended Form NRSRO for this purpose would take an average of approximately 25 hours per NRSRO.[329]

The Commission further estimates based on staff experience that approximately five of the 30 credit rating agencies expected to register with the Commission would apply to register for additional categories of credit ratings within the first year. The Commission believes that almost all NRSROs would initially apply to register for the first three categories of credit ratings identified in the definition of NRSRO: (1) Financial institutions, brokers, or dealers; (2) insurance companies; and (3) corporate issuers.[330] The Commission believes these are the most common types of credit ratings issued, particularly since some credit rating agencies limit their credit ratings to domestic companies. The Commission believes that, after these three categories, the next largest category of credit ratings for which most NRSROs would be registered would be for credit ratings with respect to issuers of government securities, municipal securities, and foreign government securities.[331] These types of credit ratings take additional expertise. Finally, the Commission believes the category of credit ratings for which the least number of NRSROs would be registered would be credit ratings of issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)).[332] This assumption is based on the fact that determining a credit rating for an asset-backed security takes specialized expertise beyond that for determining credit ratings of corporate issuers and obligors. For example, it requires analysis of complex legal structures.

For these reasons, the Commission anticipates that a number of NRSROs may register for less than all five categories of credit ratings. Moreover, some of these NRSROs , in time, may develop their businesses to include issuing credit ratings of a category for which they are not initially registered. Based on staff experience, the Commission estimates that approximately five of the estimated 30 NRSROs would apply to add another category of credit ratings to their registration within the first year. Therefore, given the 25 hour per NRSRO average burden estimate, the total aggregate one-time burden to the industry for filing the amended Form NRSRO to change the scope of registration would be approximately 125 hours.[333]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate.[334] Proposed Rule 17g–1 would require an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO. Based on staff experience, the Commission estimates that an NRSRO would file two amendments of its Form NRSRO per year on average. Furthermore, for the reasons discussed above, the Commission estimates that it would take an average of approximately 25 hours to prepare and furnish an amendment on Form NRSRO.[335] Therefore, the Commission estimates that the total aggregate annual burden to the industry to update Form NRSRO

[320] 15 U.S.C. 78a–7(a)(1).

[321] 15 U.S.C. 78o–7.

[322] As a comparison, the Commission notes that Form ADV, the registration form for investment advisers, is estimated to take approximately 22.25 hours to complete. *See* Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004). The Commission estimates that the hour burden under Rule 17g–1 would be greater, given the substantially larger amount of information that would be required in proposed Form NRSRO.

[323] 300 hours × 30 entities = 9,000 hours.

[324] $400 per hour × 40 hours = $16,000.

[325] $16,000 × 30 NRSROs = $480,000.

[326] *See* Exchange Act Release No. 49830 (June 8, 2004), at note 89; *see also* 17 CFR 240.17a–11.

[327] (1 hour × 1 entity) = 1 hour.

[328] *See* proposed Rule 17g–1(e).

[329] As noted above, the Commission's burden estimate for Form ADV is approximately 22.25 hours to complete. *See* Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004).

[330] Section 3(a)(62)(B) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)).

[331] Section 3(a)(62)(B)(v) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(v)).

[332] Section 3(a)(62)(B)(iv) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(iv)).

[333] 25 hours × 5 NRSROs = 125 hours.

[334] 15 U.S.C. 78o–7(b)(1).

[335] This estimate also is based on the estimates for the collection of information on Rule 17i–2 of the Exchange Act. *See* 17 CFR 240.17i–2.

would be approximately 1,500 hours each year.[336]

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[337] Proposed Rule 17g–1 would require an NRSRO to furnish the annual certification on Form NRSRO.[338] The Commission estimates that the annual certification, generally, would take less time than an amendment to Form NRSRO because it would be done on a regular basis (albeit yearly) and, therefore, become more a matter of routine over time. Consequently, the Commission estimates that the burden would be similar to that of broker-dealers filing the quarterly reports required under Rules 17h–1T and 17h–2T, which is approximately 10 hours per year for each respondent.[339] Therefore, the Commission estimates it would take an NRSRO approximately 10 hours to complete the annual certification for a total aggregate annual hour burden to the industry of 300 hours.[340]

Finally, section 15E(a)(3) of the Exchange Act requires an NRSRO to make the information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.[341] Proposed Rule 17g–1 would require that this be done within five business days of the granting of an NRSRO's registration or the furnishing of an amendment to the form or annual certification.[342] The Commission assumes that each NRSRO already would have a Web site and would choose to use their Web site to comply with Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o–7(a)(3)). Therefore, based on staff experience, the Commission estimates that, on average, an NRSRO would spend 30 hours to disclose the information in its initial application on its Web site and, thereafter, 10 hours per year to disclose updated information. Accordingly, the total aggregate one-time burden to the industry to make Form NRSRO publicly available would be 900 hours[343] and the total aggregate annual burden would be 300 hours.[344]

2. Proposed Rule 17g–2

Section 17(a)(1) of the Exchange Act (as amended by the Act)[345] provides the Commission with authority to require an NRSRO to make and maintain such records 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.[346] Proposed Rule 17g–2 would implement this rulemaking authority by requiring an NRSRO to make and keep current certain records relating to its business. In addition, the proposed rule would require an NRSRO to preserve those and other records for certain prescribed time periods. This proposed rule is designed to assist the Commission monitor, through its examination function, whether NRSROs are complying with the requirements of Section 15E of the Exchange Act[347] and the regulations thereunder. The Commission estimates that the average one-time burden of implementing a recordkeeping system to comply with this proposed rule would be approximately 300 hours. This estimates is based on the Commission's experience with, and burden estimates for, certain recordkeeping requirements of consolidated supervised entities (''CSEs'') subject to Commission supervision.[348]

The Commission also estimates that an NRSRO may need to purchase recordkeeping system software to establish a recordkeeping system in conformance with the proposed rule. The Commission estimates that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSRO's would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs would be approximately $1000 per firm. Therefore, the one-time cost to the industry would be $30,000.

Additionally, the Commission estimates that the average annual amount of time that an NRSRO would spend to make and maintain these records would be approximately 254 hours per year. The estimate for annual hours is based on the Commission's present estimate the amount of time it would take a broker-dealer to comply with the recordkeeping rule, Rule 17a–4.[349] Therefore, the Commission estimates that the one-time hour burden for making and preserving the records under proposed Rule 17g–2 would be approximately 9,000 hours[350] and the total annual hour burden would be approximately 7,620 hours per year.[351]

Proposed Rule 17g–2 also would require that an NRSRO that uses a third-party record custodian furnish the Commission with an undertaking from the custodian. Based on staff experience, the Commission estimates that approximately five NRSROs would file this undertaking on a one-time basis. Proposed Rule 17g–2 also would require that a non-resident NRSRO provide an undertaking to the Commission. The Commission estimates, based on staff experience, approximately five non-resident NRSROs would provide this undertaking to the Commission. The Commission estimates, based on staff experience, it would take an NRSRO approximately 10 hours to complete an undertaking prior to furnishing it to the Commission.[352] Therefore, the Commission estimates the total one-time hour burden for these undertakings would be 100 hours.[353]

3. Proposed Rule 17g–3

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[354] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[355]

[336] 25 hours per amendment × 2 amendments × 30 NRSROs = 1,500 hours.

[337] 15 U.S.C. 78o–7(b)(2).

[338] *See* proposed Rule 17g–1(g).

[339] *See* 17 CFR 240.17h–1T and 2T.

[340] 10 hour × 30 NRSROs = 300 hours.

[341] 15 U.S.C. 78o–7(a)(3).

[342] *See* proposed Rule 17g–1(d).

[343] 30 hours × 30 NRSROs.

[344] 10 hours × 30 NRSROs.

[345] *See* Section 5 of the Act.

[346] *See* Section 5 of the Act and 15 U.S.C. 78q(a)(1).

[347] 15 U.S.C. 78o–7.

[348] *See* 17 CFR 15c3–1g.

[349] *See* 17 CFR 240.17a–4 (recordkeeping requirements for broker-dealers). This rule has previously has been subject to notice and comment and has been approved by OMB. The Commission notes that proposed Rule 17g–2 is based, in part, on Exchange Act Rules 17a–3 (17 CFR 240.17a–3) and 17a–4. The annual hour burden estimate for the proposed rule, however, is based only on the PRA estimate for Rule 17a–4. The proposed rule would require substantially less records to be made and maintained than Rules 17a–3 and 17a–4. Therefore, the Commission is basing its estimate that the burden estimate for only Rule 17a–4 (as opposed to Rules 17a–3 and 17a–4 combined).

[350] 300 hours × 30 NRSROs = 9,000 hours.

[351] 254 hours × 30 NRSROs = 7,620 hours.

[352] The estimated 10 hours includes drafting, legal review and receiving corporate authorization to file the undertaking with the Commission.

[353] (10 hours × 5 NRSROs) + (10 hours × 5 NRSROs) = 100 hours.

[354] 15 U.S.C. 78o–7(k).

[355] *Id.*

Proposed Rule 17g–3 would implement this statutory provision by requiring an NRSRO to furnish audited annual financial statements to the Commission, including certain specified schedules.[356] The Commission estimates that, on average, it would take an NRSRO approximately 200 hours to prepare for and file the annual audit. This estimate is based on the current PRA estimates used for CSEs under Appendix G to Exchange Act Rule 15c3–1, as well the PRA estimates for supervised investment bank holding companies under Rule 17i–5.[357] Therefore, the Commission estimates that the total annual hour burden to prepare and furnish annual audited financial statements with the Commission would be approximately 6,000 hours.[358]

To comply with proposed Rule 17g–3, an NRSRO would need to engage the services of independent public accountant. The cost of hiring an accountant would vary substantially based on the size and complexity of the NRSRO. For example, the Commission notes, based on staff experience, that the annual audit costs of a small broker-dealer generally range from $3,000 to $5,000 a year. The Commission estimates that the annual audit costs for a small NRSRO would be comparable. The costs for a large NRSRO would be much greater. However, many of these firms already are audited by a public accountant for other regulatory purposes. These firms, however, may incur some incremental costs, given the schedules in proposed Rule 17g–3. For these reasons, the Commission estimates that the average annual cost across all NRSROs to engage the services of an independent public accountant would be approximately $15,000. Therefore, the annual cost to the industry would be $450,000.[359]

4. Proposed Rule 17g–4

Section 15E(g)(1) of the Exchange Act[360] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[361] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[362] Proposed Rule 17g–4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[363] include three specific types of procedures.[364]

The Commission expects that most credit rating agencies already have procedures in place to address the specific misuses of material nonpublic information identified in proposed Rule 17g–4.[365] Nonetheless, the Commission anticipates that some NRSROs may need to modify their procedures to comply with the specific procedures that would be required by the proposed rule. Based on staff experience, the Commission estimates that it would take approximately 50 hours for an NRSRO to establish procedures in conformance with the proposed rule for a total one-time burden of 1,500 hours.[366]

5. Proposed Rule 17g–6(b)

Proposed Rule 17g–6(b) would require an NRSRO using the exception in the rule to document in writing the reasons for refusing to issue a credit rating or withdrawing a credit rating in connection with a mortgaged-backed or asset-backed security. Based on staff experience, the Commission estimates that each NRSRO would need to document approximately five refusals per year and that it would take approximately two hours to create the record. The two hour estimate is based on staff experience and on the current one-hour estimate for a broker-dealer to file the notice under Rule 17a–11. The Commission has adjusted this estimate upwards to two hours because the Commission believes that an NRSRO would take longer to explain the applicability of the safe harbor than to explain the reasons for the notices required under Rule 17a–11. For these reasons, the Commission estimates that the total annual hour burden for this proposed rule would be 300 hours per year.[367]

E. Collection of Information Is Mandatory

These recordkeeping and notice requirements are mandatory, where applicable.

F. Confidentiality

Pursuant to section 15E(a)(1)(B) of the Exchange Act, certain information collected in Form NRSRO required under Rule 17g–1(a) would not be confidential. However, other information would be confidential under section 15E(a)(1)(B) of the Exchange Act and proposed Rule 17g–1(b). The Commission would keep this information confidential to the extent permitted by law. The books and records information collected under proposed Rules 17g–2, 17g–4, and 17g–6 would be stored by the NRSRO and made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

The information collected under Rule 17g–3 (the annual audited financial statements) would be generated from the internal records of the NRSRO. Pursuant to Section 15E(k) of the Exchange Act, the annual audit would be furnished to the Commission on a confidential basis, to the extent permitted by law.[368]

G. Record Retention Period

Paragraph (c) of proposed Rule 17g–2 would require an NRSRO to retain the records for at least three years, except records relating to customers would need to be retained until three years after the business relationship with the customer ended.[369]

H. Request for Comment

The Commission requests comment on the proposed collections of information in order to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (5) evaluate whether the proposed rules would have any effects on any other collection of information not previously identified in this section.

Persons who desire to submit comments on the collection of information requirements should direct

[356] *See* proposed Rule 17g–3.

[357] *See* 17 CFR 240.15c3–1g and 17i–5.

[358] 200 hours × 30 NRSROs = 6,000 hours.

[359] $15,000 ×30 NRSROs = $450,000.

[360] 15 U.S.C. 78o–7(g)(1).

[361] 15 U.S.C. 78a *et seq.*

[362] 15 U.S.C. 78o–7(g)(2).

[363] 15 U.S.C. 78o–7(g)(1).

[364] *See* proposed Rule 17g–4.

[365] For example, the IOSCO Code requires credit rating agencies to develop such procedures.

[366] 50 hours × 30 NRSROs = 1,500 hours.

[367] (2 hours × 5 refusals) × 30 NRSROs = 300 hours.

[368] 15 U.S.C. 78o–7(k).

[369] *See* proposed Rule 17g–2(c).

their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, and refer to File No. S7–04–07. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the **Federal Register**; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–04–07, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE., Washington, DC 20549.

V. Costs and Benefits of the Proposed Rules

The Commission is sensitive to the costs and benefits that result from its rules. The Commission has identified certain costs and benefits of the proposed rules and requests comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[370] The Commission seeks comment and data on the value of the benefits identified. The Commission also welcomes comments on the accuracy of its cost estimates in each section of this cost-benefit analysis, and requests those commenters to provide data so the Commission can improve the cost estimates, including identification of industry statistics relied on by commenters to reach conclusions on cost estimates. The Commission also seeks comment on the extent to which costs are attributable to requirements set forth in Section 15E of the Exchange Act,[371] rather than the proposed rules. Finally, the Commission seeks estimates and views regarding these costs and benefits for particular types of market participants, as well as any other costs or benefits that may result from the adoption of these proposed rules.

A. Benefits

The purposes of the Credit Rating Agency Reform Act of 2006 (the ''Act'') [372] are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.[373] As the Senate Report states, the Act establishes ''fundamental reform and improvement of the designation process,'' and ''eliminating the artificial barrier to entry will enhance competition and provide investors with more choices, higher quality ratings, and lower costs.'' [374]

To these ends, the Act establishes—through statutory provisions and the grant of Commission rulemaking authority—a regulatory program for credit rating agencies opting to have their credit ratings qualify for purposes of laws and rules using the term ''NRSRO.'' Specifically, the Act sets out a voluntary mechanism for credit rating agencies to register with the Commission as an NRSRO.[375] It requires an NRSRO to make public certain information to help users of credit ratings assess the NRSRO's credibility and compare the NRSRO with other NRSROs.[376] The Act also requires an NRSRO to furnish the Commission with periodic financial reports.[377] Further, the Act requires an NRSRO to implement policies to manage the handling of material non-public information and conflicts of interest.[378] Pursuant to authority under the Act, the Commission would prohibit certain acts and practices the Commission determines to be unfair, coercive, or abusive.[379]

The rules proposed by the Commission under the Act would be issued pursuant to specific grants of rulemaking authority in the Act. They are designed to further the goals of the Act. A primary purpose of the Act is to foster ''competition in the credit rating agency business.'' [380] The practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier for credit rating agencies seeking wider recognition and market share. The Commission believes that these proposed rules further the Act's goal of increasing competition because they would provide credit rating agencies with a transparent process to apply for registration as an NRSRO that does not favor a particular business model or larger, established firms. This would make it easier for more credit rating agencies to apply for registration. Increased competition in the credit ratings business could lower the cost to issuers, obligors, and underwriters of obtaining credit ratings.

In addition, the Act requires NRSROs to make their credit ratings and information about themselves available to the public. Part of the definition of ''credit rating agency'' in the Act is that the entity must be in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[381] Under the Act and the rules proposed to be adopted thereunder, an NRSRO would need to disclose important information such as its credit ratings performance statistics, its methods for determining credit ratings, its organizational structure, its procedures to prevent the misuse of material non-public information, the conflicts of interest that arise from its business activities, its code of ethics, and the qualifications of its credit analysts, credit analyst supervisors and compliance personnel. The Commission believes that these disclosures under the

[370] For the purposes of this cost/benefit analysis, the Commission is using salary data from the *SIA Report on Management and Professional Earnings in the Securities Industry 2005* (''SIA Management Report 2005''), which provides base salary and bonus information for middle-management and professional positions within the securities industry. The positions in the report are divided into the following categories: Accounting, Administration & Finance, Compliance, Customer Service, Floor/Trading, Human Resources Management, Internal Audit, Legal, Marketing/Corporate Communications, New Business Development, Operations, Research, Systems/Technology, Wealth Management, and Business Continuity Planning. The Commission believes that the salaries for these securities industry positions would be comparable to the salaries of similar positions in the credit rating industry. The Commission also notes that it is using salaries for New York-based employees, which tend to be higher than the salaries for comparable positions located outside of New York. This conservative approach is intended to capture unforeseen costs. Finally, the salary costs derived from the SIA Management Report 2005 and referenced in this cost benefit section, are modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[371] 15 U.S.C. 78o–7.

[372] Pub. L. No. 109–291 (2006).

[373] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[374] *Id.*

[375] Section 15E of the Exchange Act (15 U.S.C. 78o–7).

[376] Sections 15E(a)(1) and (b)(1) of the Exchange Act (15 U.S.C. 78o–7(a)(1) and (b)(1)).

[377] Section 15E(k) of the Exchange Act (15 U.S.C. 78o–7(k)).

[378] Sections 15E(g) and (h) of the Exchange Act (15 U.S.C. 78o–7(g) and (h)).

[379] Section 15E(i) of the Exchange Act (15 U.S.C. 78o–7(i)).

[380] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[381] Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

proposed rules would allow users of the credit ratings to compare the ratings quality of different NRSROs. Although the information an NRSRO would provide on its Form NRSRO and to comply with the proposed rules cannot substitute for an investor's due diligence in evaluating a credit rating, it would aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the proposed rules implement provisions of the Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO would allow the Commission to conduct regular examinations of the credit rating agency to evaluate compliance with the regulatory scheme set forth in Section 15E of the Exchange Act [382] and the proposed rules and would subject an NRSRO to disclosure, recordkeeping, and annual audit requirements, as well as requirements regarding the prevention of misuse of material, nonpublic information, the management of conflicts of interest, and certain prohibited acts and practices. Increased confidence in the integrity of NRSROs and the credit ratings they issue could promote participation in the securities markets. Better quality ratings could also reduce the likelihood of an unexpected collapse of a rated issuer or obligor, reducing risks to individual investors and to the financial markets. In addition to improving the quality of credit ratings, increased oversight of NRSROs could increase the accountability of an NRSRO to its subscribers, investors, and other persons who rely on the credibility and objectivity of credit ratings in making an investment decision.

Proposed Rule 17g–1 prescribes a process for a credit rating agency to register with the Commission as an NRSRO.[383] This proposed rule would require a credit rating agency apply for registration using Form NRSRO. Proposed Form NRSRO would require that a credit rating agency provide information required under Section 15E(a)(1)(B) of the Exchange Act and certain additional information.[384] The additional information would assist the Commission in making the assessment regarding financial and managerial resources required under Section 15E(a)(2)(C)(ii)(I) of the Exchange Act.[385] This section directs the Commission to grant a credit rating agency's application for registration as an NRSRO unless, among other things, the Commission finds that the applicant does not have adequate financial and managerial resources to consistently issue ratings with integrity and to materially comply with its procedures and methodologies disclosed under Sections 15E(a)(1)(B) of the Exchange Act [386] and with the requirements in Sections 15E(g), (h), (i) and (j) of the Exchange Act.[387] Certain other additional information that would need to be made public would assist users of credit ratings in assessing the credibility of the NRSRO and to compare the NRSRO with other NRSROs.

Proposed Rule 17g–2 would implement the Commission's recordkeeping and rulemaking authority under Section 17(a) of the Exchange Act [388] by requiring an NRSRO to make and retain certain records related to its business as a credit rating agency.[389] The proposed recordkeeping rule would assist the Commission in monitoring whether an NRSRO is complying with provisions of Section 15E of the Exchange Act and the rules thereunder. This would include monitoring whether it is operating consistently with the methodologies and procedures it establishes (and discloses) to determine credit ratings and its policies and procedures designed to ensure the impartiality of its credit ratings.

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[390] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[391] Proposed Rule 17g–3 would require an NRSRO to furnish annual audited financial statements to the Commission.[392] This proposed rule would enhance Commission oversight of an NRSRO. Specifically, it would aid the Commission in monitoring whether the initiation of a proceeding under Section 15E(d) of the Exchange Act would be appropriate because the NRSRO "fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity." [393] In addition, the audited financial statements also would assist the Commission in monitoring potential conflicts of interests of a financial nature which may arise in the operation of an NRSRO.[394]

Section 15E(g)(1) of the Exchange Act [395] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[396] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[397] Proposed Rule 17g–4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act [398] include three specific types of procedures.[399] These specific procedures would establish a baseline for the type of procedures an NRSRO must implement to meet the statutory requirement in Section 15E(g) of the Exchange Act.[400] In this way, the proposed rule is designed to ensure that an NRSRO establishes adequate procedures and controls to protect material nonpublic information.

Proposed Rule 17g–5 would implement Section 15E(h)(2) of the Exchange Act [401] by requiring an NRSRO to disclose and manage certain conflicts of interest, as well as specifically prohibiting other conflicts of interest.[402] The proposed rule would promote the disclosure and management of conflicts of interest required by Sections 15E(a)(1)(B)(vi) and 15E(h) of the Exchange Act and mitigate potential undue influences on an NRSRO's credit rating process.[403]

Proposed Rule 17g–6 would prohibit an NRSRO from engaging in certain unfair, abusive, or coercive acts or practices, including practices with

[382] 15 U.S.C. 78o–7.

[383] *See* proposed Rule 17g–1.

[384] *See* Section 15E(a)(1)(B) of the Exchange Act. 15 U.S.C. 78o–7(a)(1)(B). *See* Section III.C.2. (discussing the items included in Form NRSRO).

[385] *See* 15 U.S.C. 78o–7(a)(2)(C)(ii)(I).

[386] 15 U.S.C. 78o–7(a)(1)(B).

[387] 15 U.S.C. 78o–7(g), (h), (i) and (j).

[388] 15 U.S.C. 78q(a)(1).

[389] *See* proposed Rule 17g–2.

[390] 15 U.S.C. 78o–7(k).

[391] *Id.*

[392] *See* proposed Rule 17g–3.

[393] 15 U.S.C. 78o–7(d).

[394] *See e.g.*, proposed Rule 17g–5(c)(1) prohibiting an NRSRO from issuing or maintaining a credit rating for a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding 10% of the NRSRO's total revenue for the year.

[395] 15 U.S.C. 78o–7(g)(1).

[396] 15 U.S.C. 78a *et seq.*

[397] 15 U.S.C. 78o–7(g)(2).

[398] 15 U.S.C. 78o–7(g)(1).

[399] *See* proposed Rule 17g–4.

[400] 15 U.S.C. 78o–7(g).

[401] 15 U.S.C. 78o–7(h)(2).

[402] *See* proposed Rule 17g–5.

[403] 15 U.S.C. 78o–7(a)(1)(B)(vi) and (h).

respect to unsolicited ratings.[404] These proposed prohibitions are designed to enhance the integrity of NRSROs, promote competition and fulfill a statutory mandate.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify, including the identification of sources of empirical data that could be used for such metrics.

B. Costs

The Act requires that the rules and regulations that the Commission may prescribe under the Act ''shall be narrowly tailored'' to meet its requirements.[405] The rules proposed by the Commission are designed to adhere to this statutory mandate and, thereby, keep compliance costs as low as possible.

The cost of compliance to a given NRSRO would depend on its size and the complexity of its business activities. As discussed above, the size and complexity of credit rating agencies varies significantly. Therefore, it is difficult to quantify a cost per NRSRO. Instead, the Commission is providing estimates of the average cost per NRSRO taking into consideration the range in size and complexity of NRSROs and the fact that many already may have established policies, procedures and recordkeeping systems and processes that would comply substantially with the proposed requirements.

The Commission believes that larger NRSROs generally would already have established written policies and procedures and recordkeeping systems that would comply with a substantial portion of the requirements in the proposed rules. Many of the requirements in the proposed rules are consistent with the IOSCO Code, which a number of credit rating agencies (including the largest) have adopted. These firms would need to augment or modify existing policies and procedures and recordkeeping systems to comply with the proposed rules (rather than establish new ones). Some smaller credit rating agencies also have implemented the policies, procedures, and recordkeeping systems necessary to comply with the proposed rules. Moreover, given their smaller size and simpler structure, smaller entities would require less effort and incur less cost to comply with a substantial portion of the requirements in these proposed rules.

For these reasons, the cost estimates represent the average cost across all NRSROs (regardless of size) and take into account that many firms would only need to augment existing policies, procedures and recordkeeping systems and processes to come into compliance with the proposed rules. Furthermore, as discussed with respect to the Paperwork Reduction Act of 1995 (''PRA''),[406] the Commission is proposing to require additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act.[407] Therefore, the cost estimates for proposed Rule 17g–1 include estimates that arise from requirements imposed by Section 15E of the Exchange Act.[408] The intent is to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that would be required under the proposed Rule 17g–1. Thus, those estimates do not seek to capture costs that would be solely attributable to requirements in Section 15E of the Exchange Act.[409] The Commission requests commenters to provide data for the costs that would be solely attributable to the requirements of Section 15E of the Exchange Act.

Given the estimates set forth below, the Commission estimates that the total one-time estimated cost to NRSROs resulting from these rule proposals would be approximately $4,936,325[410] and the total estimated annual cost to NRSROs resulting from these rule proposals would be approximately $3,955,500 per year.[411]

1. Proposed Rule 17g–1, Form NRSRO and Instructions to Form NRSRO

Section 15E(a)(1) of the Exchange Act requires a credit rating agency applying for registration with the Commission to furnish an application containing certain specified information and such other information as the Commission prescribes as necessary or appropriate in the public interest or for the protection of investors.[412] Proposed Rule 17g–1 would implement this statutory provision by requiring a credit rating agency to furnish an initial application on Form NRSRO to apply to be registered under section 15E of the Exchange Act.[413]

NRSROs would incur costs to register under Section 15E of the Exchange Act and proposed Rule 17g–1 thereunder.[414] As discussed above with respect to PRA, the Commission estimates that an NRSRO would spend approximately 300 hours to complete and furnish an initial Form NRSRO. Also, as discussed with respect to the PRA, the Commission estimates there would be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $66,900[415] and the total aggregate one-time cost to the industry would be $2,007,000.[416]

Also, as discussed with respect to the PRA, the Commission also anticipates that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average, an outside counsel would spend approximately 40 hours assisting an NRSRO in preparing its application for registration. The Commission further estimates that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimates that the average hourly cost for an outside counsel would be approximately $400 per hour. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $16,000[417] and the one-time cost to the industry would be $480,000.[418]

Under proposed Rule 17g–1, an NRSRO applying to be registered for an additional category of credit ratings would need to file an amended Form NRSRO with the Commission. As discussed with respect to the PRA, the Commission estimates, on average, an NRSRO would spend 25 hours completing and furnishing a Form NRSRO for this purpose. The Commission also estimates with respect to the PRA that five of the 30 NRSROs would apply to register for an additional

[404] *See* proposed Rule 17g–6.

[405] 15 U.S.C. 78o–7(c)(2).

[406] 44 U.S.C. 3501 *et seq.*; 5 CFR 1320.11.

[407] 15 U.S.C. 78o–7(a)(1)(B).

[408] 15 U.S.C. 78o–7.

[409] *Id.*

[410] This total is derived from the total one-time costs set forth in the order that they appear in the text: $2,007,000 + $480,000 + $25,625 + $30,000 + $241,200 + $1,845,000 + $307,500 = $4,936,325.

[411] This total is derived from the total annual costs set forth in the order that they appear in the text: $307,500 + $61,500 + $80,400 + $1,562,100 + $1,494,000 + $450,000 = $3,505,500.

[412] 15 U.S.C. 78o–7(a)(1).

[413] 15 U.S.C. 78o–7.

[414] There is no filing fee for a Form NRSRO.

[415] The Commission estimates that a credit rating agency would have a senior compliance examiner perform these responsibilities. The SIA Management Report 2005 (Senior Compliance Examiner) indicates that the average hourly cost for a senior compliance examiner is $223. Therefore, the average one-time cost per NRSRO would be approximately $66,900 [(300 hours) × ($223 per/hour)].

[416] 30 NRSROs × $66,900 = $2,007,000.

[417] $400 per hour × 40 hours = $16,000.

[418] $16,000 × 30 NRSROs = $480,000.

category of credit ratings. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $5,125 [419] and the total aggregate one-time cost to the industry would be $25,625.[420]

Furthermore, as discussed above with respect to the PRA, the Commission also estimates that an NRSRO may need to purchase recordkeeping system software to establish a recordkeeping system in conformance with the proposed rule. The Commission estimates that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSRO's would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs would be approximately $1000 per firm. Therefore, the one-time cost to the industry would be $30,000.[421]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate.[422] Proposed Rule 17g–1 would require an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO. As discussed with respect to the PRA, the Commission estimates that an NRSRO would furnish two amendments on Form NRSRO per year on average. The Commission also estimates with respect to the PRA that it would take approximately 25 hours to prepare and furnish an amendment and that there would be 30 NRSROs. For these reasons, the Commission estimates that the average annual cost to an NRSRO would be $10,250 [423] and the total aggregate annual cost to the industry would be $307,500.[424]

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[425] Proposed Rule 17g–1 would require an NRSRO to furnish the annual certification on Form NRSRO.[426] As discussed with respect to the PRA, the Commission estimates an NRSRO would spend approximately 10 hours per year completing and furnishing the annual certification and that there would be 30 NRSROs. For these reasons, the Commission estimates that the average annual cost to an NRSRO would be $2,050 [427] and the total aggregate annual cost to the industry would be $61,500.[428]

Section 15E(a)(3) of the Exchange Act requires an NRSRO to make certain information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.[429] Proposed Rule 17g–1 would require that this be done within five business days of the granting of an NRSRO's registration or the furnishing of an amendment to the form or annual certification.[430] As discussed with respect to the PRA, the Commission estimates that the average hour burden for an NRSRO to disclose this information on its Web site would be approximately 30 hours on a one-time basis and 10 hours per year. Furthermore, as discussed with respect to the PRA, the Commission estimates that there would be 30 NRSROs. For these reasons, the Commission estimates that an NRSRO would incur an average one-time cost of $8,040 and an average annual cost of $2,680.[431] Consequently, the total aggregate one-time cost to the industry would be $241,200 [432] and total aggregate annual cost to the industry would be $80,400 per year.[433]

The Commission believes the requirements in proposed Rule 17g–1 to provide notices when a credit rating agency withdraws its application or an NRSRO withdraws its registration would result in *de minimis* costs.

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

2. Proposed Rule 17g–2

Section 17(a)(1) of the Exchange Act [434] provides the Commission with authority to require an NRSRO to make and maintain such records 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.[435] Proposed Rule 17g–2 would implement this rulemaking authority by requiring an NRSRO to make and preserve specified records related to its credit rating business.

As discussed with respect to the PRA, the Commission estimates that an NRSRO, on average, would spend approximately 300 hours on a one-time basis to establish a recordkeeping system and 254 hours each year updating its books and records. For these reasons, the Commission estimates that an NRSRO would incur an average one-time cost of $61,500 and an average annual cost of $52,070.[436] Consequently, the total aggregate one-time cost to the industry would be $1,845,000,[437] and the total aggregate annual cost to the industry would be $1,562,100 per year.[438]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those

[419] The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average cost to an NRSRO would be $5,125 [(25 hours for one year) × ($205)].

[420] 5 NRSROs × $5,125 = $25,625.

[421] $1,000 × 30 NRSROs = $30,000.

[422] 15 U.S.C. 78o–7(b)(1).

[423] Based on the PRA estimates, an NRSRO would spend approximately 50 hours each year updating its application on Form NRSRO (25 hours per amendment × two amendments). The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the total average annual cost to an NRSRO to update its registration on Form NRSRO would be $10,250 [(50 hours per year) × ($205 per hour)].

[424] $10,250 × 30 NRSROs = $307,500.

[425] 15 U.S.C. 78o–7(b)(2).

[426] *See* proposed Rule 17g–1(g).

[427] The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average annual cost would be $2,050 [(10 hours per year) × ($205 per hour)].

[428] $2,050 × 30 NRSROs = $61,500.

[429] 15 U.S.C. 78o–7(a)(3).

[430] *See* proposed Rule 17g–1(d).

[431] The Commission estimates that an NRSRO would have a Senior Programmer perform this work. The SIA Management Report 2005 (Senior Programmer) indicates that the average hourly cost for a senior programmer is $268. Therefore, the average one-time cost would be $8,040 [(30 hours) × ($268 per hour)] and the average annual cost would be $2,680 [(10 hours per year) × ($268 per hour)].

[432] $8,040 × 30 NRSROs = $241,200.

[433] $2,680 × 30 NRSROs = $80,400.

[434] *See* Section 5 of the Act.

[435] *See* Section 5 of the Act and 15 U.S.C 78q(a)(1).

[436] The Commission estimates that an NRSRO would have a compliance manager perform these responsibilities. The SIA Management Report 2005 indicates that the average hourly cost for a compliance manager is $205. Therefore, the average one-time cost would be $61,500 [(300 hours) × ($205 per hour)] and the average annual cost would be $52,070 [(254 hours per year) × ($205 per hour)].

[437] $61,500 × 30 NRSROs = $1,845,000.

[438] $52,070 × 30 NRSROs = $1,562,100.

identified above, such as costs arising from restructuring business practices. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

3. Proposed Rule 17g–3

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[439] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[440]

Proposed Rule 17g–3 would implement this statutory provision by requiring an NRSRO to furnish audited annual financial statements to the Commission, including certain specified schedules.[441] As discussed above with respect to the PRA, the Commission estimates that NRSRO, on average, would spend approximately 200 hours per year preparing for and furnishing the annual audit. For these reasons, the Commission estimates that the average annual cost to an NRSRO would be $49,800[442] and the total aggregate annual cost to the industry would be $1,494,000.[443]

As noted above, the average one-time and annual costs to NRSROs would vary widely depending on the size and complexity of the NRSRO. Moreover, some large credit rating agencies already prepare audited financial statements in accordance with other regulatory requirements. Nonetheless, these credit rating agencies, if they become NRSROs, may need to make changes to their accounting systems to comply with proposed annual audit requirements in Rule 17g–3. The Commission believes these costs would vary, depending on the size and complexity of the NRSRO, and seeks comment on the costs that would be incurred to make changes to their accounting systems.

Furthermore, as discussed above with respect to the PRA, an NRSRO would need to engage the services of an independent public accountant to comply with proposed Rule 17g–3. The cost of hiring an accountant would vary substantially based on the size and complexity of the NRSRO. As noted above, based on staff experience, the annual audit costs of a small broker-dealer generally range from $3,000 to $5,000 a year. As the Commission estimated above, the annual audit costs for a small NRSRO would likely be comparable to the costs incurred by a small broker-dealer. The costs for a large NRSRO would be much greater. However, many of these firms already are audited by a public accountant for other regulatory purposes. These firms, however, may incur some incremental costs, given the schedules in proposed Rule 17g–3. For these reasons, the Commission estimates that the average annual cost across all NRSROs to engage the services of an independent public accountant would be approximately $15,000. Therefore, the annual cost to the industry would be $450,000.[444]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their cost estimates.

4. Proposed Rule 17g–4

Section 15E(g)(1) of the Exchange Act[445] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[446] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[447] Proposed Rule 17g–4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[448] include three specific types of procedures.[449]

As discussed above with respect to PRA, the Commission estimates that it would take approximately 50 hours for an NRSRO to establish procedures in conformance with the proposed rule and that there would be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $10,250[450] and the total aggregate one-time cost to the industry would be $307,500.[451]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes and restructuring business practices. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

5. Proposed Rules 17g–5 and 17g–6

Proposed Rules 17g–5 and 17g–6 are conduct rules that would require NRSROs respectively to avoid certain conflicts of interest and unfair, abusive or coercive acts and practices and, consequently, do not require an NRSRO to make records or reports or create recordkeeping or accounting systems.[452] Moreover, 15E(1)(B)(vi) of the Exchange Act requires an NRSRO to disclose any conflicts of interest. Additionally, Section 15E(h) of the Exchange Act requires an NRSRO establish, maintain, and enforce written policies and procedures reasonable designed to address and manage any conflicts of interest that can arise from its business. Therefore, the Commission does not anticipate that proposed Rule 17g–5

[439] 15 U.S.C. 78o–7(k).

[440] *Id.*

[441] *See* proposed Rule 17g–3.

[442] The Commission estimates that a senior internal auditor would perform these responsibilities. The SIA Management Report 2005 (Senior Internal Auditor) indicates that the average hourly cost for a senior internal auditor is $249. Therefore, the average annual cost would be $49,800 [(200 hours per year) × ($249 per hour)].

[443] $49,800 × 30 NRSROs = $1,494,000.

[444] $15,000 × 30 NRSROs = $450,000.

[445] 15 U.S.C. 78o–7(g)(1).

[446] 15 U.S.C. 78a *et seq.*

[447] 15 U.S.C. 78o–7(g)(2).

[448] 15 U.S.C. 78o–7(g)(1).

[449] *See* proposed Rule 17g–4.

[450] The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average one-time cost to an NRSRO would be $10,250 [(50 hours) × ($205)].

[451] 30 NRSROs × $10,250 = $307,500.

[452] Paragraph (b) of Rule 17g–6 does require a record to be made in certain situations. However, the Commission estimates that this requirement would impose *de minimis* costs.

would result in any significant incremental costs.

Proposed Rules 17g–5 and 17g–6 do prohibit respectively certain conflicts of interest and unfair, coercive and abusive acts and practices. The Commission believes that most entities that would become NRSROs do not engage in these types of conflicts, acts and practices. Therefore, the Commission estimates that these proposed rules generally would impose *de minimis* costs. However, the Commission recognizes that an NRSRO may incur costs related to training employees about the requirements in these proposed rules. It also is possible that the proposed rules could require some NRSROs to restructure their business models or activities. The Commission, therefore, requests comment on such training and restructuring costs. The Commission also request comment on whether there are any other costs associated with these proposed rules.

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Under Section 3(f) of the Exchange Act,[453] the Commission must, when engaging in rulemaking that requires the Commission to consider or determine if an action is necessary or appropriate in the public interest, consider whether the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act[454] requires the Commission to consider the anticompetitive effects of any rules the Commission adopts under the Exchange Act. Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission's preliminary view is that the proposed rules should promote efficiency, competition, and capital formation. As discussed above with respect to the costs and benefits of the proposed rules, the primary purpose of the Credit Rating Agency Reform Act of 2006 (the ''Act'')[455] is to foster ''competition in the credit rating agency business.''[456] The practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier for credit rating agencies seeking wider recognition and market share. The Commission believes that these proposed rules implementing provisions of the Act further the Act's goal of increasing competition because they would provide credit rating agencies with a transparent process to apply for registration as an NRSRO that does not favor a particular business model or larger, established firms. This would make it easier for more credit rating agencies to apply for registration. Increased competition in the credit ratings business could lower the cost to issuers, obligors, and underwriters of obtaining credit ratings.

In addition, the Act requires NRSROs to make their credit ratings and information about themselves available to the public. Part of the definition of ''credit rating agency'' in the Act is that the entity must be in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[457] Under the Act and the rules proposed to be adopted thereunder, an NRSRO would need to disclose important information such as its credit ratings performance statistics, its methods for determining credit ratings, its organizational structure, its procedures to prevent the misuse of material non-public information, the conflicts of interest that arise from its business activities, its code of ethics, and the qualifications of its credit analysts, credit analyst supervisors and compliance personnel. The Commission believes that these disclosures under the proposed rules would allow users of the credit ratings to compare the ratings quality of different NRSROs. Although the information an NRSRO would provide on its Form NRSRO and to comply with the proposed rules cannot substitute for an investor's due diligence in evaluating a credit rating, it would aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the proposed rules implement provisions of the Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO would allow the Commission to conduct regular examinations of the credit rating agency to evaluate compliance with the regulatory scheme set forth in Section 15E of the Exchange Act and the proposed rules and would subject an NRSRO to disclosure, recordkeeping, and annual audit requirements, as well as requirements regarding the prevention of misuse of material, nonpublic information, the management of conflicts of interest, and certain prohibited acts and practices. Increased confidence in the integrity of NRSROs and the credit ratings they issue could promote participation in the securities markets. Better quality ratings could also reduce the likelihood of an unexpected collapse of a rated issuer or obligor, reducing risks to individual investors and to the financial markets. In addition to improving the quality of credit ratings, increased oversight of NRSROs could increase the accountability of an NRSRO to its subscribers, investors, and other persons who rely on the credibility and objectivity of credit ratings in making an investment decision.

The Commission solicits comment on these matters with respect to the proposed rules. In particular, the Commission solicits comment on whether the proposed rules would have an adverse effect on competition that is neither necessary nor appropriate in furtherance of the purposes of the Exchange Act. In addition, comment is sought on whether the proposed rules, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,''[458] the Commission must advise OMB whether a proposed regulation constitutes a major rule. Under SBREFA, a rule is ''major'' if it has resulted in, or is likely to result in:

- An annual effect on the economy of $100 million or more
- A major increase in costs or prices for consumers or individual industries; or
- A significant adverse effect on competition, investment, or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. The Commission requests comment on the potential impact of each of the proposed rules on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

[453] 15 U.S.C. 78c(f).

[454] 15 U.S.C. 78w(a)(2).

[455] Pub. L. No. 109–291 (2006).

[456] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[457] Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

[458] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

VIII. Initial Regulatiry Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis (IRFA), in accordance with the provisions of the Regulatory Flexibility Act,[459] regarding proposed rules 17g–1, 17g–2, 17g–3, 17g–4, 17g–5, and 17g–6 and proposed Form NRSRO under the Exchange Act.

The Commission encourages comments with respect to any aspect of this IRFA, including comments with respect to the number of small entities that may be affected by the proposed rules. Comments should specify the costs of compliance with the proposed rules and suggest alternatives that would accomplish the goals of the rules. Comments will be considered in determining whether a Final Regulatory Flexibility Analysis is required and will be placed in the same public file as comments on the proposed rules. Comments should be submitted to the Commission at the addresses previously indicated.

A. Reasons for the Proposed Action

The proposed rules would implement specific provisions of the Credit Rating Agency Reform Act of 2006 (the ''Act'').[460] The Act defines the term ''nationally recognized statistical rating organization'' as a credit rating agency registered with the Commission, provides authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue final implementing rules no later than 270 days after its enactment.

B. Objectives

The proposed rules would implement specific provisions of the Act. The objectives of the Act are ''to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.''[461] The proposed rules are designed to further these objectives and assist the Commission in determining whether an entity should be registered as an NRSRO, monitoring whether an NRSRO complies with the provisions of the Act and rules thereunder, fulfilling the Commission's statutory mandate to adopt rules to implement the NRSRO regulatory program, and provide information regarding NRSROs to the public and to users of credit ratings.

C. Legal Basis

Pursuant to the Exchange Act[462] and, particularly, Section 15E of the Exchange Act.[463]

D. Small Entities Subject to the Rule

Paragraph (a) of Rule 0–10 provides that for purposes of the Regulatory Flexibility Act, 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.''[464] The Commission believes that an NRSRO with total assets of $5 million or less would qualify as a ''small'' entity for purposes of the Regulatory Flexibility Act.

As noted above, the Commission believes that approximately 30 credit rating agencies would be registered as an NRSRO. Moreover, as also noted above, the Senate Report accompanying the Act states that the two largest credit rating agencies have about 80% of the market share as measured by revenues. The Senate Report also states that these two firms rate more than 99% of the debt obligations and preferred stock issues publicly traded in the United States. Given these figures, the Commission believes that the majority of the credit rating agencies registered with the Commission would be ''small'' entities.[465] Consequently, the Commission estimates that, of the approximately 30 credit rating agencies estimated to be registered with the Commission, approximately 20 would be ''small'' entities for purposes of the Regulatory Flexibility Act.[466]

E. Reporting, Recordkeeping, and Other Compliance Requirements

A credit rating agency seeking to apply to the Commission for registration as a nationally recognized statistical rating organization would apply using proposed Form NRSRO.[467] The Form would elicit certain information and require the credit rating agency to attach a number of documents, including exhibits (some of which would have to be made publicly available and some of which would be eligible for confidential treatment) and certifications from qualified institutional buyers. The public exhibits would consist of information such as performance data for the credit ratings, organizational structure, the methods used by the credit rating agency for issuing credit ratings, the policies used by the credit rating agency to manage activities that could potentially risk the impartiality of its credit ratings, and information about managers and credit analysts. To the extent permitted by law, the confidential exhibits would consist of information about the credit rating agency's financial condition, revenues and credit analyst compensation.

After registration, the credit rating agency (now an NRSRO under the Act) would generally need to promptly update the public information on its Form NRSRO whenever an item or exhibit becomes materially inaccurate. To update information, the NRSRO would furnish the Commission with an amendment using Form NRSRO. In addition, the NRSRO would need to furnish the Commission with an annual certification on Form NRSRO.[468] The annual certification would represent that all information on the form, as amended, continues to be accurate, would require the credit rating agency to list any material changes made during the previous year, and would include an update to the public exhibit relating to the performance statistics of its credit ratings. After its application for registration is approved, the NRSRO would be required to make Form NRSRO and the public exhibits submitted to the Commission, and all amendments, readily accessible to the public.

NRSROs would also be subject to a recordkeeping rule.[469] This rule would require the NRSRO to make and retain certain records relating to the business of issuing credit ratings. These records would assist the Commission, through its examination process, in monitoring whether the NRSRO continues to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity (as required under the Act) and whether the NRSRO was complying with the provisions of the Act, the rules adopted under the act, and the NRSRO's disclosed policies and procedures.

On an annual fiscal year basis, an NRSRO would be required to furnish the Commission with audited financial statements.[470] This requirement is designed to assist the Commission in monitoring whether the NRSRO continues to maintain adequate financial resources to consistently

[459] 5 U.S.C. 603.

[460] Pub. L. No. 109–291 (2006).

[461] *See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850,* Credit Rating Agency Reform Act of 2006, S. Report No. 109–326, 109th Cong., 2d Sess. (Sept. 6, 2006) (''Senate Report'').

[462] 15 U.S.C. 78a *et seq.*

[463] 15 U.S.C. 78o–7.

[464] 17 CFR 240.0–10(a).

[465] *See* 17 CFR 240.0–10(a).

[466] *Id.*

[467] Proposed Rule 17g–1.

[468] *Id.*

[469] Proposed Rule 17g–2.

[470] Proposed Rule 17g–3.

produce credit ratings with integrity. It also is designed to assist the Commission in monitoring whether the NRSRO is complying with provisions of the Act and the rules adopted thereunder regarding the potential conflicts of interest arising from dealings with large customers in terms of revenues earned.

Finally, all NRSROs would be subject to requirements designed to protect their impartiality with respect to issuing credit ratings. First, they would be required to establish, maintain and enforce specific written policies designed to prevent the misuse of material non-public information.[471] Second, NRSROs would be prohibited from having certain general conflicts unless they, as required under the Act, disclosed the conflict and adopted procedures to manage the conflict. Further certain conflicts of interest—for example, rating a security owned by the NRSRO—would be prohibited. Third, NRSROs would be prohibited from engaging in certain practices that the Commission has determined to be unfair, coercive or abusive practices.[472]

F. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap, or conflict with the proposed rules.

G. Significant Alternatives

Pursuant to section 3(a) of the RFA,[473] the Commission must consider certain types of alternatives, including: (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 rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission does not believe it is necessary or appropriate to establish different compliance or reporting requirements or timetables; clarify, consolidate, or simplify compliance and reporting requirements under the rule for small entities; or exempt small entities from coverage of the rule, or any part of the rule. The Act and the proposed rules establish a voluntary program of registration and supervision that allows NRSROs the flexibility to develop procedures tailored to their specific organizational structure and business models. The Commission also does not believe that it is necessary to consider whether small entities should be permitted to use performance rather than design standards to comply with the proposed rules as the rules already propose performance standards and do not dictate for entities of any size any particular design standards that must be employed to achieve the objectives of the proposed rules.

H. Request for Comments

The Commission encourages the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed rules and suggest alternatives that would accomplish the objective of the proposed rules.

The Commission specifically requests comment on the estimate that 30 credit rating agencies would be registered as NRSROs with the Commission, and that 20 of those 30 NRSROs would be small entities for purposes of the Regulatory Flexibility Act.[474] Commenters that disagree with these estimates are requested to describe in detail the basis for their conclusions and identify the sources of any industry statistics they relied on to reach their conclusions.

IX. Statutory Authority

The Commission is proposing Form NRSRO and Rules 17g–1, 17g–2, 17g–3, 17g–4, 17g–5 and 17g–6 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 3(b), 15E, 17, 23(a) and 36.[475]

Text of Proposed Rules

List of Subjects in 17 CFR Parts 240 and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–l, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Sections 240.17g–1 through 240.17g–6 are added to read as follows:

Nationally Recognized Statistical Rating Organizations

Sec.

240.17g–1 Application for registration as a nationally recognized statistical rating organization.
240.17g–2 Records to be made and retained by nationally recognized statistical rating organizations.
240.17g–3 Annual audited financial statements to be furnished by nationally recognized statistical rating organizations.
240.17g–4 Prevention of misuse of material nonpublic information.
240.17g–5 Conflicts of interest.
240.17g–6 Prohibited acts and practices.

§ 240.17g–1 Application for registration as a nationally recognized statistical rating organization.

(a) *Form of registration.* A credit rating agency applying to the Commission to be registered under section 15E of the Act (15 U.S.C. 78o–7) as a nationally recognized statistical rating organization with respect to one or more of the categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) must furnish the Commission with an initial application on Form NRSRO (§ 249b.300 of this chapter) that follows all applicable instructions for the form.

(b) *Furnishing and withdrawing initial application.* (1) An initial application will be considered furnished to the Commission on the date the Commission receives a complete and properly executed initial application on Form NRSRO that follows all instructions for the form. Information submitted on a confidential basis will be accorded confidential treatment to the extent permitted by law.

(2) The applicant may withdraw an application prior to the date of a Commission order granting or denying the application. To withdraw the application, the applicant must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

(c) *Updating application prior to final action by the Commission.* The applicant must promptly furnish the Commission with a written notice if information submitted to the Commission on Form NRSRO, including exhibits and attachments, is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must describe the circumstances in which the information was found to

[471] Proposed Rule 17g–4.

[472] Proposed Rule 17g–6.

[473] 5 U.S.C. 603(c).

[474] 5 U.S.C. 603.

[475] 15 U.S.C. 78c(b), 78o–7, 78q, 78w, and 78mm.

be inaccurate. The applicant must also update the application with accurate and complete information by promptly furnishing the Commission with an amended initial application on Form NRSRO that follows all applicable instructions for the form.

(d) *Public availability of Form NRSRO.* A credit rating agency registered as a nationally recognized statistical rating organization (''rating organization'') must make the current Form NRSRO and non-confidential exhibits publicly available by posting them on its Web site or by another comparable and readily accessible means within 5 business days of the date of the Commission order granting the application and, subsequently, within 5 business days of furnishing an amendment or an annual certification on Form NRSRO.

(e) *Amending scope of registration.* A rating organization that is registered for fewer than the five categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) may apply to be registered for an additional category by furnishing the Commission with an amendment on Form NRSRO indicating where appropriate on the Form the additional class for which registration is sought and following all applicable instructions for the Form. The application to amend the scope of the registration will be subject to the requirements of this section and section 15E(a)(2) of the Act (15 U.S.C. 78o–7(a)(2)) applicable to an initial application for registration, including with respect to the time periods and requirements for the Commission to grant or deny the application.

(f) *Updating Form NRSRO after registration.* A rating organization amending its application for registration pursuant to the requirements of section 15E(b)(1) of the Act (15 U.S.C. 78o–7(b)(1)) must promptly furnish the Commission with the amendment on Form NRSRO that follows all applicable instructions for the Form.

(g) *Annual certification.* A rating organization submitting its annual certification pursuant to the requirements of section 15E(b)(2) of the Act (15 U.S.C. 78o–7(b)(2)) must furnish the Commission with the 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.

(h) *Withdrawal of registration.* A rating organization withdrawing its registration must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

§ 240.17g–2 Records to be made and retained by nationally recognized statistical rating organizations.

(a) *Records required to be made and retained.* Every credit rating agency registered with the Commission as a nationally recognized statistical rating organization (''rating organization'') must make and retain the following books and records, which must be complete and current:

(1) Records of original entry into the rating organization's accounting system and records reflecting entries to and balances in all general ledger accounts of the rating organization for each fiscal year.

(2) Records with respect to each of the rating organization's current credit ratings indicating (as applicable):

(i) The identity of any credit analyst(s) that determined the rating;

(ii) The identity of the person(s) who approved the rating before it was issued;

(iii) The procedures and methodologies used to determine the rating;

(iv) The method by which the credit rating was made readily accessible;

(v) Whether the credit rating was solicited or unsolicited; and

(vi) The date the credit rating action was taken.

(3) A record for each person (for example, an obligor, issuer, underwriter, or other user) that solicits the rating organization to determine or maintain a credit rating indicating:

(i) The identity and principal business address of the person; and

(ii) The credit rating(s) determined for the person.

(4) A record for each subscriber to the credit ratings and/or credit analysis of the rating organization indicating the identity and principal business address of the subscriber and the compensation received from the subscriber.

(5) A record describing each type of service and product offered by the rating organization.

(b) *Records required to be retained.* A rating organization must retain the following books and records:

(1) All significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the rating organization's annual audited financial statements and schedules furnished to the Commission pursuant to § 240.17g–3.

(2) Internal records, including non-public information and work papers, used to determine a credit rating.

(3) Credit analysis reports, credit assessment reports, and private rating reports and internal records, including non-public information and work papers, used to form the basis for the opinions expressed in these reports.

(4) All compliance reports and compliance exception reports that relate to its business as a credit rating agency.

(5) All internal audit plans, internal audit reports, documents relating to internal audit follow-up measures that relate to its business as a credit rating agency, and all records identified by the rating organization's internal auditors as necessary to perform the audit of an activity that relates to its business as a credit rating agency.

(6) All marketing materials that relate to its business as a credit rating agency.

(7) All external and internal communications, including electronic communications, received and sent by the rating organization and its employees relating to initiating, determining, maintaining, changing, or withdrawing a credit rating.

(8) All records made pursuant to paragraph (b) of § 240.17g–6.

(9) All Form NRSROs (including information and documents in the exhibits thereto) furnished to the Commission.

(c) *Record retention periods.* (1) The records required to be retained pursuant to paragraphs (a)(1), (a)(2), and (a)(5) of this section must be retained for three years after the date the record is replaced with an updated record.

(2) The records required to be retained pursuant to paragraphs (a)(3) and (a)(4) of this section must be retained for three years after the date of the last receipt by the person in the record of a service or product of the rating organization.

(3) The records required to be retained pursuant to paragraphs (b)(1) through (b)(9) of this section must be retained for three years after the date the record is made or received by the NRSRO.

(d) *Manner of retention.* An original or true and complete copy of the original of each record required to be retained pursuant to paragraphs (a) and (b) of this section must be maintained in a manner that, for the applicable retention period specified in paragraph (c) of this section, makes the original record or copy easily accessible to the rating organization's principal office and to any other office that conducted activities causing the record to be made or received.

(e) *Third-party record custodian.* The records required to be retained pursuant to paragraphs (a) and (b) of this section may be made or retained by a third-party record custodian, provided the rating organization furnishes the Commission at its principal office in Washington, DC with a written undertaking of the custodian executed by a duly authorized person. The

undertaking must acknowledge that the records are the property of the rating organization, will be surrendered promptly on request of the rating organization, and that the custodian will permit the Commission or its representatives to examine the records. The undertaking must be in substantially the following form:

The undersigned acknowledges that books and records it has made or is retaining for [the rating organization] are the exclusive property of [the rating organization] and the undersigned undertakes that upon the request of [the rating organization] it will promptly provide the books and records to [the rating organization] or the U.S. Securities and Exchange Commission (''Commission'') and its representatives and that upon the request of the Commission it will promptly permit examination by the Commission and its representatives of the records at any time or from time to time during business hours, and promptly furnish to the Commission and its representatives a true and complete copy of any or all or any part of such books and records.

A rating organization that agrees with a third-party custodian to have the custodian make or retain any record specified in paragraphs (a) and (b) of this section remains responsible for complying with every provision in this section, notwithstanding the agreement.

(f) *Non-resident undertaking.* A non-resident rating organization, as defined in paragraph (h) of this section, must undertake to provide books and records to the Commission upon demand. The undertaking must be attached to the rating organization's initial application for registration as a nationally recognized statistical rating organization, signed by a duly authorized person, marked ''Non-Resident Books and Records Undertaking,'' and in substantially the following form:

Upon a request by the U.S. Securities and Exchange Commission (''Commission'') and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at its principal office in Washington, DC, an accurate copy of any book(s) and record(s) which [the rating organization] is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Securities Exchange Act of 1934 or any regulation under that Act. [The rating organization] will produce the requested copy of the book(s) or record(s), in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period.

(g) A rating organization must promptly furnish the Commission and its representatives with legible, complete, and current copies of those records of the rating organization required to be retained under this section, or any other records of the rating organization subject to examination under section 17(b) of the Act (15 U.S.C. 78q(b)) that are requested by the Commission and its representatives.

(h) Where used in this section *non-resident rating organization* means a rating organization that:

(1) If a corporation, is incorporated or has its principal office in a location outside the United States, its territories, or possessions; or

(2) If a partnership or other unincorporated organization or association, is organized under the laws of a jurisdiction or has its principal office in a location outside the United States, its territories, or possessions.

§ 240.17g–3 Annual audited financial statements to be furnished by nationally recognized statistical rating organizations.

(a) A credit rating agency registered with the Commission as a nationally recognized statistical rating organization (''rating organization'') annually must furnish the Commission, at its principal office in Washington, DC, with audited financial statements. The audited financial statements must be prepared in accordance with generally accepted accounting principles, must comply with applicable provisions of Regulation S–X (§ 210.1–01—§ 210.12–29, of this chapter), must be as of the fiscal year end indicated on the rating organization's current Form NRSRO, and must be furnished not more than 90 calendar days after the end of the fiscal year.

(b) The audited financial statements must include the following supporting schedules:

(1) A schedule separately itemizing the following aggregate revenues (as applicable):

(i) Revenue from determining and maintaining credit ratings;

(ii) Revenue from subscribers;

(iii) Revenue from granting licenses or rights to publish credit ratings;

(iv) Revenue from determining credit ratings that are not made readily accessible (private ratings); and

(v) Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue);

(2) A schedule providing the total aggregate and median annual compensation of the rating organization's credit analysts; and

(3) A schedule listing the 20 largest issuers and subscribers that used credit rating services provided by the rating organization by amount of net revenue received by the rating organization and its affiliates from the issuer or subscriber during the fiscal year. In addition, add to the list any obligor or underwriter that used credit rating services provided by the rating organization if the net revenue received by the rating organization and its affiliates from the obligor or underwriter during the fiscal year equaled or exceeded the net revenue received from the 20th largest issuer or subscriber. Include the net revenue amount for each customer.

Note to paragraph (b)(3): A customer would have used the ''credit rating services'' of the rating organization if the customer was any of the following: an obligor that is rated by the rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market instruments rated by the rating organization (regardless of whether the issuer paid for the credit rating); any other person that has paid the rating organization to determine a credit rating with respect to a specific obligor, security, or money market instrument; or a subscriber to the credit ratings of the rating organization. In calculating net revenue received from a customer, the rating organization should include all fees, sales proceeds, commissions, and other revenue received by the rating organization and its affiliates for any type of service or product, regardless of whether related to credit rating services, and net of any fees, sales proceeds, rebates, and monies paid to the customer by the rating organization and its affiliates.

(c) The audited financial statements must be furnished in accordance with the following:

(1) They must be certified by an accountant who is qualified and independent in accordance with paragraphs (a) through (c) of § 210.2–01 of this chapter, and the accountant must give an opinion on the financial statements and schedules in accordance with paragraphs (a) through (d) of § 210.2–02 of this chapter; and

(2) The rating organization must attach to the financial statements a signed statement by a duly authorized person at the rating organization that the person has responsibility for the financial statements and, to the best knowledge of the person, the financial statements fairly present, in all material respects, the financial condition, results of operations, and cash flows of the rating organization for the period presented.

(d) The Commission may grant an extension of time from any requirements in this section either unconditionally or on specified terms and conditions on the written request of a rating organization if the Commission finds

that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

§ 240.17g–4 Prevention of misuse of material nonpublic information.

The written policies and procedures a nationally recognized statistical rating organization (''rating organization'') establishes, maintains, and enforces to prevent the misuse of material nonpublic information in accordance with section 15E(g)(1) of the Act (15 U.S.C. 78o–7(g)(1)) must include:

(a) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of material nonpublic information obtained in connection with the performance of credit rating services;

(b) Procedures designed to prevent a person associated with the rating organization or any member of an associated person's household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments; and

(c) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of a pending credit rating action prior to making the action readily accessible.

§ 240.17g–5 Conflicts of interest.

(a) It shall be unlawful for a nationally recognized statistical rating organization (''rating organization'') or a person associated with the rating organization to have a conflict of interest relating to the issuance of a credit rating identified in paragraph (b) of this section, unless:

(1) The rating organization has disclosed the type of conflict of interest on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o–7(a)(1)(B)(vi)); and

(2) The rating organization has implemented policies and procedures to address and manage conflicts of interest in accordance with section 15E(h) of the Act (15 U.S.C. 78o–7(h)).

(b) *Conflicts of interest.* For purposes of this section, each of the following is a conflict of interest:

(1) Receiving compensation for any type of service or product from a person that is subject to a pending or issued credit rating of the rating organization.

(2) Owning securities or money market instruments of a person that is subject to a pending or issued credit rating of the rating organization.

(3) Receiving compensation from a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(4) Owning securities or money market instruments of, or having any other form of ownership interest in, a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(5) Having any other business, personal, or ownership relationship or affiliation with a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(6) Being an officer or director of a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(7) Any other type of conflict of interest identified by the rating organization on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o–7(a)(1)(B)(vi)).

(c) *Prohibited conflicts.* It shall be unlawful for a rating organization to have a conflict of interest relating to the issuance of a credit rating in the following circumstances:

(1) The rating organization issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the rating organization and its affiliates with net revenue (as determined under § 240.17g–3) equaling or exceeding 10% of the total net revenue of the rating organization and its affiliates for the year;

(2) The rating organization issues or maintains a credit rating with respect to a person where the rating organization, a credit analyst who participated in determining the credit rating, or a person associated with the rating organization responsible for approving the credit rating, owns securities of, or has any other ownership interest in, the rated person or is a borrower or lender with respect to the rated person;

(3) The rating organization issues or maintains a credit rating with respect to a person associated with the rating organization; or

(4) The rating organization issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person associated with the rating organization responsible for approving the credit rating, is also an officer or director of the person that is subject to the credit rating.

§ 240.17g–6 Prohibited acts and practices.

(a) *Prohibitions.* It shall be unlawful for a nationally recognized statistical rating organization (''rating organization'') to engage in any of the following unfair, coercive, or abusive practices:

(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 rating organization or any person associated with the rating organization.

(2) Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the rating organization'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 rating organization or any person associated with the rating organization.

(3) Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the rating organization'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 rating organization or any person associated with the rating organization.

(4) Issuing or threatening to issue a lower credit rating, or lowering or threatening to lower an existing credit rating, or refusing to issue a credit rating or withdrawing a credit rating, with respect to 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 which comprise the asset pool or the asset-backed or mortgage-backed securities also are rated by the rating organization. The prohibitions on refusing to issue a credit rating or withdrawing a credit rating shall not apply if the rating organization has rated less than 85% of the market value of the assets underlying the asset pool or the asset-backed or mortgage-backed securities.

(5) Issuing an unsolicited credit rating and communicating with the rated person to induce or attempt to induce the rated person to pay for the credit rating or any other service or product of

the rating organization or a person associated with the rating organization.

(b) A rating organization refusing to issue a credit rating or withdrawing a credit rating with respect to an asset pool or the asset-backed or mortgage-backed security must document in writing the reason for the refusal or withdrawal.

* * * * *

PART 249b—FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249b continues to read in part as follows.

Authority: 15 U.S.C. 78a *et seq.*, unless otherwise noted;

* * * * *

4. Section 249b.300 and Form NRSRO are added to read as follows:

§ 249b.300 Form NRSRO, application for registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 and § 240.17g–1 of this chapter.

This form shall be used for application for, and amendments to applications for, registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7) and § 240.17g–1 of this chapter.

Note: The text of Form NRSRO will not appear in the Code of Federal Regulations.

BILLING CODE 8010–01–P

Form NRSRO

OMB APPROVAL
OMB Number: 3235-
Expires:
Estimated average burden hours per response:

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

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.

SEC 1541 (2-07)

FORM NRSRO
Page 1

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

☐ INITIAL APPLICATION ☐ AMENDMENT ☐ ANNUAL CERTIFICATION

Briefly describe the nature of the amendment (attach extra pages if necessary):

_____

Important: Refer to Form NRSRO Instructions for General Instructions, Instructions for an INITIAL APPLICATION, AMENDMENT, and ANNUAL CERTIFICATION, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO).

1. A. Full name:

_____

B. (i) Name under which credit rating business is primarily conducted, if different from Item 1A:

_____

(ii) Any other name under which credit rating business is conducted and where it is used:

_____

C. Address of 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 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 attachments, all of which are part of this Form, are accurate. 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.

_____ _____
(Date) (Name of the Applicant/NRSRO)

By: _____ _____
(Signature) (Print Name and Title)

2. A. Legal status:

☐ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) _____

B. Month and day of fiscal year end: _____

C. The place and date of formation (i.e., state or country where incorporated, where the partnership agreement was filed, or where the entity was formed):

State/Country of formation: _____ Date of formation: _____

3. If a non-resident rating organization, attach to an INITIAL APPLICATION a written undertaking to provide books and records upon Commission request, signed by a person duly authorized by the credit rating agency (SEE INSTRUCTIONS).

4. Designated compliance officer (SEE INSTRUCTIONS):

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail below how the non-confidential information and documents submitted to the Commission in the completed INITIAL APPLICATION, any AMENDMENT, and the ANNUAL CERTIFICATION will be made publicly available on the credit rating agency's Web site or through another comparable, readily accessible means (SEE INSTRUCTIONS):

_____

_____

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION OR IF THIS IS AN APPLICATION TO CHANGE THE SCOPE OF AN EXISTING REGISTRATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the credit rating agency is applying to be registered. For each class, indicate the approximate number of credit ratings the credit rating agency currently has outstanding as of the date of the application and the number of consecutive years immediately preceding the date of this application that the credit rating agency has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act , with respect to that class (SEE INSTRUCTIONS):

Class of credit rating	Applying for registration	Approximate number of ratings currently outstanding	Consecutive years issued
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	☐		

TOTAL	

B. Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 6A readily accessible (SEE INSTRUCTIONS):

_____

_____

C. Check the applicable box and attach certifications from qualified institutional buyers, if required (SEE INSTRUCTIONS):

☐ The Applicant is submitting _____ certifications from qualified institutional buyers as part of this application. Each is marked "Certification from Qualified Institutional Buyer."

☐ The Applicant is exempt from the requirement to submit certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: Certifications from qualified institutional buyers should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make them publicly available.

7. The information in Item 7 need only be updated when an NRSRO furnishes an ANNUAL CERTIFICATION or when the NRSRO furnishes an AMENDMENT because information provided in another Item or a non-confidential exhibit has become materially inaccurate or incomplete or to apply to change the scope of its registration.

A. Indicate below each class of credit ratings for which the Registrant is currently registered as an NRSRO. For each class, indicate the approximate number of credit ratings the Registrant currently has outstanding as of the end of the preceding calendar year and the number of consecutive years that the Registrant has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act, with respect to that class (SEE INSTRUCTIONS):

Class of credit rating	Currently registered	Approximate number of ratings currently outstanding	Consecutive years issued
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	☐		

TOTAL	

B. Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 7A readily accessible (SEE INSTRUCTIONS):

_____

_____

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and attach to this form (SEE INSTRUCTIONS).		
	YES	**NO**
A. Has the credit rating agency, or any person associated with the credit rating agency, whether prior to or subsequent to becoming associated with the credit rating agency, committed or omitted any act, or been subject to an order or finding, enumerated in subparagraph (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, or any substantially equivalent foreign statute or regulation, or been enjoined from any action, conduct, or practice specified in subparagraph (C) of section 15(b)(4), or any substantially equivalent foreign statute or regulation, in the ten years preceding the date of its INITIAL APPLICATION to the Commission for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the credit rating agency, or any person associated with the credit rating agency, whether prior to or subsequent to becoming associated with the credit rating agency, 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 its INITIAL APPLICATION to the Commission for registration as an NRSRO or at any time thereafter?	☐	☐
C. Is any person associated with the credit rating agency 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 INITIAL APPLICATION.

☐ Exhibit 1 is updated and made a part of this ANNUAL CERTIFICATION.

Exhibit 2. Procedures and methodologies used in determining credit ratings.

☐ Exhibit 2 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 2 is updated and made a part of this AMENDMENT.

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 INITIAL APPLICATION.

☐ Exhibit 3 is updated and made a part of this AMENDMENT.

Exhibit 4. Organizational structure.

☐ Exhibit 4 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 4 is updated and made a part of this AMENDMENT.

Exhibit 5. The code of ethics in effect at the credit rating agency or a statement of the reasons why the credit rating agency does not have a code of ethics.

☐ Exhibit 5 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 5 is updated and made a part of this AMENDMENT.

Exhibit 6. Any conflict of interest relating to the issuance of credit ratings.

☐ Exhibit 6 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 6 is updated and made a part of this AMENDMENT.

Exhibit 7. Policies and procedures to address and manage conflicts of interest.

☐ Exhibit 7 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 7 is updated and made a part of this AMENDMENT.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 8 is updated and made a part of this AMENDMENT.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer and persons who assist the designated compliance officer.

☐ Exhibit 9 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 9 is updated and made a part of this AMENDMENT.

Exhibit 10. A list of the largest customers that used credit rating services provided by the credit rating agency by the amount of net revenue received by the credit rating agency and its affiliates from the customer during the fiscal year ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 10 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 11 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 12 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

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''). Exchange Act Rule 17g–1 requires credit rating agencies to use Form NRSRO to submit an INITIAL APPLICATION to apply to register with the U.S. Securities and Exchange Commission (''Commission'') as an NRSRO, to submit updated information as required by Section 15E(b)(1) of the Exchange Act as an AMENDMENT to Form NRSRO, and to submit the ANNUAL CERTIFICATION required by Section 15E(b)(2) of the Exchange Act.

2. Exchange Act Rule 17g–1(c) requires a credit rating agency to promptly furnish the Commission with a written notice if information submitted on an INITIAL APPLICATION, including exhibits and attachments, is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must describe the circumstances in which the information was found to be materially inaccurate, and the credit rating agency must promptly update the application with accurate information by furnishing the Commission with an amended INITIAL APPLICATION on Form NRSRO.

3. An INITIAL APPLICATION will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny the application after it has been furnished to the Commission.

4. Type or clearly print all information. Provide the name of the credit rating agency and the date on each page. Use only the current version of Form NRSRO or a reproduction of it.

5. Mark each page of information that is submitted on a confidential basis ''Confidential.'' The Commission will accord that information confidential treatment to the extent permitted by law.

6. Section 15E of the Exchange Act (15 U.S.C. 78o–7) authorizes the Commission to collect the Information on this form from Applicants and NRSROs. The principal purpose of this form is to determine whether an Applicant should be granted registration as an NRSRO and, once registration is granted, whether a credit rating agency continues to meet the criteria for registration as an NRSRO. Intentional misstatements or omissions 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 needed to complete and file this form will vary depending on individual circumstances. The estimated average time is displayed on the facing page of this form. Send comments regarding this burden estimate or suggestions for reducing the burden to Director, Office of Information Technology, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended (5 U.S.C. 552a). The Commission has published in the **Federal Register** the Privacy Act Systems of Records Notice for these records, and the Commission may make ''routine use'' disclosure of the information as outlined under the Notice.

7. Exchange Act Rule 17g–2(b)(9) requires a credit rating agency to retain copies of all information and documents submitted to the Commission with Form NRSRO These records must be made available for inspection upon a regulatory request.

8. ADDRESS—The mailing address for Form NRSRO is: U. S. Securities and Exchange Commission, Form NRSRO Mailbox, Mail Stop, 100 F Street, NE., Washington, DC 20549–

B. Instructions for Initial Applications

1. Check the appropriate box at the top of Form NRSRO;

2. All Items must be answered and all required responses must be complete. Enter ''None'' or ''N/A'' where appropriate;

3. Provide all required information and attachments, including undertakings, exhibits, certifications, and Disclosure Reporting Pages, as applicable;

4. If information submitted, including exhibits and attachments, is found to be or becomes materially inaccurate before the Commission approves the application, promptly furnish the Commission with accurate information, pursuant to Rule 17g–1(c); and

5. Execute the Form.

C. Instructions for Amendments

1. Submit an AMENDMENT to Form NRSRO in order to:

a. Promptly provide accurate information to the Commission in the event that information on the current Form NRSRO, on any Disclosure Reporting Page (NRSRO), or on Exhibits 2 through 9 becomes materially inaccurate, pursuant to Section 15E(b)(1) of the Exchange Act; or

b. Change the scope of an existing registration to add a class of credit ratings.

2. To submit an AMENDMENT:

a. Check the appropriate box at the top of Form NRSRO and briefly describe the nature of the amendment;

b. Complete Items 1, 2, 4, 5, 7, 8 (with Disclosure Reporting Pages, as applicable), and update, as required, Exhibits 2 through 9, to provide accurate information. (Do not update or attach Exhibits 2 through 9 if the information in them remains materially accurate.) If applying to change the scope of an existing registration, complete Item 6. An NRSRO is not required to update certifications by qualified institutional buyers. (*See* instructions for Item 6 below.); and

c. Execute the Form.

D. Instructions for Annual Certifications

1. Submit an ANNUAL CERTIFICATION on Form NRSRO within 90 days after the end of each calendar year, in accordance with Section 15E(b)(2) of the Exchange Act;

2. Check the appropriate box at the top of Form NRSRO;

3. Complete and update, as required, Items 1, 2, 4, 5, 7, 8 (with Disclosure Reporting Pages, as applicable), and update, as required, Exhibits 2 through 9, to provide accurate and complete information;

4. Update Exhibit 1;

5. Attach a list of all AMENDMENTs submitted during the previous calendar year; and

6. Execute the Form.

E. Instructions for Specific Line Items

Item 1E. The individual listed as the contact person must be authorized to receive all communications from the Commission and must be responsible for their dissemination within the credit rating agency's organization.

Item 3. Exchange Act Rule 17g–4(c) requires a non-resident rating organization to undertake to provide books and records upon Commission request. The undertaking must be signed by a person duly authorized by the credit rating agency, must be attached to the INITIAL APPLICATION, must be marked ''Non-Resident Books and Records Undertaking,'' and must be in substantially the following form:

''Upon a request by the U.S. Securities and Exchange Commission (''Commission'') and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at its principal office in Washington, D.C., an accurate copy of any book(s) or record(s) which [the rating organization] is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Securities Exchange Act of 1934 or any regulation under that Act. [The rating organization] will produce the requested copy of the book(s) or record(s), in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period.

_____

Signature''

Item 4. Section 15E(j) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the credit rating agency 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(d) require a credit rating agency to make certain information and documents submitted to the Commission publicly available on its Web site or through another comparable, readily accessible means within 5 business days of the date of the Commission order granting the application for registration as an NRSRO, and, subsequently, within 5 business days of furnishing an amended Form NRSRO to the Commission. All information and documents submitted to the Commission in the completed INITIAL APPLICATION, any AMENDMENT, and the ANNUAL CERTIFICATION must be made publicly available *except* Exhibits 10 through 13, the certifications from qualified institutional buyers, and the non-resident undertaking. Describe in detail how that information will be made readily accessible. If the information and documents will be posted on the credit rating agency's Web site, for example, give the Internet address and link to the information and documents.

Item 6. Complete Item 6 only if submitting an INITIAL REGISTRATION or changing the scope of an existing registration to add a class of credit ratings.

Item 6A. Pursuant to Section 15E(a)(1)(B)(vii) of the Exchange Act, a credit rating agency applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the credit rating agency is applying to be registered. Indicate these classes by checking the appropriate box or boxes. Pursuant to the definition of ''nationally recognized statistical rating agency'' in Section 3(a)(62) of the Exchange Act, a credit rating agency must have been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO. For each class of credit ratings, provide the approximate number of ratings the credit rating agency currently has outstanding and the number of consecutive years immediately preceding the date of the application that the credit rating agency has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act, with respect to that class.

Item 6B. Pursuant to Section 3(a)(61)(A) of the Exchange Act, a ''credit rating agency'' issues ''credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.'' Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee.

Item 6C. Section 15E(a)(1)(B)(ix) of the Exchange Act requires that an application for registration as an NRSRO include written certifications from qualified institutional buyers, as defined in paragraph Section 3(a)(64) of the Exchange Act, except that, under Section 15E (a)(1)(D), a credit rating agency is not required to submit these certifications if it has received a no-action letter from Commission staff prior to August 2, 2006 stating that the staff would not recommend enforcement action to the Commission against any broker or dealer that uses credit ratings issued by the credit rating agency to compute capital charges under Exchange Act Rule 15c3–1. If the credit rating agency is required to submit certifications, paragraph Section 15E(a)(1)(C) of the Exchange Act requires the credit rating agency to submit a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the credit rating agency. Each certification may address more than one class of credit ratings. Of the submitted certifications, at least two must address each class of credit rating identified in Item 6A under ''Applying for Registration.'' If this is an AMENDMENT to an existing

registration to add one or more classes of credit ratings to the scope of its NRSRO registration, the NRSRO must submit 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 following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];

(ii) Has seriously considered the credit ratings of [the credit rating agency] in the course of making investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings:

[Applicable classes of credit ratings]; and

(iii) Has not received compensation either directly or indirectly from [the credit rating agency] for executing this certification.

_____

Signature''

The certifications should be marked ''Confidential,'' and the Commission will accord them confidential treatment to the extent permitted by law. A credit rating agency is not required to make them publicly available.

Item 7. Check the appropriate boxes indicating the classes of credit ratings for which the credit rating agency is currently registered as an NRSRO. Complete other parts of this Item according to the instructions for Item 6.

Item 8. Answer each question by checking the appropriate box. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and attached to Form NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires an 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.

A. Initial Application. An Initial Application must include Exhibits 1 through 13.

B. Amendment. Update Exhibits 2 through 9 promptly with new information and documents whenever the existing information or documents contained in the exhibit becomes materially inaccurate (*see* Section 15E(b)(1) of the Exchange Act). Do not update Exhibits 10 through 13 after registration is granted.

C. Annual Certification. Section 15E(b)(2) of the Exchange Act requires an NRSRO to certify annually that the information and documents attached to Form NRSRO are accurate and to list any material changes that occurred to the information and documents during the previous year. Section 15E(b)(1) of the Exchange Act requires that an NRSRO amend the information provided with Exhibit 1 in the ANNUAL CERTIFICATION.

D. If any information or document required to be included with any exhibit is maintained in a language other than English, provide both the original document (or a true and complete 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.

E. Attach 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 provided in the exhibits must be sufficiently detailed to allow for verification. The information and documents required to be provided in Exhibits 1 through 9 must be made publicly available (*see* Item 5); the information and documents required to be provided in Exhibits 10 through 13 should be marked ''Confidential.'' The Commission will accord them confidential treatment to the extent permitted by law. The credit rating agency is not required to make them publicly available.

Exhibit 1. This exhibit must include credit ratings performance measurement statistics over short-term, mid-term, and long-term periods *(as applicable)* of the credit rating agency through the most recent calendar year-end, including, *as applicable:* historical down-grade and default rates within each credit rating category (ranking) of the credit rating agency. As part of this exhibit, define the credit ratings used by the credit rating agency and explain the performance measurement statistics, including the metrics used to determine the statistics.

Exhibit 2. This exhibit must include the procedures and methodologies that the credit rating agency uses to determine credit ratings, including unsolicited credit ratings. The procedures and methodologies furnished in this exhibit should include, *as applicable:* 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; a description of any quantitative and qualitative models and metrics used to determine credit ratings; 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; and procedures to withdraw, or suspend the maintenance of, a credit rating.

For purposes of this exhibit: *Unsolicited credit rating* means a credit rating that the credit rating agency determines without being requested to do so by the issuer or underwriter of the rated securities or money market instruments or the rated obligor.

Exhibit 3. This exhibit must include policies or procedures established, maintained, and enforced by the credit rating agency to prevent the misuse of material, nonpublic information as required by Section 15E(g) of the Exchange Act and 17 CFR 240.17g–4.

Exhibit 4. This exhibit must include a description of the organizational structure of the credit rating agency, including, *as applicable,* an organizational chart that identifies the credit rating agency's ultimate and sub-holding companies, subsidiaries, and material affiliates; an organizational chart showing the divisions, departments, and business units of the credit rating agency; and an organizational chart showing the managerial structure of the credit rating agency, including the designated compliance officer identified in Item 4.

Exhibit 5. This exhibit must include a copy of the written code of ethics in effect at the credit rating agency or a statement of the reasons why the credit rating agency does not have a written code of ethics.

Exhibit 6. This exhibit must identify in general terms the types of conflicts of interest relating to the issuance of credit ratings by the credit rating agency including, *as applicable:* whether the credit rating agency receives compensation from rated obligors, issuers of rated securities or money market instruments, and underwriters of rated securities or money market instruments to determine or maintain a credit rating and for other services (identify the services); whether an affiliate of the credit rating agency owns securities of, or has any other form of ownership interest in, a rated obligor, issuer of rated securities or money market instruments, or underwriter of rated securities or money market instruments; whether the credit rating agency's employees are permitted to own securities of a rated obligor or issuer of rated securities or money market instruments; whether the credit rating agency receives compensation from entities that use its credit ratings for regulatory purposes and for other services (identify the services); whether the credit rating agency, or an affiliate, owns securities of, or has any other form of ownership interest in, an entity that uses credit ratings for regulatory purposes; whether the credit rating agency's employees are permitted to own securities of an entity that uses credit ratings for regulatory purposes; and whether the credit rating agency, its affiliates, or its employees have any other business relationship or affiliation with a rated obligor, issuer of rated securities or money market instruments, underwriter of rated securities or money market instruments, or entity that uses credit ratings for regulatory purposes. In addition, identify each entity that is an underwriter of rated securities or money market instruments or that uses credit ratings for regulatory purposes that is also a person associated with the credit rating agency.

Exhibit 7. This exhibit must include the written policies and procedures established, maintained, and enforced by the credit rating agency pursuant to Section 15E(h) of the Exchange Act to address and manage conflicts of interest.

Exhibit 8. This exhibit must include the following information regarding each of the credit rating agency's credit analysts and each officer and employee of the credit rating agency responsible for supervising the credit rating agency's credit analysts:

- Name.
- Title and brief description of responsibilities, including whether a supervisor.
- Employment history.
- Post-secondary education.
- Whether employed by the credit rating agency full-time (at least 35 hours per week) or part-time.

For purposes of this exhibit: *Credit analyst* means an individual associated with the credit rating agency who is responsible for determining a credit rating using either a quantitative model, a qualitative model and analysis, or a combination of these methods.

Exhibit 9. This exhibit must include the following information about the credit rating agency's designated compliance officer (identified in Item 4) and any other persons that assist the designated compliance officer in carrying out the responsibilities set forth in Section 15E(j) of the Exchange Act:

- Name.
- Title and brief description of responsibilities.
- Employment history.
- Post secondary education.
- Whether employed by the credit rating agency full-time (at least 35 hours per week) or part-time.

Exhibit 10. This exhibit must include a list of the largest customers that used credit rating services provided by the credit rating agency by the amount of net revenue received by the credit rating agency and its affiliates from the customer during the fiscal year ending immediately before the date the credit rating agency submits an INITIAL APPLICATION. In making this list, the credit rating agency should first determine the 20 largest issuer and subscriber customers in terms of net revenue received by the credit rating agency and its affiliates from the issuer or subscriber. Next, the credit rating agency should add to the list any obligor or underwriter that used credit rating services provided by the credit rating agency if the net revenue received by the credit rating agency and its affiliates from the obligor or underwriter during the fiscal year equaled or exceeded the net revenue received from the 20th largest issuer or subscriber. In making the list, rank the customers from largest to smallest and include the net revenue amount for each customer.

For purposes of this exhibit:

Net revenue means all fees, sales proceeds, commissions, and other revenue received by the credit rating agency and its affiliates for any type of service or product, regardless of whether related to credit rating services, and net of any fees, sales proceeds, rebates, and other monies paid to the customer by the credit rating agency and its affiliates; 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 to a subscriber.

Exhibit 11. This exhibit must include financial statements of the credit rating agency, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in owners' equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date it submits an INITIAL APPLICATION to the Commission, subject to the following:

If the credit rating agency is a division, unit, or subsidiary of a parent company, the credit rating agency can provide audited consolidated and consolidating financial statements of the parent company.

If the credit rating agency does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date it submits an INITIAL APPLICATION to the Commission, it can provide unaudited financial statements for the applicable year or years, but the credit rating agency must provide audited financial statements for the fiscal or calendar year ending immediately before the date it submits an INITIAL APPLICATION to the Commission. The credit rating agency must attach to the unaudited financial statements a certification by a person duly authorized by the credit rating agency 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 financial condition, results of operations, and cash flows of the rating organization for the period presented.

Exhibit 12. This exhibit must include the following information, *as applicable,* regarding the credit rating agency's aggregate revenues for the fiscal or calendar year ending immediately before the date it furnishes an INITIAL APPLICATION to the Commission:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings;
- Revenue from determining credit ratings that are not made readily accessible (private ratings); and
- Revenue from all other services and products offered by the rating

organization (include descriptions of any major sources of revenue).

Exhibit 13. This exhibit must include the total and median annual compensation of the credit rating agency's credit analysts.

F. Explanation of Terms. For purposes of Form NRSRO, the following definitions and descriptions apply:

1. COMMISSION—The U. S. Securities and Exchange Commission.

2. CREDIT RATING—An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments [Section 3(a)(60) of the Exchange Act].

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, and/or other market participants.

4. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act]—A credit rating agency that:

- 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 as an NRSRO;
- Issues credit ratings certified by qualified institutional buyers 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.

5. NON-RESIDENT RATING ORGANIZATION [Exchange Act Rule 17g-4(a)]—A nationally recognized statistical rating organization that:

- If a corporation, is incorporated in or has its principal office in, a location outside the United States, its territories, or possessions;
- If a partnership or other unincorporated organization or association, has its principal office in a location outside the United States, its territories, or possessions.

6. PERSON—An individual, partnership, corporation, trust, limited liability company, or other organization.

7. PERSON ASSOCIATED WITH THE CREDIT RATING AGENCY—Any partner, officer, director, or branch manager of the credit rating agency (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a credit rating agency, or any employee of a credit rating agency [Section 3(a)(63) of the Exchange Act].

8. QUALIFIED INSTITUTIONAL BUYER—An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency [Section 3(a)(64) of the Exchange Act].

Disclosure Reporting Page (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to report information related to affirmative responses to Item 8 of Form NRSRO.

Use a separate DRP for each event or proceeding. Attach additional pages as necessary.

Name of credit rating agency

_____

Date

_____

Check Item being responded to:

☐ Item 8A
☐ Item 8B
☐ Item 8C

The individual(s) or entity(ies) for whom this DRP is being filed is (are):

☐ The credit rating agency
☐ The credit rating agency and one or more associated persons
☐ One or more associated persons

If this DRP is being filed for one or more associated persons, provide the full name of the associated person(s):

_____

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 date(s):

_____

☐ This DRP should be removed from Form NRSRO because the person(s) is (are) no longer associated with the credit rating agency.

By the Commission.

Dated: February 2, 2007.

Nancy M. Morris,

Secretary.

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