Federal Register

Monday,
June 18, 2007

Part II

Securities and Exchange Commission

17 CFR Parts 240 and 249b

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249b

[Release No. 34–55857; 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: Final rule.

SUMMARY: The Commission is adopting rules to implement provisions of the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act''), enacted on September 29, 2006. The Rating Agency 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). The rule and form prescribing the process for a credit rating agency to apply for registration are immediately effective. The remaining rules are effective on June 26, 2007.

EFFECTIVE DATES: June 18, 2007, except that §§ 240.17g-2, 240.17g-3, 240.17g-4, 240.17g-5, and 240.17g-6 are effective on June 26, 2007.

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SUPPLEMENTARY INFORMATION:

I. Background

The term *nationally recognized statistical rating organization* (''NRSRO'') is used in federal and state statutes and regulations to confer regulatory benefits or prescribe requirements based on credit ratings issued by credit rating agencies identified as NRSROs.[1] The process of identifying NRSROs has historically been undertaken by the Commission staff through the issuance of no-action letters where the staff has determined, among other things, that the credit rating agency is recognized nationally by the predominant users of credit ratings as issuing credible and reliable ratings.[2] The Rating Agency Act replaces the no-action letter process—which has been criticized as lacking transparency—with a registration program and Commission oversight of credit rating agencies that choose to be treated as NRSROs.

The Rating Agency Act implements the program for NRSRO registration and oversight by adding definitions to Section 3 of the Securities Exchange Act of 1934 (''Exchange Act''),[3] creating a new Section 15E of the Exchange Act,[4] and amending Section 17 of the Exchange Act.[5] Under these new statutory provisions, a credit rating agency seeking to be treated as an NRSRO must apply for, and be granted, registration with the Commission, make public in its application certain information to help persons assess its credibility, and implement procedures to manage the handling of material nonpublic information and conflicts of interest. In addition, the Rating Agency Act provides the Commission with rulemaking authority to prescribe: the form of the application (including requiring the furnishing of additional information); the records an NRSRO must make and retain; the financial reports an NRSRO must furnish to the Commission on a periodic basis; the specific procedures an NRSRO must implement to manage the handling of material nonpublic information; the conflicts of interest an NRSRO must manage or avoid altogether; and the practices that an NRSRO must not engage in if the Commission determines they are unfair, coercive, or abusive.

II. Timing of Final Rules

On February 2, 2007, the Commission proposed a package of rules pursuant to these grants of rulemaking authority.[6] The rules published today incorporate many of the proposed provisions but also include significant revisions based on the comments received.[7] The Commission, in adopting these rules today, intends that Rule 17g–1 (17 CFR 240.17g–1), Form NRSRO, and 17 CFR 249b.300 be issued in final form and be effective on the date of their publication in the **Federal Register**. The Commission further intends that Rules 17g–2 (17 CFR 240.17g–2), 17g–3 (17 CFR 240.17g–3), 17g–4 (17 CFR 240.17g–4), 17g–5 (17 CFR 240.17g–5), and 17g–6 (17 CFR 240.17g–6) be issued in final form on June 26, 2007 and become effective on that date.

III. Effective Date

Section 553(d) of the Administrative Procedure Act generally provides that, unless an exception applies, a substantive rule may not be made effective less than 30 days after notice of the rule has been published in the

[1] *See, e.g.,* federal statutes: 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''); 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); 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); and state rule: Cal. Ins. Code 1192.10.

[2] *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); 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); 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); letter from Mark M. Attar, Special Counsel, Division of Market Regulation, Commission, to Arthur Snyder, President, A.M. Best Company, Inc. (March 3, 2005); letter from Erik R. Sirri, Director, Division of Market Regulation, Commission, to Neal E. Sullivan, Bingham McCutchen LLP (May 21, 2007); letter from Erik R. Sirri, Director, Division of Market Regulation, Commission, to Yoshihiro Saito, Perkins Coie LLP (May 23, 2007).

[3] 15 U.S.C. 78c.

[4] 15 U.S.C. 78o–7.

[5] 15 U.S.C. 78q.

[6] *See* Exchange Act Release No. 55231 (February 2, 2007), 72 FR 6378 (February 9, 2007) (''Proposing Release'').

[7] These comments are available on the Commission's Internet Web site, located at *http://www.sec.gov/comments/s7–04–07/s70407.shtml,* and in the Commission's Public Reference Room in its Washington, DC headquarters.

Federal Register.[8] One exception to the 30-day requirement is an agency's finding of good cause for providing a shorter effective date.[9]

The Rating Agency Act provides that the new program for NRSRO registration and oversight shall apply on the earlier of the date on which regulations are issued in final form under Section 15E(n) of the Exchange Act, or 270 days after the enactment of the Rating Agency Act, which will be June 26, 2007.[10] The Rating Agency Act voids existing Commission staff no-action letters on and after the effective date of the new program for NRSRO registration and oversight, but creates a transitional measure allowing credit rating agencies with existing no-action letters to continue to act as NRSROs ''during Commission consideration of the application, if such entity has furnished an application for registration.'' [11] Consequently, as noted above, the Commission intends that Rule 17g–1 and Form NRSRO be effective immediately upon publication. Further, the Commission intends that the remaining rules, Rule 17g–2 through Rule 17g–6, be effective on June 26, 2007, the statutory deadline.

Immediate effectiveness of Form NRSRO and Rule 17g–1 is necessary to allow credit rating agencies that are currently the subject of staff no-action letters identifying them as NRSROs to have a period of time to submit applications for registration as NRSROs before the provisions of the Rating Agency Act and the recordkeeping, reporting, and conduct rules issued under the Rating Agency Act become effective, and thus before the no-action letters become void. This will avoid a gap in time when no NRSROs exist, which would disrupt the regulatory use of that term in applicable statutes and regulations, resulting in uncertainty in the marketplace for all persons that rely upon credit ratings issued by NRSROs. Further, this result would be inconsistent with Congressional intent in creating the transitional measure. Finally, the accelerated effectiveness for the remaining rules, Rule 17g–2 through Rule 17g–6, is necessary to meet the statutory deadline.

The primary purpose of the 30-day delayed effectiveness requirement is to give affected parties a reasonable period of time to adjust to the new rules. Here, the existing NRSROs would not be harmed by immediate effectiveness, and would in fact benefit from the opportunity to utilize the transitional measure Congress provided. Further, an entity would not be required to comply with Rule 17g–2 through Rule 17g–6 until its voluntary registration has been approved.

The Commission acted expeditiously in proposing and adopting these rules under a very tight, statutorily-imposed deadline. The Rating Agency Act was enacted on September 29, 2006. Just over four months later, on February 2, 2007, the Commission voted to propose the new rules and form, which were designed to comply with the statutory mandate to establish an entirely new regulatory regime for NRSROs. The Commission voted to adopt these rules and Form NRSRO on May 23, 2007, over a month before the statutory deadline. In doing so, the Commission carefully responded to industry, user, and investor perspectives to ease the transition to a new, Congressionally-created registration and regulatory scheme.

Failure to accelerate effectiveness of Rule 17g–1 through Rule 17g–6 and Form NRSRO could interfere with the goals of the Rating Agency Act. For these reasons, the Commission finds that good cause exists for Rule 17g–1 and Form NRSRO to be immediately effective upon publication, and for Rule 17g–2 through Rule 17g–6 to be effective on June 26, 2007.

IV. Review of Commission Rules

Section 15E(n)(2) of the Exchange Act requires the Commission to review its existing rules using the term ''NRSRO'' within 270 days of its enactment.[12] The statute further provides that the Commission shall amend or revise the rules in accordance with Section 15E(n)(2) of the Exchange Act.[13] The Commission has reviewed all of its rules using the term ''NRSRO.'' The Commission does not believe these rules need to be amended at this time. The term ''NRSRO'' in each rule will refer to an ''NRSRO'' as that term is defined in the Rating Agency Act when the statutory provisions become effective.[14] For example, Commission Rule 15c3–1 (the broker-dealer net capital rule) uses the term ''nationally recognized statistical rating organization'' to prescribe the amount a broker-dealer must haircut proprietary corporate debt securities when computing its regulatory capital.[15] The rule does not otherwise define the term ''nationally recognized statistical rating organization.'' Consequently, after the effective date of the NRSRO regulatory program, the term, as used in this rule, will refer to a credit rating agency that is an NRSRO as determined by the provisions of the Rating Agency Act.[16]

The Commission notes that several commenters raised potential concerns about how other Commission rules may operate after the NRSRO registration and oversight program takes effect.[17] These commenters suggested that requirements in Rule 2a–7 [18] under the Investment Company Act of 1940,[19] which regulates the operation of money market funds, may need to be modified depending on the number of credit rating agencies that become registered as NRSROs.[20] For example, one commenter noted that Rule 2a–7(c)(6)(i)(A)(2) requires a money market fund to re-assess the minimal credit risk of its portfolio whenever it becomes aware that any unrated or second tier security held by the fund has been given a credit rating by any NRSRO below the NRSRO's second highest category.[21] Another commenter noted that Rule 2a–7 prescribes that money market funds determine whether a security is eligible for purchase based on whether it has received a credit rating in one of the two highest categories from any NRSRO.[22] This commenter was concerned that this might lead to money market funds filling portfolios that most NRSROs consider third tier.[23] One of the these commenters also expressed concern that the proposal did not require that an NRSRO have a particular number of credit rating categories or that the categories of one NRSRO might not correspond to those of another NRSRO.[24] Based on the uncertainty of how many credit rating agencies ultimately will register as NRSROs, the Commission intends to monitor for now how the NRSRO regulatory program impacts Rule 2a–7 and the Commission's other rules using the term ''NRSRO.'' As the program develops, the

[8] 5 U.S.C. 553(d).

[9] *Id.*

[10] 15 U.S.C. 78o–7(p).

[11] 15 U.S.C. 78o–7(l).

[12] 15 U.S.C. 78o–7(n)(2).

[13] *Id.*

[14] *See* Sections 3(a)(62) and 15E(l)(2) of the Exchange Act (15 U.S.C. 78c(a)(62) and 15 U.S.C. 78o–7(l)(2)).

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

[16] *See* Sections 3(a)(62) and 15E(l)(2) of the Exchange Act (15 U.S.C. 78c(a)(62) and 15 U.S.C. 78o–7(l)(2)).

[17] *See* letter dated March 12, 2007 from Elizabeth Krentzman, General Counsel, Investment Company Institute (''ICI Letter''); letter dated March 12, 2007 from Stephen A. Keen, Attorney, on behalf of Federated Investors, Inc. (''FI Letter''); letter dated April 4, 2007 from Charles S. Morrison, Senior Vice President and Money Market Group Leader, Fidelity Management and Research Company (''FMRC Letter'').

[18] 17 CFR 270.2a–7.

[19] 15 U.S.C. 80a–1 *et seq.*

[20] *See* ICI Letter; FI Letter; FMRC Letter.

[21] *See* FI Letter.

[22] *See* FMRC Letter.

[23] *Id.*

[24] *See* FI Letter.

Commission will evaluate whether modifications to these rules would be appropriate.

V. The Final Rules

A. Rule 17g–1—Registration Requirements

The Rating Agency Act, through the enactment of new Section 15E of the Exchange Act, provides the Commission with rulemaking authority with respect to the process for applying for registration as an NRSRO, keeping an NRSRO registration current, and withdrawing an NRSRO registration.[25] The Commission proposed to implement its rulemaking authority in these areas through a new rule, Rule 17g–1. The provisions of proposed Rule 17g–1 would have prescribed: How a credit rating agency must apply to be registered as an NRSRO; the form of the application; how an NRSRO must make non-confidential information in the application public; how an NRSRO must apply to be registered in an additional class of credit ratings; how an NRSRO must update its application; how an NRSRO must annually certify that the information and documents in its registration continue to be accurate; and how an NRSRO must provide notice of the withdrawal of its registration.

As discussed below, the Commission is adopting Rule 17g–1 with certain modifications that address issues raised by commenters, restructure the order of the paragraphs, and remove text that was unnecessary. Any textual changes not specifically discussed are non-substantive and designed to make the rule text more cohesive and consistent both within the rule and across the other NRSRO rules published today.

1. Paragraph (a) of Rule 17g–1

As adopted, paragraph (a) of Rule 17g–1 provides that a credit rating agency applying to register with the Commission as an NRSRO must furnish an application on Form 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.[26] Paragraph (a) of Rule 17g–1, as proposed, similarly provided that a credit rating agency applying to be registered with the Commission as an NRSRO must furnish the Commission with an application on Form NRSRO that follows all instructions for the Form. The Commission did not receive any comments on the proposed rule text of this paragraph and is adopting it substantially as proposed with one modification. Specifically, there is no longer a reference in the text to the ''credit ratings described in section 3(a)(62)(B) of the [Exchange] Act (15 U.S.C. 78c(a)(62)).'' This reference to a component of the statutory definition of ''NRSRO'' in the proposed rule was redundant and unnecessary. A credit rating agency, by statutory definition, must apply to be registered in one or more of the classes of credit ratings identified in section 3(a)(62)(B) of the Exchange Act.[27]

2. Paragraph (b) of Rule 17g–1

As adopted, paragraph (b) of Rule 17g–1 provides a mechanism for an NRSRO registered for fewer than the five classes of credit ratings identified in the definition of NRSRO to apply to be registered in an additional class.[28] Specifically, the NRSRO must apply by furnishing an amendment on Form NRSRO.[29] This provision was proposed in paragraph (e) of Rule 17g–1.

Section 15E(a)(1)(B) of the Exchange Act, prescribes certain minimum information the credit rating agency must provide in its application for registration as an NRSRO.[30] This includes information regarding the classes 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.''[31] A credit rating agency may apply to be registered for fewer than all five classes of credit ratings described in Section 3(a)(62)(B) of the Exchange Act.[32] Accordingly, this provision provides a mechanism for an NRSRO to apply to be registered in an additional class.[33]

The application to register for an additional class will be subject to the requirements in Section 15E of the Exchange Act[34] applicable to an application to be registered as an NRSRO. This means 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 will apply to an application to be registered in an additional class of credit ratings.[35]

Finally, the provisions of paragraphs (c) and (h) respectively, regarding the requirement to notify the Commission and amend the application prior to final Commission action and when an application is deemed to have been furnished to the Commission also apply to these applications.

The Commission did not receive any comments on these provisions. The Commission is adopting them substantially as proposed with several technical modifications. The rule text is modified to delete language instructing the NRSRO to indicate where appropriate on the form the additional class of credit ratings for which it is applying for registration. In its place, the rule text provides that the NRSRO must follow all applicable instructions for the Form, which include an instruction to indicate where appropriate on the Form the additional class of credit ratings for which registration is sought. The Commission is adopting the provision with the modifications discussed above.

3. Paragraph (c) of Rule 17g–1

As adopted, paragraph (c) of Rule 17g–1 provides that an applicant for registration and an NRSRO applying to be registered in an additional class of credit ratings must promptly furnish the Commission with a notice if information in the application becomes, or is found to be, materially inaccurate before the Commission has granted or denied the application. Thereafter, the applicant will be required to update the application with complete and accurate information by submitting an amended application on Form NRSRO.[36]

These provisions were proposed in paragraphs (c) and (e) of Rule 17g–1 for initial applicants and for NRSROs applying to be registered in an additional class of credit ratings, respectively. The notification provision is designed to alert the Commission as soon as possible that the application under consideration is materially inaccurate. The intent is to avoid situations where the Commission continues to review an application that is no longer materially accurate. The Commission has modified Form NRSRO to further clarify how a pending application should be updated using Form NRSRO. Specifically, the Form now has a check box for ''Application Supplement'' and specific instructions

[25] 15 U.S.C. 78o–7.

[26] 15 U.S.C. 78o–7(a)(1)(A).

[27] *See* 15 U.S.C. 78c(a)(62).

[28] *See* 15 U.S.C. 78c(3)(a)(62)(B).

[29] 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)).

[30] 15 U.S.C. 78o–7(a)(1)(B).

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

[32] 15 U.S.C. 78c(a)(62)(B).

[33] 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)).

[34] 15 U.S.C. 78o–7.

[35] 15 U.S.C. 78o–7(a)(2)(A) and (B).

[36] This provision is being 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)).

about how to complete the Form in this instance. The Commission did not receive any comments on these provisions and is adopting them with the modifications discussed above.

4. Paragraph (d) of Rule 17g–1

As adopted, paragraph (d) of Rule 17g–1 provides a mechanism for an entity that has applied to be registered as an NRSRO, or an NRSRO that has applied to be registered in an additional class of credit ratings, to withdraw the registration application before the Commission takes final action on the application.[37] Specifically, it requires the applicant to furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

The application provisions were proposed in paragraphs (b)(2) and (e) of Rule 17g–1 for initial applicants and for applications to be registered in an additional class of credit ratings, respectively. The requirement for execution by a duly authorized person is designed to ensure that the withdrawal notice reflects the intent of the credit rating agency. The Commission did not receive any comments on these provisions and is adopting them substantially as proposed.

5. Paragraph (e) of Rule 17g–1

As adopted, paragraph (e) of Rule 17g–1 provides that an NRSRO updating its application for registration pursuant to Section 15E(b)(1) of the Exchange Act[38] must promptly furnish the amendment to the Commission on Form NRSRO.[39] Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly update its application for registration if, after registration, any information or document provided as part of the application becomes materially inaccurate.[40] The statute further provides that the information on credit ratings performance statistics (discussed below) must only be updated on an annual basis and that the certifications from qualified institutional buyers (QIBs), discussed below, are not required to be updated.[41] This provision was proposed in paragraph (f) of Rule 17g–1.

The Commission has added in the instructions to Form NRSRO a description of this statutory requirement as a means to alert NRSROs that they must promptly update information or a document submitted on or with their Form NRSRO that has become materially inaccurate.

The Commission is not defining the term ''promptly'' as used in Section 15E(b)(1) of the Exchange Act.[42] The Commission, however, did express its view in the proposing release that meeting the statutory requirement to update a registration when information becomes materially inaccurate should not take more than two days. In response, five commenters stated that it would be unreasonable to expect an NRSRO to submit an amendment in two days.[43] Three commenters proposed that the Commission define the term ''promptly'' to mean 10 days.[44] One commenter suggested 20 days.[45] Another commenter suggested the Commission use a facts and circumstances standard for determining whether an amendment was ''promptly'' furnished.[46] The Commission agrees that the analysis of whether an amendment is furnished promptly will depend on the facts and circumstances. For example, if an NRSRO changes its principal business address, it should not take more than a few days to complete Form NRSRO (inputting the new information), have the Form executed, and furnish the Form to the Commission. On the other hand, it may take a few days longer to complete the Form if the information or documents in an Exhibit become materially inaccurate.

One commenter also stated that the rule should require an update of the registration application only when the information in the current registration application becomes ''materially inaccurate.''[47] In response, the Commission notes that the requirement to update an application arises from Section 15E(b)(1) of the Exchange Act, which provides, in pertinent part, that an NRSRO shall promptly update its application for registration ''if any information or document provided therein becomes materially inaccurate.''[48] As noted above, the instructions to Form NRSRO have been modified to include a description of this statutory provision.

In all other respects, the Commission is adopting the provision substantially as proposed.

6. Paragraph (f) of Rule 17g–1

As adopted, paragraph (f) of Rule 17g–1 provides that an NRSRO updating its application for registration pursuant to Section 15E(b)(2) of the Exchange Act[49] (the annual certification) must furnish the amendment to the Commission on Form NRSRO.[50] 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.[51] 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.[52]

This provision was proposed in paragraph (g) of Rule 17g–1. A commenter suggested that the proposed provision should be revised to permit the filing of the annual certification within 90 days after the end of an NRSRO's fiscal year (if different than the end of the calendar year).[53] However, as noted, the calendar year requirement is statutory. The instructions to Form NRSRO have been modified from those proposed to include a description of this statutory provision. In all other respects, the Commission is adopting the provision substantially as proposed.

7. Paragraph (g) of Rule 17g–1

As adopted, paragraph (g) of Rule 17g–1 provides that an NRSRO withdrawing its registration pursuant to Section 15E(e)(1) of the Exchange Act[54] must furnish the Commission with a notice of withdrawal on Form NRSRO. The rule further provides that the withdrawal becomes effective 45

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

[38] 15 U.S.C. 78o–7(b)(1).

[39] The Commission is implementing this provision under 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.

[40] 15 U.S.C. 78o–7(b)(1).

[41] *Id.*

[42] *Id.*

[43] *See* letter dated March 12, 2007 from William G. Connolly, on behalf of A.M. Best Company, Inc. (''A.M. Best Letter''); letter dated March 12, 2007 from Yasuhiro Harada, President, Ratings & Investment Information (''R&I Letter''); letter dated March 12, 2007 from Jeanne M. Dering, Executive Vice President, Moody's Investors Services (''Moody's Letter''); letter dated March 12, 2007 from Kent Wideman, Group Managing Director, and Mary Keogh, Managing Director, Dominion Bond Rating Service (''DBRS Letter''); letter dated March 12, 2007 from Charles D. Brown, General Counsel, Fitch Ratings (''Fitch Letter'').

[44] *See* R&I Letter; A.M. Best Letter; and Fitch Letter.

[45] *See* Moody's Letter.

[46] *See* DBRS Letter.

[47] *See* Moody's Letter.

[48] 15 U.S.C. 78o–7(b)(1).

[49] 15 U.S.C. 78o–7(b)(2).

[50] The Commission is implementing this provision under Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o–7(b)(2)), which requires the Commission, by rule, to prescribe the form of the annual certification.

[51] 15 U.S.C. 78o–7(b)(2).

[52] *Id.*

[53] *See* Fitch Letter.

[54] 15 U.S.C. 78o–7(e)(1).

calendar days after the furnishing of the form. Section 15E(e)(1) of the Exchange Act[55] provides that an NRSRO may withdraw from registration, subject to such 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.[56] The rule text references this statutory standard.

This provision was proposed in paragraph (h) of Rule 17g–1 without specifying the form of the notice or the conditions for withdrawal. A commenter suggested that the withdrawal provision be modified to provide that the withdrawal of the registration becomes effective within 90 days of the notice and that the notice be provided through an amendment to registration furnished on Form NRSRO.[57] The Commission did note in the proposing release that the conditions for withdrawal 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 agrees with the commenter that the notice should be furnished on Form NRSRO. This provides for public notice of the withdrawal, since the current Form NRSRO must be made publicly available pursuant to Section 15E(a)(3) of the Exchange Act[58] and Rule 17g–1(i) discussed below. The Commission also agrees with the commenter that in the normal course an NRSRO's withdrawal of registration should become effective within a prescribed time period. This will provide a degree of certainty to the NRSRO as to when it will no longer be subject to the Commission's regulatory program. It also will be consistent with withdrawal requests by certain other regulated entities. For example, a broker-dealer's request for withdrawal of its registration becomes effective within 60 days of the filing of the appropriate form.[59] The Commission also believes users of credit ratings should have adequate prior notice of an NRSRO's intent to withdraw its application. This will give them notice that they will no longer be able to rely on the entity's credit ratings to meet statutory or regulatory requirements using the term ''NRSRO.'' It also will provide them with notice that the entity will no longer be subject to the Commission's oversight, including requirements to disclose information about its performance, methodologies, procedures, and organization.

The Commission believes the 45 calendar day time period for the withdrawal to become effective is necessary in the public interest or for the protection of investors for several reasons. First, as discussed below, pursuant to paragraph (i) of Rule 17g–1, an NRSRO must make its current Form NRSRO publicly available within 10 business days of being furnished to the Commission. Consequently, notice of an NRSRO's withdrawal will be made publicly available at least 30 calendar days before becoming effective. This notice will provide users of credit ratings with time to prepare for the NRSRO's withdrawal. Second, subject to certain limited exceptions, an entity acting as a ''broker'' or ''dealer'' as defined in Sections 3(a)(4) and (5) of the Exchange Act[60] respectively must register with the Commission.[61] Conversely, an entity may act as a ''credit rating agency'' as defined in Section 3(a)(61) of the Exchange Act[62] without being required to register with the Commission. In this sense, registration as an NRSRO is more voluntary than registration as a broker-dealer. Therefore, a shorter time period to withdraw an NRSRO registration is appropriate.

Form NRSRO has been modified to include a checkbox to indicate when the Form is being furnished to withdraw a registration and the instructions for the Form have been modified from those proposed to include an explanation of how to complete the Form in this case. Specifically, an NRSRO would complete each Item on the Form, except Item 6, and have the Form executed.

For these reasons, the Commission is adopting the provision in Rule 17g–1 concerning a withdrawal of registration with the modifications described above.

8. Paragraph (h) of Rule 17g–1

As adopted, paragraph (h) of Rule 17g–1 provides that a Form NRSRO submitted to the Commission pursuant to any provision in Rule 17g–1 will be deemed 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.[63] The requirement for completeness comports with the requirements imposed on other types of registrants under the Exchange Act.[64] In addition, Section15E(a)(2)(A) of the Exchange Act requires the Commission to grant an application for registration as an NRSRO or commence proceedings on whether to deny the application within 90 days from the date the application is furnished to the Commission or a longer period if the applicant consents.[65] Further, if proceedings are commenced, Section 15E(a)(2)(B) of the Exchange Act[66] requires the Commission to conclude them within 120 days of the date the application is furnished to the Commission.[67] These statutory requirements make it necessary for the Commission to receive a complete initial application before the 90-day and 120-day periods begin to run.

Rule 17g–1, as proposed, explicitly applied the standard described above for when a Form NRSRO would be deemed ''furnished'' for submissions of the Form to apply for registration and to add a class of credit ratings to an existing registration. The Commission did not receive any comments on these provisions as proposed.

Rule 17g–1, as adopted, clarifies that the ''when furnished'' standard also applies to furnishings of Form NRSRO to update a registration, make the annual certification, and withdraw a registration. As discussed above, amendments to update materially inaccurate information must be furnished promptly, annual certifications must be furnished within 90 days of the end of the calendar year, and withdrawals of registration become effective in 45 calendar days. Therefore, a Form NRSRO submitted for these purposes will be deemed ''furnished'' upon the submission of a complete and properly executed form.

Rule 17g–1(h), as adopted, contains a provision stating that the Commission will, to the extent permitted by law, keep confidential information that is furnished on a confidential basis and requested to be kept confidential. As in

[55] *Id.*

[56] *Id.*

[57] *See* Moody's Letter.

[58] 15 U.S.C. 78o–7(a)(3).

[59] *See* 17 CFR 240.15b6–1.

[60] 15 U.S.C. 78c(a)(4) and (5).

[61] *See* Section 15 of the Exchange Act (15 U.S.C. 78o).

[62] 15 U.S.C. 78c(a)(61).

[63] This provision is adopted 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)).

[64] *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).

[65] 15 U.S.C. 78o–7(a)(2)(A).

[66] 15 U.S.C. 78o–7(a)(2)(B).

[67] 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)). An applicant will be required 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.

any situation where a person wishes to obtain confidential treatment for information provided to the Commission, an applicant and NRSRO must comply with the requirements of the Exchange Act governing confidential treatment.[68] This provision has been added to highlight for credit rating agencies and NRSROs the fact that information required by Form NRSRO includes information that will be furnished ''on a confidential basis.''[69] Some of the information to be furnished to the Commission ''on a confidential basis'' in the Form is required by Section 15E(a)(1)(B) of the Exchange Act,[70] and the Commission will consider requests for confidential treatment for that information. In addition, certain other information also is required in the Form and it may be appropriate for the Commission to provide confidential treatment to some of this information. The Commission will evaluate all requests for confidential treatment under the existing rules governing confidential treatment for information furnished to the Commission.[71]

For these reasons, the Commission is adopting the provision in Rule 17g–1 concerning when a Form NRSRO will be deemed to have been furnished with the modifications described above.

9. Paragraph (i) of Rule 17g–1

As modified, paragraph (i) of Rule 17g–1 requires that an NRSRO make its current Form NRSRO and information and documents submitted in Exhibits 1 though 9 publicly available within 10 business days of being granted an initial registration or registration in an additional class of credit ratings and within 10 business days of furnishing an update to amend information on the form, to provide the annual certification, and to withdraw a registration. 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 application and any amendments publicly available on its Web site or through another comparable, readily accessible means.[72] The 10 business day period is intended to provide the NRSRO with sufficient time to make the information public and designed to ensure that users of credit ratings have access to the information within a reasonably short timeframe.

This provision was proposed in paragraph (d) of Rule 17g–1, except that the time period to make the information publicly available was proposed to be five business days. The Commission received three comments on the five business day time period. Two commenters stated that five business days was not enough time to make their application information publicly available, given the volume of information.[73] They commented that the time period should be 15 and 20 business days, respectively.[74] The third commenter stated that the five business day time period should not be lengthened as the information is an important way for users of credit ratings to become familiar with a new NRSRO.[75]

The Commission agrees with the third commenter that making the information publicly available as soon as possible will be an important means for users of credit ratings to understand the methodologies, procedures, and business models of new NRSROs. At the same time, the Commission agrees with the two other commenters that larger more complex NRSROs could have substantial amounts of information in their applications, which may make it difficult to provide all this information in a publicly available format in five business days. Therefore, the Commission is lengthening the time period to ten business days. This is shorter than the 15 and 20 day periods advocated by the two commenters. However, as discussed below, Form NRSRO has been modified in ways that reduce the volume of information that must be made publicly available. Consequently, the Commission believes 10 business days will be a sufficient amount of time.

Finally, while Section 15E(a)(3) of the Exchange Act[76] does not address whether an application to register as an NRSRO shall be made publicly available prior to registration, this type of information typically would be made available by the Commission to members of the public before the application is acted on by the Commission.[77] Two commenters, both current NRSROs, stated that the Commission should not make information in the application available to the public until after registration was granted.[78] The Commission notes that an applicant can seek confidential treatment for information in the application under existing laws and rules governing confidential treatment.[79] The Commission will accord this information confidential treatment to the extent permitted by law. This is consistent with how the Commission treats applications of other entities.

B. Form NRSRO

The Commission proposed Form NRSRO to serve four functions: For a credit rating agency to apply for registration as an NRSRO; for an NRSRO to apply to be registered in an additional class of credit ratings; for an NRSRO to update public information required to be disclosed and kept accurate on the Form; and for an NRSRO to make an annual certification. Proposed instructions for the Form described how an applicant, and after registration, an NRSRO, should complete the Form in each of these circumstances.

The Commission believes that having just one form (and one set of instructions) will reduce the burden on applicants, NRSROs, and Commission staff. For example, it will reduce the complexity of having different forms for the application, amendments, and annual certification. Using one form also will allow NRSROs to more quickly become familiar with the Form and its instructions, which will reduce the potential for making mistakes in completing the Form. It also will assist users of credit ratings in understanding the Form and public Exhibits and where to look on the Form for specific information.

As discussed below, the Commission is adopting Form NRSRO with substantial modifications that address issues commenters raised and allow the Form to be used to furnish a notice of withdrawal of registration. Much of the information elicited in the Form is required to be submitted to the Commission pursuant to Section 15E(a)(1)(B) of the Exchange Act.[80] The Commission, under authority in Section 15E(a)(1)(B)(x), is requiring certain additional information.[81] The Commission believes this additional information elicited in the Form is necessary or appropriate in the public

[68] *See, e.g.*, 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.

[69] *See, e.g.*, Section 15E(a)(1)(B)(viii) of the Exchange Act.

[70] *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)).

[71] *See* 17 CFR 200.80 and 17 CFR 200.83.

[72] 15 U.S.C. 78o–7(a)(3).

[73] *See* DBRS Letter; Fitch Letter.

[74] *See* Fitch Letter and DBRS Letter, respectively.

[75] *See* ICI Letter.

[76] 15 U.S.C. 78o–7(a)(3).

[77] *See* 17 CFR 200.80(b)(4) and 17 CFR 200.80a. 17 CFR 200.80a contains a compilation of records generally available at the public reference room in the principal office of the Commission, including, for example, applications for registration as a broker-dealer or investment adviser.

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

[79] *See* 17 CFR 200.80 and 17 CFR 200.83.

[80] 15 U.S.C. 78o–7(a)(1)(B).

[81] 15 U.S.C. 78o–7(a)(1)(B)(x).

interest or for the protection of investors because, as discussed below, it will: (1) Assist the Commission in making the findings required in Section 15E(a)(2)(C) of the Exchange Act with respect to whether an applicant should be granted registration as an NRSRO;[82] (2) assist the Commission in making the findings required in Section 15E(d) of the Exchange with respect to whether the Commission should 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;[83] (3) assist the Commission in reviewing whether an NRSRO is complying with Section 15E of the Exchange Act[84] and the Commission's rules thereunder; and (4) provide users of credit ratings with information that will assist them in comparing NRSROs and understanding how a given NRSRO conducts its activities.

1. Checkboxes Indicating Nature of Submission

The first entry an applicant or NRSRO must make on Form NRSRO is to indicate, by checking the appropriate box, the reason the form is being furnished: To apply for registration as an NRSRO; to apply to be registered in an additional class of credit ratings; to supplement either type of application while the application is pending; to update public information on the Form that has become materially inaccurate; to make the annual certification; and to provide notice of a withdrawal of registration. If the Form is furnished to supplement an application or update a registration, the NRSRO also must identify by number the specific items or Exhibits on the form that are being supplemented or amended. For example, if the NRSRO is furnishing an update to its registration because its address and organizational structure have changed, the NRSRO is required to enter ''Item 1C'' and ''Exhibit 4'' in the appropriate field on the Form. The Form, as proposed, required a brief description of the nature of the amendment. This requirement has been eliminated to simplify the process of completing the Form.

The Commission also has added two checkboxes that were not on the proposed version of the Form. The first new checkbox—''Application Supplement''—is for when a credit rating agency applying for registration as an NRSRO or an NRSRO applying to be registered in an additional class of credit ratings must furnish an amendment to its application because information submitted in the application is or has become materially inaccurate. As proposed, an NRSRO would have checked the more generic ''Amendment'' checkbox. The Commission added a separate checkbox to distinguish amendments relating to a pending application from other amendments, which will make the reason for the furnishing of the Form more transparent.

Second, the Commission added a checkbox to indicate when the Form is being furnished to withdraw a registration in light of the change to Rule 17g–1 requiring the notice of withdrawal to be furnished on Form NRSRO.

2. Item 1 (Identifying Information)

As adopted, Item 1 requires an applicant and NRSRO to enter on to Form NRSRO identifying information about itself and its contact person. The instructions for Form NRSRO provide that the individual listed as the contact person must be authorized to receive all communications and papers from the Commission and will be responsible for their dissemination within the NRSRO. One commenter suggested that Item 1 require the telephone number, fax, and email address of the contact person.[85] The Commission elicits the telephone number for broker-dealer contact persons.[86] The number of NRSROs will be substantially smaller than the number of registered broker-dealers. The Commission believes at this time it will be able to easily obtain the contact information for the contact person without the necessity of having the information disclosed on the Form.

The instructions to Item 1 of Form NRSRO indicate that the name entered on Line A of Item 1 must be the ''person'' that is applying for registration or registered as the NRSRO. The instructions further clarify through the definition of ''person'' that a separately identifiable department or division of a corporation or company may be registered as an NRSRO. This clarification had been made because certain credit rating agencies provide their credit rating services through operating divisions that may be a part of a larger legal entity or encompass several different legal entities located throughout the world.[87] In an effort to more narrowly tailor the requirements for registration, the Commission believes it is appropriate in these circumstances to permit the operating division to register as the NRSRO as opposed to the larger legal entity that may engage in activities not intended to be regulated under the Rating Agency Act. Similarly, the Commission believes it is appropriate that the registered operating division include each separate legal entity that provides credit rating services, provided the operating division treats the credit ratings of the separate legal entities as its own and has global procedures, methodologies, policies, and controls that apply to the separate legal entities.

The instructions to Form NRSRO now include a definition of ''separately identifiable department or division'' that is designed with these goals in mind.[88] The first component of the definition is that the operating division must be a unit of a corporation or company that is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities. The second component of the definition is that all of the records relating to the operating division's credit rating activities must be separately created or maintained in or extractable from its own facilities or the facilities of the corporation, and such records must be maintained or otherwise accessible to permit independent examination for, and enforcement by, the Commission of Section 15E of the Exchange Act[89] and rules and regulations promulgated thereunder.

In all other respects, Item 1 to Form NRSRO is being adopted substantially as proposed.

3. Certification

The applicant or NRSRO must have a duly authorized individual execute a certification that the information and statements furnished in the Form NRSRO are accurate in all significant respects. The Commission added the ''in all significant respects'' language to the certification in response to comments that the certification, as proposed, could have been construed to hold the certifying individual to an unrealistic standard of having to ensure the Form

[82] 15 U.S.C. 78o–7(a)(2)(C).

[83] 15 U.S.C. 78o–7(d).

[84] 15 U.S.C. 78o–7.

[85] *See* DBRS Letter.

[86] *See* Form BD—Uniform Application for Broker-Dealer Registration.

[87] *See, e.g.*, letter dated March 12, 2007 from Vickie A. Tillman, Executive Vice President, Standard & Poors (''S&P Letter''); DBRS Letter; Fitch Letter; Moody's Letter.

[88] *See* 15 U.S.C. 80b–2 for a similar definition of separately identifiable departments or divisions of banks.

[89] 15 U.S.C. 78o–7.

did not include even trivial inaccuracies.[90] The additional language is intended to allay these concerns. In light of this new language, the instructions for the Form now clarify that the Chief Executive Officer or the President of the applicant or NRSRO, or an individual with similar responsibilities, must execute the certification. This is designed to ensure that the person executing the certification has responsibilities that will make the person aware of the basis for the information being provided in the form.

In all other respects, the language of the certification is being adopted substantially as proposed.

4. Item 2 (Legal Status, Place of Formation, Fiscal Year End)

As adopted, Item 2 requires an applicant and NRSRO to enter on to Form NRSRO information about its legal status (for example, corporation or partnership), the place and date of its formation, and its fiscal year end. The information with respect to the fiscal year end of the applicant or NRSRO is relevant because Form NRSRO requires applicants to submit audited financial statements with the application and Rule 17g–3 requires NRSROs to annually furnish the Commission with audited financial statements covering the previous fiscal year. The Commission did not receive any comments on this provision and is adopting it substantially as proposed.

5. Item 3 (Credit Rating Affiliates)

As discussed above, commenters with global operations stated that a credit rating agency with separate legal entities in different countries should be able to include them in a single NRSRO registration.[91] The Commission agrees that permitting a single registration is appropriate in that it will lessen the burden of having a parent company register multiple legal entities that make up the parent company's credit rating division. Consequently, an applicant with affiliates that would be, or an NRSRO with affiliates that are, a part of its registered separately identifiable department or division must identify and provide the address of each such affiliate. The instructions to Form NRSRO clarify that any credit rating issued by a credit rating affiliate will be considered a credit rating issued by the NRSRO for purposes of Section 15E of the Exchange Act[92] and the regulations thereunder. For example, the provisions in Rule 17g–5 with respect to issuing or maintaining credit ratings while having certain conflicts of interest will apply.

The instructions also provide that an applicant and NRSRO in completing Form NRSRO must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, and organizational structure of each credit rating affiliate identified in Item 3 in the other items and Exhibits. For example, the description of the procedures and methodologies for determining credit ratings in Exhibit 2 must include the procedures and methodologies used by the credit rating affiliates.

For these reasons, the Commission is adopting Item 3 to Form NRSRO as described above.

6. Item 4 (Compliance Officer)

As adopted, Item 4 requires an applicant and NRSRO to provide the name and address of its designated compliance officer required under Section 15E(j) of the Exchange Act.[93] This person is 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. The Commission did not receive any comments on this provision and is adopting it substantially as proposed.

7. Item 5 (Method of Making Form and Exhibits Publicly Available)

As adopted, Item 5 requires an applicant and NRSRO to describe how it will make, or makes, its current Form NRSRO and Exhibits 1 through 9 publicly available pursuant to Section 15E(a)(3) of the Exchange Act[94] and Rule 17g–1(i) thereunder. As discussed above, paragraph (i) of Rule 17g–1 is being adopted under Section 15E(a)(3) of the Exchange Act, which provides that the Commission shall, by rule, require an NRSRO, upon the granting of its registration, to make the information 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.[95] As discussed above, paragraph (i) of Rule 17g–1 requires an NRSRO to make its current Form NRSRO and Exhibits 1 through 9 publicly available within 10 business days after the date of the Commission order granting an initial application and an application to be registered in an additional class of credit ratings and within 10 business days after furnishing the Commission with an amendment on Form NRSRO (including an annual certification and withdrawal of registration). This information elicited in Item 5 will assist the Commission in reviewing whether the NRSRO is complying with this requirement and assist the public in locating the information.

The Commission did not receive any comments on this provision and is adopting it substantially as proposed.

8. Item 6 (Classes of Credit Ratings for Which Registration Is Sought and QIB Certifications)

An applicant for registration as an NRSRO or an NRSRO applying to add another class of credit ratings to its registration must complete Item 6 of Form NRSRO. This item elicits information about the classes of credit ratings for which the applicant is applying to be registered. It also requires the applicant to attach the requisite number of QIB certifications (two for each class of credit rating for which registration is sought and at least 10 with an initial application).

Item 6 elicits the approximate number of credit ratings issued in each class as of the application date. Commenters objected to the requirement to provide the number of credit ratings in a particular class because it could make it more difficult for new entrants to obtain business.[96] The Commission believes that users of credit ratings will find this information useful in understanding an NRSRO. For example, it will provide information as to how broad an NRSRO's coverage is with respect to issuers and obligors within a particular class of credit ratings.

Item 6 also elicits the date the applicant first began issuing credit ratings in that class on a continuous basis without interruption. The Form, as proposed, required the applicant to provide the number of years it has been issuing credit ratings on a continuous basis. One commenter suggested that an NRSRO be required to provide the date of first issuance, instead of the number of years, to avoid the necessity of having to frequently update the information.[97] The Commission agrees with the commenter that this will make the information submitted on the Form less subject to change and reduce the

[90] *See* Letter dated March 26, 2007 from Vickie A. Tillman, Executive Vice President, Standard & Poors (''S&P 2nd Letter''); Moody's Letter.

[91] *See* DBRS Letter; Fitch Letter.

[92] 15 U.S.C. 78o–7.

[93] 15 U.S.C. 78o–7(j).

[94] 15 U.S.C. 78o–7(a)(3).

[95] *Id.*

[96] *See, e.g.*, A.M. Best Letter.

[97] *See* letter dated March 8, 2007 from Majorie E. Gross (''Gross Letter'').

requirement to, and burden of, updating the Form. Consequently, the Commission has modified Items 6 and 7 accordingly. The information on how long an NRSRO has issued credit ratings in a particular class will assist users of credit ratings in assessing the NRSRO's level of experience.[98] Section 15E(a)(1)(C) of the Exchange Act also requires that the QIB certifications include a representation that the QIB has used the credit ratings of the applicant in the class of credit ratings for at least the three years immediately preceding the date of the application. The instructions provide that an applicant cannot tack on periods when a credit rating affiliate issued credit ratings in the particular class if the entity was not an affiliate during that time period. This provision is designed to avoid the submission of misleading information by providing that only credit ratings issued by, or on behalf of, the NRSRO are used in determining the start date.

Item 6 also elicits a brief description of how the credit rating agency issues its credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee. The Commission will use this information to review whether the applicant is in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[99] The Rating Agency Act does not define ''readily accessible.'' The information about how an applicant issues credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee also will inform the public about where and, if applicable, the cost to access an NRSRO's credit ratings.

Further, the Rating Agency Act does not define ''reasonable fee.'' In the proposing release, the Commission sought comment on whether it should define ''reasonable fee.'' In response, four commenters stated that the Commission should not in any way regulate the fees an NRSRO charges for its credit ratings.[100] The Commission has determined not to define ''reasonable fee'' at this time in order to gain experience on the issue. Item 6 is designed to assist the Commission in gaining this experience.

One commenter stated that Item 6, as proposed, does not elicit information that would be helpful in understanding the fees charged for obtaining or accessing credit ratings.[101] The Commission notes that, to the extent that several NRSROs indicate that they make their credit ratings available for free, the Commission will have assurance that regulatory users have ready access to NRSRO credit ratings. However, the Commission believes the form should elicit more information about fees so that the information will be disclosed to users of credit ratings. This will improve price transparency, which may lead to greater competition. Accordingly, the instructions for Item 6 and Item 7 now provide that an applicant that charges a fee for accessing its credit ratings must describe the fee or include a fee schedule in the form.

Finally, Item 6 requires the applicant to provide the QIB certifications mandated pursuant to Section 15E(a)(1)(B)(ix) of the Exchange Act.[102] Under this provision, an applicant must submit a minimum of ten QIB certifications. An NRSRO will not be required to make the QIB certifications publicly available pursuant to Section 15E(a)(3) of the Exchange Act [103] and Rule 17g–1(i) thereunder or update them after registration.[104] 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 obligors identified in the definition of NRSRO; and (3) at least two of the certifications must address each category of obligor.[105] 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 [106] 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 obligors.[107] The Senate report (''Senate Report'') accompanying the Rating Agency Act explained that the term ''used'' was intended to mean the QIB ''seriously considered the ratings in some of [its] investment decisions.'' [108] 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.'' [109] The required representation for the QIB certification is that the QIB ''has seriously considered the credit ratings of [the credit rating agency] in the course of making some of its investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings.'' In addition, as a measure designed to ensure the impartiality of the QIB's representation, the QIB must certify that it has not received compensation for providing the certification.

The certification must be executed by a person duly authorized by the QIB to make the certification on behalf of the QIB. 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. The form of the certification now requires that the printed name and title of the person be provided under the signature. This will clarify the identity and level of responsibility of the person executing the certification.

The Commission did not receive any comments on the form of the QIB certification and is adopting it substantially as proposed with the two modifications described above.

Item 6 of proposed Form NRSRO also requires the applicant to indicate whether it is submitting the QIB certifications and, if so, how many certifications are being submitted or that the applicant is exempt from the requirement to provide the certifications. Under Section 15E(a)(1)(D) of the Exchange Act, a

[98] Because Item 7, discussed below, will not be filled out when the NRSRO applies for registration, it will 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, will 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 will have the access to the information through Item 6 until the NRSRO furnishes an annual certification. Thereafter, the information will be located in Item 7 and updated annually with each new annual certification.

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

[100] *See* letter dated March 12, 2007 from Cate Long, Multiple Markets (''MM Letter''); letter dated March 12, 2007 from Lawrence J. White, Professor of Economics, Stern School of Business (''White Letter''); Letter dated March 12, 2007 from Alex J. Pollack, Resident Fellow, American Enterprise Institute (''AEI Letter''); Gross Letter.

[101] *See* Gross Letter.

[102] 15 U.S.C. 78o–7(a)(1)(B)(ix).

[103] 15 U.S.C. 78o–7(a)(3).

[104] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

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

[106] 15 U.S.C. 78c(a)(64).

[107] 15 U.S.C. 78o–7(a)(1)(C)(iv).

[108] *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''). The Senate Report further explained that 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.''

[109] *Id* (emphasis added).

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.[110]

For these reasons, the Commission is adopting Item 6 with the modifications discussed above.

9. Item 7 (Classes of Credit Ratings Covered by Current Registration)

As adopted, Item 7 requires an NRSRO to provide information about the classes of credit ratings for which the NRSRO is currently registered, the approximate number of credit ratings issued in each class as of the previous calendar year end, and the date the NRSRO first issued credit ratings in that class on a continuous basis. The NRSRO also must provide information about how the NRSRO makes its credit ratings readily accessible. Item 7 has been modified from the proposed form to make the information provided in the item less subject to change, which will reduce the frequency of having to furnish updated information. Specifically, as discussed above, the number of years the NRSRO has issued credit ratings in a particular class is now indicated by having the NRSRO provide the date it first issued credit ratings in that class. As proposed, the NRSRO would have had to provide the number of years it had issued credit ratings in that class, which would constantly change with the advance of time. Also, the number of credit ratings issued in a particular class is now as of the end of the previous calendar year. Therefore, this information will change once a year and only be required to be updated on an annual basis. The instructions to the Form provide that this update can be made with the annual certification and within the 90-day time period for providing the annual certification.

10. Item 8 (Potential Statutory Disqualifications)

An applicant and NRSRO will be required to disclose, if applicable, if it or any person within its credit rating organization have been, or are, subject to certain legal judgments or orders, or regulatory findings. As explained in the proposing release, Section 15E(a)(2)(C)(ii)(II) of the Exchange Act[111] 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.[112] Section 15E(d) of the Exchange Act[113] 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 or omitted any act, or is subject to an order or finding enumerated in Sections 15(b)(4)(A), (D), (E), (G), or (H) of the Exchange Act,[114] has been convicted of any offense specified in Section 15(b)(4)(B) of the Exchange Act,[115] or is enjoined from any action, conduct, or practice specified in Section 15(b)(4)(C) of the Exchange Act.[116] The Commission also can take these actions if the NRSRO or a person associated with the NRSRO has been convicted of any crime punishable by imprisonment for 1 or more years that is not described in Section 15(b)(4)(B) of the Exchange Act[117] or a substantially equivalent crime in a foreign court of competent jurisdiction, or if a person associated with the NRSRO is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.[118] Item 8 of Form NRSRO requires an applicant or NRSRO to answer whether the applicant or the NRSRO or any person within their credit rating organizations, is subject to these acts, convictions, or orders described in Section 15E(d) of the Exchange Act.[119]

If an applicant answers ''yes'' to a question, the credit rating agency is required to provide additional information on a Disclosure Reporting Page (DRP) NRSRO as set forth in the instructions for Form NRSRO. An NRSRO will not be required to make the disclosure reporting pages publicly available pursuant to Section 15E(a)(3) of the Exchange Act[120] and Rule 17g–1(i) thereunder.[121] If an applicant answers ''yes'' to a question in Item 8, the Commission will use the disclosure reporting pages to evaluate whether the applicant's registration could be granted in light of the disclosure. After registration, if an NRSRO answers ''yes'' to one of the questions, the Commission will use the disclosure reporting pages to evaluate pursuant to the process under Section 15E(d) of the Exchange Act whether it would be appropriate to issue an order censuring, placing limitations on the activities, functions, or operations of, suspending for a period not exceeding 12 months, or revoking the registration of the NRSRO.[122]

Two commenters stated that Item 8, as proposed, was overly broad because, in asking about any person ''associated'' with the applicant and NRSRO, it reached employees in areas of a large conglomerate that performed functions wholly unrelated to credit rating services.[123] The Commission notes that its authority under Sections 15E(a)(2)(C)(ii)(II)[124] and 15E(d)[125] of the Exchange Act can be triggered by legal judgments and orders, and regulatory findings involving persons ''associated'' with the applicant and NRSRO. In considering these comments, the Commission evaluated when a disclosure would be more likely to trigger Commission action. The Commission concluded that it would involve disclosures relating to the credit rating agency and the persons directly involved in providing or supporting credit rating services. Therefore, to lessen the burden on applicants and NRSROs, the Commission believes it is appropriate to narrow the scope of the disclosure requirement to ''persons within the credit rating agency,'' which the instructions define as the credit rating agency, any credit rating affiliates of the credit rating agency identified in Item 3, and any partner, officer, director, branch manager, or employee of the credit rating agency or credit rating affiliates (or any person occupying a similar status or performing similar functions).

One commenter requested that the Commission clarify that the disclosures in Item 8 do not include disclosures relating to accusations or arrests.[126] The Commission notes that the disclosures are triggered by the provisions of Section 15E(d) of the Exchange Act,[127] which refers to convictions (not arrests or accusations). A second commenter suggested that the disclosure item not include the name of the individual.[128] The Commission believes it has reduced this concern, in part, by narrowing the disclosure item to persons within the credit rating agency and by providing

[110] 15 U.S.C. 78o–7(a)(1)(D).

[111] 15 U.S.C. 78o–7(a)(2)(C)(ii)(II).

[112] 15 U.S.C. 78o–7(d).

[113] *Id.*

[114] 15 U.S.C. 78o(b)(4)(A), (D), (E), (G) and (H).

[115] 15 U.S.C. 78o(b)(4).

[116] 15 U.S.C. 78o(b)(4)(C).

[117] 15 U.S.C. 78o(b)(4)(B).

[118] 15 U.S.C. 78o–7(d).

[119] *Id.*

[120] 15 U.S.C. 78o–7(a)(3).

[121] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[122] 15 U.S.C. 78o–7(d).

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

[124] 15 U.S.C. 78o–7(a)(2)(C)(ii)(II).

[125] 15 U.S.C. 78o–7(d).

[126] *See* R&I Letter.

[127] 15 U.S.C. 78o–7(d).

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

that the disclosure reporting pages are not required to be made publicly available pursuant to Section 15E(a)(3) of the Exchange Act [129] and Rule 17g–1(i).[130] The Commission believes the disclosure of the name of a person providing or supporting credit ratings services will be important as these persons may seek to associate with another NRSRO if they are terminated from or leave the reporting NRSRO. The Commission also notes that the events triggering an Item 8 disclosure generally are matters of public record (*e.g.*, convictions, regulatory orders) and, consequently, there may be a reduced expectation of confidentiality.

Otherwise, Item 8 is being adopted substantially as proposed.

11. Exhibit 1 (Credit Ratings Performance Statistics)

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).[131] An applicant and NRSRO will provide this information in Exhibit 1 to Form NRSRO. The Exchange Act does not otherwise define or identify the particular credit rating performance statistics to be provided with the application. Credit rating agencies typically generate statistical reports showing historical default and downgrade rates within each credit rating notch or grade.[132] 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, will be useful to users of credit ratings in evaluating an NRSRO.

The instructions to Form NRSRO provide that an applicant and NRSRO must include in the Exhibit definitions of the credit ratings (*i.e.*, an explanation of each category and notch) and explanations of the performance measurement statistics, including the metrics used to derive the statistics. One commenter requested that the Commission clarify the instruction with respect to explaining ''the metrics used to derive the statistics.'' [133] The intent is that the NRSRO explain in general terms how it calculates the default and downgrade rates. The Commission believes that requiring this information is necessary or appropriate in the public interest or for the protection of investors because it will assist users of credit ratings in understanding how the measurements were derived and in making comparisons with the measurement statistics of other NRSROs.[134]

The definitions of the categories and notches will assist the Commission in assessing whether the NRSRO's credit ratings, as a practical matter, can be used for certain Commission rules. For example, paragraph(c)(2)(vi)(F) of Exchange Act Rule 15c3–1 specifies lower haircuts for debt securities that are rated in one of the ''four highest rating categories'' of at least two NRSROs.[135] This provision was designed based on the practice of many credit rating agencies to have at least eight categories for their debt securities with the top four commonly referred to as ''investment grade.'' If an NRSRO uses less than eight categories, the Commission will be required to evaluate whether, based on the NRSRO's definitions, securities included in the top four categories would be suitable for the lower haircuts specified in paragraph(c)(2)(vi)(F) of Rule 15c3–1.[136]

The Commission requested comment on whether the performance measurement statistics should use standardized inputs, time horizons, and metrics to allow for greater comparability. This request elicited numerous comments.[137] Three commenters supported the use of standardized measures because it would make it easier to compare NRSROs.[138] A number of commenters opposed the use of standardized measures for several reasons, including that such measures would be impractical because credit rating agencies use different methodologies to determine credit ratings and different definitions of default and that the use of such measures could interfere with the methodologies for determining credit ratings.[139] In light of the varying approaches cited in the comments, the Commission is not prepared to prescribe standard metrics at this time. The Commission intends to continue to consider this issue to determine the feasibility, as well as the potential benefits and limitations, of devising measurements that would allow reliable comparisons of performance between NRSROs. As adopted, the Exhibit requires NRSROs to describe how they derive their statistics in sufficient detail to allow users of credit ratings to understand the measures. This will provide users with some basis to compare different NRSROs even if the statistics are not derived from similar measures.

The Commission requested comment on whether other performance measurement statistics would be appropriate as an alternative, or in addition, to historical default and downgrade rates. For example, the Commission requested 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. Although the Commission is not taking action in this regard at this time, the Commission intends to study these issues and consider possible future action.

For these reasons, Exhibit 1 to Form NRSRO and the instructions for the Exhibit are being adopted substantially as proposed.

12. Exhibit 2 (Procedures and Methodologies for Determining Credit Ratings)

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.[140] An applicant and NRSRO will provide this information in Exhibit 1 to Form NRSRO. The Exchange Act does not otherwise define

[129] 15 U.S.C. 78o–7(a)(3).

[130] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[131] 15 U.S.C. 78o–7(a)(1)(B)(i).

[132] The credit rating categories 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.

[133] *See* DBRS Letter.

[134] 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)).

[135] 17 CFR 240.15c3–1(c)(2)(vi)(F).

[136] *Id.*

[137] *See* letter dated March 12, 2007 from Richard M. Whiting, Executive Director and General Counsel, Financial Services Roundtable (''FSR Letter''); letter dated March 12, 2007 from Herwig M. Langohr, Professor, INSEAD Business School, Patricia T. Langohr, Professor, ESSEC Business School (''Langohr Letter''); letter dated March 22, 2007 from George P. Miller, Executive Director, American Securitization Forum (''ASF Letter''); letter dated March 16, 2007 from Makoto Utsumi, President & CEO, Ratings & Investment Information (''JCR 2nd Letter''); ICI Letter; Gross Letter; R&I Letter; MM Letter; White Letter; DBRS Letter; A.M. Best Letter; S&P Letter; AEI Letter; Moody's Letter.

[138] *See* Gross Letter; ICI Letter; JCR 2nd Letter.

[139] *See*, *e.g.*, R&I Letter; A.M Best Letter; S&P Letter; Moody's Letter; ASF Letter.

[140] 15 U.S.C. 78o–7(a)(1)(B)(ii).

or identify the procedures and methodologies that must be provided under this section.[141] 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.'' [142]

Credit rating agencies may 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; the monitoring, reviewing, and updating of credit ratings; and the withdrawal, or suspension of the maintenance, of a credit rating.

The list identifies areas where a credit rating agency may establish procedures and methodologies for determining credit ratings. The applicability of certain areas to a particular credit rating agency will depend on whether it uses subjective qualitative analysis, purely quantitative models, or a combination of both.[143] Consequently, a credit rating agency might not establish a procedure or methodology in a given area if 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 for such ratings. 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 charged 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 credit ratings. 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, credit rating agencies that rely on fees from issuers, obligors, and underwriters to determine specific credit ratings, but also issue unsolicited ratings, often establish 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 most often the case with a solicited credit rating).

The Commission believes that the information about any procedures and methodologies established in the areas described above, including any with respect to unsolicited credit ratings, will be useful to users of credit ratings. The information will provide them with 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 will provide a basis for comparing NRSROs.

Several commenters stated that the Exhibit should require that an applicant and NRSRO describe its procedures and methodologies rather than submit and disclose each actual procedure and methodology.[144] These commenters pointed out that large credit rating agencies that issue multiple types of credit ratings generally have volumes of detailed procedures that credit analysts must follow in the course of determining a credit rating.[145] They noted that disclosing all this information would be burdensome and could be difficult for users of credit ratings to parse.[146] They also noted that some of the procedures and methodologies may involve the use of proprietary models.[147]

The Commission agrees with these commenters that disclosing all the procedures could be burdensome and could result in an overload of information that would be less helpful to users of credit ratings. Therefore, the Commission has modified the instructions to require that the Exhibit contain a description of the procedures and methodologies (not the submission and disclosure of each actual procedure and methodology). The instructions provide that the description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes the applicant or NRSRO employs to determine credit ratings.

As discussed below, rather than have a credit rating agency submit its procedures and methodologies in Exhibit 2, the Commission is adopting a requirement in Rule 17g–2 that an NRSRO must document them internally. Moving this requirement from Exhibit 2 to the recordkeeping rule is designed to reduce the burden on NRSROs, while making these procedures and methodologies available to Commission examination staff. These records are important to the Commission's oversight. For example, Rule 17g–6 prohibits, among other things, an NRSRO from issuing or modifying or threatening to issue or modify a credit rating contrary to the NRSRO's established procedures and methodologies. The Commission's ability to enforce this prohibition will depend on the Commission staff being able to access an NRSRO's documented procedures and methodologies.[148]

Two commenters also suggested changes to the Commission's description of an ''unsolicited credit rating'' in the proposed instructions to Form NRSRO as being a credit rating that is not requested by the issuer or underwriter of the rated securities or the rated obligor.[149] The commenters noted that issuers and obligors may consent to the issuance and participate in the determination of a credit rating even if they did not specifically request that the credit rating be issued. As discussed below, the Commission has eliminated the prohibition in Rule 17g–6 relating to unsolicited credit ratings, in part, because of difficulties with defining the term. Therefore, the Commission has removed the definition from the instructions to Exhibit 2. The Commission wants to gain a better understanding through its examination function of how credit rating agencies define ''unsolicited credit ratings'' and

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

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

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

[144] *See* White Letter; DBRS Letter; A.M. Best Letter; Fitch Letter; Moody's Letter.

[145] *See, e.g.*, DBRS Letter; A.M. Best Letter; Fitch Letter; Moody's Letter.

[146] *Id.*

[147] *Id.*

[148] *See* letter dated March 12, 2007 from James A. Kaitz, President & CEO, Association for Financial Professionals (''AFP Letter'') stating the importance of monitoring whether an NRSRO adheres to its stated procedures and methodologies for determining credit ratings.

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

the practices they employ with respect to these ratings.

For these reasons, the Commission is adopting Exhibit 2 and the instructions for the Exhibit with the modifications described above.

13. Exhibit 3 (Procedures To Prevent the Misuse of Material Non-Public Information)

Section 15E(g)(1) of the Exchange Act [150] 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.[151] 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, nonpublic information.[152] As discussed below, Rule 17g–4 requires an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act [153] to include certain specific types of procedures.

Section 15E(a)(1)(B)(iii) of the Exchange Act [154] 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 of material, nonpublic information in violation of Exchange Act [155] provisions and rules. An applicant and NRSRO will provide this information in Exhibit 3 to Form NRSRO. Specifically, Exhibit 3 requires a copy of the policies and procedures to prevent the misuse of material, nonpublic information established pursuant to Section 15E(g) of the Exchange Act [156] and Rule 17g–4.

The Commission received two comments on this Exhibit, as proposed.[157] One commenter stated that the policies and procedures should not have to be made publicly available because they may contain proprietary information and disclosing them could hinder their effectiveness.[158] The Commission agrees that disclosing certain components of these policies and procedures could make it easier for persons to circumvent them. Therefore, the Commission has modified the instructions to provide that the applicant or NRSRO is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information is disclosed. The other commenter stated that the procedures should be disclosed on the NRSRO's Web site without further elaboration.[159] The Commission notes that Section 15E(a)(3) of the Exchange Act [160] and Rule 17g–1 thereunder require an NRSRO to make its Form NRSRO and Exhibits 1 through 9 publicly available by posting them on its Web site, or through another comparable, readily accessible means.

For these reasons, the Commission is adopting Exhibit 3 and the instructions for the Exhibit with the modifications described above.

14. Exhibit 4 (Organizational Information)

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.[161] An applicant and NRSRO will provide this information in Exhibit 4 to Form NRSRO. The Exchange Act does not otherwise define or identify the specific type of organizational information that must be provided under Section 15E(a)(1)(B)(iv) of the Exchange Act.[162] 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. Users of credit ratings will benefit from this information and, consequently, the Commission proposed that it be provided in this Exhibit. One commenter disagreed that users of credit ratings would find the information helpful in assessing or understanding the NRSRO.[163] For the reasons discussed below, the Commission continues to believe these three charts will be valuable to users of credit ratings and the Commission.

The first required organizational chart will show the credit rating agency's ultimate and sub-holding companies, subsidiaries, and material affiliates, if applicable. This chart will reveal 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 will be relevant to the Commission's evaluation of whether an applicant or NRSRO has adequate financial resources as required under the Exchange Act.[164] One commenter requested that the Commission define the term ''material affiliate.''[165] At present, the Commission believes it is more appropriate to rely on the judgment of the credit rating agency to define its material affiliates, given that the size and complexity of NRSROs could vary widely.

The second organizational chart will show the credit rating agency's divisions, departments, and business units, if applicable. This information will assist users of credit ratings and the Commission in understanding where potential conflicts of interest relating to ancillary business activities might arise.

The third organizational chart will show the credit rating agency's management structure and senior management reporting lines and include in the chart its designated compliance officer under Section 15E(j) of the Exchange Act.[166] The Commission will benefit from this chart as it will assist in evaluating whether an applicant and NRSRO has adequate managerial resources as required under the Exchange Act.[167] Users of credit ratings will be able to use this information to compare the managerial resources of different NRSROs.

Including the compliance officer in the chart will assist the Commission and users of credit ratings in understanding the degree of the compliance officer's independence from the business managers.[168] The compliance officer's reporting lines are 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 [169] and for ensuring the NRSRO's compliance with the securities laws and rules and regulations thereunder.[170] In carrying

[150] 15 U.S.C. 78o–7(g)(1).

[151] 15 U.S.C. 78a *et seq.*

[152] 15 U.S.C. 78o–7(g)(2).

[153] 15 U.S.C. 78o–7(g)(1).

[154] 15 U.S.C. 78o–7(a)(1)(B)(iii).

[155] 15 U.S.C. 78a *et seq.*

[156] 15 U.S.C. 78o–7(g).

[157] *See* letter dated March 12, 2007 from Ayal Rosenthal (''Rosenthal Letter''); R&I Letter.

[158] *See* R&I Letter.

[159] *See* Rosenthal Letter.

[160] 15 U.S.C. 78o–7(a)(3).

[161] 15 U.S.C. 78o–7(a)(1)(B)(iv).

[162] *Id. See also,* 15 U.S.C. 78a *et seq.*

[163] *See* MM Letter.

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

[165] *See* R&I Letter.

[166] 15 U.S.C. 78o–7(j).

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

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

[169] 15 U.S.C. 78o–7(g) and (h).

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

out these responsibilities, a compliance officer will be required to review activities overseen by senior business managers. The ability of the compliance officer to objectively review an area can be impacted by whether the officer reported to the senior manager responsible for the area. Thus, the relative independence of the compliance officer will be relevant in assessing the NRSRO's ability to ensure compliance with its policies and procedures.

For these reasons, the Commission is adopting Exhibit 4 and the instructions for the Exhibit substantially as proposed.

15. Exhibit 5 (Code of Ethics)

Section 15E(a)(1)(B)(v) of the Exchange Act requires that an application for registration as an NRSRO disclose whether the applicant has a code of ethics in effect or an explanation of why the applicant has not established a code of ethics.[171] Exhibit 5 of Form NRSRO elicits this information by requiring an applicant and NRSRO to attach a copy of any established code of ethics or an explanation of why it does not have a code of ethics. The Commission believes the requirement to include a copy of any established code of ethics in the Exhibit is necessary or appropriate in the public interest or for the protection of investors. A statement that an NRSRO has a code of ethics but no further disclosure would not be particularly useful to users of credit ratings. They would not be able to review the code of ethics and use it as a means of comparing different NRSROs.

The Exchange Act does not otherwise define or identify the ''code of ethics'' that should be provided under Section 15E(a)(1)(B)(v).[172] The Commission believes each credit rating agency must have the flexibility to establish a code of ethics appropriate for its business model and organizational structure and, consequently, the Exhibit does not prescribe any specific elements that must be in the code of ethics, if any, furnished in this Exhibit.

The Commission received several comments on this Exhibit.[173] Most addressed whether the Exhibit also should require the credit rating agency to disclose whether it complies with international principles and codes of conduct related to credit rating agencies.[174] One commenter suggested that the Exhibit not refer to a code of ''ethics'' but rather to a code of ''conduct.''[175] Another commenter requested that the Exhibit not require the credit rating agency to ''certify'' that it is complying with international principles and codes of conduct because some principles permit an entity to comply or explain.

The Commission reiterates that Exhibit 5 does not prescribe any requirements that must be in an NRSRO's code of ethics and that Section 15E(a)(1)(B)(v) of the Exchange Act does not require an NRSRO to have a code of ethics.[176] An applicant or NRSRO can submit a statement of why it does not have a code of ethics.[177] The Commission believes that the Exhibit should not require the inclusion of any particular type of code of conduct. It could be the case that the code of ethics provided by an applicant or NRSRO is part of a broader code of conduct. For the foregoing reasons, the Commission is adopting Exhibit 5 substantially as proposed.

16. Exhibit 6 (Conflicts of Interest)

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.[178] 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.[179] Exhibit 6, as proposed, would have required an applicant and NRSRO to describe in general terms each type of conflict that arises, or may arise, from its business model and credit rating activities. Thus, if an NRSRO receives payment from issuers to rate their securities, the NRSRO would have been required to disclose that fact. It would not have had to make a disclosure each time it received payment from an issuer. The purpose of the proposed disclosure was to alert users of credit ratings to the NRSRO's business model (subscriber fee-based, issuer fee-based, or a combination of both), and to potential conflicts that arise from the business model.

The Commission continues to believe that disclosing the types of conflicts that arise from an NRSRO's business model will 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,[180] given the types of conflicts of interest identified by the applicant.[181] The information also will 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.

Exhibit 6 of Form NRSRO, as adopted, requires an applicant and NRSRO to provide a list describing in general terms the types of conflicts of interest that arise from its business activities. The instructions to the Exhibit have been modified to include a list of 10 different generic conflicts of interest that may apply to a credit rating agency based on its business model and activities. These conflicts were included in the proposed instructions as examples of conflicts. These are the types of conflicts that generally arise from the business of issuing credit ratings depending on the business model of the credit rating agency. The instructions further provide that the credit rating agency can use the descriptions provided in the instructions to identify an applicable conflict of interest and is not required to provide any further information. Thus, the credit rating agency can review each item on the list and determine whether it describes an applicable conflict. This modification is intended to make it simpler for the credit rating agency to create the Exhibit since it may rely on the language in the instructions to identify a conflict. A credit rating agency can choose to provide its own description of the conflict or further explanation to one of the descriptions in the instructions.

Several commenters raised concerns with the Commission's identification as a potential conflict the fact that a subscriber may use the entity's credit ratings for regulatory purposes.[182] They

[171] 15 U.S.C. 78o–7(a)(1)(B)(v).

[172] *Id.*

[173] *See* letter dated March 12, 2007 from John Grout, Policy and Technical Director, The Association of Corporate Treasurers (''AST Letter''); Gross Letter; DBRS Letter; S&P Letter; Moody's Letter; Langohr Letter; JCR 2nd Letter.

[174] A number of these commenters endorsed a requirement that the credit rating agency disclose whether it has adopted a code of conduct consistent with the principles contained in the report: *Statement of Principles Regarding the Activities of Credit Rating Agencies*, Technical Committee, International Organization of Securities Commissions (''IOSCO'') (September 25, 2003). *See also Code of Conduct Fundamentals for Credit Rating Agencies*, Technical Committee of IOSCO (December 2004).

[175] *See* Moody's Letter.

[176] 15 U.S.C. 78o–7(a)(1)(B)(v).

[177] *Id.*

[178] 15 U.S.C. 78o–7(a)(1)(B)(vi).

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

[180] 15 U.S.C. 78o–7(h).

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

[182] *See, e.g.*, DBRS Letter; S&P Letter.

argued that it would be impractical to determine how subscribers might be using their credit ratings.[183] The Commission did not intend to require NRSROs to actively monitor how their subscribers were using their credit ratings. Rather, the intent is to require NRSROs to disclose that subscribers, while they do not pay to have a credit rating issued, may have an interest in a specific credit rating. Therefore, the fact that they compensate the NRSRO could give rise to a conflict of interest. The instructions now describe the conflict as the fact that subscribers *may* use the credit ratings for regulatory purposes. This means that any credit rating agency that charges subscribers to access its credit ratings will be required to identify this conflict. The credit rating agency is not required to determine whether, or how, the subscribers are using the credit ratings to comply with statutes and regulations. The purpose of the disclosure is to alert users of credit ratings to the fact that the NRSRO's business model includes charging subscribers to access its credit ratings and that a subscriber may have an interest in a particular credit rating. For similar reasons, the Commission eliminated a provision in the instructions requiring the identification of associated persons that use credit ratings for regulatory purposes as this would have required an applicant and NRSRO to monitor how another legal entity was using its credit ratings.

A commenter noted that subscribers who manage investment portfolios also may have an interest in a particular credit rating.[184] For example, such a subscriber may be limited to investing in debt securities that have investment grade credit ratings and, consequently, would be required to sell, perhaps at a loss, a debt security that is downgraded below investment grade. The Commission believes that, similar to regulatory users, this type of subscriber could raise a potential conflict of interest. Therefore, this type of conflict is specifically identified in the instructions to the Exhibit.

The instructions to the Exhibit, as proposed, also required an NRSRO to identify a person associated with the NRSRO that underwrites securities or money market instruments that are subject to a credit rating of the NRSRO. This type of conflict is identified in Section 15E(h)(2)(D) of the Exchange Act.[185] The concerns raised by commenters with respect to monitoring how subscribers use their credit ratings also apply in this context. For example, the provision, as proposed, could be interpreted to require an NRSRO to monitor whether any person associated with the NRSRO is an ''underwriter'' as that term is defined in Section 2(a)(11) of the Securities Act of 1933.[186] The Commission believes this could impose a very difficult compliance standard in that it would involve continuous monitoring of the securities trading activities of associated persons and legal judgments as to whether they were acting as ''underwriters'' at any given moment.

At the same time, the Commission believes that where there is a potential affiliation between an NRSRO and a securities underwriter that it is necessary or appropriate in the public interest or for the protection of investors to require it to be disclosed in this Exhibit. Specifically, an affiliation between an NRSRO and a broker or dealer that is in the business of underwriting securities would raise concerns that the NRSRO might be influenced by the affiliation to issue favorable credit ratings for these securities. The Commission further believes that disclosing this type of affiliation does not present the concerns discussed above since most persons associated with an NRSRO likely are not broker-dealers in the business of underwriting securities. Therefore, the NRSRO should be able to identify those associated persons. Further, the requirement to identify these persons is based on being affiliated with such an underwriter that *may* underwrite securities rated by the NRSRO. Thus, the NRSRO will not need to actively monitor whether it currently has rated such securities and update the Exhibit each time this changes. Consequently, the requirement to identify persons associated with the NRSRO that underwrite securities rated by the NRSRO has been narrowed to a requirement to identify any person associated with the NRSRO that is a broker or dealer in the business of underwriting securities or money market instruments.

Finally, the Commission notes that the Exhibit contains a catchall provision requiring the disclosure of any other material conflict of interest. Consequently, the additional conflict added to the instructions is expected to reduce the potential conflicts that must be disclosed under the catchall. With respect to the catchall, the instructions note that a ''material'' type of conflict will include one that the NRSRO has established specific policies and procedures to address.

For these reasons, the Commission is adopting Exhibit 6 and the instructions for the Exhibit with the modifications described above.

17. Exhibit 7 (Procedures To Manage Conflicts)

An applicant or NRSRO will be required to furnish in Exhibit 7 a copy of the written policies and procedures it establishes, maintains, and enforces to address and manage conflicts of interest pursuant to Section 15E(h) of the Exchange Act.[187] Requiring inclusion of these policies and procedures in the Form is necessary or appropriate in the public interest or for the protection of investors.[188] First, their disclosure will assist the Commission in monitoring whether an NRSRO is complying with Section 15E(h) of the Exchange Act.[189] Second, their disclosure will assist the Commission in evaluating whether an applicant or NRSRO has adequate financial and managerial resources to materially comply with Section 15E(h) of the Exchange Act.[190] Third, their disclosure will 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.

One commenter stated that these policies and procedures should not have to be made publicly available because they may contain proprietary information and disclosing them could hinder their effectiveness.[191] As with the Exhibit 3 policies and procedures, the Commission has modified the instructions for this Exhibit to provide that the applicant or NRSRO is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information were disclosed.

For these reasons, the Commission is adopting Exhibit 7 and the instructions for the Exhibit with the modification described above.

18. Exhibit 8 (Credit Analyst Information)

Exhibit 8, as proposed, would have required an applicant and NRSRO to provide certain background information (*e.g.*, employment history and education) with respect to each credit analyst and credit analyst supervisor.

[183] *Id.*

[184] *See* DBRS Letter.

[185] 15 U.S.C. 78o–7(h)(2)(D).

[186] 15 U.S.C. 77b(a)(11).

[187] 15 U.S.C. 78o–7(h).

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

[189] 15 U.S.C. 78o–7(h).

[190] *Id.*

[191] *See* R&I Letter.

Consistent with its reasons for proposing this request, the Commission believes that the ability of a credit rating agency to assess the creditworthiness of an issuer and obligor depends on the competence of the personnel responsible for determining the entity's credit ratings. Further, the Commission believes that information about the responsibilities, experience, and employment history of the credit analysts and supervisors is necessary or appropriate in the public interest or for the protection of investors. The information will 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. This information also will 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.[192]

The Commission received numerous comments on Exhibit 8 stating that the requirement to provide information on each credit analyst and credit analyst supervisor was unduly burdensome and unnecessary.[193] Several commenters suggested, as an alternative, that the Exhibit require general information about the education, qualifications, and number of the credit analysts and their supervisors.[194] After considering the comments and the potential burden associated with the proposed requirement, the Commission has modified the Exhibit to only require aggregate information about these employees. Consequently, the Exhibit, as adopted, requires the following information:

- The total number of credit analysts.
- The total number of credit analyst supervisors.
- A general description of the minimum required qualifications of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).
- A general description of the minimum required qualifications of the credit analyst supervisors, including education level and work experience.

The information about the total number of credit analysts and their supervisors will provide the Commission and users of credit ratings with an understanding of the human resources the credit rating agency devotes to determining credit ratings. This will assist the Commission in assessing the managerial resources of an applicant and NRSRO. The information about the qualifications of the credit analysts and their supervisors will be useful to users of credit ratings in assessing the competency of an NRSRO. The Commission believes this modification strikes an appropriate balance between reducing burden and requiring necessary information. Nonetheless, the Commission intends to monitor whether this aggregate approach to the credit analyst information is sufficient to apprise users of credit ratings of the qualifications of a given NRSRO's credit analysts.

For these reasons, the Commission is adopting Exhibit 8 and the instructions for the Exhibit with the modifications described above.

19. Exhibit 9 (Designated Compliance Officer)

As adopted, Exhibit 9 requires an applicant and NRSRO to provide certain background information on the entity's designated 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.[195] The ability of the compliance officer to carry out these statutorily mandated responsibilities will depend, in part, on the officer's experience and qualifications.

The Commission continues to believe that requiring information about the experience and employment history of the designated compliance officer is necessary or appropriate in the public interest or for the protection of investors. It will 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.[196] It also will 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 2.

The Exhibit, as proposed, also required information about the compliance personnel responsible for assisting the compliance officer. Several commenters objected to this aspect of the Exhibit as being unduly burdensome, unnecessary, and intrusive.[197] After considering the comments and the potential burden associated with the proposed requirement, the Commission has modified the Exhibit to eliminate the requirement to provide information about the persons that assist the compliance officer. As with the modifications to Exhibit 8, the Commission believes this modification to Exhibit 9 strikes an appropriate balance between reducing burden and requiring necessary information. Nonetheless, the Commission intends to monitor whether information about the designated compliance officer alone is sufficient to apprise users of credit ratings of how this statutorily required compliance function is being addressed by a given NRSRO.

For these reasons, the Commission is adopting Exhibit 9 and the instructions for the Exhibit with the modifications described above.

20. Exhibit 10 (List of Large Users of Credit Rating Services)

Section 15E(a)(1)(B)(viii) of the Exchange Act requires that an application for registration as an NRSRO include, on a confidential basis,[198] 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.[199] This information will be elicited in Exhibit 10 to Form NRSRO. An NRSRO will not be required to make this information publicly available pursuant to Section 15E(a)(3) of the Exchange Act[200] and Rule 17g–1(i) thereunder or update the Exhibit after registration.[201] An NRSRO will be required to update this information in an unaudited financial report that must be furnished to the Commission pursuant to Rule 17g–3.

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

[193] *See* letter dated May 3, 2007 from Barron H. Putnam, Ph.D, Owner and Advisor, LACE Financial Corporation (''LACE Letter''); JCR Letter; R&I Letter; DBRS Letter; A.M. Best Letter; Fitch Letter; S&P Letter; AEI Letter; Moody's Letter.

[194] *See, e.g.*, DBRS Letter; A.M. Best Letter; Fitch Letter; S&P Letter; Moody's Letter.

[195] 15 U.S.C. 78o–7(j).

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

[197] *See, e.g.*, R&I Letter; DBRS Letter; A.M. Best Letter; Fitch Letter; S&P Letter; Moody's Letter.

[198] An applicant can request that the Commission keep this information confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[199] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[200] 15 U.S.C. 78o–7(a)(3).

[201] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

Exhibit 10 also requires that an applicant disclose in the list large obligors (*i.e.*, persons who are rated as an entity as opposed to having their securities rated) and underwriters 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 will be required to identify the 20 largest issuers and subscribers as required by Section 15E(a)(1)(B)(viii) of the Exchange Act [202] and include in the list any obligor and underwriter that meets the above criteria.

The Commission believes that including large obligors and underwriters in the list of the 20 largest issuers and subscribers is necessary or appropriate in the public interest or for the protection of investors. The information will help identify persons that could potentially have undue influence on an NRSRO given the amount of revenue the person provides the NRSRO. Obligors and securities underwriters may have as much of an interest in potentially influencing a credit rating as issuers and subscribers. One commenter suggested that the list of 20 large clients be determined from the pool of issuers, subscribers, obligors, *and* underwriters, rather than from only issuers and subscribers, with obligors or underwriters being added only to the extent they meet the above criteria.[203] In this case, the list would never exceed 20 persons. The Commission notes, however, that the statute clearly refers to the 20 largest ''issuers and subscribers'' and not to obligors or underwriters.[204] Therefore, this provision of the Exhibit is being adopted as proposed.

Section 15E(a)(1)(B)(viii) of the Exchange Act limits the persons required to be included in the list to users of the ''credit rating services'' of the applicant and NRSRO.[205] The Exchange Act [206] does not define the term ''credit rating services.'' The Commission proposed to interpret this term to mean 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. The intent of this proposed interpretation is to include—along with persons that pay for credit ratings and subscriptions—persons that are rated, or whose securities or money market instruments are rated, but that did not pay for the credit rating. Even though these persons 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.

One commenter suggested expanding the definition to include providing credit ratings data and analysis to subscribers.[207] The Commission agrees that the meaning of ''subscribers'' should include persons who pay for credit ratings data and the analysis behind credit ratings because it may be difficult to separate these subscribers from other subscribers. Additionally, the Commission notes that credit rating agencies that make their credit ratings publicly available for free may offer subscriptions to receive feeds of the credit ratings or to receive more reports detailing the analysis behind the credit ratings. Consequently, the Commission is interpreting the term ''credit rating services'' to mean any of the following: Rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, *credit ratings data, or credit ratings analysis* to a subscriber.

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.[208] The Exchange Act [209] does not define the term ''net revenue.'' The Commission proposed to interpret the term ''net revenue'' for the purposes of Section 15E(a)(1)(B)(viii) of the Exchange Act [210] 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 Commission received several comments suggesting that this interpretation be narrowed in certain ways to make it more practical to employ in determining the large users of a credit rating agency's services.[211] Commenters stated that tracking revenues received by affiliates of the credit rating agency would be difficult.[212] Several commenters also stated that payables used to determine the ''net revenue'' should not include, for example, monies paid to vendors for ordinary course goods and services such as utility bills.[213] A commenter also sought clarification on how to realize revenues (*e.g.*, cash receipts, accrued receivables) for purposes of this Exhibit.

The Commission agrees with these commenters that the proposed definition of ''net revenues'' created some practical difficulties in determining the list required in Exhibit 10. Therefore, the Commission is refining the interpretation to make the calculation of ''net revenues'' easier to compute but also more focused. Specifically, the Commission interprets ''net revenues'' to mean revenue earned by the applicant or NRSRO for any type of service or product, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person by the applicant or NRSRO. This definition excludes revenues received by affiliates that are not part of the credit rating organization. Also the intent in describing the netting payables as ''rebates or allowances'' is to limit them to items that directly reduce a payable on the revenue side and to exclude unrelated payables (*e.g.*, payables for utility bills). Finally, by using the term ''revenue earned'' the Commission intends that the applicant and NRSRO apply its standard accounting convention for recognizing revenue. The Commission is incorporating these interpretations into the instructions for Exhibit 10 and, as discussed below, Rule 17g–3.

The Commission notes that one commenter stated that the Exhibit requires public disclosure and that such disclosure is unnecessary because credit rating agencies establish barriers between credit analysts and the business units.[214] In response, the Commission notes that, as discussed above, an NRSRO is not required to make this information publicly available under Rule 17g–1(i). The information is intended to be used by the Commission to identify persons that could potentially exert undue influence on an NRSRO. The Commission further notes

[202] *Id.*

[203] *See* R&I Letter.

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

[205] *Id.*

[206] 15 U.S.C. 78a *et seq.*

[207] *See* DBRS Letter.

[208] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[209] 15 U.S.C. 78a *et seq.*

[210] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[211] *See* Gross Letter; Fitch Letter; S&P Letter; Moody's Letter.

[212] *See*, *e.g.*, Fitch Letter; S&P Letter; Moody's Letter.

[213] *See*, *e.g.*, Gross Letter; Moody's Letter.

[214] *See* FSR Letter.

that Congress specifically prescribed that an applicant and NRSRO provide the information with respect to the 20 largest issuers and subscribers in terms of net revenues.[215]

For these reasons, the Commission is adopting Exhibit 10 and the instructions for the Exhibit with the modifications described above.

21. Exhibit 11 (Audited Financial Statements)

As adopted, Exhibit 11 requires an applicant to furnish audited financial statements for the past three fiscal or calendar years immediately preceding the date of the application. An NRSRO will not be required to make this information publicly available pursuant to Section 15E(a)(3) of the Exchange Act[216] and Rule 17g–1(i) thereunder or update the Exhibit after registration.[217] An NRSRO will be required to provide audited financial statements to the Commission annually under Rule 17g–3.

The Commission continues to believe this financial information is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in making the finding required by Section 15E(a)(2)(C) of the Exchange Act.[218] 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 pursuant to Section 15E(1)(B) of the Exchange Act and established pursuant to the Sections 15E(g), (h), (i) and (j) of the Exchange Act.[219] The financial statements will provide the Commission with information as to the applicant's net worth and income, which will assist the Commission in determining whether the applicant has sufficient financial resources. Financial statements for three years will assist the Commission in reviewing whether the applicant has been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration.[220] The information also will 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 requirement that the financial statements be audited will provide the Commission with independent verification of the information in the statements. However, the Commission anticipates that some applicants may not have been audited in the past. Consequently, the instructions to the Exhibit provide that in this case the applicant may provide an audited financial statement for the fiscal year immediately preceding the date of the application. The prior years can be covered by unaudited financial statements. The instructions also provide that the applicant must attach a statement by a duly authorized person that the unaudited financial statements present fairly, in all material respects, the financial condition, results of operations, and the cash flows of the applicant. This will provide a level of assurance that the information in the financial statements has been reviewed and verified by the applicant.

Finally, the Commission anticipates that some applicants will be subsidiaries of holding companies. In this case, the applicant may provide audited consolidated financial statements of the parent company. Consolidated financial statements will provide information on the financial strength of the credit rating agency's parent. The parent is in a position to support the credit rating agency and, consequently, its financial condition may be indicative of the financial resources of the credit rating agency. Further, the information on revenues elicited in Exhibit 12 will augment the financial statements by providing information specific to the credit rating agency.

Several commenters sought clarification on whether the financial statements provided in Exhibit 11 must be prepared in accordance with Regulation S–X.[221] The Commission's intent with respect to Exhibit 11 is that applicants, to the extent possible, will be able to provide financial statements that have already been prepared for other reasons.

Two commenters also requested that the proposed rule be modified to permit an NRSRO to furnish a tax return prepared by an accountant in lieu of audited financial statements.[222] The Commission believes a tax return will not provide sufficient detail about an applicant's financial condition. For example, it would not provide the information that can be derived from a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity. Moreover, as indicated above, the Commission believes it is important to have an auditor provide independent verification that all this information is presented fairly, in all material respects.

For these reasons, the Commission is adopting Exhibit 11 and the instructions for the Exhibit with the modifications described above.

22. Exhibit 12 (Revenues)

As adopted, Exhibit 12 requires 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 instructions provide that this information be for the most recently completed fiscal or calendar year and is not required to be audited. An NRSRO will not be required to make this information publicly available pursuant to Section 15E(a)(3) of the Exchange Act[223] and Rule 17g–1(i) thereunder or update the Exhibit after registration.[224] An NRSRO will be required to update this information in an unaudited financial report furnished to the Commission under Rule 17g–3.

Two commenters stated that the Exhibit should be eliminated because it was unnecessary given the submission of financial statements in Exhibit 11.[225] The Commission continues to believe that this information is necessary or appropriate in the public interest or for the protection of investors. It will assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act[226] by providing detail as to the revenues generated by different types of credit rating services. Financial statements alone may not separate out or itemize revenues earned from credit rating services as opposed to other services. For example, an applicant that has earned less revenue from credit rating services than its total credit analyst compensation may not be able to

[215] 15 U.S.C. 78o–7(a)(1)(B)(viii).

[216] 15 U.S.C. 78o–7(a)(3).

[217] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[218] *See* 15 U.S.C. 78o–7(a)(2)(C).

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

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

[221] *See* DBRS Letter; Fitch Letter; Moody's Letter.

[222] *See* Letter dated March 12, 2007 from Sean Egan, President, Egan-Jones Ratings Company (''EJR Letter''); LACE Letter.

[223] 15 U.S.C. 78o–7(a)(3).

[224] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[225] *See* S&P Letter; AEI Letter.

[226] *See* 15 U.S.C. 78o–7(a)(2)(C).

continue to support this business line at levels consistent with the statutory mandate.

One commenter stated that the determination of the revenue amounts should be made using a ''net revenue'' definition that permits flexibility in terms of how revenue is recognized.[227] As with Exhibit 10 and Rule 17g–3, the Commission intends that the credit rating agency apply its standard accounting convention for recognizing revenue as this will make revenue calculations consistent across the various financial reports required in Form NRSRO and Rule 17g–3.

Another commenter, with respect to Rule 17g–3, requested the elimination of a requirement to separately report revenues from determining private credit ratings (*i.e.*, credit ratings that are not made readily accessible to the public).[228] The commenter stated that it would be difficult to separate private ratings revenue from public ratings revenue. In an effort to reduce burden, the Commission has eliminated the requirement to separately itemize revenue from private ratings. The private ratings revenue must be included in the revenue item for determining or maintaining credit ratings.

Two commenters disagreed on the information that should be included in the revenue item relating to subscribers.[229] One commenter stated that the item should include revenue from subscribers to an applicant's credit analysis in addition to credit ratings subscribers.[230] The other commenter stated that the item should only apply to credit ratings subscribers.[231] The Commission intends the Exhibit to include both types of subscribers. The Commission believes separating out revenues from these two types of subscribers could be difficult in that some credit rating agencies may offer subscriptions that include access to credit ratings and credit analysis. Furthermore, some credit rating agencies make their credit ratings available for free but charge subscribers for credit ratings data and credit analysis. The Commission believes there is no reason to distinguish between a subscriber to credit ratings and a subscriber to credit ratings data and analysis in this context.

For these reasons, the Commission is adopting Exhibit 12 and the instructions for the Exhibit with the modifications described above.

23. Exhibit 13 (Analyst Compensation)

As adopted, Exhibit 13 will require an applicant to disclose to the Commission the amount of total aggregate annual compensation paid to its credit analysts and the median compensation. The instructions provide that the information must be for the most recently completed fiscal or calendar year and will not have to be audited. An NRSRO will not be required to make this information publicly available pursuant to Section 15E(a)(3) of the Exchange Act[232] and Rule 17g–1(i) thereunder or update the Exhibit after registration.[233] An NRSRO will be required to update this information in a financial report furnished to the Commission under Rule 17g–3.

One commenter stated that the information may not be necessary given the different sizes and business models of credit rating agencies.[234] The Commission continues to believe this compensation information is necessary or appropriate in the public interest or for the protection of investors. It will assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act.[235] Similar to the revenue information, this information will augment the financial statements that are required under Exhibit 11 because it provides detail on the expenses necessary to retain the credit rating agency's credit analysts. The Commission will compare this information with the revenues earned by the applicant for credit ratings services to evaluate an applicant's financial condition.

For these reasons, the Commission is adopting Exhibit 13 and the instructions for the Exhibit with the modifications described above.

C. Rule 17g–2—Recordkeeping

The Rating Agency Act amended 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.[236] 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.[237]

The Commission is implementing this rulemaking authority through Rule 17g–2. This rule requires an NRSRO to make and retain certain records relating to its business and to retain certain other business records made in the normal course of business operations. The rule also prescribes the time periods and manner in which all these records will be required to be retained.

Several commenters stated that Rule 17g–2 as proposed was unduly burdensome or onerous.[238] The Commission believes the rule is necessary or appropriate in the public interest or for the protection of investors and narrowly tailored to achieve its purpose.[239] The Commission designed the rule based on its experience with recordkeeping rules for other regulated entities.[240] These other books and records rules have proven integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.[241] Rule 17g–2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission in monitoring, through its examination authority, whether an NRSRO is complying with the provisions of Section 15E of the Exchange Act[242] and the rules thereunder. For example, examiners will use the records to review whether an NRSRO is following its disclosed procedures and methodologies for determining credit ratings, its disclosed policies and procedures for preventing the misuse of material nonpublic

[227] *See* Moody's Letter.

[228] *See* Fitch Letter.

[229] *See* Gross Letter; R&I Letter.

[230] *See* Gross Letter.

[231] *See* R&I Letter.

[232] 15 U.S.C. 78o–7(a)(3).

[233] An applicant can request that this information be kept confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[234] *See* AEI Letter.

[235] *See* 15 U.S.C. 78o–7(a)(2)(C).

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

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

[238] *See, e.g.,* FSR Letter; AEI Letter.

[239] Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o–7(c)(2)) requires that the Commission's rules under the Rating Agency Act be narrowly tailored.

[240] *See, e.g.,* 17 CFR 240.17a–3 and 17a–4 (broker-dealers); 17 CFR 275.204–2 (investment advisers); 17 CFR 240.17Ad–6 and 17Ad–7 (transfer agents).

[241] *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 recordkeeping 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.'').

[242] 15 U.S.C. 78o–7.

information, and managing conflicts of interest, and whether it is complying with Rules 17g–4, 17g–5, and 17g–6 discussed below.

Nonetheless, the Commission is adopting Rule 17g–2 with modifications to address issues commenters raised, to reduce burden, and to enhance recordkeeping requirements with respect to the issuance of credit ratings on certain asset-backed and mortgage-backed securities transactions. As a preliminary matter, the Commission notes that several commenters raised concerns with how examiners would use the books and records required under Rule 17g–2.[243] One commenter requested that the Commission clarify that examiners would not use their inspection of records to second-guess credit rating opinions.[244] The Commission does not intend that Rule 17g–2 be used as a means to substitute the Commission's judgment for that of an NRSRO with respect to the NRSRO's credit rating opinion.

Further, Section 15E(c)(2) of the Exchange Act provides that the Commission may not ''regulate the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings.'' [245] The purpose of the recordkeeping requirements in Rule 17g–2 is to allow examiners to review whether an NRSRO is following its stated procedures and methodologies and otherwise complying with Section 15E of the Exchange Act [246] and the rules thereunder. It is important that users of credit ratings be given the opportunity to understand how a specific NRSRO determines its credit ratings. Consequently, Sections 15E(a)(1)(B)(ii) and 15E(a)(3) of the Exchange Act require an NRSRO to make this information publicly available.[247] The Commission's role is to examine whether an NRSRO has accurately disclosed this information so that users of credit ratings can assess its credit rating procedures and methodologies. The Commission's role also is to examine whether an NRSRO adheres to its credit rating procedures and methodologies.

A second commenter raised the concern that using records to examine whether an NRSRO has accurately disclosed information about how it determines credit ratings would result in the Commission's tacit endorsement of the credit ratings.[248] The Commission reiterates that the purpose of examining these records is to review whether an NRSRO has accurately disclosed information about, and adheres to, the procedures and methodologies it uses to determine credit ratings. As noted above, the Commission cannot ''regulate the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings.'' [249] Users of credit ratings should not view the fact that the Commission has examined whether an NRSRO has accurately disclosed information about, and adheres to, its credit rating procedures and methodologies as an endorsement of the credit ratings or the procedures and methodologies used to determine the credit ratings. Users of credit ratings must evaluate a given NRSRO's procedures and methodologies for themselves and reach their own conclusions as to the quality of the procedures and methodologies. The Commission's role is limited to reviewing whether the information disclosed by an NRSRO is consistent with how the NRSRO conducts its credit rating activities. The Commission also notes that Section 15E(f) of the Exchange Act bars an NRSRO from representing that it has been ''designated, sponsored, recommended, or approved, or that [its] abilities or qualifications. * * * have in any respect been passed upon, by the United States, or any agency, officer, or employee thereof.'' [250]

Finally, another commenter stated that the recordkeeping rule should be principles based and permit an NRSRO to implement a recordkeeping system appropriate for its organizational structure and business model.[251] The Commission does not intend that Rule 17g–2 require a specific form of record or recordkeeping system. An NRSRO will have the flexibility to implement a recordkeeping system that captures the records required in Rule 17g–2 in a manner that conforms to the NRSRO's internal processes. At the same time, as noted above, Rule 17g–2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission in monitoring, through its examination authority, whether an NRSRO is complying with the provisions of Section 15E of the Exchange Act [252] and the rules thereunder. The Commission believes that a principles based recordkeeping rule would be difficult to administer. It could lead to inconsistent recordkeeping by NRSROs and also create uncertainty for NRSROs and Commission examiners as to the records that must be retained. The Commission believes the better approach is to prescribe certain records that must be made and retained at a minimum to provide for consistent recordkeeping requirements across all NRSROs.

1. Paragraph (a) of Rule 17g–2

As adopted, paragraph (a) of Rule 17g–2 requires an NRSRO to make and retain certain books and records. The records required under paragraph (a) must be complete and current and not contain inaccurate information.[253] With respect to the specific records required under paragraph (a), the Commission has made several modifications in light of comments that will ease the recordkeeping burden. The Commission believes the records required in this paragraph are necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. As described below, they will assist the Commission in monitoring whether an NRSRO is complying with Section 15E of the Exchange Act and the rules thereunder.[254]

a. Paragraph (a)(1) of Rule 17g–2

As adopted, paragraph (a)(1) of Rule 17g–2 requires an NRSRO to make records of original entry into an NRSRO's accounting system, and records reflecting entries to and balances in all general ledger accounts of the NRSRO for each fiscal year. Rule 17g–2, as proposed, contained a similar provision. The Commission believes these fundamental business records are necessary for the preparation of the financial reports required to be prepared under Rule 17g–3. In addition, they will assist Commission examiners in reviewing the financial resources of an NRSRO and its revenue sources. The latter information will be important in identifying customers that provide an NRSRO with significant revenues and, consequently, could be in a position to exercise undue influence over a credit rating decision.

One commenter stated that, while it already maintains these types of records, the requirement to make them

[243] *See* DBRS Letter; Langohr Letter.

[244] *See* DBRS Letter.

[245] 15 U.S.C. 78o–7(c)(2).

[246] 15 U.S.C. 78o–7.

[247] 15 U.S.C. 78o–7(a)(1)(B)(ii) and 15 U.S.C. 78o–7(a)(3).

[248] *See* Langohr Letter.

[249] 15 U.S.C. 78o–7(c)(2).

[250] 15 U.S.C. 78o–7(f).

[251] *See* Moody's Letter.

[252] 15 U.S.C. 78o–7.

[253] *See, e.g., In the Matter of SG Cowens Securities Corporation*, Exchange Act Release No. 48335 (August 14, 2003) (''Implicit in the Commission's recordkeeping rules is the requirement that information in a required book or record be accurate.'').

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

should be eliminated because the information in the Rule 17g–3 financial reports will be sufficient.[255] The Commission believes it is important that an NRSRO make and retain these records. They will provide Commission examiners with the source information that feeds into the Rule 17g–3 financial reports. Further, those financial reports are a snap shot of the NRSRO's financial condition as of its fiscal year end. These records will provide examiners with current financial information as of the time of their exam. For these reasons, the Commission is adopting paragraph (a)(1) of Rule 17g–2 substantially as proposed.

b. Paragraph (a)(2) of Rule 17g–2

As adopted, paragraph (a)(2) of Rule 17g–2 requires an NRSRO to make the following records with respect to each of the NRSRO's current credit ratings, as applicable: The identity of any credit analyst(s) that participated in the determination of the credit rating; the identity of the person(s) who approved the credit rating before it was issued; whether the credit rating was solicited or unsolicited; and the date the credit rating action was taken. This information will assist the Commission in monitoring whether the NRSRO is following its procedures and methodologies for determining credit ratings and whether the NRSRO is complying with procedures designed to prevent the misuse of material nonpublic information. For example, if questions arise about a particular credit rating, the record will provide the Commission staff with the names of the credit analysts that participated in determining the credit rating and the persons that approved the credit rating. This will identify for the Commission staff the persons with the best information as to how the credit rating was determined.

Rule 17g–2, as proposed, also would have required a record identifying the procedures and methodologies used to determine the credit rating and the method by which the credit rating was made publicly available. The Commission has eliminated these requirements to reduce recordkeeping burden and because Commission examiners can ascertain the information through a less burdensome requirement.[256] Under paragraph (a)(6) of Rule 17g–2, an NRSRO is required to separately document the procedures and methodologies it uses to determine credit ratings. The Commission examination staff will be able to refer to these records to understand how specific types of credit ratings are determined by the NRSRO. Therefore, examiners will not need an individual record identifying the methodology used to determine each credit rating. For similar reasons, the Commission has eliminated the proposed requirement to make a record of the method by which each credit rating was made readily accessible. An NRSRO must disclose in Form NRSRO how it makes its credit ratings readily accessible. Commission examiners can review this disclosure to understand how a specific credit rating was made readily accessible.

The Commission notes, however, that if an NRSRO materially diverges from its stated methodology for determining a specific type of credit rating or for making credit ratings readily accessible, it may violate the requirements to disclose in Form NRSRO information about credit ratings methodologies and how credit ratings are made readily accessible and, in the former case, the requirement in paragraph (a)(6) to document the procedures and methodologies for determining credit ratings. Consequently, an NRSRO must include in its documented procedures any alternative methodologies for determining a specific type of credit rating and when such alternatives may be used by a credit analyst.

Finally, consistent with changes to Form NRSRO discussed above, the final rule changes the requirement proposed in Rule 17g–2(a)(2) to identify the credit analysts ''who determined'' the credit rating to credit analysts ''who participated in determining'' the credit rating. In all other respects, the Commission is adopting paragraph (a)(2) of Rule 17g–2 substantially as proposed.

c. Paragraph (a)(3) of Rule 17g–2

As adopted, paragraph (a)(3) of Rule 17g–2 requires an NRSRO to make an account record for each person (for example, an obligor, issuer, underwriter, or other user) that has paid for the issuance or maintenance of a credit rating indicating the identity and address of the person and the credit ratings determined or maintained for the person. This information will assist the Commission in monitoring whether the NRSRO is complying with procedures for addressing and managing conflicts of interest as well as complying with the requirements in Rule 17g–5 prohibiting certain conflicts of interest. For example, examiners can use this record to identify persons that have paid the NRSRO for a significant number of credit ratings (*e.g.*, a regular sponsor of structured products). These persons, given the large volume of business they provide the NRSRO, may be in a position to exert inappropriate influence on the NRSRO to issue favorable credit ratings.

One commenter pointed out that by using the term ''solicits'' the rule could be construed to require a record of each person that asks the NRSRO to issue a credit rating, regardless of whether the person ultimately pays for the credit rating or the NRSRO ultimately issues the credit rating.[257] The Commission agrees that the rule text, as proposed, contained a degree of ambiguity. Further, the Commission believes it could be difficult and unduly burdensome to create a record of each person who approaches the NRSRO about having a credit rating issued. For example, some contacts between the NRSRO and a person may never progress beyond initial inquiries. For these reasons, the Commission modified the rule to clarify that the requirement is limited to persons who pay for credit ratings that are issued publicly.

The Commission also modified paragraph (a)(3) of Rule 17g–2 by eliminating the requirement to provide the customer's ''principal'' address. The term ''principal address'' has a legal meaning in some contexts and, accordingly, could unduly complicate the process of creating the record. The rule now requires the customer's ''address'' without regard to whether it is the principal address. In all other respects, the Commission is adopting paragraph (a)(3) of Rule 17g–2 substantially as proposed.

d. Paragraph (a)(4) of Rule 17g–2

As adopted, paragraph (a)(4) of Rule 17g–2 requires an NRSRO to make an account record for each subscriber to the credit ratings and/or credit analysis reports of the NRSRO indicating the identity and address of the subscriber. This information will assist the Commission in monitoring whether the NRSRO was complying with its procedures for addressing and managing conflicts of interest and the handling of material, nonpublic information as well as complying with the requirements in Rule 17g–5 prohibiting certain conflicts of interest. The Commission did not receive any comments on this provision.

[255] *See* Fitch Letter.

[256] Several commenters requested that the Commission eliminate the requirement to make a record identifying the procedures and methodologies used to determine the credit rating. *See* DBRS Letter; Fitch Letter; Moody's Letter; Langohr Letter. These commenters argued, among other things, that the requirement interfered with the process of determining credit ratings, was not consistent with normal practice, and was burdensome. *Id.*

[257] *See* Fitch Letter.

For the reasons discussed above with respect to paragraph (a)(3) of Rule 17g–2, the Commission has modified the provision to eliminate the reference to a customer's ''principal'' address. In all other respects, the Commission is adopting paragraph (a)(4) of Rule 17g–2 substantially as proposed.

e. Paragraph (a)(5) of Rule 17g–2

As adopted, paragraph (a)(5) of Rule 17g–2 requires an NRSRO to make a record listing the general types of services and products offered by the NRSRO. This record will provide the Commission with details of the ancillary business activities of the NRSRO and, therefore, will be useful in identifying potential conflicts of interest that arise from such activities. Commission examiners then will be able to review whether the NRSRO has implemented procedures to manage these potential conflicts.

One commenter pointed out that the rule text as proposed could be construed to require a record each time the NRSRO made an offer to provide a service to a customer.[258] This was not the intent of the proposed requirement. Rather, it was to require a record listing the general types of services the NRSRO offers. The record is designed to provide Commission examiners with a way to quickly understand the NRSRO's business model based on the types of services and products it provides to persons. The record does not require an entry for each offer to a person or transaction with a person. The final rule has been modified to clarify that the provision only requires a list of the types of services offered by the NRSRO. In all other respects, the Commission is adopting paragraph (a)(5) of Rule 17g–2 substantially as proposed.

f. Paragraph (a)(6) of Rule 17g–2

As adopted, paragraph (a)(6) of Rule 17g–2 requires an NRSRO to make a record documenting the established procedures and methodologies used by the NRSRO to determine credit ratings. This provision is being added to Rule 17g–2 in response to comments regarding Exhibit 2 to Form NRSRO, which, as proposed, required an NRSRO to attach the procedures and methodologies to the Form and make them publicly available after registration. As discussed above, Exhibit 2 has been modified so that it now requires a description of the procedures and methodologies as opposed to each procedure and methodology. The intent is to require sufficient information in Exhibit 2 to allow users of credit ratings to develop an understanding of how the NRSRO determines credit ratings without imposing the burden of making a voluminous submission to the Commission and public disclosure. It also is designed to avoid the public disclosure of proprietary information.

Accordingly, rather than require these procedures and methodologies to be attached to Form NRSRO and disclosed publicly, the Commission is requiring that they be documented internally. This will permit Commission examiners to review the procedures and methodologies in order to review whether the NRSRO has disclosed sufficient information about them in Form NRSRO to permit users of credit ratings to understand how the NRSRO determines credit ratings. It also will permit Commission examiners to review whether the NRSRO is adhering to its procedures and methodologies and complying with other rules.[259] For example, Rule 17g–6 prohibits, among other things, an NRSRO from issuing or modifying, or threatening to issue or modify, a credit rating contrary to the NRSRO's established procedures and methodologies. The Commission's ability to enforce this prohibition will depend in part on the NRSRO having fully documented its procedures and methodologies. As discussed below, these records also will be an important means for the Commission to gain a better understanding of the procedures and methodologies used by credit rating agencies to treat the credit ratings of other credit rating agencies when determining the overall credit rating for securities or money market instruments issued by asset pools or as part of any asset-backed or mortgage-backed securities transactions (''structured products'').

As noted above, to the extent a credit rating agency permits credit analysts to diverge from the procedures or methodologies it has established, the NRSRO must document the circumstances under which such a divergence will be permitted and the alternative procedure or methodology that must be used. In effect, documenting the divergence in this manner will make it part of the NRSRO's established procedures and methodologies and, therefore, the NRSRO will be adhering to the requirements of paragraph (a)(6) of Rule 17g–2. Failing to document when the divergence will be permitted or required will expose the NRSRO to potential violations of Rules 17g–1, 17g–2, and 17g–6.

For the foregoing reasons and the reasons discussed with respect to Exhibit 2 of Form NRSRO, the Commission is eliminating the requirement that an NRSRO attach to Form NRSRO and make publicly available its procedures and methodologies for determining credit ratings. Instead, the Commission is adopting paragraph (a)(6) of Rule 17g–2 to require that the procedures and methodologies be documented internally.

g. Paragraph (a)(7) of Rule 17g–2

As adopted, paragraph (a)(7) of Rule 17g–2 requires an NRSRO to make a record that lists each security and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the NRSRO in determining the credit rating for the security treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the NRSRO by one or more of four ways specified in the rule to determine a credit rating for the security. This provision was not proposed but is being added because of modifications to paragraph (a)(4) of Rule 17g–6, which prohibits anti-competitive practices relating to determining credit ratings for structured products. As discussed below with respect to paragraph (a)(4) of Rule 17g–6, the Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in monitoring practices in the structured product area that many commenters believe are anti-competitive.

2. Paragraph (b) of Rule 17g–2

As adopted, paragraph (b) of Rule 17g–2 requires an NRSRO to retain certain records (excluding drafts of documents) that relate to its business as a credit rating agency.[260] The records required to be retained in paragraph (b) of Rule 17g–2 are those an NRSRO makes or receives as a matter of business practice but are not records an NRSRO is required to make. The Commission believes the records required to be retained under paragraph (b) are necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of

[258] *See* Fitch Letter.

[259] *See* AFP Letter.

[260] As discussed below, several commenters sought clarification as to whether the record retention requirements in paragraph (b) of Rule 17g–2, as proposed, would apply to drafts of documents. The Commission did not intend these requirements to apply to drafts and has added language the introductory text of paragraph (b) of Rule 17g-2 excluding drafts of documents.

the Exchange Act because, as described below, they will assist the Commission in monitoring whether an NRSRO is complying with Section 15E of the Exchange Act [261] and the rules thereunder.

Since these records are not required to be made, an NRSRO will not have to update them. Rather, the NRSRO is required to 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,[262] an NRSRO must update, as provided in that section, certain information in the Forms and Exhibits that are required to be retained under paragraph (b)(9) of Rule 17g–2 (discussed below).

a. Paragraph (b)(1) of Rule 17g–2

As adopted, paragraph (b)(1) of Rule 17g–2 requires an NRSRO to retain all significant records underlying the information included in the NRSRO's annual financial reports required pursuant to Rule 17g–3. This includes bank statements, bills payable and receivable, trial balances, and records relating to the determination of the largest customers. These records will assist Commission examiners in understanding and reviewing the basis of information provided in the financial reports the NRSRO will be required to annually furnish to the Commission. For example, examiners can use the records relating to the list of the largest customers to review whether the NRSRO has identified such customers in accordance with Rule 17g–3.

The Commission received one comment on this provision.[263] The commenter stated that, while it retains these records, the requirement should be eliminated because the financial reports required in Rule 17g–3 provide sufficient information in these areas. Similar to the records required in paragraph (a)(1) of Rule 17g–2, the Commission believes it is important that an NRSRO retain these records. They will provide Commission examiners with the source information that feeds into the Rule 17g–3 financial reports. Further, as noted above, those financial reports are a snap shot of the NRSRO's financial condition as of its fiscal year end. These records will provide examiners with current information as of the time of their exam. For these reasons, the Commission is adopting paragraph (b)(1) of Rule 17g–2 substantially as proposed.

b. Paragraph (b)(2) of Rule 17g–2

As adopted paragraph (b)(2) of Rule 17g–2 requires an NRSRO to retain internal records, including nonpublic information and work papers, used to form the basis of a credit rating. These records will 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, will assist the Commission in reviewing whether an NRSRO is adhering to its established procedures and methodologies for determining credit ratings and for preventing the misuse of material nonpublic information. It also will assist the Commission in gaining a better understanding of the practices used by credit rating agencies to incorporate the credit ratings of other credit rating agencies into the overall credit rating of a structured product.

The Commission received several comments on the rule text in this paragraph as proposed.[264] The comments generally were similar in that they sought clarification that the provision does not require the retention of every record that somehow relates to the credit rating.[265] In response, the Commission notes that it did not intend the rule to be interpreted that broadly. The provision only applies to internal records and documents that are used to form the basis of the credit rating. The provision explicitly excludes publicly available information and the introductory text to paragraph (b) of Rule 17g–2 excludes drafts of documents from its provisions. The rule does not require an NRSRO to retain internal documents that a credit analyst reviews but that do not factor into the determination of the credit rating. For the foregoing reasons, the Commission is adopting paragraph (b)(2) of Rule 17g–2 substantially as proposed.

c. Paragraph (b)(3) of Rule 17g–2

As adopted, paragraph (b)(3) of Rule 17g–2 requires 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 will assist the Commission in monitoring whether the NRSRO is complying with its policies and procedures for preventing the misuse of material nonpublic information.

The Commission received several comments on the rule text of this paragraph as proposed.[266] Similar to the comments regarding paragraph (b)(2) of Rule 17g–2, the comments sought clarification that the provision does not require the retention of every potentially relevant record such as records that do not contain information that the credit analysis used to form the basis of conclusions in the report.[267] In response to these comments, the Commission notes that it does not intend the rule to be interpreted to apply to internal documents that a credit analyst reviews but that do not factor into the conclusions in the final report. Further, the provision explicitly excludes publicly available information and the introductory text to paragraph (b) of Rule 17g–2 excludes drafts of documents from its provisions. Consequently, the Commission is adopting paragraph (b)(3) of Rule 17g–2 substantially as proposed.

d. Paragraph (b)(4) of Rule 17g–2

As adopted, paragraph (b)(4) of Rule 17g–2 requires an NRSRO to retain compliance reports and compliance exception reports. The retention of these reports will identify activities of the NRSRO that its designated compliance officer had determined raised, or did not raise, compliance and control issues. Commission examiners will then be able to review how the NRSRO addressed the compliance issues. This can lead to more focused examinations, which also will decrease the burden on the NRSRO. The reports also will provide information as to whether the NRSRO is

[261] 15 U.S.C. 78o–7.

[262] *See* 15 U.S.C. 78o–7(b)(1).

[263] *See* Fitch Letter.

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

[265] *Id.*

[266] *See* Letter dated March 8, 2007 from John B. Rutherfurd, Jr. (''Rutherfurd Letter''); DBRS Letter; Fitch Letter; Moody's Letter; S&P Letter.

[267] *Id.*

complying with its established methodologies, procedures, and policies.

The Commission received two comments on this provision.[268] One commenter stated that it should be narrowed to exclude compliance reports that do not find any deficiencies.[269] The commenter stated that Commission examiners might use reports that do not contain deficiencies to second-guess the designated compliance officer.[270] As noted above, compliance reports that do not contain deficiencies will be useful to examiners in terms of focusing exams. This commenter also stated that the provision should not apply to whistleblower reports. The Commission understands the concern that including whistleblower reports with the provision's scope could have a chilling effect on an employee's willingness to report violations, particularly in smaller organizations. For the purposes of this rule, the Commission does not view a whistleblower report as a final compliance report or a compliance exception report. It is an allegation made by someone within the organization about inappropriate or unlawful conduct. However, any final report of the NRSRO's compliance officer resulting from the allegations or disclosures contained in the report of a whistleblower will be a compliance report subject to this provision. The compliance officer's final compliance report on the matter can be drafted in a manner to protect the whistleblower by not identifying the person.

The other commenter stated that the Commission should clarify that the rule does not require the retention of draft reports.[271] In response, the Commission notes, as discussed above, that it did not intend the rule to be interpreted to require the retention of draft reports and other interim work product. The Commission has clarified this by adding introductory text to paragraph (b) of Rule 17g–2 that excludes drafts of documents from its provisions. For the foregoing reasons, the Commission is adopting paragraph (b)(4) of Rule 17g–2 substantially as proposed.

e. Paragraph (b)(5) of Rule 17g–2

As adopted, paragraph (b)(5) of Rule 17g–2 requires an NRSRO to retain internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by its internal auditors as necessary to perform the audit of an activity that relates to its business as a credit rating agency. The retention of these records will identify activities of the NRSRO that its internal auditors had determined raised, or did not raise, compliance or control issues. They also will assist the Commission in reviewing whether the NRSRO is complying with its established methods, procedures, and policies.

The Commission received two comments on this provision.[272] The first commenter requested that the provision be deleted because it would chill NRSROs from establishing robust internal audit departments.[273] The Commission continues to believe these are important records that will assist the Commission examination staff in understanding a given NRSRO's internal operations and activities. As noted above, one of the Commission's oversight roles is to review whether an NRSRO is accurately disclosing information about, and adhering to, its procedures and methodologies for determining credit ratings. Reports of an NRSRO's internal auditors can provide highly useful information to assist the Commission in performing this regulatory function. The Commission notes that the provision requires an NRSRO to maintain internal audit records for three years. This retention period is designed to provide Commission examiners with the opportunity to review them. Finally, the Commission staff's experience with reviewing supervised entities such as broker-dealers and broker-dealer holding companies has not indicated that having access to internal audit reports chills the robust functioning of their internal audit departments.

The second commenter requested that the Commission clarify that the provision only requires the retention of final internal audit reports and not interim work product.[274] In response, the Commission notes that it does not intend the provisions to apply to drafts of internal audit records and, as noted above, has added introductory text to paragraph (b) of Rule 17g–2 that excludes drafts of documents from its provisions. The commenter also requested that the provision permit an NRSRO to tailor its internal audit records to its business plan.[275] In response, the Commission notes that the provision only requires an NRSRO to retain internal audit records. It does not specify the types of audit records that must be made. An NRSRO is free to establish an internal audit process that is tailored to its business model. Finally, this commenter requested that the Commission clarify that the provision does not require an NRSRO that is a public company to retain financial reporting internal auditing reports beyond those required under the Exchange Act.[276] The Commission notes that Rule 17g–2 requires an NRSRO to retain internal audit reports that relate to its business as a credit rating agency. The NRSRO must determine whether an internal audit report created under a statutory or regulatory requirement is one that relates to its credit rating business and, therefore, must be retained under this provision.

For the foregoing reasons, the Commission is adopting paragraph (b)(5) of Rule 17g–2 substantially as proposed.

f. Paragraph (b)(6) of Rule 17g–2

As adopted, paragraph (b)(6) of Rule 17g–2 requires an NRSRO to retain copies of marketing materials that are published or otherwise made available to persons that are not associated with the NRSRO. 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.[277] The retention of marketing materials will assist the Commission in reviewing whether the NRSRO is complying with this statutory provision.

The Commission received two comments on the provision.[278] One commenter sought clarification that it does not apply to internal documents of the marketing department.[279] The second commenter requested that the Commission provide guidance on the meaning of ''marketing materials.''[280] The Commission intended that the provision only apply to materials that are actually used to market the NRSRO's credit rating services. The Commission has modified the rule text to clarify that the requirement only applies to marketing materials that are published or otherwise made available to persons who are not associated with the NRSRO. The Commission does not intend that the provision be interpreted to apply to records that are used by the marketing department for internal purposes. This modification is designed to provide greater clarity on the marketing materials that must be retained. In

[268] *See* DBRS Letter; Moody's Letter.

[269] *See* DBRS Letter.

[270] *Id.*

[271] *See* Moody's Letter.

[272] *See* DBRS Letter; Moody's Letter.

[273] *See* DBRS Letter.

[274] *See* Moody's Letter.

[275] *Id.*

[276] *Id.*

[277] 15 U.S.C. 78o–7(f).

[278] *See* R&I Letter; DBRS Letter.

[279] *See* R&I Letter.

[280] *See* DBRS Letter.

response to the second commenter, the Commission notes that marketing materials, generally, will include any written documents that an NRSRO publishes or provides to persons that explain or describe its credit rating services and are designed to induce persons to purchase the services.

In all other respects, the Commission is adopting paragraph (b)(6) of Rule 17g–2 substantially as proposed.

g. Paragraph (b)(7) of Rule 17g–2

As adopted, paragraph (b)(7) of Rule 17g–2 requires an NRSRO to retain external and internal communications, including electronic communications, received and sent by the nationally recognized statistical rating organization and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating. The Commission received several comments on the proposed rule text of the paragraph.[281] The commenters all stated generally that the requirement was overbroad and should be narrowed.[282] One suggested that it only require external communications.[283] Two suggested it only require communications used by a credit analyst to form the basis of a credit rating.[284] Another commenter suggested the provision should have a materiality threshold.[285]

In response to these comments, the Commission notes that 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.[286] The Commission believes that internal communications will play an important role in assisting the Commission in identifying legal violations and compliance issues in its oversight of NRSROs. For example, paragraph (a)(4) of Rule 17g–6 prohibits certain practices if they are undertaken with anti-competitive intent. The ability of the Commission to prove intent will be difficult absent communications that demonstrate why an NRSRO engaged in a particular act. Further, the Commission believes that narrowing the provision to communications used by a credit analyst to form the basis of a credit rating would carve out highly relevant communications, including communications that could be relevant to compliance with Rule 17g–4 (nonpublic information), Rule 17g–5 (conflicts of interest), and, as noted above, Rule 17g–6 (prohibited practices). Finally, the Commission believes that a materiality threshold would be very difficult to comply with and enforce. The degree of materiality of a communication viewed in isolation may not be apparent. In some cases, a seemingly innocuous communication may in fact be highly material when placed in the context of related events and other communications.

For the foregoing reasons, the Commission is adopting paragraph (b)(7) of Rule 17g–2 substantially as proposed.

h. Paragraph (b)(8) of Rule 17g–2

As adopted, paragraph (b)(8) of Rule 17g–2 requires an NRSRO to retain internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another NRSRO for the purpose of determining a credit rating of a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.[287] This provision was not proposed but is being added because of modifications to paragraph (a)(4) of Rule 17g–6, which prohibits anti-competitive practices relating to determining credit ratings for structured products. As discussed below with respect to paragraph (a)(4) of Rule 17g–6, the Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in monitoring practices in the structured product area that many commenters believe are anti-competitive.

i. Paragraph (b)(9) of Rule 17g–2

As adopted, paragraph (b)(9) of Rule 17g–2 requires an NRSRO to retain for each security identified in the record required under paragraph (a)(7) of Rule 17g–2, any document that contains a description of how any assets within such pool or as a part of such transaction not rated by the NRSRO but rated by another NRSRO were treated for the purpose of determining the credit rating of the security. This provision was not proposed but is being added because of modifications to paragraph (a)(4) of Rule 17g–6, which prohibits anti-competitive practices relating to determining credit ratings for structured products. As discussed below with respect to paragraph (a)(4) of Rule 17g–6, the Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in monitoring practices in the structured product area that many commenters believe are anti-competitive.

j. Paragraph (b)(10) of Rule 17g–2

As adopted, paragraph (b)(10) of Rule 17g–2 requires an NRSRO to retain Form NRSROs (including Exhibits and accompanying information and documents) submitted to the Commission. This provision will make the Forms and Exhibits subject to the retention and production requirements in Rule 17g–2. For example, NRSROs will be required to retain them in a manner that makes them easily accessible to the NRSRO's principal office. This will assist Commission examiners, particularly examiners in regional offices, in accessing the records on site during an examination.

The Commission did not receive any comments on the proposed rule text in this paragraph (proposed as paragraph (b)(9)) and is adopting it substantially as proposed.

3. Paragraph (c) of Rule 17g–2

As adopted, paragraph (c) of Rule 17g–2 requires an NRSRO to retain the records identified in paragraphs (a) and (b) for three years after the date the record is made or received. The Commission believes the three-year retention period is necessary or appropriate in the public interest or for the protection of investors because it is designed to ensure that the records are preserved for at least one internal audit or Commission exam cycle.

The proposed rule, however, articulated different retention periods for the records identified in paragraphs (a)(2) and (a)(3); namely, for three years after the NRSRO's business relationship with the person ended. The Commission received a number of comments on this proposed retention period all of which stated that it was either too long or

[281] *See* ASF Letter; Rutherfurd Letter; DBRS Letter; Fitch Letter; S&P Letter.

[282] *Id.*

[283] *See* DBRS Letter.

[284] *See* Rutherfurd Letter; S&P Letter.

[285] *See* Fitch Letter.

[286] *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).

[287] As proposed, paragraph (b)(8) required an NRSRO to retain a record required to be made under paragraph (b) of proposed Rule 17g–6. The record required under paragraph (b) of proposed Rule 17g–6 would have documented when an NRSRO refused to issue or withdrew a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage backed securities transaction. This proposed provision in Rule 17g–6 has been eliminated and, therefore, the requirement to retain this record in Rule 17g–2 also has been eliminated.

unclear.[288] The Commission believes there has been some confusion regarding the retention requirement for these records. The proposed rule was designed so that an NRSRO would retain the last version of an account record for three years after the account was closed. The Commission believes the simpler and clarified text in the adopted version of the rule is designed to ensure this record is retained for this period.

In other respects, paragraph (c) of Rule 17g–2 is being adopted substantially as proposed.

4. Paragraph (d) of Rule 17g–2

As adopted, paragraph (d) of Rule 17g–2 requires an NRSRO to maintain an original, or a true and complete copy of the original, of each record required to be retained pursuant to paragraphs (a) and (b) of Rule 17g–2 in a manner that, for the applicable retention period specified in paragraph (c) of Rule 17g–2, makes the original record or copy easily accessible to the principal office of the NRSRO and to any other office that conducted activities causing the record to be made or received. The Commission believes this rule is necessary or appropriate in the public interest or for the protection of investors because it is designed to facilitate Commission examination of the NRSRO and to avoid delays in obtaining the records during an on-site examination. The rule does not specify the format in which the records must be retained. Consequently, NRSROs may retain them in, for example, paper form, on microfilm or microfiche, or electronically.

The Commission did not receive any comments on this provision and is adopting it substantially as proposed.

5. Paragraph (e) of Rule 17g–2

As adopted, paragraph (e) of Rule 17g–2 provides that an NRSRO can use the services of a third-party record custodian to make and retain the records identified in paragraphs (a) and (b), provided the NRSRO furnishes the Commission with a written undertaking of the custodian. The rule prescribes the form of the undertaking; namely, that the third-party must represent that the records are the exclusive property of the NRSRO, will be produced promptly to the NRSRO or the Commission or its representatives at the request of the NRSRO, and will be available for inspection by the Commission or its representatives. The rule also provides that an NRSRO remains responsible for complying with the Commission's books and records rules, notwithstanding the fact that a third-party is making and/or storing them. The Commission believes this rule is necessary or appropriate in the public interest or for the protection of investors because it 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.

The Commission received three comments on this provision.[289] One commenter stated that the form of the undertaking could conflict with certain foreign business practices and, therefore, suggested that the NRSRO be required to provide the undertaking.[290] The Commission notes, however, that the undertaking is designed to ensure that a third-party custodian is under a direct obligation to produce the records to the Commission and its representatives. An NRSRO already is obligated under Section 17(b)(1) of the Exchange Act and Rule 17g–2 to produce these records.[291] This obligation is in no way diminished because a third-party custodian is holding the records. The undertaking establishes a direct obligation on the third-party to produce the records to the Commission and its representatives. This direct obligation will be particularly important in situations where the NRSRO is unable or unwilling to request that the third-party produce the records.

The second commenter requested that the form of the undertaking be modified in a manner that would obligate the third-party to only comply with ''reasonable'' requests for records and only to the extent that producing the records was permitted by local law.[292] While the Commission is not codifying this suggestion into the rule, the Commission and its representatives make every effort to work with regulated entities on the scope and timing of record requests to lessen the burden and establish a production schedule that is practicable, given the circumstances.

The final commenter stated that an NRSRO should not be required to use a third-party to store its records.[293] The Commission notes that the rule does not require an NRSRO to use a third-party custodian to store its records. Rather, it provides the option for an NRSRO to use a third-party record custodian.

For these reasons, the Commission is adopting paragraph (e) of Rule 17g–2 substantially as proposed.

6. Paragraph (f) of Rule 17g–2

As adopted, paragraph (f) of Rule 17g–2 requires an NRSRO to promptly furnish the Commission or its representatives with legible, complete, and current copies, and, if specifically requested English translations, of those records of the NRSRO required to be retained under Rule 17g–2, or any other records of the NRSRO subject to examination under Section 17(b) of the Exchange Act[294] that are requested by the Commission or its representatives. As discussed in the next section, the proposed rule has been modified to incorporate a provision that the produced records be translated if necessary. The Commission believes this rule is necessary or appropriate in the public interest or for the protection of investors because it is designed to facilitate Commission examinations of NRSROs.

The Commission received one comment on the provision.[295] Specifically, the commenter stated that the provision should not require an NRSRO to produce compliance and audit reports because doing so could adversely impact deliberations related to these functions and chill whistleblowers. The Commission explained above how the retention of compliance and audit reports under paragraphs (b)(4) and (b)(5) of Rule 17g–2, respectively, will assist Commission examiners in reviewing NRSROs. However, the retention of these records without the corresponding requirement to produce them would prevent the Commission and its examiners from using the records for these purposes. Therefore, the Commission believes they must be produced upon request to the Commission and its representatives.

For these reasons, the Commission is adopting the provisions in paragraph (f) of Rule 17g–2 substantially as proposed.

7. Non-Resident NRSROs

Rule 17g–2, as proposed, contained provisions in two paragraphs (paragraphs (f) and (h)) designed to address the fact that credit rating agencies not located in the U.S. may become NRSROs. After consideration of the comments and for the reasons discussed below, the Commission is eliminating these provisions from Rule 17g–2, as adopted, except for the provision concerning translating records.

[288] *See* Gross Letter; Rutherfurd Letter; R&I Letter; DBRS Letter; Fitch Letter; S&P Letter; Moody's Letter; LACE Letter.

[289] *See* R&I Letter; Fitch Letter; LACE Letter.

[290] *See* R&I Letter.

[291] 15 U.S.C. 78q(b)(1).

[292] *See* Fitch Letter.

[293] *See* LACE Letter.

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

[295] *See* Moody's Letter.

Paragraph (f) of proposed Rule 17g–2 would have required that a non-resident NRSRO must undertake to send books and records to the Commission and its representatives upon request. The undertaking would have been required to be attached to an initial application for registration as an NRSRO. The Commission explained in the proposing release that the undertaking was 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 have required a translation if the Commission requested it.

The Commission received four comments on the proposed rule text in this paragraph.[296] Generally, the commenters objected to various representations in the form of the non-resident undertaking [297] or to the requirement to provide the undertaking altogether.[298] After considering the comments, the Commission believes the requirement for non-resident NRSROs to provide a special undertaking is unnecessary. As NRSROs, they are subject to the production requirements of Section 17(b) of the Exchange Act [299] and Rule 17g–2(f). Therefore, the Commission and its representatives will not require the non-resident undertaking to compel a foreign NRSRO to produce the records. Moreover, Rule 17g–2(f), as adopted, requires the records to be ''furnished'' to the Commission. Thus, an NRSRO located outside the U.S. is required to send the records to the Commission upon request.

However, the Commission continues to believe that the representation in the proposed undertaking to provide translated records is necessary or appropriate in the public interest or for the protection of investors. Providing un-translated records to the Commission could significantly delay and hinder its oversight function. Consequently, this provision has been moved into the provisions of paragraph (f) of Rule 17g–2. In all other respects, the provisions of paragraph (f) of proposed Rule 17g–2 have been eliminated from the final rule.

The provisions of paragraph (h) of proposed Rule 17g–2 would have defined the term *non-resident rating organization* for the purpose of specifying the type of NRSRO that would have been required to provide the non-resident undertaking. The definition is no longer necessary and has been eliminated from the adopted rule.

For these reasons, the Commission is eliminating the provisions in Rule 17g–2 relating to non-resident NRSROs except for the provision concerning the translation of records.

D. Rule 17g–3—Annual Financial Reports

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis [300] and at intervals determined by the Commission, such financial statements and information concerning its financial condition as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[301] The statute also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[302] Rule 17g–3 requires an NRSRO to furnish the Commission on an annual basis certain financial reports. The furnishing of these reports will serve two important functions in the NRSRO regulatory program.

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.[303] The financial reports will assist the Commission in monitoring the NRSRO's financial resources and the resources it commits to management to evaluate whether the Commission must take action under Section 15E(d) of the Exchange Act.[304]

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.[305] Form NRSRO requires 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 is required to be as of, or for, the NRSRO's previous fiscal year. Accordingly, the information only will become materially inaccurate and, therefore, be required to be updated on an annual basis. In addition, the information will be submitted with Form NRSRO on a confidential basis to the extent permitted by law [306] and will not have to be made publicly available pursuant to Section 15E(a)(3) of the Exchange Act [307] and Rule 17g–1(i) thereunder. Therefore, because the information only will be disclosed to the Commission, it is more appropriate to require that it be updated through the Commission's authority under Section 15E(k) of the Exchange Act and Rule 17g–3 thereunder than through annual furnishings of Form NRSRO.[308]

After consideration of the comments, Rule 17g–3 has been modified in several ways. In particular, the rule has been restructured to prescribe that the audit requirement only applies to the financial statements. The proposed schedules to the financial statements are now separate financial reports that are not required to be audited. For the reasons discussed above and below, the Commission believes Rule 17g–3, as modified, is necessary or appropriate in the public interest or for the protection of investors.[309]

1. Paragraph (a) to Rule 17g–3

As adopted, paragraph (a) of Rule 17g–3 requires an NRSRO to annually furnish the Commission four, or in some cases five, financial reports. The reports must be furnished not more than 90 days after the end of the NRSRO's fiscal year and the information in the reports must be as of the most recently ended fiscal year. The reports will consist substantially of the same information that would have been in the financial statements and schedules required under Rule 17g–3, as proposed. The Commission received numerous comments requesting that the proposed schedules to the audited financial

[296] *See* AEI Letter; R&I Letter; DBRS Letter; Fitch Letter.

[297] *See*, *e.g.*, DBRS Letter.

[298] *See* AEI Letter.

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

[300] An applicant can request that the Commission keep this information confidential. *See* 17 CFR 200.80 and 17 CFR 200.83.

[301] 15 U.S.C. 78o–7(k).

[302] *Id.*

[303] 15 U.S.C. 78o–7(d).

[304] *Id.*

[305] 15 U.S.C. 78o–7(b)(1).

[306] An applicant can request that the Commission keep this information confidential. *See* 17 CFR 200.80 and 17 CFR 200.83.

[307] 15 U.S.C. 78o–7(a)(3).

[308] The Commission notes that some NRSROs may have fiscal year ends that are not on December 31. Therefore, if the Commission required that this financial information be updated through furnishing Form NRSROs, these entities would not be able to furnish the update with their annual certifications, which—pursuant to Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o–7(b)(2))—must be furnished on a *calendar* year basis.

[309] *See* 15 U.S.C. 78o–7(k).

statements not be subject to the audit requirement.[310] The comments stated generally that obtaining an audit of the information in the proposed schedules would be difficult and unduly expensive. After consideration of these comments, the Commission has modified Rule 17g–3 to eliminate the requirement that the information that would have been provided in the schedules be audited. This will lessen the burden of preparing the information for submission to the Commission. Moreover, Rule 17g–3 no longer requires that this information be submitted in schedules to the NRSRO's financial statements. Instead, the information must be furnished in separate financial reports. This is intended to clarify that the independent auditor that certifies the NRSRO's financial statements is not required to include the other unaudited financial reports in the opinion covering the financial statements.

As noted above, Rule 17g–3 requires that the financial reports be furnished within 90 days after the end of the NRSRO's fiscal year. One commenter requested that the period be lengthened to 120 days for non-resident NRSROs.[311] The Commission notes that paragraph (c) of Rule 17g–3 provides a mechanism for an NRSRO to seek an extension of the time to furnish the financial reports. An NRSRO that cannot provide its financial reports within 90 days will be able to request an extension under this provision. Therefore, the Commission does not believe it is necessary to create a different standard for non-resident NRSROs, particularly since Rule 17g–3 has been modified to make the preparation of the financial reports less burdensome.

a. Paragraph (a)(1): Audited Financial Statements

The first report, required under paragraph (a)(1) of Rule 17g–3, must contain audited financial statements of the NRSRO. Rule 17g–3, as proposed, also required the submission of audited financial statements and, as noted above, certain schedules to the financial statements. The schedules are now separate financial reports that are not required to be audited. Two commenters stated that an NRSRO that is a separately identifiable department or division of a public company should be permitted to furnish audited financial statements of its parent.[312] As noted above with respect to Exhibit 11, the Commission believes that, in this case, the financial statements of the parent provide information from which it can assess the financial resources of the NRSRO. The Commission believes, however, that certain financial information about the NRSRO must be furnished as well. For these reasons, the rule has been modified to permit an NRSRO to furnish audited consolidated financial statements of its parent; however, the NRSRO also will have to furnish unaudited consolidating financial statements under paragraph (a)(2) of Rule 17g–3 discussed below.

The audited financial statements must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity. They must be prepared in accordance with generally accepted accounting principles in the jurisdiction where the NRSRO or its parent is incorporated, organized, or has its principal office. Finally, the audited financial statements must be certified by an accountant who is qualified and independent in accordance with 17 CFR 240.210.2–01(a), (b), and (c)(1), (2), (3), (4), (5) and (8). In addition, the accountant must give an opinion on the financial statements in accordance with 17 CFR 210.2–02(a), (b), (c) and (d). The first financial report is how an NRSRO will update the information initially provided in Exhibit 11 of Form NRSRO.

The requirement to have the financial statements audited will provide the Commission with an independent verification that the information in them is presented fairly, in all material respects. The Commission received numerous comments on these audit requirements. Several commenters stated that non-resident NRSROs should be permitted to provide financial statements prepared in accordance with generally accepted accounting principles of the jurisdiction where the NRSRO is incorporated or has its principal place of business.[313] The commenters stated that preparing them according U.S. generally accepted accounting principles could be very expensive.[314] Similarly, several commenters stated that complying with certain provisions of Regulation S–X (17 CFR 210.1–01—12–29) would be unduly burdensome for non-resident NRSROs and non-reporting companies.[315]

The Commission notes that the financial statements will be prepared to assist the Commission in carrying out its oversight responsibilities with respect to monitoring the financial resources of NRSROs and not as a disclosure item for public consumption. The Commission staff will have the opportunity to discuss the financial statements with a non-resident NRSRO to gain an understanding of any material divergences from U.S. generally accepted accounting principles. Accordingly, the Commission believes that it is appropriate to permit the financial statements to be prepared in accordance with generally accepted accounting principles in the jurisdiction where the NRSRO or its parent is incorporated, organized, or has its principal office. This will lessen the burden for non-resident NRSROs and still provide the Commission with the financial information necessary to carry out its oversight responsibilities.

For these reasons, the Commission also agrees that applying many provisions of Regulation S–X would be unnecessary and, therefore, has eliminated most of this requirement from the rule. The Commission does believe that certain provisions of Regulation S–X relating to the qualifications and independence of the auditor and the auditor's attestation and the scope of the auditor's opinion are appropriate for all NRSROs, including non-residents and non-public companies. Consequently, Rule 17g–2, as adopted, eliminates the proposed requirement to comply with all the provisions of Regulation S–X. Instead, the rule requires the auditor to be qualified and independent in accordance with 17 CFR 240.210.2–01(a), (b), and (c)(1), (2), (3), (4), (5) and (8).[316] These provisions are designed to ensure that auditors are independent of their audit clients.[317] In addition, the accountant must give an opinion on the financial statements in accordance with 17 CFR 210.2–02(a), (b), (c) and (d). The retained provisions of Regulation S–X are appropriate for any audit as they relate to general standards of competence, independence, and audit work and are not specifically designed for public companies. Accordingly, the audited financial statements in Rule 17g–3 must be prepared in accordance with them.

[310] *See* DBRS Letter; A.M. Best Letter; Fitch Letter; AEI Letter; Moody's Letter.

[311] *See* R&I Letter.

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

[313] *See* Letter dated March 12, 2007 from Makoto Utsumi, President & CEO, Japan Credit Rating Agency, Ltd. (''JCR Letter''); R&I Letter; DBRS Letter.

[314] *Id.*

[315] *See* JCR Letter; R&I Letter; DBRS Letter; Fitch Letter.

[316] The Commission notes NRSROs that furnish consolidated audited financial statements of parents that are public companies should furnish those statements as they are prepared in accordance with all applicable reporting requirements for public companies, which may include adhering to all provisions of Regulation S–X.

[317] *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).

As noted with respect to Exhibit 11, two commenters also requested that the proposed rule be modified to permit an NRSRO to furnish a tax return prepared by an accountant in lieu of audited financial statements.[318] One of the commenters suggested that this lesser requirement only apply to smaller entities (less than $5 to $10 million in asset size) and could be augmented with a requirement to include with the tax return a balance sheet and income statement signed by an accountant.[319]

As discussed with respect to Exhibit 11, the Commission does not believe a tax return will provide sufficient information. Further, the Commission notes that the financial responsibility rules for broker-dealers require audited financial statements for small broker-dealers with a minimum capital requirement of $5,000.[320] The accountants performing an audit of a small NRSRO will tailor the audit and audit report to the size and complexity of the entity's business. This will keep costs for smaller NRSROs lower. This is especially true in light of the changes discussed above with respect to eliminating requirements with respect to Regulation S–X and the proposed requirement that the information proposed for the schedules be audited. Moreover, in response to the second commenter, it is unclear to the Commission in what capacity an accountant would sign financial statements short of performing an audit of them. For the purposes of Rule 17g–3, the Commission believes that the only appropriate review of the financial statements is an audit by an independent accountant. The audit, as noted above, is designed to provide a reasonable level of assurance that the financial statements are free of material misstatement.

The Commission believes that the annual audit will be integral to its ability to effectively monitor the financial resources of an NRSRO as required under Section 15E(d) of the Exchange Act, since it provides an independent verification of an NRSRO's financial condition. For these reasons, Rule 17g–3, as adopted, requires audited financial statements on an annual basis.[321]

Finally, one commenter suggested that the requirement that the audited financial statements be ''certified'' by the accountant is inconsistent with accounting practice because financial statements are either ''audited'' or ''certified.''[322] The Commission notes that the authority to require that an auditor ''certify'' the audited financial statements is set forth in Section 15E(k) of the Exchange Act.[323] Moreover, this provision is consistent with other Commission financial reporting requirements.[324] Consequently, the final rule retains the provision.

b. Paragraph (a)(2): Consolidating Financial Statements

As adopted, paragraph (a)(2) of Rule 17g–3 requires an NRSRO furnishing audited consolidated financial statements of its parent to furnish a second report containing unaudited consolidating financial statements of its parent that include the NRSRO. This will provide the Commission with information about the financial condition of the NRSRO as distinct from the financial condition of its parent. One commenter requested that this information not be subject to the audit requirement if the audited consolidated statements include operating segment reporting in accordance with Regulation S–X.[325] As noted above, this financial report is not required to be audited.

c. Paragraph (a)(3): Revenue Information

The third report, required under paragraph (a)(3) of Rule 17g–3, must contain the following unaudited information about the NRSRO's revenues: (1) Revenue from determining and maintaining credit ratings; (2) revenue from subscribers; (3) revenue from granting licenses or rights to publish credit ratings; and (4) revenue from all other services and products offered by the NRSRO. This financial report will be how an NRSRO updates the information initially provided in Exhibit 12 to Form NRSRO. This information would have been required in the first schedule to the financial statements required under Rule 17g–3, as proposed.

This information will augment the audited financial statements by providing detail as to the revenues generated specifically from credit rating services. The revenue information will assist the Commission in monitoring whether an NRSRO maintains adequate financial resources to consistently produce credit ratings with integrity.[326] As discussed with respect to Exhibit 12, one commenter requested the elimination of a requirement in the proposed rule to separately report revenues from determining private credit ratings (*i.e.*, credit ratings that are not made readily accessible to the public).[327] The commenter stated that it would be difficult to separate private ratings revenue from public ratings revenue. The Commission agrees and the requirement to separately itemize private ratings revenue has been eliminated. This revenue must be included in the revenue item for determining or maintaining credit ratings.

The Commission is adopting this provision with the modifications discussed above.

d. Paragraph (a)(4): Credit Analyst Compensation

The fourth report, required under paragraph (a)(4) of Rule 17g–3, must contain the total aggregate and median annual compensation of the NRSRO's credit analysts. The information in this report is not required to be audited. This financial report will be how an NRSRO updates the information initially provided in Exhibit 13 to Form NRSRO. This information would have been required in the second schedule to the financial statements required under Rule 17g–3, as proposed.

The information on analyst compensation will augment the audited financial statements by providing detail as to expenses necessary to retain the credit rating agency's credit analysts. This information collectively will assist the Commission in monitoring whether an NRSRO maintains adequate financial resources to consistently produce credit ratings with integrity.[328] As discussed with respect to Exhibit 13, one commenter requested that the Commission clarify how an NRSRO should treat deferred compensation.[329] The Commission believes an NRSRO should have the flexibility to include or exclude deferred compensation in making the calculation. If deferred compensation is excluded, the rule requires the NRSRO to make a note of that fact in the financial report. The Commission also believes that an NRSRO must be consistent in its approach of either including or excluding deferred compensation.

The Commission is adopting this provision with the modifications discussed above.

[318] *See* EJR Letter; LACE Letter.

[319] *See* LACE Letter.

[320] *See* 17 CFR 240.17a–5.

[321] 15 U.S.C. 78o–7(d).

[322] *See* DBRS Letter.

[323] 15 U.S.C. 78o–7(k).

[324] *See*, *e.g.*, Section 13(a) of the Exchange Act (15 U.S.C. 78m(a)) and the rules thereunder; Section 17 of the Exchange Act (15 U.S.C. 78q).

[325] *See* Moody's Letter.

[326] 15 U.S.C. 78o–7(d).

[327] *See* Fitch Letter.

[328] 15 U.S.C. 78o–7(d).

[329] *See* Fitch Letter.

e. Paragraph (a)(5): List of Large Customers

The fifth report, required under paragraph (a)(5) of Rule 17g–3, must contain a list of the NRSRO's 20 largest issuer and subscriber customers in terms of net revenue earned from the customers and, include in the list, any obligor or underwriter customers that are as large as or larger than the 20th largest issuer or subscriber customer. The information in this report is not required to be audited. This financial report will be the mechanism that an NRSRO uses to update the information initially provided in Exhibit 10 to Form NRSRO. This information would have been required in the third schedule to the financial statements required under Rule 17g–3, as proposed.

The largest customers will be determined applying the same definitions of ''net revenues'' and ''credit rating services'' used for Exhibit 10, including the changes to those definitions discussed above with respect to Exhibit 10. In addition, just as with Exhibit 10, obligor and underwriter customers must be added to the list to the extent they are as large as, or larger than, the 20th largest issuer or subscriber customer.

The list will assist the Commission in identifying conflicts arising from any influence a person may have on the NRSRO given the amount of revenue the person provides the credit rating agency.

2. Paragraph (b) of Rule 17g–3

Paragraph (b) of Rule 17g–3 requires that the NRSRO attach to each financial report provided under paragraph (a) a statement by a duly authorized person of the NRSRO that the information in the report presents fairly, in all material respects and as applicable, the financial condition, results of operations, income, cash flows, revenues, and analyst compensation of the NRSRO. This information will provide a level of assurance that the information in the financial reports has been reviewed by the NRSRO. Further, the 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.[330] This requirement was proposed in paragraph (c) of Rule 17g–3.

One commenter suggested that the Commission eliminate this requirement because it was unnecessary given the NRSRO's legal exposure for furnishing an inaccurate report.[331] The commenter stated that the requirement could dissuade a credit rating agency from registering with the Commission. The Commission believes it is important that a person within the NRSRO be responsible for reviewing the information in the financial reports and stating that they are a fair representation of its financial condition, results of operations, income, cash flows, revenues, and analyst compensation. This provision is designed to enhance the accuracy of these reports insomuch as the individual within the NRSRO will perform some level of due diligence before executing the statements. Moreover, since only the information in the first financial report will be audited, the Commission believes a person within the NRSRO must be responsible for the information in all the reports. For these reasons, the Commission is retaining the requirement in the final rule.

3. Paragraph (c) of Rule 17g–3

Paragraph (c) of Rule 17g–3 provides that the Commission may grant an extension of time or exemption from any requirements in the rule either unconditionally or on specified terms and conditions on the written request of an NRSRO, if the Commission finds that such extension or exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. This provision was proposed in paragraph (d) of Rule 17g–3. The Commission did not receive any comments on this provision and is adopting it substantially as proposed.

E. Rule 17g–4—Procedures To Prevent the Misuse of Material, Nonpublic Information

Rule 17g–4 will require an NRSRO to establish procedures to address three areas where material, nonpublic information could be inappropriately disclosed or used. Section 15E(g)(1) of the Exchange Act[332] requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[333] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures reasonably designed to prevent the misuse of material, nonpublic information.[334]

1. Paragraph (a)(1) of Rule 17g–4

Paragraph (a)(1) of Rule 17g–4 requires procedures reasonably 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.[335] Credit rating agencies have commented that this confidential information greatly assists them in issuing credible and reliable ratings.[336] In fact, the Commission's Regulation FD, which governs the disclosure of material, nonpublic information by issuers, contains an exception that permits issuers to intentionally disclose such information to a credit rating agency without making a simultaneous public disclosure of the information.[337] The selective disclosure to the credit rating agency, however, must be solely for the purpose of developing a publicly available credit rating.[338]

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.[339] If the credit analyst is in possession of material, nonpublic information, there is a risk the information may be inappropriately disclosed to the subscriber during the course of communications with the credit analyst.[340]

The rule does not prescribe specific procedures that must be established. Therefore, NRSROs will have flexibility to develop procedures tailored to their organizational structures and business

[330] 17 CFR 240.17a–5(e)(2).

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

[332] 15 U.S.C. 78o–7(g)(1).

[333] 15 U.S.C. 78a *et seq.*

[334] 15 U.S.C. 78o–7(g)(2).

[335] *See Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization*, Securities Act Release No. 8570 (April 19, 2005), 70 FR 21306 (April 25, 2005).

[336] *Id.*

[337] *See* 17 CFR 243.100.

[338] 17 CFR 243.100(b)(2)(iii).

[339] *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 nonpublic information in the possession of a credit analyst.

[340] *Id.*

models. An NRSRO may have procedures requiring credit analysts to receive training in the laws governing the misuse of material, nonpublic 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 may prohibit credit analysts from contacting rated issuers or obligors.

The Commission received one comment on this provision.[341] The commenter stated that an NRSRO should be permitted to disclose material, nonpublic information in aggregate form (*e.g.*, through usage in models) in a manner that does not identify individual issuers.[342] The Commission notes, however, that the rule, by itself, does not expressly prohibit any types of disclosures. As discussed above, Section 15E(g)(1) of the Exchange Act[343] 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 and the rules thereunder.[344] Rule 17g–4 requires an NRSRO to address the inappropriate disclosure of material, nonpublic information when establishing these procedures required by statute.

For these reasons, the Commission is adopting paragraph (a)(1) of Rule 17g–4 substantially as proposed.

2. Paragraph (a)(2) of Rule 17g–4

Paragraph (a)(2) of Rule 17g–4 requires procedures reasonably designed to prevent a person within the NRSRO from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material, nonpublic information obtained for the purpose of developing a credit rating. This provision requires an NRSRO to address the risk that individuals in possession of material, nonpublic information about an issuer or obligor may trade securities or money market instruments on the information.[345]

As with paragraph (a), the provision does not prescribe specific procedures that must be established. An NRSRO may have policies prohibiting persons within the NRSRO from purchasing or selling a security or money market instrument that is subject to a pending credit rating action; requiring persons within the NRSRO to obtain pre-approval before purchasing or selling a security or money market instrument; or requiring persons within the NRSRO to be notified of securities or money market instruments that are on a ''do not trade'' list.

The Commission made three modifications to the provision, as proposed, to address comments. The Commission believes the commenters identified areas where the provision could cause some practical difficulties in designing procedures. The changes are designed to remove these impediments.

First, the Commission deleted a reference in the provision to members of the household of an NRSRO employee. This change was made in response to a comment that it would be difficult to design procedures addressing the trading activities of household members since a household may include persons that the employee has no influence over, such as roommates.[346] The commenter further noted that procedures designed to prevent an employee ''from otherwise benefiting'' from the use of material non-public information would cover an employee's immediate family members.[347]

Second, the Commission replaced a reference in the provision to an employee ''possess[ing]'' or having ''access'' to material, non-public information. The provision, as adopted, refers to an employee being ''aware'' of material, nonpublic information. This change was made in response to a comment that having ''access'' to material, nonpublic information could be interpreted very broadly, which would make designing procedures to address the issue difficult.[348] The commenter also noted that Commission Rule 10b5–1, which concerns trading on the basis of material, nonpublic information in insider trading cases, refers to being ''aware'' of material, nonpublic information.[349]

The third modification narrowed the scope of the provision to ''persons within'' the NRSRO. As proposed, the provision would have required procedures designed to prevent persons ''associated'' with the NRSRO from trading on material, nonpublic information. A commenter stated that this made the provision overly broad since the definition of persons ''associated'' with an NRSRO in Section 3(a)(63) of the Exchange Act includes employees of affiliates engaged in activities wholly unrelated to credit rating services.[350] Similar to Item 8 of Form NRSRO (statutory disclosures) and, as discussed next, Rule 17g–5, the Commission is narrowing the scope of this provision to persons ''within'' the NRSRO. Paragraph (b) of Rule 17g–4 defines a person ''within'' the NRSRO to mean the NRSRO, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the NRSRO or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

Finally, a commenter stated that the provision should not apply to indirect trading in securities such as through transactions in mutual funds.[351] The Commission notes that the rule by itself does not expressly prohibit any types of transactions. As discussed above, Section 15E(g)(1) of the Exchange Act[352] 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 and the rules thereunder.[353] Rule 17g–4 requires an NRSRO to address the inappropriate use of material, nonpublic information when establishing these procedures required by statute.

For these reasons, paragraph (a)(2) of Rule 17g–4 is being adopted with the modifications described above.

3. Paragraph (a)(3) of Rule 17g–4

Paragraph (a)(3) of Rule 17g–4 requires procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of a credit rating action before issuing the credit rating on the Internet or through another readily accessible means. This provision recognizes that a credit rating action of an NRSRO may be material, nonpublic information. Consequently, an NRSRO must have policies designed to ensure that its pending credit rating actions are not selectively disclosed before the credit rating is issued on the Internet or

[341] *See* S&P Letter.

[342] *Id.*

[343] 15 U.S.C. 78o–7(g)(1).

[344] 15 U.S.C. 78a *et seq.*

[345] *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).

[346] *See* S&P Letter.

[347] *Id.*

[348] *See* Moody's Letter.

[349] *See* 17 CFR 240.10b5–1.

[350] *See* Moody's Letter.

[351] *See* Moody's Letter.

[352] 15 U.S.C. 78o–7(g)(1).

[353] 15 U.S.C. 78a *et seq.*

through another readily accessible means.

As with paragraphs (a)(1) and (a)(2), paragraph (a)(3) does not prescribe specific procedures. However, as applicable to the business model of the NRSRO, these policies may 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 or by making it available to all subscribers simultaneously. The policies also may 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, 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 must have procedures reasonably 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.

For these reasons, the Commission is adopting paragraph (a)(3) of Rule 17g–4 substantially as proposed.

4. Paragraph (b) of Rule 17g–4

As discussed above with respect to paragraph (a)(2) of Rule 17g–4, paragraph (b) of Rule 17g–4 contains the definition of a person ''within'' the NRSRO. The definition narrows the scope of the paragraph (a)(2) to persons involved in credit rating activities.

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

Section 15E(h)(1) of the Exchange 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.[354] Section 15E(h)(2) of the Exchange 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.[355] The statute also identifies certain types of conflicts relating to the issuance of credit ratings that the Commission may include in its rules.[356] It also contains a catchall provision for any other potential conflict of interest the Commission deems is necessary or appropriate in the public interest or for the protection of investors to include in its rules.[357] Rule 17g–5 implements these statutory provisions by prohibiting the conflicts identified in the statute and certain additional conflicts either outright or if the NRSRO has not disclosed them and established policies and procedures to manage them.

1. Paragraph (a) of Rule 17g–5

Paragraph (a) of Rule 17g–5 prohibits a person within an NRSRO from having a conflict of interest relating to the issuance of a credit rating that is identified in paragraph (b) of the rule *unless* the NRSRO has disclosed the type of conflict of interest in compliance with Rule 17g–1 (*i.e.*, in Exhibit 6 to Form NRSRO) and has implemented policies and procedures to address and manage the type of conflict of interest in accordance with Section 15E(h)(1) of the Exchange Act.[358] Paragraph (d) of Rule 17g–5 defines a person within an NRSRO. The Commission believes that these prohibitions are 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 it identifies.

This provision, as proposed, would have made it ''unlawful'' for an NRSRO to have a conflict in these circumstances. As adopted, paragraph (a) ''prohibits'' an NRSRO from having the conflict. The Commission adopted this change to make the rule text more consistent with the Section 15E(h)(2) of the Exchange Act, which provides the Commission with authority to ''prohibit, or require the management and disclosure of'' conflicts of interest.[359]

For these reasons, the Commission is adopting paragraph (a) of Rule 17g–5 substantially as proposed with the modification described above.

2. Paragraph (b) of Rule 17g–5

The types of conflicts identified in paragraph (b) of Rule 17g–5 are the same conflicts listed in the instructions to Exhibit 6 of Form NRSRO.[360] These are the types of conflicts that commonly arise from the business of providing credit rating services. Prohibiting these types of conflicts outright may adversely impact the ability of an NRSRO to operate as a credit rating agency. Nonetheless, the conflicts must 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.

Paragraph (b), as adopted, has been restructured from the proposed version of the rule. For example, certain conflicts are now identified in separate paragraphs as opposed to a single paragraph.[361] The Commission's intent is to provide greater clarity to the descriptions of the types of conflicts and, as noted above, to have them track the conflicts described in Exhibit 6 to Form NRSRO. As discussed below, the conflicts identified in paragraph (b) of Rule 17g–5 are substantially the same conflicts identified in the paragraph as proposed; though they have been refined to address comments. The one exception is the conflict identified in paragraph (b)(5) of Rule 17g–5, which—as discussed below—the Commission added in response to a comment identifying it as a potential conflict.

a. Paragraph (b)(1) Rule 17g–5

The conflict identified in paragraph (b)(1) of Rule 17g–5 involves being paid by an issuer or underwriter to determine credit ratings with respect to securities or money market instruments they issue or underwrite. The Commission believes the inclusion of this conflict in the rule is necessary or appropriate in the public interest or for the protection of investors. The concern is that an NRSRO may be influenced to issue a more favorable credit rating than warranted in order to obtain or retain the business of the issuer or underwriter. The Commission did not receive any comments on prohibiting this type of conflict unless it is disclosed and managed as required pursuant to Section 15E of the Exchange Act[362] and Rule 17g–1 and is adopting the requirement substantially as proposed.

[354] 15 U.S.C. 78o–7(h)(1).

[355] 15 U.S.C. 78o–7(h)(2).

[356] *See* 15 U.S.C. 78o–7(h)(2)(A)–(D).

[357] *See* 15 U.S.C. 78o–7(h)(2)(E).

[358] 15 U.S.C. 78o–7(h)(1).

[359] 15 U.S.C. 78o–7(h)(2); *see also* R&I Letter.

[360] *See* DBRS Letter proposing that the conflicts identified in Exhibit 6 and Rule 17g–5 better track one another.

[361] For example, the conflicts identified in paragraphs (b)(1), (2) and (3) were all identified in paragraph (b)(1) of the proposed rule.

[362] 15 U.S.C. 78o–7.

b. Paragraph (b)(2) of Rule 17g–5

The conflict identified in paragraph (b)(2) of Rule 17g–5 involves being paid by an obligor to determine a credit rating of the obligor as an entity. This conflict is identified in Section 15E(h)(2)(A) of the Exchange Act.[363] This business practice raises the same concerns as being paid by an issuer or underwriter to determine a credit rating on a security or money market instrument. The Commission did not receive any comments on prohibiting this type of conflict unless it is disclosed and managed as required pursuant to Section 15E of the Exchange Act[364] and Rule 17g–1 and is adopting the requirement substantially as proposed.

c. Paragraph (b)(3) of Rule 17g–5

The conflict identified in paragraph (b)(3) of Rule 17g–5 involves being paid by issuers, underwriters, or obligors for ancillary services when they also have paid for a credit rating. This conflict as it relates to obligors is identified in Section 15E(h)(2)(B) of the Exchange Act.[365] The Commission believes the inclusion of this conflict in the rule as it relates to issuers and underwriters is necessary or appropriate in the public interest or for the protection of investors. The concern with respect to all of these types of entities is that the NRSRO may issue a more favorable than warranted credit rating in order to obtain business from them for the ancillary services.[366] The Commission did not receive any comments on the requirement that this type of conflict be prohibited unless it is disclosed and managed as required pursuant to Section 15E of the Exchange Act[367] and Rule 17g–1 and is adopting the requirement substantially as proposed.

d. Paragraph (b)(4) of Rule 17g–5

The conflict identified in paragraph (b)(4) of Rule 17g–5 involves being paid by subscribers for access to credit ratings and for other credit ratings services where such subscribers may use the credit ratings to comply with, and obtain benefits or relief under, statutes and regulations using the term ''nationally recognized statistical rating organization.'' The Commission believes the inclusion of this conflict in the rule is necessary or appropriate in the public interest or for the protection of investors. The concern is that a subscriber potentially could be subject to one or more of these statutes and regulations and, consequently, benefit depending on how the NRSRO rates the subscriber, or securities held or issued by the subscriber. A broker-dealer subscriber holding debt securities is 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.[368] Broker-dealers frequently subscribe to receive credit analysis or other services from credit rating agencies.

As noted with respect to Exhibit 6 to Form NRSRO, several commenters raised a concern with the identification of this conflict because, as proposed, it could have been construed to require an NRSRO to affirmatively ascertain whether, and how, its subscribers were using its credit ratings.[369] For this reason, the Commission has modified the description in Exhibit 6 and Rule 17g–5 to make it generally applicable to any subscriber, since any subscriber potentially could be a user of credit ratings for regulatory purposes. Consequently, an NRSRO that has subscribers will be required to make the disclosure in Exhibit 6 and have a policy and procedure to address the conflict.

The Commission notes, however, that Rule 17g–5 does not prescribe any specific policies and procedures to address conflicts of interest. The Commission does not expect that an NRSRO will be required to affirmatively ascertain whether, and how, its subscribers were using its credit ratings to manage this conflict. General policies and procedures designed to keep persons within the NRSRO who participate in the determination of credit ratings free of the undue influence of all persons who pay the NRSRO for credit rating services (*e.g.*, issuers, underwriters, obligors, and subscribers) will be a way of addressing this conflict.

For these reasons, the Commission is adopting the requirement with the modifications discussed above.

e. Paragraph (b)(5) of Rule 17g–5

The conflict identified in paragraph (b)(5) of Rule 17g–5 involves being paid by subscribers that also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the nationally recognized statistical rating organization. As discussed with respect to Exhibit 6, this conflict was added in response to a commenter who pointed out that subscribers who manage investment portfolios also may have interests in a particular credit rating.[370] The Commission believes the inclusion of this conflict in the rule is necessary or appropriate in the public interest or for the protection of investors. The Commission believes the commenter identified a conflict that should be disclosed and managed because certain large investors that may derive benefits from the issuance of a particular credit rating could provide a credit rating agency with substantial revenues for credit rating services. As with potential regulatory users, the Commission does not expect that an NRSRO will be required to affirmatively ascertain how the investment portfolios of its subscribers would be impacted by a pending credit rating. General policies and procedures designed to keep persons within the NRSRO who participate in the determination of credit ratings free of the undue influence of clients will be a way of addressing this conflict.

For these reasons, the Commission is adding this conflict to the conflicts identified in paragraph (b) of Rule 17g–5.

f. Paragraph (b)(6) of Rule 17g–5

The conflict identified in paragraph (b)(6) of Rule 17g–5 involves allowing persons within the NRSRO to own directly securities or money market instruments of, or having any other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO.[371] This conflict as it relates to obligors is identified in Section 15E(h)(2)(C) of the Exchange Act.[372] The Commission believes the inclusion of this conflict in the rule as it relates to issuers is necessary or appropriate in the public interest or for the protection of

[363] 15 U.S.C. 78o–7(h)(2)(A).

[364] 15 U.S.C. 78o–7.

[365] 15 U.S.C. 78o–7(h)(2)(B).

[366] *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 that arise when a credit rating agency offers consulting or other advisory services to issuers it rates.

[367] 15 U.S.C. 78o–7.

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

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

[370] *See* DBRS Letter.

[371] *See Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization*, Securities Act Release No. 8570 (April 19, 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.

[372] 15 U.S.C. 78o–7(h)(2)(C).

investors. The concern is that allowing persons within the NRSRO, even if they are not directly involved in determining the credit rating, to own securities of an issuer or obligor subject to a credit rating could lead to situations where they seek to influence a credit analyst to issue a credit rating favorable to their trading position.[373] For example, a manager or supervisor may be in a position to exert undue influence on a credit analyst.

The Commission, however, does not believe this conflict should be prohibited for employees that have no involvement in determining or approving the credit rating. They should be able to own securities or money market instruments of an issuer or obligor subject to a credit rating issued by the NRSRO, provided the practice is disclosed and managed.[374] A prohibition against owning any rated securities may be a particular hardship for the employees of an NRSRO that issues credit ratings with respect to most public companies.

The Commission has modified the description of the conflict so it now involves ''allowing'' persons within the NRSRO to have these ownership interests. This is intended to clarify that the conflict does not arise only when these persons actually have such an ownership interest. This distinction is intended to simplify the rule. Specifically, as proposed, the rule could have been construed as requiring an NRSRO to affirmatively determine if, and when, an employee purchased a rated security. The rule, as adopted, only requires the NRSRO to disclose that it allows persons within the NRSRO to have these direct ownership interests in rated securities.

Finally, two commenters noted that indirect ownership of rated securities—such as through mutual funds and blind trusts—should not be within the scope of the provision.[375] The Commission believes that indirect ownership of rated securities by employees does not present the same concerns as direct ownership, since an indirect ownership interest implies the investor does not have control over the decision to purchase or sell a specific security. Therefore, the provision specifically references ''direct'' ownership. The Commission also believes that an NRSRO must have flexibility to define through its policies and procedures when an ownership interest would not be ''direct'' for the purposes of this provision.

For these reasons, the Commission is adopting the requirement with the modifications described above.

g. Paragraph (b)(7) of Rule 17g–5

The conflict identified in paragraph (b)(7) of Rule 17g–5 involves allowing persons within the NRSRO to have a business relationship that is more than an ordinary course business relationship with an issuer or obligor subject to a credit rating determined by the NRSRO. This conflict as it relates to obligors is identified in Section 15E(h)(2)(C) of the Exchange Act.[376] The Commission believes the inclusion of this conflict in the rule as it relates to issuers is necessary or appropriate in the public interest or for the protection of investors. The concern is that persons within the NRSRO having these types of business relationships may be influenced to determine a favorable credit rating for the entity based on the business relationship or exert improper influence on credit analysts to determine a favorable credit rating. The Commission believes an NRSRO should be required to disclose that it allows these types of relationships and be required to have policies and procedures to manage them. Otherwise, the conflicts should be prohibited.

The Commission notes that in the case of a credit analyst it may be difficult to remain impartial with respect to an issuer or obligor where the credit analyst has a non-ordinary course business relationship with the entity. For example, in the case where the issuer or obligor extends a loan to the credit analyst that has an interest rate far below market rates. However, the Commission believes that NRSROs should have flexibility in designing policies and procedures to address these types of conflicts, in part, because of the difficulty of defining when a business relationship creates too much potential for a loss of impartiality on behalf of the credit analyst or person within the NRSRO. Consequently, the Commission is not prohibiting these conflicts outright.

The Commission is modifying the provision to clarify that it does not apply to ordinary course business relationships such as arms length mortgage loans and bank and credit card accounts. Commenters stated that these types of business relationships do not raise conflict of interest concerns.[377] The Commission agrees that, for example, a credit analyst likely would not be influenced to issue a favorable credit rating simply because the analyst has a bank account at the rated entity. Examples of a non-ordinary course business relationship would be an employee entering into a joint business venture with a rated obligor or, as noted above, obtaining a loan from an obligor with an interest rate far below market rates.

For these reasons, the Commission is adopting the requirement with the modifications discussed above.

h. Paragraph (b)(8) of Rule 17g–5

The conflict identified in paragraph (b)(8) of Rule 17g–5 involves having a person associated with the NRSRO that is a broker or dealer engaged in the business of underwriting securities or money market instruments. This type of conflict is identified in Section 15E(h)(2)(D) of the Exchange Act.[378] The Commission believes the inclusion of this conflict in the rule is necessary or appropriate in the public interest or for the protection of investors. As the Commission discussed with respect to Exhibit 6 of Form NRSRO, an affiliation with a broker or dealer that is in the business of underwriting securities would raise concerns that the NRSRO might be influenced by the affiliation to issue favorable credit ratings for these securities.

This requirement was in paragraph (b)(5) of Rule 17g–5, as proposed. However, the conflict identified was broader in that it referred to ''having any * * * affiliation with * * * an underwriter of securities or money market instruments rated by the [NRSRO].'' As discussed with respect to Exhibit 6, the Commission has narrowed the description of the conflict to address concerns that the requirement, as proposed, could have created a difficult compliance standard by requiring an NRSRO to monitor whether any person associated with the NRSRO is an ''underwriter'' as that term is defined in Section 2(a)(11) of the Securities Act of 1933.[379]

For these reasons, the Commission is adopting the requirement with the modifications discussed above.

i. Paragraph (b)(9) of Rule 17g–5

The conflict referred to in paragraph (b)(9) of Rule 17g–5 is any other type of conflict that the NRSRO identifies on Form NRSRO in compliance with

[373] As discussed below, the NRSRO and a person within the NRSRO who participated in the determination of a credit rating is prohibited from having this conflict under paragraph (c) of Rule 17g–5.

[374] *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).

[375] *See, e.g.,* S&P Letter; JCR 2nd Letter.

[376] 15 U.S.C. 78o–7(h)(2)(C).

[377] *See, e.g.,* Moody's Letter.

[378] 15 U.S.C. 78o–7(h)(2)(D).

[379] 15 U.S.C. 77b(a)(11).

Section 15E(a)(1)(B)(vi) of the Exchange Act[380] and Rule 17g–1. The Commission believes the inclusion of this provision is necessary or appropriate in the public interest or for the protection of investors. This catchall provision will capture conflicts not specifically listed in the instructions for Exhibit 6 and Rule 17g–5 that the NRSRO has identified on Exhibit 6 to Form NRSRO as arising from its business activities.[381] The Commission did not receive any comments on the proposal that this type of conflict be prohibited unless it is disclosed and managed as required pursuant to Section 15E of the Exchange Act[382] and Rule 17g–1 and is adopting the requirement substantially as proposed.

3. Paragraph (c) of Rule 17g–5

Section 15E(h)(2) of the Exchange 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.[383] Paragraph (c) of proposed Rule 17g–5 specifically prohibits outright four types of conflicts of interest. The Commission believes prohibiting these conflicts is necessary or appropriate in the public interest or for the protection of investors. These are conflicts that are not a necessary consequence of how credit rating agencies operate. They would be difficult to manage given the risk that they could cause undue influence. Therefore, the Commission is prohibiting them; rather than requiring they be disclosed and managed. Nonetheless, the Commission intends to monitor how the prohibitions operate in practice and, if it appears a prohibition is interfering inappropriately, the Commission will re-evaluate whether it should be subject to disclosure and management (rather than prohibited).[384]

a. Paragraph (c)(1) of Rule 17g–5

As adopted, paragraph (c)(1) prohibits an NRSRO from having 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 during the most recently ended fiscal year.[385] Such a person will be in a position to exercise substantial influence on the NRSRO.[386] Consequently, it will be difficult for the NRSRO to remain impartial, given the impact on the NRSRO's income if the person withdrew its business. Given the Commission's understanding that fees from a single entity generally compose a very small percentage of the revenues of entities currently identified as NRSROs, the Commission believes that a 10% threshold is a reasonable threshold for registered NRSROs.[387]

Several commenters stated that this conflict should not be prohibited but rather subject to procedures to manage it.[388] One commenter, while not requesting that the proposal be changed, noted that in an atypical circumstance such as issuing credit ratings for structured products sponsored by a large client an NRSRO may be required to request a waiver of the prohibition.[389] Another commenter also mentioned structured product sponsors as clients that potentially could approach the 10% revenue threshold and, therefore, that exemptive relief may be appropriate in such circumstances.[390] The Commission continues to believe that 10% of net revenues is a very high threshold. Moreover, the definition of net revenues has been narrowed to exclude revenues earned by affiliates that are not persons within the NRSRO. Therefore, the threshold will be higher than that proposed for NRSROs with affiliates engaged in activities unrelated to credit ratings. Consequently, the Commission does not believe the conflict should be subject to a requirement that it be managed (rather than prohibited).

Nonetheless, as noted above, the Commission intends to monitor how the prohibition operates in practice, particularly with respect to structured products. The intent behind all the prohibitions in paragraph (c) is not to prohibit a business practice that is a normal part of an NRSRO's activities. Rather, the intent is to prohibit conflicts that are not a necessary consequence of providing credit rating services. If the prohibition in paragraph (c)(1) interferes with how NRSROs as a matter of course deal with structured product sponsors, the Commission will evaluate whether the rule should be modified to accommodate this business practice or whether—as suggested by the commenter—an exemption would be appropriate.

For these reasons, the Commission is adopting the prohibition substantially as proposed.

b. Paragraph (c)(2) of Rule 17g–5

As adopted, paragraph (c)(2) prohibits an NRSRO from having a conflict relating to the issuance of a credit rating with respect to a person (excluding a sovereign governments nation or an agency of a sovereign nation) where the nationally recognized statistical rating organization, a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the rated person. This conflict as it relates to obligors is identified in Section 15E(h)(2)(C) of the Exchange Act.[391] The Commission believes prohibiting these conflicts, including with respect to issuers, is necessary or appropriate in the public interest or for the protection of investors. An NRSRO and persons within the NRSRO that participate in the credit rating should not have a direct financial interest in the issuer or obligor subject to the credit rating. It will be difficult for these persons to remain impartial and issue an objective credit rating in this circumstance.[392]

As with the provision in paragraph (b)(6) of Rule 17g–5, the Commission has narrowed the scope of this provision to ''direct'' ownership interests. These persons will be permitted to have indirect ownership interests, for example, through mutual funds or blind trusts. The prohibition also excludes from its scope ownership of securities issued by a sovereign government or an agency of a sovereign government. The Commission added this exclusion in response to a comment that sovereign government and agency securities may be held as cash equivalents.[393] Further, the Commission believes for many of these securities it would be difficult to influence their market price through the issuance of a credit rating. Therefore, a prohibition on a credit analyst owning securities of sovereign governments the

[380] 15 U.S.C. 78o–7(a)(1)(B)(vi).

[381] *See* 15 U.S.C. 78o–7(h)(2)(E).

[382] 15 U.S.C. 78o–7.

[383] 15 U.S.C. 78o–7(h)(2).

[384] *See, e.g.*, S&P Letter stating that all the conflicts identified in paragraph (c) of Rule 17g–5 should not be prohibited as they can be managed.

[385] The determination of ''net revenue'' is same as the determination of net revenue for purposes of Form NRSRO and Rule 17g–3.

[386] 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.

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

[388] *See* R&I Letter; Fitch Letter; S&P Letter; AEI Letter; Langohr Letter; AST Letter; ASF Letter.

[389] *See* LACE Letter.

[390] *See* R&I Letter.

[391] 15 U.S.C. 78o–7(h)(2)(C).

[392] 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.

[393] *See* S&P Letter.

analyst rates is not necessary. The Commission notes that this ownership interest is subject to the requirements of paragraphs (a) and (b)(6) of Rule 17g–5. Consequently, it will be required to be addressed in the procedures for managing the conflicts that arise from direct ownership of rated securities.

For the reasons, the Commission is adopting the prohibition with the modifications discussed above.

c. Paragraph (c)(3) of Rule 17g–5

Paragraph (c)(3) prohibits an NRSRO from having a conflict relating to the issuance of a credit rating where the rated entity is a person associated with the NRSRO (*i.e.*, a company directly or indirectly controlling, controlled by, or under common control with, the NRSRO).[394] This conflict as it relates to obligors is identified in Section 15E(h)(2)(C) of the Exchange Act.[395] The Commission believes prohibiting this conflict, including with respect to issuers, is necessary or appropriate in the public interest or for the protection of investors. The Commission believes that it is appropriate to prohibit such conflicts because of the degree of difficulty the Commission foresees in maintaining an appropriate level of impartiality, when issuing a credit rating with respect to an affiliated entity.

Two commenters stated that this conflict can be managed and should not be prohibited.[396] The Commission believes that for a credit analyst to determine a credit rating for the company where the analyst works or an affiliate of that company would place the analyst in an untenable position. Moreover, the Commission does not believe there will be a need for such a credit rating as long as other NRSROs are available to determine credit ratings for these companies. The Commission will entertain requests for exemptive relief from this prohibition where appropriate, such as if circumstances develop to a point where an NRSRO or its affiliate requires a public credit rating and cannot obtain one from another NRSRO. For these reasons, the Commission is adopting this prohibition substantially as proposed.

d. Paragraph (c)(4) of Rule 17g–5

Paragraph (c)(4) prohibits an NRSRO from having a conflict relating to the issuance of a credit rating where the credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, also is an officer or director of the person that is the subject of the credit rating.[397] This conflict as it relates to obligors is identified in Section 15E(h)(2)(C) of the Exchange Act.[398] The Commission believes prohibiting this conflict, including with respect to issuers, is necessary or appropriate in the public interest or for the protection of investors. The Commission believes that an NRSRO or person associated with the NRSRO having such a position will have difficulty remaining objective in these circumstances.

The Commission did not receive any comments on this specific prohibition and is adopting it substantially as proposed.

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

Section 15E(i)(1) of the Exchange Act[399] 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.[400] 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.''

In the proposing release, the Commission made a preliminary determination that the acts and practices described in paragraphs (i)(1)(A)–(C) of Section 15E of the Exchange Act[401] would be unfair, coercive, or abusive. Consequently, the Commission proposed that they be prohibited through provisions in paragraphs (a)(1) through (a)(4) of Rule 17g–6, with one conditional exception. The Commission also made a preliminary determination in the proposing release that using an unsolicited credit rating to pressure an issuer or obligor into paying for the rating or another service would be unfair, coercive, or abusive. Consequently, the Commission proposed to use its authority under Section 15E(i)(1) of the Exchange Act[402] to prohibit such act and practice through the provisions in paragraph (a)(5) of Rule 17g–6.[403]

1. Paragraph (a)(1) of Rule 17g–6

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[.][404]

In the proposing release, the Commission preliminarily determined that this practice would be unfair, coercive, or abusive. Consequently, the Commission proposed to prohibit it in paragraph (a)(1) of Rule 17g–6. Specifically, this paragraph, as proposed, would have prohibited 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.[405]

Credit ratings play an important role in the financial markets. Market participants use them in making financial decisions on 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 the credit rating makes its securities more marketable; or the credit rating qualifies the entity for an exemption or privilege or makes 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.

[394] *See* Section 3(a)(63) of the Exchange Act (15 U.S.C. 78c(a)(63)) defining ''person associated with an NRSRO.''

[395] 15 U.S.C. 78o–7(h)(2)(C).

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

[397] *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.

[398] 15 U.S.C. 78o–7(h)(2)(C).

[399] 15 U.S.C. 78o–7(i)(1).

[400] 15 U.S.C. 78o–7(i)(1)(A), (B) and (C).

[401] *Id.*

[402] 15 U.S.C. 78o–7(i)(1).

[403] *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 the issuer did not request.

[404] 15 U.S.C. 78o–7(i)(1)(A).

[405] *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.

The Commission did not receive any comments objecting to its preliminary determination that this practice would be unfair, coercive, or abusive. The Commission has determined this practice would be unfair, coercive, or abusive and, consequently, is adopting paragraph (a)(1) of Rule 17g–6 substantially as proposed in order to prohibit it.

One commenter did state that there are certain circumstances where it would not be unfair, coercive, or abusive to condition the determination of a credit rating on a security on further analysis of the issuer.[406] Specifically, the commenter stated that to determine a credit rating for a subordinated debt security, a credit rating agency may be required to analyze the overall capital structure of the issuer and determine credit ratings for the issuer as an entity and for its senior debt.[407] The commenter requested that the rule text in paragraph (a)(1) of proposed Rule 17g–6 be amended to clarify that this specific practice is not prohibited.[408]

The Commission believes that the rule text as proposed and as adopted would not prohibit this specific practice. The prohibition applies to conditioning a credit rating on the purchase of ''other'' services of the credit rating agency. In the situation described above, the requirement to analyze the capital structure of the issuer and the creditworthiness of its senior debt is part of the process of determining the credit rating on the subordinated debt. Therefore, the Commission views this as all part of one service and not three different services.

For these reasons, the Commission is adopting the prohibition substantially as proposed.

2. Paragraphs (a)(2) and (a)(3) of Rule 17g–6

Section 15E(i)(1)(C) of the Exchange Act provides that the Commission shall prohibit the following practices if the Commission 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.[409]

In the proposing release, the Commission preliminarily determined that these practices would be unfair, coercive, or abusive. Consequently, the Commission proposed to prohibit them through paragraphs (a)(2) and (a)(3) of proposed Rule 17g–6. The Commission did not receive any comments objecting to its preliminary determination that these practices are unfair, coercive, or abusive. The Commission has determined they are unfair, coercive, or abusive for the reasons discussed below and, consequently, is adopting paragraphs (a)(2) and (a)(3) of Rule 17g–6 substantially as proposed in order to prohibit them.

As adopted, paragraph (a)(2) prohibits 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.[410] Under this provision, an NRSRO is 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 will be prohibited from issuing or promising to issue a higher credit rating in these circumstances.[411]

The practice prohibited in this paragraph is distinguishable from the practice prohibited in Paragraph (a)(1) of Rule 17g–6. 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 opinion reached in the credit rating on the purchase of the credit rating or another service or product.[412] Thus, unlike paragraph (a)(1), an NRSRO will violate paragraph (a)(2) if it conditions the issuance of the credit rating on the obligor or issuer paying for the credit rating. This is because the NRSRO will 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. Rather, the NRSRO will be agreeing to skew the credit rating higher based on the issuer or obligor agreeing to pay for it.

Paragraph (a)(3) Rule 17g–6 prohibits 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 Rule 17g–6 applies to threats or promises with respect to the issuance of a credit rating. Paragraph (a)(3) extends this prohibition to threats or promises with respect to changing an existing credit rating.[413]

The Commission believes these practices are unfair, coercive, or abusive because 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.

An 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 credit rating than would have resulted from using its established methodologies. The NRSRO also could issue a lower credit 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 credit rating than would have resulted from using its established methodologies as a reward for purchasing the credit rating or other services or products. Paragraphs (a)(2) and (3) of Rule 17g–6 are designed to 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.

[406] *See* Moody's Letter.

[407] *Id.*

[408] *Id.*

[409] 15 U.S.C. 78o–7(i)(1)(C).

[410] Paragraph (a)(2) of Rule 17g–6.

[411] 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.

[412] *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.

[413] As noted above, the prohibitions in paragraphs (a)(2) and (a)(3) Rule 17g–6 are being adopted pursuant to authority in Section 15E(i)(1)(C) of the Exchange Act (15 U.S.C. 78o–7(i)(1)(C)).

The Commission further notes that these practices could result in credit ratings that 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 will 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.[414]

For these reasons, the Commission is adopting the prohibition substantially as proposed.

3. Paragraph (a)(4) of Rule 17g–6

Section 15E(i)(1)(B) of the Exchange Act provides that the Commission by rule shall prohibit any act or practice the Commission determines to be unfair, coercive, or abusive relating to:

> 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[.][415]

In explaining this statutory provisions, 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.''

a. Structured Product Credit Rating Practices

Two of the current NRSROs—Fitch and DBRS—believe two other NRSROs—S&P and Moody's engage in anti-competitive practices in the area of determining credit ratings for structured products and, consequently, these practices should be found by the Commission to be unfair, coercive, or abusive.[416] These practices relate to instances where the credit rating agency has not rated particular securities that have been rated by another credit rating agency and that underlie a structured product. S&P and Moody's believe their practices are necessary to determine a credible credit rating.[417]

The practices take several forms. The credit rating agency may, as a condition of issuing a credit rating for a structured product, require that it effectively issue a public credit rating for a fee for most, if not all, the assets underlying the structured product.[418] The second form involves the credit rating agency insisting that it provide a private credit rating or credit assessment for a fee with respect to the unrated assets.[419] The third form involves the credit rating agency taking into consideration the internal credit analysis of another person (*e.g.*, the underwriter, sponsor, or manager of the structured product) with respect to the unrated assets to determine a credit rating or private credit rating, or perform a credit assessment of the unrated assets.[420] The fourth form involves the credit rating agency taking into consideration but not necessarily adopting the credit ratings of another credit rating agency to determine a credit rating or private credit rating, or perform a credit assessment of the unrated assets.[421] Under this last form, the credit rating agency may employ a standardized methodology to discount (notch down) the credit ratings of the other credit rating agency based on the type of security and category of credit rating.[422]

b. Proposed Rule 17g–6(a)(4)

In the proposing release, the Commission preliminarily determined 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 proposed to prohibit these practices in paragraph (a)(4) of proposed Rule 17g–6.

The Commission also proposed an exception to the prohibition that would permit an NRSRO to refuse to issue the credit rating or withdraw the credit rating if the NRSRO has rated less than 85% of the market value of the assets underlying the structured product. This was designed to address the concern that an NRSRO when assessing the creditworthiness of the structured product would be forced to issue a credit rating either when a substantial portion of the underlying assets were 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 credit rating on the structured product. In the case 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.

c. Comments on Proposed Rule 17g–6(a)(4)

i. Support for a Prohibition

The Commission received far more comments on this provision of the proposed rules than on any other provision. Many commenters expressed strong support for the prohibition; though many of the supporters stated that the 85% exception was too high and should be lowered to at least 66%.[423] These commenters generally

[414] 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 will 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, of itself, not 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)).

[415] 15 U.S.C. 78o–7(i)(1)(B).

[416] *See* DBRS Letter; Fitch Letter; letter dated April 11, 2007 from Charles D. Brown, General Counsel, Fitch Ratings (''Fitch 2nd Letter'').

[417] *See* letter dated March 30, 2007 from Raymond W. McDaniel, President, Moody's Investor Services (''Moody's 2nd Letter''); letter dated April 24, 2007 from Jeanne M. Dering, Executive Vice President, Global Regulatory Affairs & Compliance (''Moody's 3rd Letter); S&P Letter; Moody's Letter.

[418] *Id.*

[419] *Id.*

[420] *Id.*

[421] *Id.*

[422] *Id.*

[423] *See e.g.*, DBRS Letter; Fitch letter; Fitch 2nd Letter. *See also* letter dated February 13, 2007 from Janet M. Tavakoli, President, Tavakoli Structured Finance, Inc.; letter dated February 14, 2007 from Gregory G. Raab, Chief Executive Officer, Axon; letter dated February 16, 2007 from Emile Van den Bol, Managing Director, Deutsche Bank; letter dated February 16, 2007 from Kent D. Born, Senior Managing Director, PPM America; letter dated February 23, 2007 from Patti Unti, Managing Director, Capmark Investments LP; letter dated February 23, 2007 from David Lazarus, Managing Director, Capmark Securities, Inc.; letter dated February 28, 2007 from Ronald E. Schrager, Chief Executive Officer, LNR Property Corporation; letter

Continued

believe the proposed rule would serve to increase competition within the credit ratings market, thus benefiting investors in structured products.[424]

For example, DBRS stated that notching has a ripple effect on competition wider than just the structured products and affects competition in the corporate bond rating market and that the practices employed by S&P and Moody's could have a profound and harmful effect on efforts to increase competition among NRSROs.[425] Fitch stated that adoption of the proposed rule is critical to achieving the Rating Agency Act's objective of greater accountability, transparency, and competition in the credit ratings market.[426] Fitch noted that structured products increasingly are designed to hold other structured products.[427] Fitch stated that the practices employed by S&P and Moody's have increased their market share in rating structured products,

> As the structured finance market has grown exponentially in terms of both dollar value and number of market participants, it has become increasingly circular. Most notably, [structured product] issuers regularly acquire securities of other [structured product] issuers. The circularity of the market, in which large, intertwined investors are each subject to notching guidelines mandated by Moody's and S&P, has allowed Moody's and S&P to extend their partner monopoly in the traditional bond market to the increasingly prominent structured finance market. Therein lies the power of the unfair, coercive, and abusive practice of notching.[428]

Academic commenters also stated that Moody's and S&P's practices are unfair, coercive, and abusive within the meaning of the Rating Agency Act.[429] They stated that the securities market would benefit from increased competition in the credit rating market, and that these practices have served to hinder Fitch's ability to compete.[430] One commenter also argued that these practices may lead to misleading credit ratings if another credit rating agency's ratings are categorically reduced without analytic support.[431]

As noted above, many of the commenters that supported the prohibition stated that the 85% threshold should be lowered to 66% or less.[432] They based this assertion on Fitch's showing that S&P, Moody's, and Fitch each shared approximately 66% of the structured product market before S&P and Moody's began their practices in 2001.[433] They further stated that as a direct result of notching, S&P and Moody's have significantly increased their market share; while Fitch has lost market share.[434]

The commenters that support prohibiting the practices of S&P and Moody's believe that the remedy is to require an NRSRO to rely on the credit ratings of another NRSRO without employing any mapping methodology that would lower the credit rating.[435] For example, Fitch argues that historical default, transition rate, and rating comparability studies indicate that the credit ratings of S&P, Moody's, and Fitch for structured products are comparable.[436] Therefore, Fitch asserts that NRSROs should rely on the credit ratings of other NRSROs at face value.[437] Fitch suggested that the proposed rule be modified to provide that if an NRSRO has rated 66% of the par value of an asset pool, and all assets in the pool are publicly rated by two or more NRSROs, for those assets the NRSRO has not itself rated, the NRSRO be required to use one of the two or more public ratings assigned to the underlying asset.[438]

ii. Opposition to a Prohibition

S&P, Moody's, and several other commenters (including academic commenters) strongly opposed the prohibition in paragraph (a)(4) of proposed Rule 17g–6.[439] They cited a number of reasons, most notably that it would require one NRSRO to rely on the credit ratings of another NRSRO.[440] Several commenters asserted that the proposed rule would have an anticompetitive effect.[441] They argued that requiring an NRSRO to adopt the credit ratings of competitors in its credit ratings analysis would reduce competition because the ability of an NRSRO to reach an independent determination of creditworthiness based on different methodologies or criteria would be impeded.[442] These commenters state that value is brought to the market by allowing NRSROs to deliver different analytical perspectives on issuers and securities.[443] Another commenter wrote that the proposed rule would require an NRSRO to put its own reputation at risk on behalf of the commercial interests of a competitor.[444] Further, Moody's argued that differences among credit rating opinions on the same security tend to be larger than those observed when comparing only published credit ratings on jointly-rated securities, and that differences between credit rating opinions are more common and are often greater when Moody's rates securities in a category other than Aaa.[445] A rule that prohibited notching would, in the view of many commenters, prohibit an agency from

dated March 5, 2007 from David Hynes, Partner, Northcross Capital LLP; letter dated March 6, 2007 from S. Trezevant Moore, Jr., President & COO, Luminent Mortgage Capital, Inc.; letter dated March 7, 2007 from Bruce E. Stern, Chairman, Government Affairs Committee, Association of Financial Guaranty Insurers; letter dated March 9, 2007 from Petra Spiegel, Eurohypo AG; letter dated March 9, 2007 from Landon D. Parsons, Managing Director, G-Bass (''G-Bass Letter''); letter dated March 9, 2007 from Pat G. Halter, Chief Executive Officer, Principal Real Estate Investors; letter dated March 12, 2007 from Charles Covell, Executive Vice President, Citigroup Alternative Investments; letter dated March 12, 2007 from Rodney J. Dillman, General Counsel, Babson Capital Management LLC; letter dated March 12, 2007 from Louis C. Lucido, Group Managing Director, Trust Company of the West; letter dated March 12, 2007 from Daniel Ivascyn, Managing Director, PIMCO (''PIMCO Letter''); letter dated March 27, 2007 from Dottie Cunningham, Chief Executive Officer, Commercial Mortgage Securities Association; letter dated April 23, 2007 from Dwight M. Jaffe, Professor, Haas School of Business (''Jaffe Letter''); letter dated April 24, 2007 from Daniel Rubinfeld, Professor, Boalt Law School (''Rubinfeld Letter''); letter dated April 25, 2007 from Dottie Cunningham, Chief Executive Officer, Commercial Mortgage Securities Association; letter dated May 11, 2007 from Kent Wideman, Group Managing Director, Policy and Rating Committee, and Mary Keogh, Managing Director, Policy and Regulatory Affairs, Dominion Bond Rating Service (''DBRS 2nd Letter'').

[424] *Id.*

[425] *See* DBRS Letter; DBRS 2nd Letter.

[426] *See* Fitch Letter.

[427] *Id.*

[428] Fitch Letter.

[429] *See* Rubinfeld Letter; Jaffe Letter.

[430] *Id.*

[431] *See* Jaffe Letter.

[432] *See, e.g.*, Fitch Letter; PIMCO Letter; G-Bass Letter.

[433] *Id.*

[434] *Id.*

[435] *See, e.g.*, Fitch Letter.

[436] *Id.*

[437] *See* Fitch Letter.

[438] *See* Fitch 2nd Letter.

[439] *See, e.g.*, S&P Letter; S&P 2nd Letter; Moody's Letter; Moody's 3rd; R&I Letter; FSR Letter; Rutherfurd Letter; Langohr Letter; AST Letter; letter dated March 30, 2007 from Raymond W. McDaniel, President, Moody's Investor Services (''Moody's 2nd Letter''); letter dated March 30, 2007 from Charles W. Calomiris, Professor, Columbia University, *et al.* (''Calomiris Letter''); letter dated April 3, 2007, from J. Darrell Duffie, Professor, Stanford University, Graduate School of Business; letter dated April 6, 2007 from Jean Helwege, Associate Professor of Finance, Penn State University; letter dated April 13, 2007 from Robert M. Chilstrom, Esq., Skadden, Arps, Slate, Meagher & Flom LLP, on behalf of Moody's Investor Services; letter dated April 18, 2007 from Gunter Loeffler, Professor, University of Ulm, Germany; letter dated April 26, 2007 from Louis H. Ederington, Professor, Price College of Business, University of Oklahoma; letter dated April 28, 2007 from Mitchell A. Petersen, Professor, Kellogg School of Management, Northwestern University; letter dated May 3, 2007 from the Honorable Charles E. Schumer, Senator, Robert Menendez, Senator, John E. Sununu, Senator, and Mike Enzi, Senator, U.S. Senate; letter dated May 12, 2007 from Ren-Raw Chen, Professor, Rutgers University.

[440] *Id.*

[441] *See* Calomiris Letter.

[442] *See* Moody's 3rd Letter; Calomiris Letter.

[443] *See* Moody's Letter; Calomiris Letter.

[444] *See* Langohr Letter.

[445] *See* Moody's 2nd Letter.

forming its own opinion about the risks of collateral in a structured product.[446]

Additionally, S&P and Moody's believe the proposed rule would unduly interfere with their methodologies for determining credit ratings, could lead to inaccurate credit ratings and credit ratings that violate securities laws, and unnecessarily raise constitutional issues.[447] They argue that users of credit ratings believe ratings reflect the agency's bona fide opinion of the creditworthiness of a particular issuer, security, or transaction.[448] S&P wrote that when an agency is asked to rate structured products it must understand the credit quality of all of the underlying assets.[449] If an NRSRO was required to use the credit rating of another NRSRO, it would in effect lose the right to understand the credit quality of the underlying assets, and lose control over the credit rating opinions it publishes.[450] Such a result, it argues, would be contrary to the legislative intent that credit ratings be independent and free from interference by third parties, including governments, issuers, investors, and competitors.[451] Moody's similarly argues that such a credit rating would not reflect an evaluation of the credit risk of all the assets in the pool, and therefore, negatively impact the credibility and reliability of its credit ratings and increase the risks to investors who rely on its credit ratings.[452]

S&P and Moody's argue that prohibiting their practices, in effect, would require them to rely on another NRSRO's credit rating even when they believed that credit rating to be unsupportable.[453] Further, if they were required to rely on a credit rating from another NRSRO, they argue they would be placed in a position of having to publish credit ratings that they do not believe are accurate or engage in a prohibited practice.[454] They state that this would create the untenable choice of taking an action that is inconsistent with general securities law principles or violating Rule 17g–6.[455]

S&P and Moody's state that their practices are analytically justified methods of forming an independent credit rating opinion.[456] S&P asserts that it is appropriate to reserve the right to discount the credit ratings of other credit rating agencies when incorporating these credit ratings into its own analysis to account for differences in analytical and surveillance practices among credit rating agencies, preserve its ability to perform its own surveillance of the underlying assets, and account for the possibility that the assets could be down-rated by another credit rating agency without notice.[457]

S&P and Moody's also have disputed the assertion that there are no differences between their credit ratings and Fitch's credit ratings.[458] S&P argues that historical correlations that may have existed are not a justification for adopting a rule that would require recognition of future credit ratings issued by credit rating agencies that may register as NRSROs.[459] Moreover, S&P and Moody's say that their practice of mapping to other credit ratings was developed to accommodate structured product sponsors who did not want to wait or pay for credit analysis on the assets underlying a structured product that the agency had not previously rated.[460] They asserted that this practice provides a quicker means to close a structured product issuance because the existing credit rating serves as a starting point in analyzing a portion of the pool of underlying assets.[461] Therefore, in their view, prohibiting their practices would harm users of credit ratings.[462]

S&P and Moody's also commented on how paragraph (a)(4) of proposed Rule 17g–6 should be revised. For example, Moody's commented that the 85% threshold in the proposed rule was not appropriate.[463] It argued that credit ratings for tranches of structured products are sensitive to the accuracy of credit ratings for even small portions of the underlying asset pool. Further, S&P and Moody's argued that the 85% threshold would create an incentive for collateral managers to include the riskiest securities in the 15% unrated portion of the structured product.[464] Other commenters also argued the proposed rule would undermine the market's ability to offset potential harm from credit rating shopping.[465]

Moody's and S&P recommended that the Commission strike paragraph (a)(4) of Proposed Rule 17g–6 in its entirety. Alternatively, Moody's commented that if paragraph (a)(4) is retained, the rule should be revised to clearly prohibit only conduct that is motivated by an ''unfair, coercive or abusive'' intent.[466] Moody's suggested that the rule be amended to provide, among other things, that the prohibitions of paragraph (a)(4) shall not apply if any such action is taken in accordance with the NRSRO's analytical procedures and methodologies and that the rule should not compel credit rating agencies to use or to rely upon the credit rating opinions of other persons as their own.

S&P commented that one alternative to prohibiting these practices would be a record retention regime whereby NRSROs would be required to retain records related to their decisions to treat another NRSRO's credit ratings, including the NRSRO's reasons for the treatment.[467] S&P stated that requiring the firm to explain its reasons would guard against unfair, coercive, or abusive practices.[468]

In lieu of striking paragraph (a)(4) or adopting only recordkeeping requirements, S&P commented that paragraph (a)(4) should be revised to provide that in situations where it has not rated 100% of the underlying assets, an NRSRO should have three options: (i) Accepting the credit ratings of others at face value; (ii) refusing to rate the transaction at all; or (iii) reviewing all the underlying assets and receiving compensation for the additional work involved.[469]

d. Final Rule 17g–6(a)(4)

At this time, the Commission cannot determine that the acts and practices described above are unfair, coercive, or abusive in and of themselves. The Commission needs more information about these practices to gain a better understanding of how they were developed and are being employed. The Commission is concerned, however, that these practices have adversely affected competition among credit rating agencies and that they may occur for anticompetitive purposes. Consequently, the Commission is adopting a final rule that is intended to increase accountability and

[446] *See, e.g.*, Moody's Letter.

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

[448] *Id.*

[449] *See* S&P Letter.

[450] *Id.*

[451] *Id.*

[452] *See* Moody's 3rd Letter.

[453] *See* Moody's Letter; Moody's 2nd Letter; Moody's 3rd Letter; S&P Letter; S&P 2nd Letter.

[454] *Id.*

[455] *Id.*

[456] *Id.*

[457] *See* S&P Letter; S&P 2nd Letter.

[458] *See* S&P 2nd Letter; Moody's 3rd Letter.

[459] *See* S&P 2nd Letter.

[460] *See* Moody's Letter; Moody's 2nd Letter; Moody's 3rd Letter; S&P Letter; S&P 2nd Letter.

[461] *Id.*

[462] *Id.*

[463] *See* Moody's Letter; Moody's 2nd Letter; Moody's 3rd Letter; S&P Letter; S&P 2nd Letter.

[464] *Id.*

[465] *See* Calomiris Letter.

[466] *See* Moody's Letter.

[467] *See* S&P Letter; *see also* DBRS 2nd Letter supporting increased recordkeeping and revising its earlier comment that an NRSRO should be required to rely on the credit ratings of another NRSRO in light of objections that this would interfere with how an NRSRO determines credit ratings.

[468] *See* S&P Letter.

[469] *Id.*

transparency in the structured product credit ratings market.

First, the Commission has determined that the practices identified in Section 15E(i)(1)(B) of the Exchange Act [470] are unfair, coercive, or abusive to the extent they are practiced with anticompetitive intent. Consequently, paragraph (a)(4) of Rule 17g–6 prohibits an NRSRO from issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw 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 all or a portion of the assets within such pool or part of such transaction also are rated by the nationally recognized statistical rating organization where such practice is engaged in by the nationally recognized statistical rating organization for an anticompetitive purpose.

The Commission recognizes that proving anticompetitive intent will be difficult, particularly where an NRSRO has analysis to support the contention that its methodology is not arbitrary and is designed to make the credit rating of a structured product more accurate. Nonetheless, the Commission believes this prohibition will be an important deterrent against anticompetitive practices when combined with the enhanced recordkeeping requirements in Rule 17g–2 discussed below.

e. Enhanced Recordkeeping Requirements

As noted above, two commenters suggested that an alternative to banning the practices of S&P and Moody's would be a record retention regime whereby NRSROs would be required to retain records related to their decisions on how to treat, and methodology for treating, another NRSRO's credit ratings into the credit rating of a structured product.[471] S&P stated that requiring an NRSRO to explain its reasons for the treatment would guard against unfair, coercive, or abusive practices.[472]

The Commission believes that recordkeeping requirements aimed at these practices are necessary or appropriate in the public interest or for the protection of investors. Consequently, the Commission is adopting three recordkeeping requirements in this area. These requirements will assist the Commission in better understanding how these practices are developed and employed. This information may provide a basis for the Commission to determine whether it should find a specific practice to be unfair, coercive, or abusive. The Commission also believes that increased scrutiny on the practices coupled with the potential for liability under Rule 17g–6 will deter an NRSRO from acting with anticompetitive intent.

i. Paragraph (a)(7) of Rule 17g–2

As adopted, paragraph (a)(7) of Rule 17g–2 requires an NRSRO to make a record that lists each security and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the NRSRO in determining the credit rating for the security treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the NRSRO by any or a combination of the practices described above and identified in paragraphs (a)(7)(i) through (iv) of Rule 17g–2.

As discussed above, there are four practices by which a credit rating agency may treat unrated assets underlying a structured product when determining a credit rating for the structured product.[473] Moreover, the credit rating agency may condition the issuance of a credit rating for the structured product on its employing one or more of these practices. First, the credit rating agency may require that it effectively issue a public credit rating for most, if not all, the assets underlying the structured product.[474] This practice is described in paragraph (a)(7)(i) of Rule 17g–2. Second, the credit rating agency may require that it provide a private credit rating or credit assessment for a fee with respect to the unrated assets.[475] This practice is described in paragraph (a)(7)(ii) of Rule 17g–2.

Third, the credit rating agency may take into consideration the internal credit analysis of another person (*e.g.*, the underwriter, sponsor, or manager of the structured product) with respect to the unrated assets to determine a credit rating or private credit rating, or perform a credit assessment of the unrated assets.[476] This practice is employed after the credit rating agency has done a review of how the person performs its credit analysis, including a review of the specific procedures and methodologies employed by the person. This practice is described in paragraph (a)(7)(iii) of Rule 17g–2.

Fourth, the credit rating agency may take into consideration but not necessarily adopt the credit ratings of another credit rating agency for the unrated assets to determine a credit rating or private credit rating, or perform a credit assessment of the unrated assets.[477] Under this last practice, the credit rating agency may employ a standardized methodology to discount (notch down) the credit ratings of the other credit rating agency based on the type of security and category of credit rating.[478] This practice is described in paragraph (a)(7)(iv) of Rule 17g–2.

The intent of the recordkeeping provision in paragraph (a)(7) of Rule 17g–2 is to alert Commission examiners to those structured product credit ratings issued by an NRSRO that have been determined using one or more of these practices, which commenters have argued are unfair, coercive, or abusive. This will assist the examiners in requesting the records relating to these credit ratings in order to monitor these practices and get a better understanding of how they are employed. The Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in reviewing whether these practices are being engaged in with anticompetitive intent in violation of Rule 17g–6(a)(4).

For these reasons, the Commission is adopting the provision in Rule 17g–2.

ii. Paragraph (b)(8) of Rule 17g–2

As adopted, paragraph (b)(8) of Rule 17g–2 requires an NRSRO to retain internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another NRSRO for the purpose of determining a credit rating of a security or money market instrument issued by an asset pool or part of any asset-backed or mortgage-backed securities transaction.

As discussed above, the commenters who opposed the prohibition in Rule 17g–6(a)(4), as proposed, stated that there were legitimate reasons for using, but lowering, another credit rating agency's credit ratings or insisting on performing an independent assessment of the assets rated by another credit rating agency.[479] As noted above, the Commission has insufficient information at this time to determine

[470] 15 U.S.C. 78o–7(i)(1)(B).

[471] *See* S&P Letter; DBRS 2nd Letter.

[472] *See* S&P Letter.

[473] *See* DBRS Letter; Fitch Letter; Fitch 2nd Letter; Moody's Letter; Moody's 2nd Letter; Moody's 3rd Letter; S&P Letter; S&P 2nd Letter.

[474] *Id.*

[475] *Id.*

[476] *Id.*

[477] *Id.*

[478] *Id.*

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

that such practices are a pretext for anticompetitive behavior or that such practices are appropriate. The records that an NRSRO must retain under this provision will assist the Commission in understanding whether the NRSROs that engage in these practices have analytical, statistical, or other bases to support their methodologies. The existence (or absence) and nature of such information will assist the Commission in analyzing whether the practices are employed with the intent to improve the quality and accuracy of credit ratings or as pretexts for anticompetitive behavior.

For example, the Commission understands issuers may ask for pre-credit rating assessments for a security from three or more credit rating agencies and, based on the assessments or other considerations, hire one or more, but not all, of the credit rating agencies to issue the credit rating.[480] A credit rating agency that was not hired to issue a credit rating for the security may use its pre-credit rating assessment as part of an analysis of how it would rate this type of security as compared to the other credit rating agencies. This analysis may be used to develop a procedure or methodology to treat the credit ratings of the other credit rating agencies for securities underlying a structured product in developing a credit rating for the structured product.[481] The treatment may include a schedule in which the credit ratings of the other credit rating agencies are notched down to the extent they are included in the structured product. Under paragraph (b)(8) of Rule 17g–2, an NRSRO that uses pre-credit rating assessments to develop such a schedule will need to retain any records documenting its pre-credit rating assessments and the process by which the pre-credit rating assessments were used to arrive at the number of notches the securities will be discounted.

The Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in reviewing whether these practices are being engaged in with anticompetitive intent in violation of Rule 17g–6(a)(4).

iii. Paragraph (b)(9) of Rule 17g–2

As adopted, paragraph (b)(9) of Rule 17g–2 requires an NRSRO to retain for each security identified in the record required under paragraph (a)(7) of Rule 17g–2, any document that contains a description of how assets within such pool or as a part of such transaction not rated by the NRSRO but rated by another NRSRO were treated for the purpose of determining the credit rating of the security.

These records will permit Commission examiners to review on a case-by-case basis the method by which an NRSRO incorporates the credit ratings of another NRSRO into the credit rating of a structured product. For example, examiners will be able to compare the methodologies for incorporating highly rated assets with those for lower rated assets. One commenter that strongly supports prohibiting these practices states that credit rating agencies engaging in these practices notch down assets they have rated in the highest credit rating categories even though studies suggest that its credit ratings perform comparably.[482]

The Commission believes this provision is necessary or appropriate in the public interest or for the protection of investors because it will assist the Commission in reviewing whether these practices are being engaged in with anticompetitive intent in violation of Rule 17g–6(a)(4).

5. Unsolicited credit ratings

In the proposing release, the Commission preliminarily determined that it would be unfair, coercive, or abusive to issue an unsolicited credit rating and communicate with the issuer or obligor to induce or attempt to induce them to pay for the credit rating or another product or service of the NRSRO or its affiliates. Consequently, paragraph (a)(5) of proposed Rule 17g–6 would have prohibited this practice.

Commenters raised a number of concerns with respect to how this prohibition would operate in practice.[483] For the most part, they worried it was overbroad and, consequently, would prohibit legitimate business activities that are not coercive.[484] As discussed with respect to Exhibit 2, issuers and obligors, for example, may consent to the issuance, and participate in the determination, of a credit rating even if they did not specifically request that the credit rating be issued. The Commission wants to gain a better understanding through its examination function of how credit rating agencies define ''unsolicited credit ratings'' and the practices they employ with respect to these ratings. The Commission believes it must gain this understanding before prohibiting any practices in this area.

For these reasons, the prohibition has been eliminated from Rule 17g–6.

V. Paperwork Reduction Act

Certain provisions of the rules contain a ''collection of information'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[485] The Commission published a notice requesting comment on the collection of information requirements in the proposing release and submitted the proposed rules to the Office of Management and Budget (''OMB'') for review in accordance with the PRA. The Commission will publish notice in the Federal Register when it receives clearance from OMB. The Commission did not receive any comments on the burden estimates in the proposing release.

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 organization; 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 financial reports to be furnished by nationally recognized statistical rating organizations; and

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

A. Collections of Information in the Rules

The rules being adopted implement registration, recordkeeping, financial reporting, and oversight provisions of the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act'').[486] The rules contain recordkeeping and disclosure requirements that are subject to the PRA for registered NRSROs and impose mandatory collection of information obligations.

In summary, the rules require a credit rating agency that wishes to register as an NRSRO to furnish an initial application to the Commission for registration on Form NRSRO;[487] and a credit rating agency or NRSRO to furnish a written notice to the

[480] *See* Moody's 3rd Letter.

[481] *See* 17 CFR 240.17g–2(b)(8).

[482] *See* Fitch Letter.

[483] *See* R&I Letter; FSR Letter; DBRS Letter; A.M. Best Letter; Fitch Letter; S&P Letter; Moody's Letter; Langohr Letter; LACE Letter.

[484] *Id.*

[485] 44 U.S.C. 3501 *et seq.*; 5 CFR 1320.11.

[486] Pub. L. 109–291 (2006).

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

Commission to withdraw an initial application or application to be registered in an additional class of credit ratings prior to final action by the Commission.[488] Further, the rules require an NRSRO to (1) furnish an application to the Commission on Form NRSRO for registration in an additional class of credit ratings;[489] (2) furnish an application supplement on Form NRSRO to update information for an initial application or for an application to register an additional class of credit ratings prior to final Commission action;[490] (3) furnish an amendment to the Commission on Form NRSRO to update information in the application after registration;[491] (4) furnish an annual certification to the Commission on Form NRSRO;[492] (5) furnish a withdrawal of registration to the Commission on Form NRSRO;[493] (6) make the current Form NRSRO and Exhibits 1 through 9 publicly available on its Web site, or through another comparable, readily accessible means;[494] (7) make, retain, and preserve certain records;[495] (8) furnish an undertaking to the Commission if a third-party custodian makes or retains these records;[496] (9) furnish the Commission with annual financial reports;[497] and (10) establish certain procedures to prevent the misuse of material nonpublic information.[498] Many of these requirements are prescribed in Section 15E of the Exchange Act.[499]

B. Use of the Information

Rules 17g–1 through 17g–6, Form NRSRO, and the Instructions for Form NRSRO establish a framework for Commission oversight of NRSROs. The collections of information in the rules are designed to allow the Commission to determine whether an entity should be registered as an NRSRO. Further, they will 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[500] and the rules thereunder. The rules also are designed to assist users of credit ratings by requiring the disclosure of information that may be used to compare the credit ratings quality of different NRSROs. The disclosures include information about methods for determining credit ratings, organizational structure, policies for safeguarding non-public information, conflicts of interest, policies for managing conflicts of interest, and credit analyst qualifications. As noted in the Senate Report accompanying the Rating Agency Act, this information ''will facilitate informed decisions by giving investors the opportunity to compare ratings quality of different firms.''[501]

C. Respondents

The number of respondents will depend, in part, on the number of entities that meet the statutory requirements to be eligible for registration. The Rating Agency Act, by adding definitions to Section 3 of the Exchange Act,[502] identifies the types of entities that may apply for registration with the Commission as an NRSRO.[503] 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.[504]

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.[505] The definition specifically excludes a commercial credit reporting company.[506] 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.''[507]

These definitions create threshold eligibility requirements with respect to the entities that are 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 are eligible to register as NRSROs.

In 2000, a working group of the Basel Committee on Banking Supervision[508] 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.[509] In its report, the working group estimated that there were approximately 150 credit rating agencies located world-wide.[510] 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.[511] In addition, the working group noted that some credit rating agencies focus exclusively on issuers in the countries where they are located.[512]

The Web site *http://www.DefaultRisk.com,* which has

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

[489] Rule 17g–1(b).

[490] Rule 17g–1(c).

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

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

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

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

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

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

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

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

[499] *See* 15 U.S.C. 78o–7.

[500] 15 U.S.C. 78o–7.

[501] *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'').

[502] 15 U.S.C. 78c.

[503] *See* Section 3 of the Rating Agency Act.

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

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

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

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

[508] 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/.*

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

[510] *Id.*

[511] *Id.*

[512] *Id.*

tracked the number of credit rating agencies, identifies 57 credit rating agencies as of February 2006 and indicates that this count reflects a decrease from a previous count of 74.[513] The Web site attributed the decrease to smaller firms either being consolidated into larger firms or ceasing operations.[514]

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. We cannot determine how many of the entities included in these estimates meet the statutory requirements to apply for, and be registered as, an NRSRO.

In addition, it is difficult to estimate with certitude how many credit rating agencies ultimately would volunteer to be registered as NRSROs.[515] 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 expiring 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, if 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 no-action letter process. It is possible that certain firms that did not seek NRSRO status previously will seek it under Section 15E of the Exchange Act.[516] 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 are eligible for registration as an NRSRO.

For all these reasons, we estimated 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 that requested no-action letters. At the same time, the Commission did not believe that all of the 57 credit rating agencies identified by *DefaultRisk.Com* would apply for, or be granted, registration. Consequently, the Commission estimated that approximately 30 credit rating agencies would be registered as NRSROs under Section 15E of the Exchange Act.[517]

The Commission requested comment on this estimate and whether more or fewer credit rating agencies would be registered as NRSROs. The Commission also requested comment on whether the sources of industry information referenced in the proposing release (the *Basel Report* and the *DefaultRisk.Com* Web site) provided a reasonable basis for arriving at the estimate of 30 NRSROs. The Commission further requested comment on whether there were 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.

The Commission did not receive any comments in response to these requests. The Commission continues to estimate, for purposes of this PRA, that approximately 30 credit rating agencies will be registered as NRSROs.

D. Total Annual Recordkeeping and Reporting Burden

The Commission estimates the total recordkeeping burden resulting from these rules is approximately 15,722 hours[518] on an annual basis and 21,755 hours[519] on a one-time basis.

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

The Commission further estimated that some smaller entities also have implemented the policies, procedures, and recordkeeping systems that substantially would comply with the proposed rules. Moreover, given their smaller size and simpler structure, the Commission assumed that 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 in the proposing release were designed to represent the average time across all NRSROs (regardless of size) and taking into account that many firms would only be required to augment existing policies, procedures, and recordkeeping systems and processes to comply with the proposed rules. The Commission noted 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, were skewed higher by the largest firms. Furthermore, because the Commission proposed to require additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act,[520] the burden estimates for Rule 17g–1 included estimates arising from requirements of Section 15E of the Exchange Act.[521] The intent was to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that would be required under Rule 17g–1. Thus, the estimates did not seek to capture paperwork burden that would be solely attributable to requirements in Section 15E of the Exchange Act.[522]

The Commission sought comment on whether these factors were reasonably incorporated into the burden estimates. The Commission did not receive any comments in response to this request. The Commission continues to believe that it is appropriate to incorporate these factors into the final estimates, and has done so.

1. 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 the public interest or for the protection of investors.[523] Rule 17g–1[524]

[513] *See http://www.defaultrisk.com ("DefaultRisk.com").*

[514] *Id.*

[515] Section 15E(a)(1) of the Exchange Act makes registration voluntary (15 U.S.C. 78o–7(a)(1)).

[516] 15 U.S.C. 78o–7.

[517] 15 U.S.C. 78o–7.

[518] 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 + 1 + 300 + 7,620 + 6,000 = 15,722 hours.

[519] This total is derived from the total one-time hours set forth in the order that the totals appear in the text: 9,000 + 1,200 + 125 + 900 + 9,000 + 50 + 1,500 = 21,775 hours.

[520] 15 U.S.C. 78o–7(a)(1)(B).

[521] 15 U.S.C. 78o–7.

[522] *Id.*

[523] 15 U.S.C. 78o–7(a)(1).

[524] *See* paragraphs (a), (c), and (h) of Rule 17g–1.

implements this statutory provision by requiring a credit rating agency to furnish a completed initial application on Form NRSRO to the Commission to apply to be registered under Section 15E of the Exchange Act.[525] The Commission estimated 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 was based on staff experience with the current NRSRO no-action letter process.[526] The Commission, therefore, estimated that the total one-time burden to the industry as a result of this requirement would be approximately 9,000 hours.[527]

The Commission did not receive any comments on these specific estimates. The Commission notes that Form NRSRO has been changed to ease the burden of completing the Form. For example, applicants will not be required to provide information about each credit analyst, credit analyst supervisor, and compliance employee that assists the designated compliance officer. As discussed above, we developed these estimates based on the rules as proposed. We continue to believe the estimates are appropriate for the rules as now modified. Indeed, because we have in a variety of respects narrowed the requirements of the rules, we believe the estimates are likely to be conservative. We also note that NRSROs with small staffs will be less impacted by these modifications.

The Commission also noted that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The Commission estimated that the amount of time an outside attorney will spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimated 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.[528] The Commission further estimated that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimated that the average hourly cost for an outside counsel would be approximately $400 per hour. For these reasons, the Commission estimated that the average one-time cost to an NRSRO would be $16,000[529] and the one-time cost to the industry would be $480,000.[530] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

Rule 17g–1 requires that an NRSRO registered for fewer than the five classes of credit ratings listed in Section 3(a)(62)(B) of the Exchange Act apply to be registered for an additional class by furnishing an amendment on a completed Form NRSRO.[531] The Commission estimated 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 burden estimate to complete a Form ADV, the Commission estimated that furnishing an application on Form NRSRO for this purpose would take an average of approximately 25 hours per NRSRO.[532]

The Commission further estimated 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 classes of credit ratings within the first year. The Commission explained that almost all NRSROs would initially apply to register for the first three classes of credit ratings identified in the definition of NRSRO: (1) Financial institutions, brokers, or dealers; (2) insurance companies; and (3) corporate issuers.[533] 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 explained that, after these three classes, the next largest class 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.[534] These types of credit ratings take additional expertise. Finally, the Commission explained that the class 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 is defined in 17 CFR 229.1101(c)).[535] This assumption was 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 anticipated that some NRSROs might register for less than all five classes of credit ratings. Moreover, these NRSROs, in time, may develop their businesses to include issuing credit ratings in a class for which they are not initially registered. Based on staff experience, the Commission estimated that approximately five of the 30 NRSROs would apply to add another class 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 was estimated be approximately 125 hours.[536] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

Rule 17g–1 requires a credit rating agency to provide the Commission with a written notice if it intends to withdraw its application prior to final Commission action.[537] Based on staff experience, the Commission estimated 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 current estimates for a broker-dealer to file a notice under Rule 17a–11, the Commission estimated the average burden to an NRSRO to furnish the notice of withdrawal would be one hour.[538] Thus, the Commission estimated that the aggregate annual burden to the industry of providing a

[525] 15 U.S.C. 78o–7.

[526] As a comparison, the proposing release noted 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 estimated that the hour burden under Rule 17g–1 would be greater, given the substantially larger amount of information that will be required in Form NRSRO.

[527] 300 hours × 30 entities = 9,000 hours.

[528] 40 hours × 30 entities = 1,200 hours.

[529] $400 per hour × 40 hours = $16,000.

[530] $16,000 × 30 NRSROs = $480,000.

[531] *See* paragraphs (c), (d), and (h) of Rule 17g–1.

[532] 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).

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

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

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

[536] 25 hours × 5 NRSROs = 125 hours.

[537] *See* paragraph (d) of Rule 17g–1.

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

notice of withdrawal prior to final Commission action would be one hour per year.[539] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

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.[540] Rule 17g–1 requires an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO.[541] Based on staff experience, the Commission estimated that an NRSRO would file two amendments of its Form NRSRO per year on average. Furthermore, for the reasons discussed above, the Commission estimated that it would take an average of approximately 25 hours to prepare and furnish an amendment on Form NRSRO.[542] Therefore, the Commission estimated that the total aggregate annual burden to the industry to update Form NRSRO would be approximately 1,500 hours each year.[543] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[544] Rule 17g–1 requires an NRSRO to furnish the annual certification on Form NRSRO.[545] The Commission estimated 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 estimated 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.[546] Therefore, the Commission estimated 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.[547] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

Rule 17g–1 has been modified to require an NRSRO to furnish the Commission with a withdrawal of registration on Form NRSRO.[548] As proposed, the Commission required a written notice without prescribing the form of the notice. The Commission expects that the furnishing of these withdrawals will be rare, given that only 30 credit rating agencies are expected to register. Based on staff experience, the Commission estimates that one NRSRO per year will withdraw its registration. Further, the instructions to Form NRSRO provide that only the items on the Form are required to be completed in the case of a withdrawal; an NRSRO would not be required to update or attach any of the information required in the Exhibits. Based on current estimates for a broker-dealer to file a notice under Rule 17a–11, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal would be one hour.[549] 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.[550]

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.[551] Rule 17g–1 requires that this be done within 10 business days of the granting of an NRSRO's registration or the furnishing of an amendment, annual certification, or withdrawal.[552] The Commission believed that each NRSRO already would have a Web site and would choose to use its 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 estimated 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[553] and the total aggregate annual burden would be 300 hours.[554] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

2. Rule 17g–2

Section 17(a)(1) of the Exchange Act (as amended by the Rating Agency Act)[555] 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.[556] Rule 17g–2 implements this rulemaking authority by requiring an NRSRO to make and keep current certain records relating to its business. In addition, the rule requires an NRSRO to preserve these and other records for certain prescribed time periods. This rule is designed to assist the Commission in monitoring, through its examination function, whether NRSROs are complying with the requirements of Section 15E of the Exchange Act[557] and the regulations thereunder. The Commission estimated that the average one-time burden of implementing a recordkeeping system to comply with this rule would be approximately 300 hours. This estimate was based on the Commission's experience with, and burden estimates for, certain recordkeeping requirements of consolidated supervised entities (''CSEs'') subject to Commission supervision.[558]

The Commission also estimated that an NRSRO might be required to purchase recordkeeping system software to establish a recordkeeping system in conformance with the rule. The Commission estimated that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimated that some NRSRO's would not require 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 estimated that the average cost for recordkeeping software across all NRSROs would be

[539] 1 hour × 1 entity = 1 hour.

[540] 15 U.S.C. 78o–7(b)(1).

[541] *See* paragraph (e) of Rule 17g–1.

[542] This estimate also is based on the estimates for the collection of information on Rule 17i–2 under the Exchange Act (17 CFR 240.17i–2).

[543] 25 hours per amendment × 2 amendments × 30 NRSROs = 1,500 hours.

[544] 15 U.S.C. 78o–7(b)(2).

[545] *See* paragraph (f) of Rule 17g–1.

[546] *See* 17 CFR 240.17h–1T and 2T.

[547] 10 hour × 30 NRSROs = 300 hours.

[548] *See* paragraph (g) of Rule 17g–1.

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

[550] 1 hour × 1 entity = 1 hour.

[551] 15 U.S.C. 78o–7(a)(3).

[552] *See* Rule 17g–1(i).

[553] 30 hours × 30 NRSROs = 900 hours.

[554] 10 hours × 30 NRSROs = 300 hours.

[555] *See* Section 5 of the Rating Agency Act.

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

[557] 15 U.S.C. 78o–7.

[558] *See* 17 CFR 15c3–1g.

approximately $1000 per firm. Therefore, the one-time cost to the industry would be $30,000.

Additionally, the Commission estimated 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 was based on the Commission's present estimate for the amount of time it would take a broker-dealer to comply with the recordkeeping rule, Rule 17a–4.[559] Therefore, the Commission estimated that the one-time hour burden for making and preserving the records under proposed Rule 17g–2 would be approximately 9,000 hours[560] and the total annual hour burden would be approximately 7,620 hours per year.[561]

Rule 17g–2 also requires an NRSRO that uses a third-party record custodian to furnish the Commission with an undertaking from the custodian. Based on staff experience, the Commission estimated that approximately five NRSROs would file this undertaking on a one-time basis. The Commission estimated, based on staff experience, it would take an NRSRO approximately 10 hours to process an undertaking prior to furnishing it to the Commission.[562] Therefore, the Commission estimated the total one-time hour burden for these undertakings would be 50 hours.[563]

The Commission did not receive any comments on these specific burden estimates. The Commission notes that Rule 17g–2 has been modified in certain respects that decrease the burden, but also in other respects that will increase burden. For example, requirements to make records identifying the methodology used to determine each credit rating and how the credit rating was made readily available have been eliminated. Further, the retention periods for all the records have been harmonized and the requirement for a non-resident NRSRO to furnish an undertaking has been eliminated. On the other hand, the rule now requires an NRSRO to document its methodologies for determining credit ratings and, if applicable, to make and retain certain records relating to practices with respect to rating structured products. The Commission believes that these adjustments will largely offset each other or result in a net decrease in burden. For example, the elimination of the requirement to identify the methodology used to determine a credit rating would have impacted all NRSROs and required them to make a record for each credit rating (which could be in the many thousands). Conversely, the requirements with respect to structured products only will impact NRSROs that rate these types of securities, which the Commission estimates is less than five. While the Commission could reduce its burden estimate, it is taking a conservative approach to the net results of these changes. For these reasons, the Commission is retaining the rule's overall burden estimates without revision.

3. 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.[564] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[565]

Rule 17g–3 implements this statutory provision by requiring an NRSRO to furnish financial reports to the Commission. We estimated that, on average, it would take an NRSRO approximately 200 hours to prepare for and file the annual financial reports. This estimate was based on the current PRA estimates used for CSEs under Appendix G to Exchange Act Rule 15c3–1, as well as the PRA estimates for supervised investment bank holding companies under Rule 17i–5.[566] Therefore, the Commission estimated that the total annual hour burden to prepare and furnish annual audited financial statements with the Commission would be approximately 6,000 hours.[567]

To comply with Rule 17g–3, an NRSRO would be required to engage the services of an independent public accountant. The Commission estimated that the cost of hiring an accountant would vary substantially based on the size and complexity of the NRSRO. For example, the Commission noted that, based on staff experience, the annual audit costs of a small broker-dealer generally range from $3,000 to $5,000 per year. The Commission estimated 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. For these reasons, the Commission estimated 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.[568]

The Commission did not receive any comments on these specific estimates. The Commission notes that Rule 17g–3 has been modified to decrease the burden. For example, the requirement to comply with all provisions of Regulation S–X has been eliminated, as has the requirement to have the information in the proposed schedules audited. As discussed above, we developed these estimates based on the rule as proposed. We continue to believe the estimates are appropriate for the rule as now modified. Indeed, because we have in a variety of respects narrowed the requirements of the rule, we believe the estimates are likely to be conservative.

4. Rule 17g–4

Section 15E(g)(1) of the Exchange Act[569] 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.[570] 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.[571] Rule 17g–4 implements this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[572] include three specific types of procedures.

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

[560] 300 hours × 30 NRSROs = 9,000 hours.

[561] 254 hours × 30 NRSROs = 7,620 hours.

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

[563] 10 hours × 5 NRSROs = 50 hours.

[564] 15 U.S.C. 78o–7(k). An applicant can request that the Commission keep this information confidential. *See* 17 CFR 200.80 and 17 CFR 200.83.

[565] *Id.*

[566] *See* 17 CFR 240.15c3–1g and 17 CFR 240.17i–5.

[567] 200 hours × 30 NRSROs = 6,000 hours.

[568] $15,000 × 30 NRSROs = $450,000.

[569] 15 U.S.C. 78o–7(g)(1).

[570] 15 U.S.C. 78a *et seq.*

[571] 15 U.S.C. 78o–7(g)(2).

[572] 15 U.S.C. 78o–7(g)(1).

The Commission assumed that most credit rating agencies already have procedures in place to address the specific misuses of material nonpublic information identified in Rule 17g–4.[573] Nonetheless, the Commission anticipated that some NRSROs might need to modify their procedures to comply with the rule. Based on staff experience, the Commission estimated that it would take approximately 50 hours for an NRSRO to establish procedures in conformance with the rule for a total one-time burden of 1,500 hours.[574] The Commission did not receive any comments on these specific estimates and continues to believe that they are appropriate. Therefore, the Commission is retaining these estimates without revision.

E. Collection of Information Is Mandatory

These recordkeeping and notice requirements are mandatory.

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) will not be confidential. However, credit rating agencies and NRSROs may seek confidential treatment of information furnished to the Commission under existing rules, and the Commission will keep this information confidential to the extent permitted by law. The books and records information collected under Rules 17g–2 and 17g–4 will 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 financial reports) will be generated from the internal records of the NRSRO. Pursuant to Section 15E(k) of the Exchange Act, the annual financial reports will be furnished to the Commission on a confidential basis, to the extent permitted by law.[575]

G. Record Retention Period

Paragraph (c) of Rule 17g–2 requires an NRSRO to retain the records for at least three years.

H. Request for Comment

The Commission requested comment on the 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.

VI. Costs and Benefits of the Rules

The Commission is sensitive to the costs and benefits that result from its rules. The Commission identified certain costs and benefits arising from these rules and requested comment on all aspects of the cost-benefit analysis contained therein, including identification and assessment of any costs and benefits not discussed in the analysis.[576] The Commission sought comment and data on the value of the benefits identified. The Commission also elicited comment on the accuracy of the cost estimates in each section of the cost-benefit analysis, and requested those commenters to provide data so the Commission could improve the cost estimates, including identification of industry statistics relied on by commenters to reach conclusions on cost estimates. The Commission also sought comment on the extent to which costs were attributable to requirements set forth in Section 15E of the Exchange Act,[577] rather than the rules. Finally, the Commission requested estimates and views regarding the costs and benefits for particular types of market participants, as well as any other costs or benefits that might result from the rules.

As discussed below, the Commission received very limited comment on the cost-benefit analysis in the proposing release. Except as discussed below, the Commission continues to believe that the specific estimates are appropriate and is retaining these estimates generally without revision.

A. Benefits

The purposes of the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act'') [578] 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.[579] As the Senate Report states, the Rating Agency 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.'' [580]

To these ends, the Rating Agency 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 Rating Agency Act sets out a voluntary mechanism for credit rating agencies to register with the Commission as an NRSRO.[581] 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.[582] The Rating Agency Act also requires an NRSRO to furnish the Commission with periodic financial reports.[583] Further, the Rating Agency Act requires an NRSRO to implement policies to manage the handling of material non-

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

[574] 50 hours × 30 NRSROs = 1,500 hours.

[575] 15 U.S.C. 78o–7(k).

[576] 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.

[577] 15 U.S.C. 78o–7.

[578] Pub. L. 109–291 (2006).

[579] *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'').

[580] *Id.*

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

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

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

public information and conflicts of interest.[584] Pursuant to authority under the Rating Agency Act, the Commission must prohibit certain acts and practices the Commission finds to be unfair, coercive, or abusive.[585]

The rules the Commission is adopting under the Rating Agency Act are being issued pursuant to specific statutory mandates and grants of rulemaking authority. They are designed to further the goals of the Rating Agency Act, including fostering ''competition in the credit rating agency business.'' [586] 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 rules further the goal of increasing competition because they 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 will 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 Rating Agency Act requires NRSROs to make their credit ratings and information about themselves available to the public. Part of the Rating Agency Act's definition of ''credit rating agency'' 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.[587] Under the Rating Agency Act and the rules adopted thereunder, an NRSRO will be required to disclose information about 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 and credit analyst supervisors. The Commission believes that these disclosures will allow users of the credit ratings to compare the credit ratings quality of different NRSROs. Although the information an NRSRO will provide on its Form NRSRO and to comply with the rules cannot substitute for an investor's due diligence in evaluating a credit rating, it will aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the rules implement provisions of the Rating Agency Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO will 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 [588] and the rules thereunder and will subject an NRSRO to disclosure, recordkeeping, and annual financial reporting 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.

Rule 17g–1 prescribes a process for a credit rating agency to register with the Commission as an NRSRO. The rule requires a credit rating agency to apply for registration using Form NRSRO. Form NRSRO requires that a credit rating agency provide information required under Section 15E(a)(1)(B) of the Exchange Act and certain additional information.[589] The additional information will 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.[590] 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 [591] and with the requirements in Sections 15E(g), (h), (i) and (j) of the Exchange Act.[592] Certain other additional information required to be made public will assist users of credit ratings in assessing the credibility of the NRSRO and in comparing the NRSRO with other NRSROs.

Rule 17g–2 implements the Commission's recordkeeping and rulemaking authority under Section 17(a) of the Exchange Act [593] by requiring an NRSRO to make and retain certain records related to its business as a credit rating agency. This recordkeeping rule will assist the Commission in monitoring whether an NRSRO is complying with provisions of Section 15E of the Exchange Act and the rules thereunder by requiring information about each NRSRO's financial condition, management, and operations. This information will permit the Commission to observe differences between NRSROs and changes over time in individual NRSROs. The information also will permit the Commission to review whether an NRSRO is operating consistently with the methodologies and procedures it establishes 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.[594] The section also provides that the Commission may, by rule, require that an independent public accountant certify the financial statements.[595] Rule 17g–3 implements this rulemaking authority by requiring an NRSRO to furnish annual financial reports to the Commission. This rule will enhance Commission oversight of an NRSRO. Specifically, it will aid the Commission in monitoring whether the initiation of a proceeding under Section 15E(d) of the Exchange Act will be appropriate because the NRSRO ''fails to maintain adequate financial and managerial resources to consistently produce credit

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

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

[586] *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'').

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

[588] 15 U.S.C. 78o–7.

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

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

[591] 15 U.S.C. 78o–7(a)(1)(B).

[592] 15 U.S.C. 78o–7(g), (h), (i) and (j).

[593] 15 U.S.C. 78q(a)(1).

[594] 15 U.S.C. 78o–7(k).

[595] *Id.*

ratings with integrity.'' [596] In addition, the financial reports also will assist the Commission in monitoring potential conflicts of interests of a financial nature arising from the operation of an NRSRO.[597]

Section 15E(g)(1) of the Exchange Act [598] 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.[599] 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, nonpublic information.[600] Rule 17g–4 implements this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act [601] include three specific types of procedures. These specific procedures 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.[602] By providing this baseline, the rule is designed to ensure that an NRSRO establishes adequate procedures and controls to protect material nonpublic information.

Rule 17g–5 implements Section 15E(h)(2) of the Exchange Act [603] by requiring an NRSRO to disclose and manage certain conflicts of interest, as well as specifically prohibiting other conflicts of interest. This rule will 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.[604]

Rule 17g–6 prohibits an NRSRO from engaging in certain unfair, abusive, or coercive acts or practices. These prohibitions are designed to enhance the integrity of NRSROs, promote competition and fulfill a statutory mandate.

The Commission requested 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. The Commission did not receive any comments in response to this request.

B. Costs

The Rating Agency Act requires that the rules and regulations that the Commission may prescribe ''be narrowly tailored'' to meet its requirements.[605] The rules being adopted 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 will 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 provided 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 will comply substantially with the requirements.

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

For these reasons, the cost estimates represent the average cost across all NRSROs (regardless of size) and take into account that many firms will only be required to augment existing policies, procedures, and recordkeeping systems and processes to come into compliance with the rules. Furthermore, as discussed with respect to the Paperwork Reduction Act of 1995 (''PRA''),[606] the Commission is requiring additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act.[607] Therefore, the cost estimates for Rule 17g–1 include estimates that arise from requirements imposed by Section 15E of the Exchange Act.[608] The intent is to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that will be required under Rule 17g–1. Thus, those estimates do not seek to capture costs that are solely attributable to requirements in Section 15E of the Exchange Act.[609]

The Commission requested commenters to provide data for the costs that would be solely attributable to the requirements of Section 15E of the Exchange Act. The Commission received one comment from an entity that the overall cost of complying with the rules would be $207,515.[610] The commenter did not provide any further detail on how these costs would be solely attributable to the Commission's proposed rules (as opposed to provisions of the Rating Agency Act).[611] The commenter also did not identify the specific costs that would arise from each discreet rule provision.[612] The Commission believes that the estimated costs the commenter would incur if registered as an NRSRO are included in the cost estimates discussed below.

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 [613] and the total estimated annual cost to NRSROs resulting from these rule proposals would be approximately $3,955,500 per year.[614]

1. 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

[596] 15 U.S.C. 78o–7(d).

[597] *See, e.g.*, 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.

[598] 15 U.S.C. 78o–7(g)(1).

[599] 15 U.S.C. 78a *et seq.*

[600] 15 U.S.C. 78o–7(g)(2).

[601] 15 U.S.C. 78o–7(g)(1).

[602] 15 U.S.C. 78o–7(g).

[603] 15 U.S.C. 78o–7(h)(2).

[604] 15 U.S.C. 78o–7(a)(1)(B)(vi) and (h).

[605] 15 U.S.C. 78o–7(c)(2).

[606] 44 U.S.C. 3501 *et seq.* 5 CFR 1320.11.

[607] 15 U.S.C. 78o–7(a)(1)(B).

[608] 15 U.S.C. 78o–7.

[609] *Id.*

[610] *See* Lace Letter.

[611] *Id.*

[612] *Id.*

[613] 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 + $241,200 + $1,845,000 + $30,000 + $307,500 = $4,936,325.

[614] 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 = $3,955,500.

of investors.[615] Rule 17g–1 [616] implements this statutory provision by requiring a credit rating agency to furnish an initial application on a completed Form NRSRO to apply to be registered under section 15E of the Exchange Act.[617]

NRSROs will incur costs to register under Section 15E of the Exchange Act and Rule 17g–1.[618] As discussed above with respect to PRA, the Commission estimates that an NRSRO will spend approximately 300 hours to complete and furnish an initial Form NRSRO. Also, as discussed with respect to the PRA, the Commission estimates there will be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO will be $66,900 [619] and the total aggregate one-time cost to the industry will be $2,007,000.[620]

Also, as discussed with respect to the PRA, the Commission anticipates that an NRSRO likely will engage outside counsel to assist in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney will spend on this work will depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average, an outside counsel will spend approximately 40 hours assisting an NRSRO in preparing its application for registration. The Commission further estimates that this work will 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 will be approximately $400 per hour. For these reasons, the Commission estimates that the average one-time cost to an NRSRO will be $16,000 [621] and the one-time cost to the industry will be $480,000.[622]

Under Rule 17g–1, an NRSRO applying to be registered for an additional class of credit ratings will be required to file an amended Form NRSRO with the Commission.[623] As discussed with respect to the PRA, the Commission estimates, on average, an NRSRO will 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 will apply to register for an additional class of credit ratings. For these reasons, the Commission estimates that the average one-time cost to an NRSRO will be $5,125 [624] and the total aggregate one-time cost to the industry will be $25,625.[625]

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.[626] Rule 17g–1 requires an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO.[627] As discussed with respect to the PRA, the Commission estimates that an NRSRO will furnish two amendments on Form NRSRO per year on average. The Commission also estimates with respect to the PRA that it will take approximately 25 hours to prepare and furnish an amendment and that there will be 30 NRSROs. For these reasons, the Commission estimates that the average annual cost to an NRSRO will be $10,250 [628] and the total aggregate annual cost to the industry will be $307,500.[629]

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[630] Rule 17g–1 will require an NRSRO to furnish the annual certification on Form NRSRO.[631] As discussed with respect to the PRA, the Commission estimates an NRSRO will spend approximately 10 hours per year completing and furnishing the annual certification and that there will be 30 NRSROs. For these reasons, the Commission estimates that the average annual cost to an NRSRO will be $2,050 [632] and the total aggregate annual cost to the industry will be $61,500.[633]

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.[634] Rule 17g–1 requires that this be done within 10 business days of the granting of an NRSRO's application or the furnishing of an amendment to the form or annual certification.[635] 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 will 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 will be 30 NRSROs. For these reasons, the Commission estimates that an NRSRO will incur an average one-time cost of $8,040 and an average annual cost of $2,680.[636] Consequently, the total aggregate one-time cost to the industry will be $241,200 [637] and total aggregate annual cost to the industry will be $80,400 per year.[638]

The Commission believes the requirements in Rule 17g–1 to furnish a notice on Form NRSRO when an NRSRO withdraws its registration will result in *de minimis* costs.

The Commission requested comment on these cost estimates. We also requested comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes. Comment also was sought on whether these requirements 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 were asked to identify the

[615] 15 U.S.C. 78o–7(a)(1).

[616] *See* paragraphs (a), (c) and (h) of Rule 17g–1.

[617] 15 U.S.C. 78o–7.

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

[619] The Commission estimates that a credit rating agency will 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 will be approximately $66,900 [(300 hours) × ($223 per/hour)].

[620] 30 NRSROs × $66,900 = $2,007,000.

[621] $400 per hour × 40 hours = $16,000.

[622] $16,000 × 30 NRSROs = $480,000.

[623] *See* paragraph (b) of Rule 17g–1.

[624] The Commission estimates an NRSRO will 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 will be $5,125 [(25 hours for one year) × ($205)].

[625] 5 NRSROs × $5,125 = $25,625.

[626] 15 U.S.C. 78o–7(b)(1).

[627] *See* paragraph (e) of Rule 17g–1.

[628] Based on the PRA estimates, an NRSRO will spend approximately 50 hours each year updating its application on Form NRSRO (25 hours per amendment × two amendments). The Commission estimates an NRSRO will 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 will be $10,250 [(50 hours per year) × ($205 per hour)].

[629] $10,250 × 30 NRSROs = $307,500.

[630] 15 U.S.C. 78o–7(b)(2).

[631] *See* paragraph (f) Rule 17g–1.

[632] The Commission estimates an NRSRO will 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 will be $2,050 [(10 hours per year) × ($205 per hour)].

[633] $2,050 × 30 NRSROs = $61,500.

[634] 15 U.S.C. 78o–7(a)(3).

[635] *See* paragraph (i) of Rule 17g–1.

[636] The Commission estimates that an NRSRO will 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 will be $8,040 [(30 hours) × ($268 per hour)] and the average annual cost will be $2,680 [(10 hours per year) × ($268 per hour)].

[637] $8,040 × 30 NRSROs = $241,200.

[638] $2,680 × 30 NRSROs = $80,400.

metrics and sources of any empirical data that supported their costs estimates. The Commission did not receive any comments in response to these requests.

2. Rule 17g–2

Section 17(a)(1) of the Exchange Act[639] 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.[640] Rule 17g–2 implements 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, will 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 will incur an average one-time cost of $61,500 and an average annual cost of $52,070.[641] Consequently, the total aggregate one-time cost to the industry will be $1,845,000,[642] and the total aggregate annual cost to the industry will be $1,562,100 per year.[643]

Furthermore, as discussed above with respect to the PRA, the Commission also estimates that an NRSRO may be required to purchase recordkeeping system software to establish a recordkeeping system in conformance with the rule. The Commission estimates that the cost of the software will vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSROs will not require such software because they already have adequate recordkeeping systems or, given their small size, such software will not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs will be approximately $1,000 per firm. Therefore, the one-time cost to the industry will be $30,000.[644]

The Commission requested comment on these cost estimates. We also requested comment on whether there would be costs in addition to those identified above, such as costs arising from restructuring business practices. Comment also was sought on whether these rules 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 were asked to identify the metrics and sources of any empirical data that supported their costs estimates. The Commission did not receive any comments in response to these requests.

3. Rule 17g–3

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis[645] 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.[646] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[647]

Rule 17g–3 implements this statutory provision by requiring an NRSRO to furnish annual financial reports to the Commission. As discussed above with respect to the PRA, the Commission estimates that an NRSRO, on average, will spend approximately 200 hours per year preparing for and furnishing these financial reports. For these reasons, the Commission estimates that the average annual cost to an NRSRO will be $49,800[648] and the total aggregate annual cost to the industry will be $1,494,000.[649]

As noted above, the average one-time and annual costs to NRSROs will 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 may be required to make changes to their accounting systems to comply with the requirements in Rule 17g–3. The Commission believes these costs will vary depending on the size and complexity of the NRSRO. The Commission sought comment on the costs that would be incurred to make changes to their accounting systems.

The Commission received one comment in response to this specific request from a large credit rating agency.[650] The commenter stated that it would cost between $6 and $8 million to develop a system that could capture revenues received by the credit rating agency and its affiliates from customers in order to create the list of large customers that could be audited.[651] The Commission notes, as an initial matter, that Section 15E(a)((B)(viii) of the Exchange Act requires an NRSRO to create this list with respect to issuers and subscribers.[652] Consequently, the costs of developing a system that can capture this information can largely be attributed to the statute. Nonetheless, Rule 17g–3 has been modified in ways that the Commission believes will largely reduce these costs. First, an NRSRO is not required to include revenue received by affiliates that are not part of the credit rating organization in determining this list. Second, the list is now a separate financial report that is not required to be audited. Third, the definition of net revenue was modified to refer to revenues ''earned'' by the NRSRO (as opposed to revenues ''received''). This is designed to provide flexibility so that each NRSRO can define ''revenues'' consistent with how its accounting system recognizes revenues. The Commission believes these modifications significantly reduce the operational difficulties in determining the list of large customers.

As discussed above with respect to the PRA, an NRSRO will be required to engage the services of independent public accountant to comply with Rule 17g–3. The cost of hiring an account will vary substantially based on the size and complexity of the NRSRO. As the 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 will likely be comparable to the costs incurred by a

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

[640] *Id.*

[641] The Commission estimates that an NRSRO will 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 will be $61,500 [(300 hours) × ($205 per hour)] and the average annual cost will be $52,070 [(254 hours per year) × ($205 per hour)].

[642] $61,500 × 30 NRSROs = $1,845,000.

[643] $52,070 × 30 NRSROs = $1,562,100.

[644] $1,000 × 30 NRSROs = $30,000.

[645] An applicant can request that the Commission keep this information confidential to the extent permitted by law. *See* 17 CFR 200.80 and 17 CFR 200.83.

[646] 15 U.S.C. 78o–7(k).

[647] *Id.*

[648] The Commission estimates that a senior internal auditor will 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 will be $49,800 [(200 hours per year) × ($249 per hour)].

[649] $49,800 × 30 NRSROs = $1,494,000.

[650] *See* Fitch Letter.

[651] *Id.*

[652] 15 U.S.C. 78o–7(a)(1)(B)(viii).

small broker-dealer. The costs for a large NRSRO will be much greater. However, many of these firms already are audited by a public accountant for other regulatory purposes. For these reasons, the Commission estimates that the average annual cost across all NRSROs to engage the services of an independent public account will be approximately $15,000. Therefore, the annual cost to the industry will be $450,000.[653]

The Commission requested comment on these cost estimates. We also requested comment on whether there would be costs in addition to those identified above. Comment was sought on whether these requirements 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 were asked to identify the metrics and sources of any empirical data that supported their costs estimates. Other than the one comment discussed above, the Commission did not receive any comments in response to these requests.

4. Rule 17g–4

Section 15E(g)(1) of the Exchange Act[654] 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.[655] 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.[656] Rule 17g–4 implements this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[657] include three specific types of procedures.

As discussed above with respect to PRA, the Commission estimates that it will take approximately 50 hours for an NRSRO to establish procedures in conformance with the rule and that there will be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO will be $10,250[658] and the total aggregate one-time cost to the industry will be $307,500.[659]

The Commission requested comment on these cost estimates. We also requested comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes and restructuring business practices. Comment also was sought on whether these requirements 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 were asked to identify the metrics and sources of any empirical data that supported their costs estimates. The Commission did not receive any comments in response to these requests.

5. Rules 17g–5 and 17g–6

Rules 17g–5 and 17g–6 are conduct rules that 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. 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 Rule 17g–5 will result in any significant incremental costs.

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

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

Under Section 3(f) of the Exchange Act,[660] 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[661] 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 view is that the rules will promote efficiency, competition, and capital formation. As discussed above with respect to the costs and benefits of the rules, the primary purpose of the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act'')[662] is to foster ''competition in the credit rating agency business.''[663] 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 rules implementing provisions of the Rating Agency Act further the Rating Agency Act's goal of increasing competition because they will 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 will make it easier for more credit rating agencies to apply for registration. Increased competition in the credit ratings business may lower the cost to issuers, obligors, and underwriters of obtaining credit ratings.

In addition, the Rating Agency 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 Rating Agency Act is that the entity must be in the business of

[653] $15,000 × 30 NRSROs = $450,000.

[654] 15 U.S.C. 78o–7(g)(1).

[655] 15 U.S.C. 78a *et seq.*

[656] 15 U.S.C. 78o–7(g)(2).

[657] 15 U.S.C. 78o–7(g)(1).

[658] The Commission estimates an NRSRO will 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 will be $10,250 [(50 hours) × ($205)].

[659] 30 NRSROs × $10,250 = $307,500.

[660] 15 U.S.C. 78c(f).

[661] 15 U.S.C. 78w(a)(2).

[662] Pub. L. 109–291 (2006).

[663] *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'').

issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[664] Under the Rating Agency Act and the rules adopted thereunder, an NRSRO will be required to disclose information about 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 and credit analyst supervisors. The Commission believes that these disclosures will allow users of the credit ratings to compare the ratings quality of different NRSROs. Although the information an NRSRO will provide on its Form NRSRO and to comply with the rules cannot substitute for an investor's due diligence in evaluating a credit rating, it will aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the rules implement provisions of the Rating Agency Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO will 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 rules thereunder and will 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 may promote participation in the securities markets and facilitate capital formation. Better quality credit 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 may 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 sought comment on these matters. In particular, the Commission solicited comment on whether the 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 was sought on whether the rules would promote efficiency, competition, and capital formation. Commenters were requested to provide empirical data and other factual support for their views, if possible.

The Commission received several comments on how the rules will impact competition.[665] Many commenters weighing in on this issue stated that the rules will further the goals of the Rating Agency Act by fostering more competition.[666] Other commenters stated that the rules create undue burden and would be a barrier to entry for new or smaller credit rating agencies.[667] In response to this concern, the Commission notes that the rules have been modified in ways designed to decrease burden. Some of these modifications address specific issues raised by the commenters. For example, one commenter stated that the requirements to provide background information on each credit analyst and for non-resident NRSROs to provide a special undertaking should be eliminated.[668] As discussed above with respect to Form NRSRO and Rule 17g–2, these requirements have been eliminated. As discussed above in the sections on each rule, the Commission believes that the requirements in the rules that have been retained are necessary and narrowly tailored. The Commission believes these requirements represent a proper balance in promoting competition and the quality and integrity of credit ratings, and in fulfilling the Commission's statutory mandate to create a regulatory framework for NRSROs.

Finally, the Commission also notes that most of the commenters that weighed in on the prohibition in Rule 17g–6(a)(4) expressed an opinion as to how the provision, as proposed, would impact competition. For example, many of the commenters stated that the 85% threshold in the proposed rule was too high and, therefore, the prohibition would not achieve the desired goal of increasing competition insomuch as it would maintain the status quo in which the two largest credit rating agencies dominate the market for rating structured products.[669] On the other side of the issue, as discussed in the section describing Rule 17g–6, commenters argued that the Commission has insufficient data upon which to make a finding that a specific practice is unfair, abusive, or coercive and, consequently, the prohibition, as proposed, would interfere with natural market forces.[670]

The Commission notes that the rule has been modified to eliminate the 85% threshold. The rule now prohibits the practices where the practice is engaged in for an anticompetitive purpose. In this way, the rule is designed to prohibit conduct that inappropriately stifles competition and, at the same time, avoid the establishment of artificial constraints that could interfere with natural market forces. The Commission recognizes that the two largest credit rating agencies dominate the market for rating structured products. Consequently, the Commission intends—aided by the enhanced recordkeeping requirements around rating structured products—to monitor closely the practices NRSROs employ in this area.

VIII. Final Regulatory Flexibility Analysis

The Commission proposed Rules 17g–1, 17g–2, 17g–3, 17g–4, 17g–5, and 17g–6 and Form NRSRO in the proposing release under Section 15E of the Exchange Act.[671] An Initial Regulatory

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

[665] *See, e.g.*, Gross Letter; AFP Letter; FSR Letter; ICI Letter; AEI Letter.

[666] *See, e.g.*, Gross Letter; AFP Letter; FSR Letter; ICI Letter.

[667] *See, e.g.*, AEI Letter.

[668] *Id.*

[669] *See, e.g.*, DBRS Letter; Fitch Letter; letter dated February 13, 2007 from Janet M. Tavakoli, President, Tavakoli Structured Finance, Inc.; letter dated February 14, 2007 from Gregory G. Raab, Chief Executive Officer, Axon; letter dated February 16, 2007 from Emile Van den Bol, Managing Director, Deutsche Bank; letter dated February 16, 2007 from Kent D. Born, Senior Managing Director, PPM America; letter dated February 23, 2007 from Patti Unti, Managing Director, Capmark Investments LP; letter dated February 23, 2007 from David Lazarus, Managing Director, Capmark Securities, Inc.; letter dated February 28, 2007 from Ronald E. Schrager, Chief Executive Officer, LNR Property Corporation; letter dated March 5, 2007 from David Hynes, Partner, Northcross Capital LLP; letter dated March 6, 2007 from S. Trezevant Moore, Jr., President & COO, Luminent Mortgage Capital, Inc.; letter dated March 7, 2007 from Bruce E. Stern, Chairman, Government Affairs Committee, Association of Financial Guaranty Insurers; letter dated March 8, 2007 from Majorie E. Gross; letter dated March 9, 2007 from Petra Spiegel, Eurohypo AG; letter dated March 9, 2007 from Landon D. Parsons, Managing Director, G–Bass; letter dated March 9, 2007 from Pat G. Halter, Chief Executive Officer, Principal Real Estate Investors; letter dated March 12, 2007 from Charles Covell, Executive Vice President, Citigroup Alternative Investments; letter dated March 12, 2007 from Rodney J. Dillman, General Counsel, Babson Capital Management LLC; letter dated March 12, 2007 from Louis C. Lucido, Group Managing Director, Trust Company of the West; letter dated March 12, 2007 from Daniel Ivascyn, Managing Director, PIMCO.

[670] *See, e.g.*, S&P Letter; Moody's Letter; R&I Letter; FSR Letter; Rutherfurd Letter; Langohr Letter; AST Letter.

[671] 15 U.S.C. 78o–7.

Flexibility Analysis (''IRFA'') was published in the proposing release. The Commission has prepared the following Final Regulatory Flexibility Analysis (FRFA), in accordance with the provisions of the Regulatory Flexibility Act,[672] regarding Rules 17g–1, 17g–2, 17g–3, 17g–4, 17g–5, and 17g–6 and Form NRSRO under Section 15E of the Exchange Act.[673]

A. Need for and Objective of the Rules

The rules implement specific provisions of the Credit Rating Agency Reform Act of 2006 (the ''Rating Agency Act'').[674] The Rating Agency 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.

The objectives of the Rating Agency 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.'' [675] The rules are designed to further these objectives and to: Assist the Commission in determining whether an entity should be registered as an NRSRO; assist the Commission in reviewing whether an NRSRO complies with the provisions of the Rating Agency Act and rules thereunder; adhere to 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.

B. Significant Issues Raised by Commenters

The Commission sought comment with respect to every aspect of the IRFA, including comments with respect to the number of small entities that may be affected by the proposed rules. Commenters were asked to specify the costs of compliance with the proposed rules and suggest alternatives that would accomplish the goals of the rules. The Commission did not receive any specific comments on the IRFA. The Commission did, however, receive a limited number of comments that discussed the effect the rules might have on smaller credit rating agencies, although these commenters did not address whether their comments pertained to entities that would be small businesses for purposes of Regulatory Flexibility Act analysis. For example, one commenter stated that the rules, as proposed, created an undue burden and would be a barrier to entry for new or smaller credit rating agencies.[676] Several commenters stated that the prohibition in Rule 17g–5 from having a conflict with respect to a client that has provided 10% or more of the NRSRO's annual revenues could prevent smaller credit rating agencies from registering as NRSROs.[677]

C. Legal Basis

The Commission is adopting the rules pursuant to the Exchange Act [678] and, particularly, Section 15E of the Exchange Act.[679]

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.'' [680] 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 will be registered as NRSROs. Moreover, as also noted above, the Senate Report accompanying the Rating Agency 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 will be ''small'' entities.[681] 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.[682]

E. Reporting, Recordkeeping, and Other Compliance Requirements

A credit rating agency seeking to apply to the Commission for registration as an NRSRO will apply using Form NRSRO.[683] The Form elicits certain information and requires the credit rating agency to attach a number of documents as Exhibits (some of which would have to be made publicly available) and certifications from qualified institutional buyers. The public Exhibits consist of information about credit ratings performance data, the credit rating agency's 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 the credit rating agency's credit analysts. To the extent permitted by law, the confidential Exhibits 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) generally will be required to promptly update the public information on its Form NRSRO whenever an Item or Exhibit becomes materially inaccurate. To update information, the NRSRO must furnish the Commission with an amendment using Form NRSRO. In addition, the NRSRO must furnish the Commission with an annual certification on Form NRSRO.[684] In the annual certification, the NRSRO must represent that all information on the Form, as amended, continues to be accurate, list any material changes made during the previous year, and 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 must make Form NRSRO and the public Exhibits submitted to the Commission, and all amendments, readily accessible to the public.

NRSROs also are subject to a recordkeeping rule.[685] This rule requires an NRSRO to make and retain certain records relating to the business of issuing credit ratings. These records will assist the Commission, through its examination process, in monitoring whether the NRSRO continues to maintain adequate financial and

[672] 5 U.S.C. 603.

[673] 15 U.S.C. 78o–7.

[674] Pub. L. 109–291 (2006).

[675] *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'').

[676] *See* AEI Letter.

[677] *See, e.g.,* Fitch Letter; AEI Letter; AST Letter; ASF Letter.

[678] 15 U.S.C. 78a *et seq.*

[679] 15 U.S.C. 78o–7.

[680] 17 CFR 240.0–10(a).

[681] *See* 17 CFR 240.0–10(a).

[682] *Id.*

[683] Rule 17g–1.

[684] *Id.*

[685] Rule 17g–2.

managerial resources to consistently produce credit ratings with integrity (as required under the Rating Agency Act) and whether the NRSRO is complying with the provisions of the Rating Agency Act, the rules adopted thereunder, and the NRSRO's disclosed policies and procedures.

On an annual fiscal year basis, an NRSRO must furnish the Commission with audited financial statements.[686] This requirement is designed to assist the Commission in monitoring whether the NRSRO continues to maintain adequate financial resources to consistently produce credit ratings with integrity. It also is designed to assist the Commission in monitoring whether the NRSRO is complying with provisions of the Rating Agency Act and the rules adopted thereunder regarding potential conflicts of interest arising from dealings with large customers in terms of revenues earned.

Finally, all NRSROs will be subject to requirements designed to protect their impartiality with respect to issuing credit ratings. First, they must establish, maintain, and enforce specific written policies designed to prevent the misuse of material non-public information.[687] Second, an NRSRO is prohibited from having certain general conflicts unless it, as required under the Rating Agency Act, disclosed the conflict and adopted procedures to manage the conflict.[688] Further certain conflicts of interest—for example, rating a security owned by the NRSRO—are prohibited.[689] Third, NRSROs are prohibited from engaging in certain practices that the Commission has found to be unfair, coercive, or abusive practices.[690]

F. Duplicative, Overlapping, or Conflicting Federal Rules

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

G. Significant Alternatives

Pursuant to section 3(a) of the RFA,[691] 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 appropriate to establish different compliance or reporting requirements or timetables; clarify, consolidate, or simplify compliance and reporting requirements under the rules for small entities; or exempt small entities from coverage of the rules, or any part of the rules. The Rating Agency Act and the rules establish a voluntary program of registration and supervision that allows all NRSROs the flexibility to develop procedures tailored to their specific organizational structures and business models. Further, many of the rules, as adopted, are due to a direct statutory mandate. 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 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 rules.

As for the comment that the rules will be a barrier to entry for small entities, the Commission notes that the commenter did not specify how the rules would disproportionately burden small entities, nor did it provide cost estimates for small entities.[692] The Commission believes the burden associated with the rules will impact all NRSROs in a proportionate manner based on their size and complexity. Therefore, the Commission does not believe it would be appropriate to prescribe lesser requirements for small entities, nor have any commenters suggested lesser requirements.

Further, the Commission notes that the rules, as adopted, have been modified in ways designed to decrease burden. Some of these modifications address specific issues raised by the commenter.[693] For example, the commenter stated that the requirements to provide background information on each credit analyst and for non-resident NRSROs to provide a special undertaking should be eliminated.[694] These requirements have been eliminated. As discussed above in the sections on each rule, the Commission believes that the requirements in the rules that have been retained are necessary and narrowly tailored.

As for the comment that the prohibition on having a conflict with respect to a client that has provided 10% or more of the NRSRO's revenues, the Commission notes that the commenters did not provide any supporting data. In addition, no commenter specifically identifying itself as a small entity raised this prohibition as an issue.[695] The Commission believes that it would be highly unusual for a small credit rating agency to derive 10% or more of its revenues from a single client and, if this was the case, that it would very difficult for the credit rating agency to issue an impartial rating requested by the client. The Commission notes that the smaller credit rating agencies tend to use a subscriber fee-based business model. Thus, they are not paid to determine specific credit ratings and, consequently, would not be impacted by this prohibition.

IX. Statutory Authority

The Commission is adopting 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.[696]

Text of Rules

List of Subjects

17 CFR Parts 240 and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

■ In accordance with the foregoing, the Commission hereby amends Title 17, Chapter II of the Code of Federal Regulation 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, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 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.

* * * * *

[686] Rule 17g–3.

[687] Rule 17g–4.

[688] Rule 17g–5.

[689] *Id.*

[690] Rule 17g–6.

[691] 5 U.S.C. 603(c).

[692] *See* AEI letter.

[693] *Id.*

[694] *Id.*

[695] The Commission intends to monitor how the prohibition operates in practice, particularly with respect to structured products. If the prohibition interferes with how NRSROs as a matter of course deal with structured product sponsors, the Commission will evaluate whether the rule should be modified to accommodate this business practice or whether an exemption would be appropriate.

[696] 15 U.S.C. 78c(b), 78o–7, 78q, 78w, and 78mm.

■ 2. An undesignated center heading and §§ 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 financial reports 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.

Nationally Recognized Statistical Rating Organizations

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

(a) *Initial application.* 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 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) *Application to register for an additional class of credit ratings.* A nationally recognized statistical rating organization applying to register for an additional class of the 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 application to add a class of credit ratings on Form NRSRO that follows all applicable instructions for the Form. The application will be subject to the requirements of section 15E(a)(2) of the Act (15 U.S.C. 78o–7(a)(2)).

(c) *Supplementing an application prior to final action by the Commission.* An applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an initial application to be registered as a nationally recognized statistical rating organization or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information that was found to be materially inaccurate. The applicant also must promptly furnish the Commission with an application supplement on Form NRSRO that follows all applicable instructions for the Form.

(d) *Withdrawing an application.* An applicant may withdraw an initial application to be registered as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings 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.

(e) *Update of registration.* A nationally recognized statistical rating organization amending materially inaccurate information in its application for registration pursuant to section 15E(b)(1) of the Act (15 U.S.C. 78o–7(b)(1)) must promptly furnish the Commission with the update of its registration on Form NRSRO that follows all applicable instructions for the Form.

(f) *Annual certification.* A nationally recognized statistical rating organization amending its application for registration pursuant to section 15E(b)(2) of the Act (15 U.S.C. 78o–7(b)(2)) must 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.

(g) *Withdrawal from registration.* A nationally recognized statistical rating organization withdrawing from registration pursuant to section 15E(e)(1) of the Act (15 U.S.C. 78o–7(e)(1)) must furnish the Commission with a notice of withdrawal from registration on Form NRSRO that follows all applicable instructions for the Form. The withdrawal from registration will become effective 45 calendar days after the notice is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors.

(h) *Furnishing Form NRSRO.* A Form NRSRO submitted under any paragraph of this section will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form. Information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law.

(i) *Public availability of Form NRSRO.* A nationally recognized statistical rating organization must make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 to Form NRSRO publicly available on its Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission order granting an initial application for registration as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings and within 10 business days after furnishing a Form NRSRO to the Commission under paragraphs (e), (f), or (g) of this section.

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

(a) *Records required to be made and retained.* A nationally recognized statistical rating organization must make and retain the following books and records, which must be complete and current:

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

(2) Records with respect to each current credit rating of the nationally recognized statistical rating organization indicating (as applicable):

(i) The identity of any credit analyst(s) that participated in determining the credit rating;

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

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

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

(3) An account record for each person (for example, an obligor, issuer, underwriter, or other user) that has paid the nationally recognized statistical rating organization for the issuance or maintenance of a credit rating indicating:

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

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

(4) An account record for each subscriber to the credit ratings and/or credit analysis reports of the nationally recognized statistical rating organization indicating the identity and address of the subscriber.

(5) A record listing the general types of services and products offered by the nationally recognized statistical rating organization.

(6) A record documenting the established procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings.

(7) A record that lists each security and money market instrument and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the nationally recognized statistical rating organization, in determining the credit rating for the security or money market instrument, treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the nationally recognized statistical rating organization by any or a combination of the following methods:

(i) Determining credit ratings for the unrated assets;

(ii) Performing credit assessments or determining private credit ratings for the unrated assets;

(iii) Determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration the internal credit analysis of another person; or

(iv) Determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration (but not necessarily adopting) the credit ratings of another nationally recognized statistical rating organization.

(b) *Records required to be retained.* A nationally recognized statistical rating organization must retain the following books and records (excluding drafts of documents) that relate to its business as a credit rating agency:

(1) Significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports furnished by the nationally recognized statistical rating organization to the Commission pursuant to § 240.17g–3.

(2) Internal records, including nonpublic information and work papers, used to form the basis of a credit rating issued by the nationally recognized statistical rating organization.

(3) Credit analysis reports, credit assessment reports, and private credit rating reports of the nationally recognized statistical rating organization and internal records, including nonpublic information and work papers, used to form the basis for the opinions expressed in these reports.

(4) Compliance reports and compliance exception reports.

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

(6) Marketing materials of the nationally recognized statistical rating organization that are published or otherwise made available to persons that are not associated with the nationally recognized statistical rating organization.

(7) External and internal communications, including electronic communications, received and sent by the nationally recognized statistical rating organization and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating.

(8) Internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another nationally recognized statistical rating organization for the purpose of determining a credit rating for a security or money market instrument issued by an asset pool or part of any asset-backed or mortgage-backed securities transaction.

(9) For each security or money market instrument identified in the record required to be made and retained under paragraph (a)(7) of this section, any document that contains a description of how assets within such pool or as a part of such transaction not rated by the nationally recognized statistical rating organization but rated by another nationally recognized statistical rating organization were treated for the purpose of determining the credit rating of the security or money market instrument.

(10) Form NRSROs (including Exhibits and accompanying information and documents) submitted to the Commission by the nationally recognized statistical rating organization.

(c) *Record retention periods.* The records required to be retained pursuant to paragraphs (a) and (b) of this section must be retained for three years after the date the record is made or received.

(d) *Manner of retention.* An original, or a 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 principal office of the nationally recognized statistical rating organization 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 nationally recognized statistical 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 be in substantially the following form:

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

A nationally recognized statistical rating organization that engages a third-party record custodian remains responsible for complying with every provision of this section.

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

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

(a) A nationally recognized statistical rating organization must annually, not more than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO), furnish the Commission, at the Commission's principal office in Washington, DC, with the following financial reports as of the end of its most recent fiscal year:

(1) Audited financial statements of the nationally recognized statistical rating organization or audited consolidated financial statements of its parent if the nationally recognized statistical rating organization is a separately identifiable

division or department of the parent. The audited financial statements must:

(i) Include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity;

(ii) Be prepared in accordance with generally accepted accounting principles in the jurisdiction in which the nationally recognized statistical rating organization or its parent is incorporated, organized, or has its principal office; and

(iii) Be certified by an accountant who is qualified and independent in accordance with paragraphs (a), (b), and (c)(1), (2), (3), (4), (5) and (8) of § 210.2–01 of this chapter. The accountant must give an opinion on the financial statements in accordance with paragraphs (a) through (d) of § 210.2–02 of this chapter.

(2) If applicable, unaudited consolidating financial statements of the parent of the nationally recognized statistical rating organization that include the nationally recognized statistical rating organization.

Note to paragraph (a)(2): This financial report must be furnished only if the audited financial statements provided pursuant to paragraph (a)(1) of this section are consolidated financial statements of the parent of the nationally recognized statistical rating organization.

(3) An unaudited financial report providing information concerning the revenue of the nationally recognized statistical rating organization in each of the following categories (as applicable) for the fiscal year:

(i) Revenue from determining and maintaining credit ratings;

(ii) Revenue from subscribers;

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

(iv) Revenue from all other services and products (include descriptions of any major sources of revenue).

(4) An unaudited financial report providing the total aggregate and median annual compensation of the credit analysts of the nationally recognized statistical rating organization for the fiscal year.

Note to paragraph (a)(4): In calculating total and median annual compensation, the nationally recognized statistical rating organization may exclude deferred compensation, provided such exclusion is noted in the report.

(5) An unaudited financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the nationally recognized statistical rating organization by amount of net revenue attributable to the issuer or subscriber during the fiscal year. Additionally, include on the list any obligor or underwriter that used the credit rating services provided by the nationally recognized statistical rating organization if the net revenue attributable to the obligor or underwriter during the fiscal year equaled or exceeded the net revenue attributable to the 20th largest issuer or subscriber. Include the net revenue amount for each person on the list.

Note to paragraph (a)(5): A person is deemed to have ''used the credit rating services'' of the nationally recognized statistical rating organization if the person is any of the following: an obligor that is rated by the nationally recognized statistical rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market instruments subject to a credit rating of the nationally recognized statistical rating organization (regardless of whether the issuer paid for the credit rating); any other person that has paid the nationally recognized statistical 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, credit ratings data, or credit analysis of the nationally recognized statistical rating organization. In calculating net revenue attributable to a person, the nationally recognized statistical rating organization should include all revenue earned by the nationally recognized statistical rating organization for any type of service or product, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person by the nationally recognized statistical rating organization.

(b) The nationally recognized statistical rating organization must attach to each financial report furnished pursuant to paragraph (a) of this section a signed statement by a duly authorized person associated with the nationally recognized statistical rating organization that the person has responsibility for the report and, to the best knowledge of the person, the financial report fairly presents, in all material respects, the financial condition, results of operations, cash flows, revenues, and analyst compensation, as applicable, of the nationally recognized statistical rating organization for the period presented.

(c) The Commission may grant an extension of time or an exemption with respect to any requirements in this section either unconditionally or on specified terms and conditions on the written request of a nationally recognized statistical rating organization if the Commission finds that such extension or exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

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

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

(1) The inappropriate dissemination within and outside the nationally recognized statistical rating organization of material nonpublic information obtained in connection with the performance of credit rating services;

(2) A person within the nationally recognized statistical rating organization from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments; and

(3) The inappropriate dissemination within and outside the nationally recognized statistical rating organization of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.

(b) For the purposes of this section, the term *person within a nationally recognized statistical rating organization* means a nationally recognized statistical rating organization, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the nationally recognized statistical rating organization or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

§ 240.17g–5 Conflicts of interest.

(a) A person within a nationally recognized statistical rating organization is prohibited from having a conflict of interest relating to the issuance or maintenance of a credit rating identified in paragraph (b) of this section, unless:

(1) The nationally recognized statistical rating organization has disclosed the type of conflict of interest in Exhibit 6 to 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 § 240.17g–1; and

(2) The nationally recognized statistical rating organization has established and is maintaining and enforcing written 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) Being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

(2) Being paid by obligors to determine credit ratings with respect to the obligors.

(3) Being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the nationally recognized statistical rating organization to determine a credit rating.

(4) Being paid by persons for subscriptions to receive or access the credit ratings of the nationally recognized statistical rating organization and/or for other services offered by the nationally recognized statistical rating organization where such persons may use the credit ratings of the nationally recognized statistical rating organization to comply with, and obtain benefits or relief under, statutes and regulations using the term *nationally recognized statistical rating organization.*

(5) Being paid by persons for subscriptions to receive or access the credit ratings of the nationally recognized statistical rating organization and/or for other services offered by the nationally recognized statistical rating organization where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the nationally recognized statistical rating organization.

(6) Allowing persons within the nationally recognized statistical rating organization to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the nationally recognized statistical rating organization.

(7) Allowing persons within the nationally recognized statistical rating organization to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the nationally recognized statistical rating organization.

(8) Having a person associated with the nationally recognized statistical rating organization that is a broker or dealer engaged in the business of underwriting securities or money market instruments.

(9) Any other type of conflict of interest relating to the issuance of credit ratings by the nationally recognized statistical rating organization that is material to the nationally recognized statistical rating organization and that is identified by the nationally recognized statistical rating organization in Exhibit 6 to 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 § 240.17g–1.

(c) *Prohibited conflicts.* A nationally recognized statistical rating organization is prohibited from having the following conflicts of interest relating to the issuance or maintenance of a credit rating as a credit rating agency:

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

(2) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to a person (excluding a sovereign nation or an agency of a sovereign nation) where the nationally recognized statistical rating organization, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating;

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

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

(d) For the purposes of this section, the term *person within a nationally recognized statistical rating organization* means a nationally recognized statistical rating organization, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the nationally recognized statistical rating organization or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

§ 240.17g–6 Prohibited acts and practices.

(a) *Prohibitions.* A nationally recognized statistical rating organization is prohibited from engaging 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 nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

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

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

(4) Issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw 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 all or a portion of the assets within such pool or part of such transaction also are rated by the nationally recognized statistical rating organization, where such practice is engaged in by the nationally recognized statistical rating organization for an anticompetitive purpose.

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 an initial application for and an application to add a class of credit ratings to, a supplement to an initial application for and an application to add a class of credit ratings to, an update and amendment to an application for, and a withdrawal from a 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.

Form NRSRO—Application for Registration as a Nationally Recognized Statistical Rating Organization (NRSRO)

OMB Approval

OMB Number: 3235–0625.

Expires: May 31, 2010.

Estimated average burden hours per response: 300.

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)

BILLING CODE 8010–01–P

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

☐ INITIAL APPLICATION

☐ APPLICATION TO ADD CLASS OF CREDIT RATINGS

☐ APPLICATION SUPPLEMENT
Items and/or Exhibits Supplemented:
_____

☐ ANNUAL CERTIFICATION

☐ UPDATE OF REGISTRATION
Items and/or Exhibits Amended:
_____

☐ WITHDRAWAL FROM REGISTRATION

Important: Refer to Form NRSRO Instructions for General Instructions, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO). "You" and "your" mean the person furnishing this Form NRSRO to the Commission. "Applicant" and "NRSRO" mean the person furnishing this Form NRSRO to the Commission and any credit rating affiliate identified in Item 3.

1. **A.** Your full name:
_____

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

(ii) Any other name under which your credit rating business is conducted and where it is used (other than the name of a credit rating affiliate identified in Item 3):
_____

C. Address of your principal office (do not use a P.O. Box):
_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:
_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (See Instructions):
_____
(Name and Title)
_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form NRSRO on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including Exhibits and attachments, all of which are part of this Form, are accurate in all significant respects. If this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate in all significant respects.

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

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

2. A. Your legal status:

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

B. Month and day of your fiscal year end: _____

C. Place and date of your formation (i.e., state or country where you were incorporated, where your partnership agreement was filed, or where you otherwise were formed):

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

3. Your credit rating affiliates (See Instructions):

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

4. The designated compliance officer of the Applicant/NRSRO (See Instructions):

_____
(Name and Title)

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

5. Describe in detail how this Form NRSRO and Exhibits 1 through 9 to this Form NRSRO will be made publicly available on Web site of the Applicant/NRSRO, or through another comparable, readily accessible means (See Instructions):

_____

_____

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION, APPLICATION SUPPLEMENT, OR APPLICATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. For each class, indicate the approximate number of credit ratings the Applicant/NRSRO presently has outstanding in that class as of the date of this application and the approximate date the Applicant/NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit ratings	Applying for registration	Approximate number currently outstanding	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		

issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

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

☐ The Applicant/NRSRO is attaching _____ certifications from qualified institutional buyers to this application. Each is marked "Certification from Qualified Institutional Buyer."

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

Note: You are not required to make a Certification from a Qualified Institutional Buyer submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the certifications confidential upon request to the extent permitted by law.

7. DO NOT COMPLETE ITEM 7 IF THIS IS AN INITIAL APPLICATION.

A. Indicate below the classes of credit ratings for which the NRSRO is currently registered. For each class, indicate the approximate number of credit ratings the NRSRO had outstanding in that class as of the most recent calendar year end and the approximate date the NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit rating	Currently registered	Approximate number outstanding as of the most recent calendar year end	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		

issuers of government securities as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

	YES	NO
8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and submit the Disclosure Reporting Page with this form (See Instructions). You are not required to make any disclosure reporting pages submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.		
A. Has the Applicant/NRSRO or any person within the Applicant/NRSRO committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934 in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the Applicant/NRSRO or any person within the Applicant/NRSRO been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
C. Is any person within the Applicant/NRSRO subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐	☐

9. Exhibits (See Instructions).

Exhibit 1. Credit ratings performance measurement statistics. ☐ Exhibit 1 is attached and made a part of this Form NRSRO.
Exhibit 2. A description of the procedures and methodologies used in determining credit ratings. ☐ Exhibit 2 is attached and made a part of Form NRSRO.
Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information. ☐ Exhibit 3 is attached and made a part of this Form NRSRO.

Exhibit 4. Organizational structure.

☐ Exhibit 4 is attached to and made a part of this Form NRSRO.

Exhibit 5. The code of ethics or a statement of the reasons why a code of ethics is not in effect.

☐ Exhibit 5 is attached to and made a part of this Form NRSRO.

Exhibit 6. Identification of conflicts of interests relating to the issuance of credit ratings.

☐ Exhibit 6 is attached to and made a part of this Form NRSRO.

Exhibit 7. Policies and procedures to address and manage conflicts of interest.

☐ Exhibit 7 is attached to and made a part of this Form NRSRO.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached to and made a part of this Form NRSRO.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer.

☐ Exhibit 9 is attached to and made a part of this Form NRSRO.

Exhibit 10. A list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application.

☐ Exhibit 10 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application.

☐ Exhibit 11 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application.

☐ Exhibit 12 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

BILLING CODE 8010–01–C

Form NRSRO Instructions

A. General Instructions

1. Form NRSRO is the Application for Registration as a Nationally Recognized Statistical Rating Organization (''NRSRO'') under Section 15E of the Securities Exchange Act of 1934 (''Exchange Act'') and Exchange Act Rule 17g–1. Exchange Act Rule 17g–1 requires an Applicant/NRSRO to use Form NRSRO to furnish the U.S. Securities and Exchange Commission (''Commission'') with:

- An initial application to be registered as an NRSRO;
- An application to register for an additional class of credit ratings;
- An application supplement;
- An update of registration pursuant to Section 15E(b)(1) of the Exchange Act;
- An annual certification pursuant to Section 15E(b)(2) of the Exchange Act; and
- A withdrawal of registration pursuant to Section 15E(e) of the Exchange Act.

2. Exchange Act Rule 17g–1(c) requires that an Applicant/NRSRO promptly provide the Commission with a written notice if information submitted to the Commission in an initial application for registration or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must identify the information found to be materially inaccurate. The Applicant/NRSRO must also promptly furnish the Commission with accurate and complete information as an application supplement on Form NRSRO.

3. Pursuant to Exchange Act Rule 17g–1(i), an NRSRO must make its current Form NRSRO and information and documents furnished in Exhibits 1 through 9 to Form NRSRO publicly available on its Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission Order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after submitting an update of registration, annual certification, or withdrawal from registration to the Commission on Form NRSRO. The certifications from qualified institutional buyers, disclosure reporting pages, and Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Rule 17g–1(i). An Applicant/NRSRO may request that the Commission keep confidential the certifications from qualified institutional buyers, the disclosure reporting pages, and the information and documents in Exhibits 10–13 submitted to the Commission. An Applicant/NRSRO seeking confidential treatment for these submissions should mark each page ''Confidential Treatment'' and comply with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep this information confidential to the extent permitted by law.

4. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny an initial application for registration as an NRSRO. These time periods also apply to an application to register for an additional class of credit ratings.

5. Type or clearly print all information. Use only the current version of Form NRSRO or a reproduction of it.

6. Section 15E of the Exchange Act (15 U.S.C. 78o–7) authorizes the Commission to collect the Information on Form NRSRO from an Applicant/NRSRO. The principal purposes of Form NRSRO are to determine whether an Applicant should be granted registration as an NRSRO, whether an NRSRO should be granted registration in an additional class of credit ratings, whether an NRSRO continues to meet the criteria for registration as an NRSRO, to withdraw a registration, and to provide information about an NRSRO to users of credit ratings. Intentional misstatements or omissions may constitute federal criminal violations under 18 U.S.C. 1001.

The information collection is in accordance with the clearance requirements of Section 3507 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). The Commission may not conduct or sponsor, and you are not required to respond to, a collection of information unless it displays a valid Office of Management and Budget (OMB) control number. The time required to complete and furnish this form will vary depending on individual

circumstances. The estimated average time to complete an initial application is displayed on the facing page of this Form. Send comments regarding this burden estimate or suggestions for reducing the burden to Director, Office of Information Technology, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

7. Under Exchange Act Rule 17g–2(b)(10), an NRSRO must retain copies of all Form NRSROs (including Exhibits, accompanying information, and documents) submitted to the Commission. Exchange Act Rule 17g–2(c) requires that these records be retained for three years after the date the record is made.

8. ADDRESS—The mailing address for Form NRSRO is: U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

9. A Form NRSRO will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form.

B. Instructions for an Initial Application

An Applicant applying to be registered with the Commission as an NRSRO must furnish the Commission with an initial application on Form NRSRO. To complete an initial application:

- Check the ''INITIAL APPLICATION'' box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, and 8. (See Instructions below for each Item). Enter ''None'' or ''N/A'' where appropriate.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers, marked ''Certification from Qualified Institutional Buyer'' (See Instructions below for Item 6C).
- Attach Exhibits 1 through 13 (See Instructions below for each Exhibit).
- Execute the Form.

The Applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an initial application is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly furnish the Commission with an application supplement on Form NRSRO (See instructions below for an application supplement).

C. Instructions for an Application to Add a Class of Credit Ratings

An NRSRO applying to register for an additional class of credit ratings must furnish the Commission with an application on Form NRSRO. To complete an application to register for an additional class of credit ratings:

- Check the ''APPLICATION TO ADD CLASS OF CREDIT RATINGS'' box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter ''None'' or ''N/A'' where appropriate. Complete each Item even if the Item is not being updated.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers for the additional class of credit ratings marked ''Certification from Qualified Institutional Buyer'' (See Instructions below for Item 6C).
- If any information in an Exhibit previously furnished is materially inaccurate, update that information.
- Execute the Form.

The Applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an application to add a class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly furnish the Commission with an application supplement on Form NRSRO (See instructions below for an application supplement).

D. Instructions for an Application Supplement

An Applicant must furnish an application supplement to the Commission on Form NRSRO if information submitted to the Commission in a pending initial application for registration as an NRSRO or a pending application to register for an additional class of credit ratings is found to be or becomes materially inaccurate. To complete an application supplement:

- Check the ''APPLICATION SUPPLEMENT'' box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being supplemented.
- Complete Items 1, 2, 3, 4, 5 and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If supplementing an initial application, also complete Item 6. If supplementing an application for registration in an additional class of credit ratings, also complete Items 6 and 7. If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter ''None'' or ''N/A'' where appropriate. Complete each Item even if the Item is not being updated.
- If a certification from a qualified institutional buyer is being updated or a new certification is being added, attach the updated or new certification.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

E. Instructions for an Update of Registration

After registration is granted, Section 15E(b)(1) of the Exchange Act requires that an NRSRO must *promptly* amend its application for registration if information or documents provided in the previously furnished Form NRSRO become *materially inaccurate*. This requirement does not apply to Item 7 and Exhibit 1, which only are required to be updated annually with the annual certification. It also does not apply to Exhibits 10–13 and the certifications from qualified institutional buyers, which are not required to be updated on Form NRSRO after registration. An NRSRO amending its application for registration must furnish the Commission with an update of its registration on Form NRSRO. To complete an update of registration:

- Check the ''UPDATE OF REGISTRATION'' box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being updated.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter ''None'' or ''N/A'' where appropriate. Complete each Item even if the Item is not being updated.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

F. Instructions for Annual Certifications

After registration is granted, Section 15E(b)(2) of the Exchange Act requires that an NRSRO furnish the Commission with an annual certification not later than 90 days after the end of each

calendar year. The annual certification must be furnished to the Commission on Form NRSRO and must include an update of the information in Item 7 and the credit ratings performance measurement statistics furnished in Exhibit 1, a certification that the information and documents furnished on or with Form NRSRO continue to be accurate (use the certification on the Form), and a list of material changes to the application for registration that occurred during the previous calendar year. To complete an annual certification:

- Check the ''ANNUAL CERTIFICATION'' box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter ''None'' or ''N/A'' where appropriate. Complete each Item even if the Item is not being updated.
- If any information in an Exhibit previously furnished is materially inaccurate, update that information.
- Attach a list of all material changes made to the information or documents in the application for registration of the NRSRO that occurred during the previous calendar year.
- Execute the Form.

G. Instructions for a Withdrawal From Registration

Section 15E(e)(1) of the Exchange Act provides that an NRSRO may voluntarily withdraw its registration with the Commission. To withdraw from registration, an NRSRO must furnish the Commission with a notice of withdrawal from registration on Form NRSRO. The withdrawal from registration will become effective 45 calendar days after the withdrawal from registration is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors. To complete a withdrawal from registration:

- Check the ''WITHDRAWAL FROM REGISTRATION'' box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter ''None'' or ''N/A'' where appropriate. Complete each Item even if the Item is not being updated.
- Execute the Form.

H. Instructions for Specific Line Items

Item 1A. Provide the name of the person (*e.g.*, XYZ Corporation) that is furnishing the Form NRSRO to the Commission. This means the name of the person that is applying for registration as an NRSRO or is registered as an NRSRO and not the name of the individual that is executing the Form.

Item 1E. The individual listed as the contact person must be authorized to receive all communications and papers from the Commission and must be responsible for their dissemination within the Applicant/NRSRO.

Certification. The certification must be executed by the Chief Executive Officer or the President of the person that is furnishing the Form NRSRO to the Commission or an individual with similar responsibilities.

Item 3. Identify credit rating affiliates that issue credit ratings on behalf of the person furnishing the Form NRSRO to the Commission in one or more of the classes of credit ratings identified in Item 6 or Item 7. A ''credit rating affiliate'' is a separate legal entity or a separately identifiable department or division thereof that determines credit ratings that are credit ratings of the person furnishing the Form NRSRO to the Commission. The information in Items 4–8 and all the Exhibits must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, personnel, and organizational structure of each credit rating affiliate identified in Item 3, as applicable. Any credit rating determined by a credit rating affiliate identified in Item 3 will be treated as a credit rating issued by the person furnishing the Form NRSRO to the Commission for purposes of Section 15E of the Exchange Act and the Commission's rules thereunder. The terms ''Applicant'' and ''NRSRO'' as used on Form NRSRO and the Instructions for the Form mean the person furnishing the Form NRSRO to the Commission and any credit rating affiliate identified in Item 3.

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 NRSRO established pursuant to Sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations.

Item 5. Section 15E(a)(3) of the Exchange Act and Exchange Act Rule 17g–1(i) require an NRSRO to make Form NRSRO and Exhibits 1–9 to Form NRSRO furnished to the Commission publicly available on the NRSRO's Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after furnishing the Commission with an amendment, annual certification, or withdrawal of registration on Form NRSRO. The certifications from qualified institutional investors, Disclosure Reporting Pages, and Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's Web site, or through another comparable, readily accessible means. Describe how the current Form NRSRO and Exhibits 1–9 will be made publicly available. If they will be posted on a Web site, for example, give the Internet address and link to the Form and Exhibits.

Item 6. Complete Item 6 only if furnishing an initial application for registration, an application to be registered in an additional class of credit ratings, or an application supplement.

Item 6A. Pursuant to Section 15E(a)(1)(B)(vii) of the Exchange Act, an Applicant applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. Indicate these classes by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of credit ratings the Applicant/NRSRO presently has outstanding as of the date of the application. Pursuant to the definition of ''nationally recognized statistical rating organization'' in Section 3(a)(62) of the Exchange Act, an Applicant/NRSRO 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, also provide in the appropriate box the approximate date the Applicant/NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a ''credit rating agency,'' as that term is defined in Section 3(a)(61) of the Exchange Act. If there was a period when the Applicant/NRSRO stopped issuing credit ratings in a particular

class or stopped operating as a credit rating agency, provide the approximate date the Applicant/NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of ''credit rating agency'' in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the Applicant/NRSRO began operating as a ''credit rating agency.''

Item 6B. To meet the definition of ''credit rating agency'' pursuant to Section 3(a)(61)(A) of the Exchange Act, the Applicant must, among other things, issue ''credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.'' Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the Applicant/NRSRO, provide a fee schedule or describe the price(s) charged.

Item 6C. If the Applicant/NRSRO is required to furnish qualified institutional buyer certifications, under Section 15E(a)(1)(C) of the Exchange Act, submit a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the Applicant/NRSRO. Each certification may address more than one class of credit ratings. To be registered as an NRSRO for a class of credit ratings identified in Item 6A under ''Applying for Registration,'' the Applicant/NRSRO must submit at least two certifications that address the class of credit ratings. If this is an application of an NRSRO to be registered in one or more additional classes of credit ratings, furnish at least two certifications that address each additional class of credit ratings. The required certifications must be signed by a person duly authorized by the certifying entity, must be notarized, must be marked ''Certification from Qualified Institutional Buyer,'' and must be in substantially the following form:

''I, [Executing official], am authorized by [Certifying entity] to execute this certification on behalf of [Certifying entity]. I certify that all actions by stockholders, directors, general partners, and other bodies necessary to authorize me to execute this certification have been taken and that [Certifying entity]:

(i) Meets the definition of a 'qualified institutional buyer' as set forth in section 3(a)(64) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(64)) pursuant to the following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];

(ii) Has seriously considered the credit ratings of [the Applicant/NRSRO] in the course of making some of its investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings: [Insert applicable classes of credit ratings]; and

(iii) Has not received compensation either directly or indirectly from [the Applicant/NRSRO] for executing this certification.

[*Signature*]

Print Name and Title

You are not required to make a Certification from a Qualified Institutional Buyer submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). You may request that the Commission keep these certifications confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the certifications confidential upon request to the extent permitted by law.

Item 7. An Applicant furnishing Form NRSRO to apply for registration as an NRSRO should not complete Item 7. An NRSRO furnishing Form NRSRO for any other reason must complete Item 7. The information in Item 7 must be updated on an annual basis with the furnishing of the annual certification.

Item 7A. Indicate the classes of credit ratings for which the NRSRO is currently registered by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of credit ratings the NRSRO had outstanding as of the end of the most recently ended calendar year. For each class of credit ratings, also provide in the appropriate box the approximate date the NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a ''credit rating agency,'' as that term is defined in Section 3(a)(61) of the Exchange Act. If there was a period when the NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of ''credit rating agency'' in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the NRSRO began operating as a ''credit rating agency.''

Item 7B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the NRSRO, provide a fee schedule or describe the price(s) charged.

Item 8. Answer each question by checking the appropriate box. Refer to the definition of ''person within an Applicant/NRSRO'' set forth below to determine the persons to which the questions apply. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and furnished with Form NRSRO. Submit a separate Disclosure Reporting Page (NRSRO) for each person that: (a) has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions. Note: the definition of ''person within an Applicant/NRSRO'' is narrower than the definition of ''person associated with a nationally recognized statistical rating organization'' in Section 3(a)(63) of the Exchange Act.

You are not required to make any disclosure reporting pages submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires a credit rating agency's application for registration as an NRSRO to contain certain specific information and documents and, pursuant to Section 15E(a)(1)(B)(x), any other information and documents concerning the applicant and any person associated

with the applicant that the Commission requires as necessary or appropriate in the public interest or for the protection of investors. If any information or document required to be included with any Exhibit is maintained in a language other than English, provide a copy of the original document and a version of the document translated into English. Attach a certification by an authorized person that the translated version is a true, accurate, and complete English translation of the information or document. Attach the Exhibits to Form NRSRO in numerical order. Bind each Exhibit separately, and mark each Exhibit or bound volume of the Exhibit with the appropriate Exhibit number. The information provided in the Exhibits must be sufficiently detailed to allow for verification. The information and documents provided in Exhibits 1 through 9 must be made publicly available on the NRSRO's Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). The information and documents required to be provided in Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). An NRSRO may request that the Commission keep these Exhibits confidential by marking each page of them ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in these Exhibits confidential upon request to the extent permitted by law.

Exhibit 1. Provide in this Exhibit performance measurement statistics of the credit ratings of the Applicant/NRSRO over short-term, mid-term, and long-term periods (as applicable) through the most recent calendar year-end, including, as applicable: historical down-grade and default rates within each of the credit rating categories, notches, grades, or rankings used by the Applicant/NRSRO as an indicator of the assessment of the creditworthiness of an obligor, security, or money market instrument. As part of this Exhibit, define the credit rating categories, notches, grades, and rankings used by the Applicant/NRSRO and explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics.

Exhibit 2. Provide in this Exhibit a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the Applicant/NRSRO is seeking registration or is registered. The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings, including, as applicable, descriptions of: policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; the quantitative and qualitative models and metrics used to determine credit ratings; the methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating. An Applicant/NRSRO may provide in Exhibit 2 the location on its Web site where additional information about the procedures and methodologies is located.

Exhibit 3. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to prevent the misuse of material, nonpublic information pursuant to Section 15E(g) of the Exchange Act and 17 CFR 240.17g–4. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 4. Provide in this Exhibit information about the organizational structure of the Applicant/NRSRO, including, as applicable, an organizational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the Applicant/NRSRO; an organizational chart showing the divisions, departments, and business units of the Applicant/NRSRO; and an organizational chart showing the managerial structure of the Applicant/NRSRO, including the designated compliance officer identified in Item 4.

Exhibit 5. Provide in this Exhibit a copy of the written code of ethics the Applicant/NRSRO has in effect or a statement of the reasons why the Applicant/NRSRO does not have a written code of ethics in effect.

Exhibit 6. Identify in this Exhibit the types of conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO that are material to the Applicant/NRSRO. First, identify the conflicts described in the list below that apply to the Applicant/NRSRO. The Applicant/NRSRO may use the descriptions below to identify an applicable conflict of interest and is not required to provide any further details. Second, briefly describe any other type of conflict of interest relating to the issuance of credit ratings by the Applicant/NRSRO that is not covered in the descriptions below that is material to the Applicant/NRSRO (for example, one the Applicant/NRSRO has established specific policies and procedures to address):

- The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.
- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.
- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term ''nationally recognized statistical rating organization.''
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:
  - Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or

issuers subject to a credit rating determined by the Applicant/NRSRO.

○ Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.

• A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).

• The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

Exhibit 7. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to address and manage conflicts of interest pursuant to Section 15E(h) of the Exchange Act. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 8. Provide in this Exhibit the following information about the Applicant/NRSRO's credit analysts (See definition below) and the persons who supervise the credit analysts:

• The total number of credit analysts.

• The total number of credit analyst supervisors.

• A general description of the minimum qualifications required of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).

• A general description of the minimum qualifications required of the credit analyst supervisors, including education level and work experience.

Exhibit 9. Provide in this Exhibit the following information about the designated compliance officer (identified in Item 4) of the Applicant/NRSRO:

• Name.

• Employment history.

• Post secondary education.

• Whether employed by the Applicant/NRSRO full-time or part-time.

Exhibit 10. Provide in this Exhibit a list of the largest users of credit rating services of the Applicant by the amount of net revenue earned by the Applicant attributable to the person during the fiscal year ending immediately before the date of the initial application. First, determine and list the 20 largest *issuers* and *subscribers* in terms of net revenue. Next, add to the list any *obligor* or *underwriter* that, in terms of net revenue during the fiscal year, equaled or exceeded the 20th largest issuer or subscriber. In making the list, rank the persons in terms of net revenue from largest to smallest and include the net revenue amount for each person. For purposes of this Exhibit:

Net revenue means revenue earned by the Applicant for any type of service or product provided to the person, regardless of whether related to credit rating services, and net of any rebates and allowances the Applicant paid or owes to the person; and

Credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Provide in this Exhibit the financial statements of the Applicant, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date of the Applicant's initial application to the Commission, subject to the following:

If the Applicant is a division, unit, or subsidiary of a parent company, the Applicant may provide audited consolidated financial statements of its parent company.

If the Applicant does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date of the initial application, the Applicant can provide unaudited financial statements for the applicable year or years, but must provide audited financial statements for the fiscal or calendar year ending immediately before the date of the initial application. Attach to the unaudited financial statements a certification by a person duly authorized by the Applicant to make the certification that the person has responsibility for the financial statements and that to the best knowledge of the person making the certification the financial statements fairly present, in all material respects, the Applicant's financial condition, results of operations, and cash flows for the period presented.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Provide in this Exhibit the following information, as applicable, and which is not required to be audited, regarding the Applicant's aggregate revenues for the fiscal or calendar year ending immediately before the date of the initial application:

• Revenue from determining and maintaining credit ratings;

• Revenue from subscribers;

• Revenue from granting licenses or rights to publish credit ratings; and

• Revenue from all other services and products offered by your credit rating organization (include descriptions of any major sources of revenue).

An NRSRO is not required to make this Exhibit publicly available on its Web site or, through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. Provide in this Exhibit the approximate total and median annual compensation of the Applicant's credit analysts for the fiscal or calendar year ending immediately before the date of this initial application. In calculating total and median annual compensation, the Applicant may exclude deferred compensation, provided such exclusion is noted in the Exhibit.

An NRSRO is not required to make this Exhibit publicly available on its

Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g–1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page ''Confidential Treatment'' and complying with Commission rules governing confidential treatment (*See* 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

F. Explanation of Terms

1. COMMISSION—The U. S. Securities and Exchange Commission.

2. CREDIT RATING [Section 3(a)(60) of the Exchange Act]—An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.

3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act]—Any person:

- Engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
- Employing either a quantitative or qualitative model, or both to determine credit ratings; and
- Receiving fees from either issuers, investors, other market participants, or a combination thereof.

4. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act]—A credit rating agency that:

- 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 in accordance with section 15(a)(1)(B)(ix) of the Exchange Act with respect to:
  - ○ Financial institutions, brokers, or dealers;
  - ○ Insurance companies;
  - ○ Corporate issuers;
  - ○ Issuers of asset-backed securities;
  - ○ Issuers of government securities, municipal securities, or securities issued by a foreign government; or
  - ○ A combination of one or more of the above; and
- Is registered as an NRSRO.

6. PERSON—An individual, partnership, corporation, trust, company, limited liability company, or other organization (including a separately identifiable department or division).

7. PERSON WITHIN AN APPLICANT/NRSRO—The person furnishing Form NRSRO identified in Item 1, any credit rating affiliates identified in Item 3, and any partner, officer, director, branch manager, or employee of the person or the credit rating affiliates (or any person occupying a similar status or performing similar functions).

8. SEPARATELY IDENTIFIABLE DEPARTMENT OR DIVISION—A unit of a corporation or company:

- That is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities; and
- For which all of the records relating to its credit rating activities are separately created or maintained in or extractable from such unit's own facilities or the facilities of the corporation, and such records are so maintained or otherwise accessible as to permit independent examination and enforcement by the Commission of the Exchange Act and rules and regulations promulgated thereunder.

8. QUALIFIED INSTITUTIONAL BUYER [Section 3(a)(64) of the Exchange Act]—An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency.

Disclosure Reporting Page (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to provide information concerning affirmative responses to Item 8 of Form NRSRO.

Submit a separate DRP for each person that: (a) Has committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.

Name of Applicant/NRSRO

_____

Date

_____

Check Item being responded to:

☐ Item 8A
☐ Item 8B
☐ Item 8C

Full name of the person for whom this DRP is being submitted:

_____

If this DRP provides information relating to a ''Yes'' answer to Item 8A, describe the act(s) that was (were) committed or omitted; or the order(s) or finding(s); or the injunction(s) (provide the relevant statute(s) or regulation(s)) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a ''Yes'' answer to Item 8B, describe the crime(s) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a ''Yes'' answer to Item 8C, attach the relevant Commission order(s) and provide the date(s):

_____

By the Commission.
Dated: June 5, 2007.

Florence E. Harmon,

Deputy Secretary.

[FR Doc. E7–11166 Filed 6–15–07; 8:45 am]

BILLING CODE 8010–01–P