The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 28368

September 10, 2014

SEC Adopts Rules to Enhance Regulation of Credit Rating Agencies

[28368]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 56-14
FIXED-INCOME ADVISORY COMMITTEE No. 16-14
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 23-14
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 19-14
SEC RULES MEMBERS No. 36-14
SMALL FUNDS MEMBERS No. 22-14 RE: SEC ADOPTS RULES TO ENHANCE REGULATION OF CREDIT RATING AGENCIES

On August 27, by a 3-2 vote, the SEC adopted a number of new rules and rule amendments to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act," or the "Act") related to nationally recognized statistical rating organizations ("NRSROs"). [1] Among other things, the new requirements for NRSROs address internal controls, conflicts of interest, disclosure of credit rating performance statistics, procedures to protect the integrity and transparency of rating methodologies, disclosures to promote the transparency of credit ratings, and standards for training, experience, and competence of credit analysts. The new rules and amendments also impose requirements on issuers, underwriters, and third-party due diligence service providers to promote the transparency of the findings and conclusions of third-party due diligence regarding asset-backed securities ("ABS"). ICI was generally supportive of the proposed rules and amendments, [2] which we believed would enhance disclosure and transparency, address potential conflicts of interest, and increase the accountability of an NRSRO for its credit ratings.

Internal Control Structure

The Dodd-Frank Act contains a self-executing requirement that an NRSRO must establish, maintain, enforce, and document an effective internal control structure governing the implementation of, and adherence to, policies, procedures, and methodologies for determining credit ratings. The Act authorized, but did not require, the SEC to prescribe factors that an NRSRO must consider with respect to its internal control structure. In a departure from the proposing release, the SEC has exercised this authority by incorporating into new Rule 17g-8 ("Policies, procedures, and internal controls") under the Securities Exchange Act of 1934 ("Exchange Act") a number of factors for consideration, related to

the establishment, maintenance, and enforcement of the NRSRO's internal control structure. [3] In the Release, the SEC cautioned against treating the factors as a checklist or "safe harbor" that would allow NRSROs to conclude that they have established, maintained, enforced, and documented effective internal control structures.

Additionally, while the Dodd-Frank Act requires an NRSRO to document its internal control structure, it does not prescribe how an NRSRO would need to maintain these records. The SEC has amended the NRSRO recordkeeping rule, Rule 17g-2, to require that NRSROs retain records relating to their internal control structures.

- Finally, the Dodd-Frank Act provides that the SEC must prescribe rules requiring an NRSRO to submit an annual internal controls report to the SEC. The report must contain: (1) a description of the responsibility of management in establishing and maintaining an effective internal control structure; (2) an assessment of the effectiveness of the internal control structure; and (3) the attestation of the CEO or equivalent individual. The SEC has implemented these requirements through amendments to Rule 17g-3, which requires an NRSRO to furnish various annual reports to the SEC. This annual report on internal controls need not be audited and will not be made public. [4]

Conflicts of Interest Relating to Sales and Marketing

The Dodd-Frank Act requires the SEC to issue rules to prevent an NRSRO's sales and marketing considerations from influencing its production of credit ratings. The rules must provide for exceptions for "small" NRSROs for which the SEC determines that the separation of the production of ratings and sales and marketing activities is not appropriate. In addition, the rules must provide for the suspension or revocation of an NRSRO's registration if the SEC finds, on the record, after notice and opportunity for a hearing, that: (1) the NRSRO has violated a rule under Section 15E(h) of the Exchange Act; [5] and (2) the violation affected a rating.

The SEC has implemented these requirements by amending Rule 17g-5, which addresses NRSRO conflicts of interest. The amendments prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating (including qualitative or quantitative models), also (1) participates in the sales or marketing of a product or service of the NRSRO (or those of an affiliate), [6] or (2) is influenced by sales or marketing considerations. [7]

The amendments also provide that upon written application by an NRSRO, the SEC may exempt a "small" NRSRO, either conditionally or unconditionally, from the foregoing prohibition. The SEC would have to find that: (1) due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities; and (2) such exemption is in the public interest. The SEC will make these determinations on a case-by-case basis, and neither the statute nor the rule defines "small" for this purpose.

The amendments also provide that in a proceeding pursuant to Section 15E(d)(1) of the Exchange Act, [8] the SEC must suspend or revoke the registration of an NRSRO if it finds that the NRSRO has violated a rule issued under Section 15E(h) of the Exchange Act, and the violation affected a rating.

“Look-Back” Review

The Dodd-Frank Act contains a self-executing provision designed to address a particular conflict of interest. Specifically, it requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that two things happen in any case in which an employee of a person subject to a credit rating of the NRSRO (or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO) was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken. First, the NRSRO must conduct a review to determine whether any conflicts of interest of the employee influenced the credit rating (the “look-back” review). Second, the NRSRO must take action to revise the rating, if appropriate, in accordance with SEC rules.

To implement this rulemaking mandate, the SEC has included a provision in new Rule 17g-8 requiring that the policies and procedures referred to above must address instances in which a look-back review determines that a conflict of interest influenced a credit rating. Those policies and procedures must include, at a minimum, procedures reasonably designed to ensure that the NRSRO will: (1) promptly determine whether the credit rating must be revised so it no longer is influenced by a conflict of interest and is solely the product of the NRSRO’s documented procedures and methodologies for determining credit ratings; [9] and (2) promptly publish a revised credit rating, if appropriate, or an affirmation of the credit rating, if appropriate. [10] The SEC points out in the Release that it does not expect, and the rule does not require, an NRSRO to revise a credit rating in every circumstance in which an earlier rating action was influenced by a conflict of interest. If the NRSRO does not publish a rating revision or affirmation within 15 days of discovering the influence of the conflict, the NRSRO must publish a rating action placing the rating on watch or review, along with an explanation that the action was taken because of the discovery that the rating was influenced by a conflict of interest. The SEC has also amended Rule 17g-2 to require NRSROs to make and retain a record documenting these “look-back” policies and procedures.

Fines and Other Penalties

The Dodd-Frank Act provides that the SEC shall establish, by rule, fines and other penalties applicable to any NRSRO that violates the requirements of Section 15E of the Exchange Act and the SEC’s rules thereunder. The SEC states in the Release that it is deferring establishing new fines and penalties beyond those already provided for in the Exchange Act. The SEC has adopted amendments to the instructions of Form NRSRO, [11] reminding NRSROs and applicants that they are subject to applicable fines, penalties, and sanctions under the Exchange Act for violations of the securities laws.

Public Disclosure of Information about the Performance of Credit Ratings

The Dodd-Frank Act requires the SEC to adopt rules requiring NRSROs to publicly disclose information on initial credit ratings and subsequent changes to allow users of credit ratings to evaluate the accuracy of ratings and compare the performance of ratings by different NRSROs. [12] The rules must require disclosures that, among other things, are comparable among different NRSROs, include performance information over a range of years and for a variety of types of credit ratings, are made freely available on an easily accessible portion of an NRSRO’s website and in writing when requested, and require an NRSRO to include an attestation with any credit rating it issues.

The SEC has implemented these requirements by significantly enhancing current requirements for generating and disclosing information about performance statistics and rating histories, through amendments to the instructions to Form NRSRO relating to Exhibit 1 to the Form [13] and amendments to Rules 17g-1, 17g-2, and 17g-7. The revised instructions to Exhibit 1 address, among other things, how required information must be presented in the Exhibit (including the order of presentation and the use of a standardized matrix for presenting the data), the methodology for calculating transition (e.g., upgrades and downgrades) and default rates for each class [14] and subclass [15] of credit rating, and stipulate that information not required to be disclosed cannot be presented as part of this Exhibit. The amendments to Rule 17g-1 require an NRSRO to make its Form NRSRO and information and documents in Exhibits 1 through 9 publicly and freely available on an easily accessible portion of its corporate Internet website , and to make its most recently filed Exhibit 1 freely available in writing when requested.

Rule 17g-2 currently requires an NRSRO to make publicly available on its corporate Internet website certain information (most notably, all ratings actions and their dates) for any credit rating initially determined by the NRSRO on or after June 26, 2007 (the "100% Rule"). The SEC has enhanced the 100% Rule in several respects and moved its provisions to Rule 17g-7, along with other requirements for NRSROs to disclose information outside of Form NRSRO. The enhancements include:

- requiring an NRSRO to publicly disclose ratings history information for free on an easily accessible portion of its website;
- broadening the scope of credit ratings that are subject to the disclosure requirements, to require disclosure about all outstanding credit ratings for each class and subclass of credit ratings for which the NRSRO is registered, within certain prescribed timeframes (an NRSRO need only retrieve information that is no more than three years old);
- increasing the number of required data fields; and
- providing that an NRSRO may cease disclosing a rating history no earlier than 15 years after withdrawal of the credit rating.

As in the proposal, an NRSRO must make these disclosures within 12 or 24 months from the date the rating action is taken, depending on whether the rating is "issuer paid" or "non-issuer paid," respectively. [16]

Credit Rating Methodologies

The Dodd-Frank Act provides that the SEC must prescribe rules with respect to the procedures and methodologies, including qualitative and quantitative data models, used by NRSROs that require each NRSRO to achieve various objectives identified in the statute. The SEC has implemented this provision by requiring in new Rule 17g-8 that an NRSRO establish, maintain, enforce, and document policies and procedures that are reasonably designed [17] to ensure that:

- The procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine its credit ratings are approved by its board or another body performing a similar function.

- The procedures and methodologies are developed and modified in accordance with the policies and procedures of the NRSRO.
- Material changes to the procedures and methodologies are:
    - applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply; and

    - to the extent that the changes are to surveillance or monitoring procedures and methodologies, that they are applied to current credit ratings within a reasonable period of time.
- The NRSRO promptly publishes on an easily accessible portion of its corporate Internet website:
    - material changes to the procedures and methodologies, the reason for the changes, and the likelihood the changes will result in changes to any current ratings; and
    - notice of significant errors in a procedure or methodology that may result in a change to current credit ratings.
- The NRSRO discloses the version of a credit rating procedure or methodology used with respect to a particular credit rating.

These policies and procedures are subject to the record retention requirements of Rule 17g-2.

Form and Certifications to Accompany Credit Ratings

The Dodd-Frank Act provides that the SEC must adopt rules requiring an NRSRO to prescribe a form to accompany the publication of each credit rating that discloses: (1) information relating to the assumptions underlying the credit rating procedures and methodologies, the data that was relied on to determine the credit rating and, if applicable, how the NRSRO used servicer or remittance reports to conduct surveillance of the credit rating; and (2) information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the NRSRO. The form must be made readily available to users of credit ratings in electronic or paper form as the SEC may determine by rule. The Act further requires the SEC to adopt rules requiring an NRSRO, at the time it produces a credit rating, to disclose any certifications from providers of third-party due diligence services to the public in a manner that allows the public to determine the adequacy and level of due diligence of services provided by a third party. In addition, the SEC's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.

The SEC has implemented these provisions through paragraph (a) of Rule 17g-7. The prefatory text requires an NRSRO to publish the form (including the attestation) and, when applicable, a certification from a third-party due diligence provider, each time the NRSRO takes a specified rating action. [18] The items described in the form and any applicable certifications must be made available to the same persons who can receive or access the credit rating. New paragraph (a)(1)(i) of Rule 17g-7 addresses the format of the form, and requires that the required quantitative content be disclosed in a manner that is directly comparable across types of obligors, securities, and money market instruments.

New paragraph (a)(1)(ii) of Rule 17g-7 prescribes the required contents of the form, mirroring in certain respects the specific items of "qualitative content" and "quantitative content" identified in the statute. [19] New paragraph (a)(1)(iii) implements the attestation requirement. The attestation must be signed by a person within the NRSRO that has responsibility for the rating action and attached to the form. Finally, new paragraph (a)(2) of Rule 17g-7 (in conjunction with the prefatory text of paragraph (a)) requires an NRSRO to include with the publication of a credit rating any written certification (executed on new Form ABS Due Diligence-15E) related to the credit rating received from a provider of third-

party due diligence services.

Third-Party Due Diligence for Asset-Backed Securities

The Dodd-Frank Act contains several provisions regarding due diligence services relating to an "asset-backed security" as defined under the Exchange Act ("Exchange Act-ABS"), including requirements that:

- the issuer or underwriter make publicly available the findings and conclusions of any third-party due diligence report;
- in any case in which an NRSRO, issuer, or underwriter employs third-party due diligence services, the person providing the due diligence services provide written certification to any NRSRO that produces a rating to which the services relate; [20] and
- the SEC establish the appropriate format and content for such written certifications to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating.

To implement the first requirement above, the SEC has adopted new Rule 15Ga-2 under the Exchange Act. The new rule requires an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO, whether the offering is registered or unregistered, to furnish a Form ABS-15G through the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. The form must be furnished at least five business days prior to the first sale in the offering. The new rule exempts from this requirement certain offshore transactions, along with certain municipal offerings. [21]

To implement the requirements above relating to written certifications by providers of due diligence services, the SEC has adopted new Rule 17g-10, which requires, among other things, that such written certifications be provided on new Form ABS Due Diligence-15E. Rule 17g-10 defines several terms for these purposes, including "due diligence services." [22] Form ABS Due Diligence-15E elicits the following information from a provider of third-party due diligence services:

- the identity and address of the provider of third-party due diligence services;
- the identity and address of the person who paid the provider of third-party due diligence services;
- the identity of each NRSRO whose published criteria for performing due diligence the third-party intended to satisfy in performing the due diligence review;
- a description of the scope and manner of the due diligence performed; and
- a summary of the findings and conclusions resulting from the review.

Standards of Training, Experience, and Competence

The Dodd-Frank Act requires the SEC to issue rules reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings: (1) meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates; and (2) is tested for knowledge of the credit rating process. The SEC has implemented this requirement through new Rule 17g-9. The rule requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in determining credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO

is registered. The rule identifies several factors the NRSRO must consider when establishing those standards. It also prescribes two requirements that must be included in the standards: (1) a requirement for periodic testing of individuals employed to participate in determining credit ratings on their knowledge of the relevant procedures and methodologies used by the NRSRO; and (2) a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating. The SEC has also amended Rule 17g-2 to require documentation of these standards as a record that must be retained.

Universal Rating Symbols

The Dodd-Frank Act provides that the SEC must require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures that: (1) assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument; (2) clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating; and (3) apply any such symbol in a manner that is consistent for all types of securities and money market instruments for which the symbol is used. The SEC has implemented this requirement through paragraph (b) of new Rule 17g-8. The rule text largely tracks the statutory language, but adds a requirement that the NRSRO "document" the required policies and procedures. The SEC has also amended Rule 17g-2 to apply its record retention requirements to these policies and procedures.

The Dodd-Frank Act also required the SEC to study certain matters related to credit rating standardization, including the feasibility and desirability of standardizing credit rating terminology across asset classes. The Commission submitted the SEC staff's report to Congress in 2012, [23] and did not take the opportunity in this rulemaking to require additional forms of standardization in this area.

Annual Report of Designated Compliance Officer

The Dodd-Frank Act contains self-executing provisions that: (1) require an NRSRO to designate a compliance officer responsible for administering the NRSRO's required policies and procedures related to preventing the misuse of nonpublic information and managing conflicts of interest, and for compliance with the securities laws and the rules and regulations thereunder; and (2) address the activities, duties, and compensation of the designated compliance officer. Pursuant to the Act, the compliance officer must submit to the NRSRO an annual report on the NRSRO's compliance with the securities laws and with the policies and procedures of the NRSRO. The report must include a description of any material changes to the NRSRO's code of ethics and conflict of interest policies and a certification that the report is accurate and complete. The Act specifies that the annual report must be filed with certain financial information NRSROs currently are required to furnish annually to the SEC.

Existing Rule 17g-3 outlines the reports that NRSROs must provide to the SEC annually. The SEC has amended Rule 17g-3 to identify the annual report of the designated compliance officer (which need not be audited and is not made public) as an additional annual report that must be filed with the SEC.

Electronic Submission of Form NRSRO and Rule 17g-3 Annual Reports

Applicants and NRSROs have been submitting to the SEC Forms NRSRO (which, along with Exhibits 1 through 9 thereto, must be made publicly available) and annual reports under

Rule 17g-3 (which need not be made publicly available) in paper form. Pursuant to the adopted amendments, NRSROs must submit Forms NRSRO and the information and documents contained in Exhibits 1 through 9 through the EDGAR system as PDF documents if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g-1 (i.e., an update of registration, an annual certification, or a withdrawal from registration). [24] NRSROs must also submit electronically through EDGAR as PDF documents annual reports required by Rule 17g-3, which are not required to be made public and therefore may be submitted on a confidential basis.

Effective Dates and Implementation

The effective dates for the various new rules and amendments are designed to take into consideration the time needed for NRSROs, issuers, underwriters, and third-party due diligence service providers to comply with the new requirements. Certain amendments will become effective 60 days after publication in the Federal Register. [25]

The amendments with respect to the annual report on internal controls and the amendments to Form NRSRO (including, e.g., the production and disclosure of performance statistics) will be effective on January 1, 2015, which means that the first internal controls report to be submitted by an NRSRO would cover the fiscal year that ends on or after January 1, 2015, and the first annual certification on Form NRSRO will be required for the annual certifications filed after the end of the 2015 calendar year.

The following provisions are effective nine months after publication in the Federal Register: the prohibition on the conflict between sales and marketing and the production of credit ratings; policies and procedures with respect to methodologies used to determine credit ratings; policies and procedures with respect to universal rating symbols; requirements for internal control structures; standards of training, experience, and competence; policies and procedures for "look-back" reviews; issuer and underwriter disclosure of third-party due diligence findings (new Rule 15Ga-2); the certification from a third-party due diligence provider (i.e., new Rule 17g-10 and Form ABS Due Diligence-15E); the form and certification to accompany credit rating actions; and the disclosure of rating histories.

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endnotes

[1] See Nationally Recognized Statistical Rating Organizations, SEC Release No. 34-72936 (the "Release"), available at www.sec.gov/rules/final/2014/34-72936.pdf.

[2] See Institute Memorandum No. 25266, dated June 9, 2011, for a summary of the SEC's initial proposal. ICI's comment letter on the SEC's initial proposal ("ICI Letter") is available at www.sec.gov/comments/s7-18-11/s71811-34.pdf.

[3] See Rule 17g-8(d) for all of the factors. Commissioners Gallagher and Piwowar each pointed to this change as a reason for not supporting the final package of new rules and amendments.

[4] The report must include: (1) a description of the responsibility of management in establishing and maintaining an effective internal control structure; (2) a description of

each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and (3) a statement as to whether the internal control structure was effective as of the end of the fiscal year.

[5] Section 15E(h) concerns management of conflicts of interest.

[6] In the Release, the SEC provides the following examples of participation in sales and marketing activities: “pitching” the NRSRO’s services, contacting institutional investors and offering subscriptions, and being contacted by an issuer or investor about the costs of its products and services. Engaging in analytical discussions with those outside of the NRSRO generally would not violate the rule, provided the discussions do not involve commercial matters.

[7] Commissioners Gallagher and Piwowar were critical of this second prong of this prohibition. In his dissenting statement, Commissioner Piwowar stated, “This new rule text sets an impossible standard for compliance and has no limiting principle.”

[8] Section 15E(d)(1) provides that the SEC 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 the SEC finds, on the record after notice and opportunity for a hearing, that such sanction is necessary for the protection of investors and in the public interest and the NRSRO (or a person associated with the NRSRO) has engaged in a number of specified categories of conduct.

[9] The Release states that an NRSRO’s procedures could, but need not, require a de novo review of the obligor or obligation.

[10] A revised rating must also include an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest, a description of the conflict, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and a description of the impact of the conflict on the prior rating action(s). An affirmation must include an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest, a description of the conflict, an explanation of why no action was taken notwithstanding the conflict, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and a description of the impact of the conflict on the prior rating action(s).

[11] Form NRSRO is the form that an applicant must use to apply for registration with the SEC as an NRSRO. In addition to initial applications, it is used by NRSROs for applications to register for an additional class of credit ratings, application supplements, updates of registration, annual certifications, and withdrawals from registration.

[12] NRSROs are currently required to publish two types of information about the performance of their credit ratings, rating statistics and rating history, but prior to adoption of these amendments, Form NRSRO did not prescribe a methodology for providing rating statistics.

[13] Exhibit 1 to Form NRSRO contains credit ratings performance measurement statistics. Under existing rules, an NRSRO must make its current Form NRSRO and information and documents furnished in Exhibits 1 through 9 publicly available on its website, or through

another comparable, readily accessible means.

[14] The classes include: financial institutions, brokers, and dealers; insurance companies; corporate issuers; issuers of asset-backed securities; and issuers of government securities, municipal securities, or securities issued by a foreign government.

[15] For example, NRSROs (as applicable) have to provide this information for the following subclasses of asset-backed securities: RMBS, CMBS, CLOs, CDOs, asset-backed commercial paper, other ABS, and other structured finance products.

[16] The ICI Letter requested that these periods be shortened, because "such delay is excessive and severely diminishes the usefulness of the information."

[17] The SEC states in the Release that the rule is designed to provide NRSROs the flexibility to design the required policies and procedures.

[18] "Rating action" is defined to mean any of the following: the publication of an expected or preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); and an affirmation or withdrawal of an existing credit rating, if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using applicable procedures and methodologies for determining credit ratings.

[19] Under Rule 17g-7(a)(1)(ii), the required "qualitative" information includes: information about the NRSRO's rating and the obligor, security, or money market instrument; the version of the procedure or methodology used to determine the credit rating; the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating; the potential limitations of the credit rating; information on the uncertainty of the credit rating; a description of the types of data that were relied upon; a statement containing an overall assessment of the quality of information available and considered, in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments; and information relating to conflicts of interest, including whether the NRSRO was paid to determine the credit rating by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, or by another person. The required "quantitative" information includes: an explanation or measure of the potential volatility of the credit rating; information on the content of the credit rating, including, if applicable, the historical performance of the credit rating and the expected probability of default and the expected loss in the event of default; information on the sensitivity of the credit rating to assumptions made by the NRSRO; and if the credit rating is assigned to an ABS, information on the representations, warranties, and enforcement mechanisms available to investors.

[20] As noted above, pursuant to another statutory requirement, the SEC is requiring an NRSRO to publish, when applicable, a certification from a third-party due diligence provider each time the NRSRO takes a rating action.

[21] The ICI Letter recommended that municipal securities be excluded from the rule's ABS disclosure requirements. However, the statute still requires municipal issuers and underwriters of Exchange Act-ABS to make publicly available the findings and conclusions of any third-party due diligence reports that they obtain, which could be done by posting

the information on an issuer- or underwriter-sponsored Internet website.

[22] This rule also provides that a person providing third-party due diligence services satisfies its obligations if it delivers the executed Form ABS Due Diligence-15E to any NRSRO requesting it and to the issuer or underwriter that maintains the Internet website pursuant to Rule 17g-5.

[23] See 2012 Staff Report to Congress on Credit Rating Standardization, September 2012, available at www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf. The SEC staff recommended in the Report that "the Commission not take any further action at this time with respect to: (1) standardizing credit rating terminology, so that all credit rating agencies issue credit ratings using identical terms; (2) standardizing the market stress conditions under which ratings are evaluated; (3) requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and (4) standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity."

[24] An applicant or NRSRO will continue to submit in paper format Forms NRSRO pursuant to paragraphs (a), (b), (c), and (d) of Rule 17g-1 (initial applications for registration, applications to register for an additional class of credit ratings, or supplements to or withdrawals of either of those two types of applications) due to the iterative nature of the NRSRO application process.

[25] E.g., the amendments described above under "Electronic Submission of Form NRSRO and Rule 17g-3 Annual Reports;" certain amendments to Rule 17g-2; amendments to Rule 17g-3 relating to the annual report on compliance of the NRSRO and the ability to seek confidential treatment of annual reports; and the amendments to Rule 17g-5 permitting the SEC to exempt "small" NRSROs from the new provision meant to separate the production of ratings from sales and marketing activities.
