

MEMO# 23252

February 13, 2009

SEC Re-Proposes Amendments to NRSRO Rules

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TO: SEC RULES COMMITTEE No. 5-09
EQUITY MARKETS ADVISORY COMMITTEE No. 5-09
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 3-09
FIXED-INCOME ADVISORY COMMITTEE No. 3-09
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 4-09
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 4-09 RE: SEC RE-PROPOSES
AMENDMENTS TO NRSRO RULES

The Securities and Exchange Commission has re-proposed amendments to its existing rules governing the conduct of nationally recognized statistical rating organizations (“NRSROs”).

[\[1\]](#) The rule amendments would (1) require the public disclosure of credit rating histories for all outstanding issuer-paid credit ratings issued by an NRSRO and (2) prohibit an NRSRO from issuing an issuer-paid rating for a structured finance product unless the information about the product provided to the NRSRO to determine the rating and, thereafter, to monitor the rating is made available to other NRSROs.

Comments on the proposed amendments are due to the Commission by March 26, 2009. We will hold a conference call on Thursday, February 19, at 2:00 p.m. Eastern time to discuss the Institute’s comments relating to the Commission’s proposal. The dial-in number for the conference call will be 1- 866-541-3298 and the passcode for the call will be 6501781. If you plan to participate on the call, please contact Jennifer Odom by email at jodom@ici.org or by phone at 202-326-5833.

Ratings Performance Measurement Statistics

The proposal would require the public disclosure of credit rating histories for 100% of issuer-paid credit ratings issued by an NRSRO on or after June 26, 2007. An NRSRO would have until 12 months after the action is taken to disclose the ratings action. [2] In the Proposing Release, the Commission stated its belief that this information would provide users of credit ratings, investors, and other market participants and observers with the maximum amount of raw data with which to compare how NRSROs subject to the rule initially rated an obligor or security and, subsequently, adjusted those ratings, including the timing of the adjustments. This, in turn, would allow market participants to develop performance measurement statistics to supplement those required to be published by the NRSROs themselves and to compare rating histories on an obligor-by-obligor or instrument-by-instrument basis. It also would foster greater accountability for NRSROs and competition among NRSROs by making it easier for users of credit ratings to judge the output of the NRSROs.

The Commission is soliciting comment about the proposed amendments and the application of a disclosure requirement on subscriber-paid credit ratings.

- Should the proposed amendments apply equally to issuer-paid and subscriber-paid credit ratings; in what ways and to what extent might the objectivity of NRSROs in determining subscriber-paid credit ratings be impaired because of conflicts of interest; and, are the goals of the proposal – greater accountability of NRSROs and promotion of competition – achievable if subscriber-paid credit ratings are not subject to the proposal’s requirements?
- Do subscribers value rating action histories for subscriber-paid credit ratings; do subscribers value the in-depth analysis that is delivered with a rating action; and, how material is the value that subscribers place on the historical rating action itself as compared to the value placed on the in-depth analysis or materials that are delivered along with the rating action?
- Do subscribers believe that subscriber-paid NRSROs act more quickly to adjust credit ratings because of their business model; and what diligence do potential subscribers to subscriber-paid credit ratings perform in deciding whether to subscribe to such ratings of a particular NRSRO?
- What length of time would be appropriate to address NRSROs’ concerns regarding the loss of revenues from subscribers for access to their subscriber-paid credit ratings?

Conflicts of Interest

As re-proposed, the rule amendments would prohibit an NRSRO from issuing a rating for a structured finance product unless the information about the product provided to the NRSRO to determine the rating and, thereafter, to monitor the rating is made available to other NRSROs. [3] Specifically, an NRSRO would need to disclose to other NRSROs (and only other NRSROs) the deals for which they were in the process of determining. It would be required to maintain a password protected Internet Web site that lists each deal it has been hired to rate in chronological order and identifying the type of security or money market instrument, the name of the issuer, the date the rating process was initiated, and the Web site address where the issuer, sponsor, or underwriter represents that the information required by the proposed amendment can be accessed. Pursuant to the proposal, the NRSRO would be required to post this information no later than when the arranger first

transmits it to the NRSRO. [\[4\]](#)

The proposal also would require that an arranger provide an NRSRO it hires to rate a structured finance product with four representations regarding providing information given to the hired NRSRO to other NRSROs.

- First, the arranger would need to represent that it would maintain the requisite information on an identified password protected Internet Web site indicating which information currently should be relied on to determine or monitor the credit rating, and which information is final and will be used by the NRSRO to determine the credit rating that is published.
- Second, the arranger would need to agree to make all of the information available to any other NRSRO at the same time as the hired NRSRO, including posting new information contemporaneously with providing it to the hired NRSRO. The proposed amendment would only apply to written information provided to the hired NRSRO.^[5]
- Third, the arranger would have to represent that it will provide access during the applicable calendar year to any NRSRO that provides it with a copy of its annual certification (discussed below).
- Fourth, the arranger would need to agree to post all written information it provides to the NRSRO for the purpose of undertaking credit rating surveillance, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the hired NRSRO.

Obtaining these representations would provide the NRSRO with a safe harbor if (1) the arranger did not act in accordance with a representation and (2) reliance on the representations was reasonable.

The proposal would require that an NRSRO seeking to access information maintained by other NRSROs and arrangers would need to furnish the Commission an annual certification that it is accessing the information solely to determine or monitor credit ratings, that it will keep the information confidential and treat it as material non-public information, and that it will determine credit ratings for at least 10% of the deals for which it obtains information. The NRSRO also would be required to disclose in the certification the number of deals for which it obtained information and the number of ratings it issued using that information during the year covered by the most recent certification. In the Proposing Release, the Commission stated that this requirement would increase the number of ratings for a given structured finance product and, thereby, improve the quality of such ratings.

The Commission seeks comment on whether other entities besides NRSROs should be permitted to access the arrangers' Internet Web sites. The Commission also asks whether it should provide a standardized list of information that, at a minimum, should be disclosed by the arrangers.

Regulation FD

The proposal would amend Regulation FD to accommodate the information disclosure program that would be established under the re-proposed amendments. Regulation FD currently provides that an issuer need not make a public disclosure if the disclosure of material non-public information is made to an entity whose primary business is the

issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available. Under the proposal, the Commission would amend Regulation FD to permit the disclosure of material non-public information to an NRSRO irrespective of whether it makes its ratings publicly available. This would accommodate subscriber-based NRSROs that do not make their ratings publicly available for free, and it would accommodate NRSROs that access the information under the re-proposed amendments but ultimately do not issue a credit rating using the information.

Definition of Structured Finance Product

The proposed amendments would apply to a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-back securities transaction (e.g., securities collateralized by pools of loans or receivables, collateralized debt obligations, synthetic collateralized debt obligations that reference debt securities or indexes, and hybrid collateralized debt obligations). As described in the Proposing Release, the Commission intends that the definition is sufficiently broad to cover all structured finance products and is not limited to those structured finance products that meet narrower definitions such as the one in Section 3(a)(62)(B) of the Exchange Act. [\[6\]](#)

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endnotes

[\[1\]](#) See Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC Release No. 59343 (February 2, 2009) 74 FR 6485 (February 9, 2009) ("Proposing Release"). In conjunction with the re-proposal, the Commission adopted rule amendments designed to improve investor understanding of credit ratings through enhanced disclosure of NRSRO methods and performance data, and to promote investor confidence in credit ratings by minimizing conflicts of interest. See Memo to SEC Rules Members No. 15-09; Equity Markets Advisory Committee No. 4-09; Municipal Securities Advisory Committee No. 2-09; Fixed-Income Advisory Committee No. 2-09; Money Market Funds Advisory Committee No. 3-09; and Inst. Money Market Funds Advisory Committee No. 3-09, dated February 12, 2009 [23248].

[\[2\]](#) In its companion release adopting rule amendments to the disclosure requirements for an NRSRO, the Commission adopted a requirement that an NRSRO make publicly available, on a six-month delayed basis, a random sample of 10% of the issuer-paid ratings and their histories for each class of credit rating for which the NRSRO is registered and has issued 500 or more issuer-paid ratings.

[\[3\]](#) As originally proposed, an NRSRO would have been required to disclose and manage the conflict of repeatedly being paid by an issuer, sponsor, or underwriter to rate structured finance products. Specifically, as a condition of rating such products, an NRSRO would have needed to disclose the information provided to the NRSRO, and used by the NRSRO in determining the credit rating, through a means designed to provide reasonably broad dissemination of the information. The condition would have applied to information provided

to the NRSRO by the issuer, underwriter, sponsor, depositor, or trustee. The proposed amendments did not specify, however, the party that would have been required to disclose the information.

[4] The proposal would permit an NRSRO to remove the information about the security or money market instrument from the list on its Web site once a final rating is issued or if the arranger decides to terminate the rating process without having a final rating issued.

[5] The Commission stated in the Proposing Release that it would review whether arrangers started providing information orally to avoid having to disclose it on their Web sites.

[6] This provision – a component of the definition of “NRSRO” – refers to issuers of asset-backed securities (as that term is defined in Section 1101(c) of part 229 of Title 17 of the Code of Federal Regulations, as in effect on the date of enactment of this paragraph.)

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