

MEMO# 23992

December 2, 2009

SEC Proposes Additional Requirements on Credit Rating Agencies; Comments Due February 2, 2010

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 58-09
EQUITY MARKETS ADVISORY COMMITTEE No. 54-09
FIXED-INCOME ADVISORY COMMITTEE No. 29-09
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 49-09
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 58-09
SEC RULES MEMBERS No. 130-09 RE: SEC PROPOSES ADDITIONAL REQUIREMENTS ON
CREDIT RATING AGENCIES; COMMENTS DUE FEBRUARY 2, 2010

The Securities and Exchange Commission is proposing rule amendments and a new rule that would impose additional requirements on nationally recognized statistical rating organizations (“NRSROs”). [\[1\]](#) The SEC also is soliciting comments regarding measures that could be taken to differentiate NRSRO’s structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information. Comments on the proposal, which is briefly summarized below, are due to the SEC by February 2, 2010.

Proposed Amendment to Rule 17g-3

The SEC is proposing an amendment to Rule 17g-3 under the Securities Exchange Act of 1934 to require an NRSRO to furnish a new unaudited annual report to the SEC describing the steps taken by the NRSRO’s designated compliance officer during the fiscal year to fulfill the compliance officer’s responsibilities under Section 15E(j) of the Exchange Act. The Release notes the SEC’s preliminary belief that the proposed amendment would improve

the integrity of the credit ratings process by establishing a more structured discipline under which the NRSRO's designated compliance officer would need to report to the SEC the steps taken to fulfill the officer's statutory responsibilities. According to the SEC, the report also is designed to further strengthen the SEC's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and providing an additional tool for the SEC to determine whether the NRSRO's designated compliance officer is fulfilling the responsibilities under the Exchange Act.

Proposed Amendments to Form NRSRO Regarding Sources of Revenue

The SEC is proposing to amend the instructions for Exhibit 6 of Form NRSRO to require a credit rating agency in an application for registration as an NRSRO or an NRSRO providing its annual update to disclose: (1) the percentage of the net revenue of the applicant/NRSRO attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and (2) the percentage of the net revenue of the applicant/NRSRO attributable to other services and products of the applicant/NRSRO. The SEC notes that the proposed disclosures are designed to increase transparency regarding sources of revenue that might create conflicts of interest for an NRSRO, and, thereby, allow investors and users of credit ratings to better assess these potential conflicts of interest that could influence an NRSRO's objectivity in determining credit ratings. According to the SEC, the proposed amendments also are designed to enhance the disclosures already made by NRSROs in Exhibit 6 to Form NRSRO and to provide users of credit ratings with tools to compare concentrations of revenues across all NRSROs.

New Rule 17g-7—Credit Rating Reports on Revenue

The SEC is proposing new Rule 17g-7 that would require annually an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO and, if applicable, its affiliates as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. Specifically, with respect to each person that paid the NRSRO to issue or maintain a credit rating that was outstanding as of the end of the fiscal year, the rule would require the NRSRO to include in the report: (1) the percent of the net revenue attributable to the person that paid the NRSRO that was earned by the NRSRO during the most recently ended fiscal year from providing services and products other than credit rating services to the person; (2) the relative standing of the person in terms of the person's contribution to the NRSRO's net revenue as compared with other persons that contributed to the NRSRO's net revenues; and (3) the identity of all outstanding credit ratings issued by the NRSRO and paid for by the person.

The SEC states that the purpose of this proposed rule is to provide users of credit ratings with information to assist them in evaluating the potential risk to the integrity of a credit rating that arises from the conflict inherent when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

Differentiating Structured Finance Credit Ratings

The SEC is deferring consideration of action with respect to a proposed rule that would have required an NRSRO to include, each time it published a credit rating for a structured finance product, a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments, or alternatively, to use distinct ratings symbols for structured finance products that differentiate them from the credit ratings for other types of financial instruments. [2] The SEC, however, is soliciting comments on how the risk characteristics of structured finance products and credit ratings differ from the risk characteristics of corporate, municipality, and sovereign nation debt instruments and their credit ratings. Specifically, the SEC requests market participants and others to provide their views in the following four areas: (1) the differences between structured finance products and other debt instruments; (2) the differences between credit ratings for structured finance products and credit ratings for other types of debt instruments; (3) potential measures to communicate differences in structured finance products to investors; and (4) potential measures to communicate differences in structured finance credit ratings to investors.

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endnotes

[1] See *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-61051 (November 23, 2009) (“Release”), available on the SEC’s website at <http://sec.gov/rules/proposed/2009/34-61051.pdf>.

[2] See *Proposed Rules for Nationally Recognized Statistical Rating Organizations*, SEC Release No. 34-57967 (June 17, 2008), 73 FR 36211 (June 25, 2008). For a discussion of ICI’s views on this proposal, see Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Florence Harmon, Acting Secretary, Securities and Exchange Commission, dated July 25, 2008.