

**MEMO# 21273**

June 18, 2007

## **SEC Adopts Rules to Implement the Credit Rating Agency Reform Act**

[21273]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 37-07  
ETF ADVISORY COMMITTEE No. 22-07  
FIXED-INCOME ADVISORY COMMITTEE No. 14-07  
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 15-07  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 14-07  
SEC RULES MEMBERS No. 64-07  
UNIT INVESTMENT TRUST MEMBERS No. 13-07 RE: SEC ADOPTS RULES TO IMPLEMENT THE CREDIT RATING AGENCY REFORM ACT

The Securities and Exchange Commission has adopted rules to implement provisions of the Credit Rating Agency Reform Act of 2006 (the "Act"). [\[1\]](#) The Act defines the term "nationally recognized statistical rating organization" or "NRSRO" and provides authority for the SEC to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies.

The Release notes that several commenters, including the Institute, raised potential concerns about how other SEC rules may operate after the NRSRO registration and oversight program takes effect, including Rule 2a-7 under the Investment Company Act of 1940. Based on the uncertainty of how many credit rating agencies will register as NRSROs, the Release states that the Commission intends to monitor how the NRSRO regulatory program impacts Rule 2a-7 and the Commission's other rules using the term "NRSRO." As the program develops, the Release notes that the Commission will evaluate whether modifications to these rules would be appropriate.

Under the rules, a credit rating agency seeking to register as an NRSRO will be required to apply to the SEC using Form NRSRO. Upon applying for registration, a credit rating agency

must submit both non-confidential information that the credit rating agency would need to make public upon registration [\[2\]](#) and update thereafter, and certain confidential information that would not need to be made public (but would have to be kept current through proposed financial reporting requirements).

The information required by a credit rating agency in its Form NRSRO includes the classes of credit ratings for which it is applying to be registered; credit ratings performance measurement statistics; a general description of its procedures and methodologies for determining credit ratings; its organizational structure; procedures to prevent the misuse of material nonpublic information; conflicts of interest; procedures to address and manage conflicts of interest; a description of the minimum qualifications of its credit analysts and credit analysts supervisors; and information regarding the designated compliance officer. The credit rating agency also will be required to provide certifications from qualified institutional buyers; a list of its largest customers; audited financial statements; and certain summary financial information.

After registration, the credit rating agency (now considered an NRSRO under the Act) will need to update the information on its Form NRSRO to the extent an item or exhibit becomes materially inaccurate (with certain exceptions). In addition, on a calendar year basis, the NRSRO will need to furnish the SEC with an annual certification on Form NRSRO that the information and documents in the form continue to be accurate and list any material changes that occurred during the year.

After registration, the NRSRO will be subject to several substantive rules. The NRSRO will be required to make and retain certain records relating to the business of issuing credit ratings. According to the Release, these records will assist the SEC, through its examination process, in monitoring whether the NRSRO complies with the requirements of the Act and in monitoring whether the NRSRO follows its established policies and procedures. The NRSRO will be required to annually furnish, on a confidential basis, certain financial reports, including audited financial statements. All NRSROs also will be subject to requirements designed to protect their impartiality with respect to issuing credit ratings, including requirements to establish, maintain, and enforce specific written policies designed to prevent the misuse of material non-public information. Finally, the NRSRO will be prohibited from engaging in certain unfair, coercive, or abusive practices. For example, an NRSRO is prohibited from the practice of “notching” [\[3\]](#) where such practice is engaged in by the NRSRO for an anticompetitive purpose.

The Release states that the rules relating to registration requirements and Form NRSRO will be effective on June 18, 2007. The rules relating to recordkeeping, annual financial reports, procedures to prevent the misuse of material, nonpublic information, management of conflicts of interest, and prohibition of unfair, coercive, or abusive practices will become effective on June 26, 2007.

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#### **endnotes**

[\[1\]](#) Securities Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33563 (June 18, 2007) (“Release”). The Release can be found on the SEC’s website at

<http://sec.gov/rules/final/2007/34-55857.pdf>. The Institute filed a comment letter on March 12, 2007. See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated March 12, 2007.

[2] The Release cites the Institute's letter, which encourages the Commission to make the non-confidential information available, if possible, even earlier than the proposed five-day time limit as a means for users of credit ratings to evaluate new NRSROs. Although the Release notes the Commission's agreement with the Institute's letter on this point, the Commission decided to lengthen the time period to ten days to accommodate the substantial amounts of information larger NRSROs may have in their applications. The ten-day time period, however, is shorter than the 15 or 20 days requested by other commenters.

[3] Notching is a practice where a credit rating agency refuses to rate securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transactions or discounts the rating for such a product because it has not rated all of the underlying assets. The Release notes that the Commission received more comments on the practice of notching than on any other provision in the proposing release. Under the Commission's proposal, an NRSRO could have refused to issue a credit rating to, or withdrawn a credit rating of, a product if the NRSRO had rated less than 85% of the market value of the assets underlying the product.

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