

**MEMO# 20475**

October 10, 2006

## **President Signs Into Law "Credit Rating Agency Reform Act"**

[20475] October 10, 2006 TO: INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 6-06 ©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. SEC RULES MEMBERS No. 90-06 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-06 FIXED-INCOME ADVISORY COMMITTEE No. 8-06 RE: PRESIDENT SIGNS INTO LAW "CREDIT RATING AGENCY REFORM ACT" On September 29, President Bush signed into law the "Credit Rating Agency Reform Act of 2006."<sup>1</sup> The Act amends the registration process and oversight of NRSROs and is intended to introduce greater transparency, accountability and competition into the credit rating industry. The Institute strongly supported, and testified before House and Senate Committees regarding, the Act. The most significant aspects of the Act are summarized below. Registration of NRSROs Under the Act, a credit rating agency<sup>2</sup> that elects to be treated as an NRSRO<sup>3</sup> must register with the SEC. Each application for registration must contain certain information including, among other things, information regarding (1) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the applicant; (2) the procedures and methodologies that the applicant uses in determining credit ratings; (3) policies or procedures adopted and 1 Public Law No. 109-291. The full text of the Act can be found at

[http://frwebgate.access.gpo.gov/cgi-](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s3850enr.txt.pdf)

[bin/getdoc.cgi?dbname=109\\_cong\\_bills&docid=f:s3850enr.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s3850enr.txt.pdf). 2 Under the Act, the term "credit rating agency" is defined as any person (A) 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; (B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and (C) receiving fees from either issuers, investors, or other market participants, or a combination thereof. 3 Under the Act, the term "nationally recognized statistical rating organization" is defined as a credit rating agency that (A) 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; (B) issues credit ratings certified by qualified institutional buyers with respect to (i) financial institutions, brokers, or dealers; (ii) insurance companies; (iii) corporate issuers; (iv) issuers of asset-backed securities; (v) issuers of government securities, municipal securities, or securities issued by a foreign government; or (vi) a combination of one or more categories of obligors described in any of clauses (i) through (v); and (C) is registered with the SEC. 2 implemented by the applicant to prevent the misuse of material, nonpublic information; (4) the organizational structure of the applicant; (5) any conflict of interest relating to the issuance of credit ratings by the applicant; (6) on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services of

the applicant, by amount of net revenues received in the fiscal year immediately preceding the date of submission of the application; and (7) on a confidential basis, certain written certifications from qualified institutional buyers (discussed below). Not later than 90 days after the date on which the application for registration is filed with the SEC, the SEC must either approve the registration or institute proceedings to determine whether registration should be denied. Each application for NRSRO registration must contain written certifications provided from not fewer than 10 qualified institutional buyers, none of which is affiliated with the applicant. The certifications must state that the qualified institutional buyer meets the definition of a qualified institutional buyer under new Section 3(a)(64) of the Exchange Act and has used the credit ratings of the applicant for at least the 3 years immediately preceding the date of the certification in the subject category or categories of obligors described in the definition of NRSRO. A written certification will not be required with respect to any credit rating agency which has received, or been the subject of, an NRSRO no-action letter from SEC staff prior to August 2, 2006. Not later than 90 days after the end of each calendar year, each NRSRO must provide the SEC with an amendment to its registration certifying that the information and documents in its application for registration continue to be accurate and listing any material change that occurred to the information or documents in its application for registration during the previous calendar year. Each NRSRO also will be required to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate, except that an NRSRO is not required to amend its credit ratings performance measurement statistics (which is required to be amended in the annual certification required by the Act) or the written certifications provided by qualified institutional buyers.

**Public Availability of Information** The Act requires that an NRSRO, upon the granting of registration, make the information and documents submitted to the SEC in its completed application for registration (except information provided on a confidential basis), or in any amendment to its registration, publicly available on its website, or through another comparable, readily accessible means.

**Accountability for Ratings Procedures** The Act provides that the SEC will have exclusive authority to enforce the provisions of the Act with respect to any NRSRO that issues credit ratings in material contravention of the procedures and methodologies that the NRSRO includes in its application for registration or makes and disseminates in reports pursuant to Section 17(a) of the Exchange Act or the rules and regulations 3 thereunder. The Act also states that the SEC may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.

**Review of Existing Regulations** The Act requires that, not later than 270 days after the date of enactment of the Act, the SEC must review, and amend or revise, its existing rules and regulations which use the term “nationally recognized statistical rating organization” or “NRSRO.”

Ari Burstein Associate Counsel