
**2014 SUMMARY REPORT OF COMMISSION STAFF'S EXAMINATIONS OF
EACH NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION**

As Required by Section 15E(p)(3)(C)
of the Securities Exchange Act of 1934



This is a report of the Staff of the U.S. Securities and Exchange Commission.

**The Commission has expressed no view regarding the analysis, findings, or conclusions
contained herein.**

December 2014

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I. REGULATORY AND NRSRO OVERVIEW

This report summarizes the examinations conducted by staff from the U.S. Securities and Exchange Commission (the “Staff”) under Section 15E(p)(3) of the Securities Exchange Act of 1934 (“Exchange Act”).¹ This is a report of the Staff and, as such, reflects solely the Staff’s views. The U.S. Securities and Exchange Commission (“Commission”) is making this Staff report public as required by Section 15E(p)(3)(C) of the Exchange Act.

A. Statutory Framework and Rules

On September 29, 2006, President George W. Bush signed into law the Credit Rating Agency Reform Act of 2006 (the “Rating Agency Act”).² Section 4 of the Rating Agency Act added Section 15E to the Exchange Act (“Section 15E”), which provided authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to those credit rating agencies that register with the Commission as nationally recognized statistical rating organizations (“NRSROs”). The Rating Agency Act also amended Section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over registered NRSROs.³ Significantly, Section 15E(c)(2) expressly prohibits the Commission from regulating “the substance of credit ratings or the procedures and methodologies by which any [NRSRO] determines credit ratings.”⁴

In 2007, the Commission implemented the NRSRO registration and oversight program created by the Rating Agency Act by adopting Rules 17g-1 through 17g-6 and Form NRSRO.⁵ Pursuant to these rules, registered NRSROs must, among other things, make certain public disclosures, make and retain certain records, furnish certain financial reports to the Commission, establish and enforce procedures to manage the handling of material non-public information, and disclose and manage conflicts of interest. These rules also prohibit an NRSRO from having certain conflicts of interest and engaging in certain unfair, coercive, or abusive practices. The Commission amended several of these rules in February 2009 and December 2009 with the goals of further increasing the transparency of NRSRO rating methodologies; strengthening the disclosures of rating performance; prohibiting NRSROs from engaging in certain unfair, coercive, or abusive practices; and enhancing NRSRO record keeping.⁶

¹ 15 U.S.C. § 78o-7(p)(3)(C). Unless otherwise noted, all Section and Rule references in this report are to the Exchange Act and rules under the Exchange Act. *See* 15 U.S.C § 78o-7; 15 U.S.C. § 78q (a) & (b); 17 CFR 240.17g-1 through 17g-7.

² Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327 (2006).

³ *See* Sections 17(a) and 17(b) of the Exchange Act.

⁴ 15 U.S.C. § 78o-7(c)(2).

⁵ *See* Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857 (Jun. 5, 2007), 72 FR 33564 (Jun. 18, 2007).

⁶ *See* Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (Feb. 2, 2009), 74 FR 6456 (Feb. 9, 2009) and Amendments to Rules for Nationally

On July 21, 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which, among other things, amended Section 15E to enhance the regulation and oversight of NRSROs by imposing new reporting, disclosure, and examination requirements.⁷ The Dodd-Frank Act mandated the creation of the Office of Credit Ratings (“OCR”), which was established in June 2012 with the appointment of its Director, Thomas J. Butler. OCR is responsible for oversight of credit rating agencies registered with the Commission as NRSROs.

The Dodd-Frank Act directed the Commission to adopt rules to implement a number of provisions related to NRSROs. In January 2011, the Commission adopted new Rule 17g-7.⁸ In August 2014, the Commission adopted new rules and amended certain existing rules.⁹ Specifically, the Commission adopted new Rules 17g-8, 17g-9, and 17g-10 as well as Form ABS Due Diligence-15E, and amended Rules 17g-1 through 17g-3 and 17g-5 through 17g-7 as well as Form NRSRO. These new rules and amended rules were not in effect as of the time period covered by the 2014 examinations, thus the Staff’s 2014 examination activities did not review whether the NRSROs’ conduct complied with these new rules and amended rules.

B. Registered NRSROs

In 2007, following the adoption of its first set of NRSRO rules, the Commission began granting registrations to credit rating agencies that applied to be registered as an NRSRO. A credit rating agency may apply to be registered with respect to one or more of the following five classes of credit ratings: (1) financial institutions, brokers, or dealers (“financial institutions”); (2) insurance companies; (3) corporate issuers; (4) issuers of asset-backed securities (“asset-backed securities” or “ABS”); and (5) issuers of government securities, municipal securities, or securities issued by a foreign government (“government securities”).¹⁰

The ten credit rating agencies registered as NRSROs as of December 1, 2014, and dates of their initial registrations are listed below:

Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009).

⁷ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 932, 124 Stat. 1376, 1872-83 (2010).

⁸ *See* Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Securities Act of 1933 Release No. 9175; Exchange Act Release No. 63741 (Jan. 20, 2011), 76 FR 4515 (Jan. 26, 2011).

⁹ *See* Final Rule: Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 72936 (Aug. 27, 2014); 79 FR 55078 (Sept. 15, 2014).

¹⁰ *See* Section 3(a)(62)(A) of the Exchange Act.

NRSRO ¹¹	Date of Registration
A.M. Best Company, Inc. (“AMB”)	September 24, 2007
DBRS, Inc. (“DBRS”)	September 24, 2007
Egan-Jones Ratings Company (“EJR”)	December 21, 2007
Fitch Ratings, Inc. (“Fitch”)	September 24, 2007
HR Ratings de México, S.A. de C.V. (“HR”)	November 5, 2012
Japan Credit Rating Agency, Ltd. (“JCR”)	September 24, 2007
Kroll Bond Rating Agency, Inc. (“KBRA”) ¹²	February 11, 2008
Moody’s Investors Service, Inc. (“Moody’s”)	September 24, 2007
Morningstar Credit Ratings, LLC (“Morningstar”) ¹³	June 23, 2008
Standard & Poor’s Ratings Services (“S&P”)	September 24, 2007

More information on NRSRO registration applications and the state of competition, transparency, and conflicts of interest among NRSROs is included in the Annual Report to Congress under Section 6 of the Rating Agency Act, available on the Commission’s website: <http://www.sec.gov/ocr>.

II. OFFICE OF CREDIT RATINGS AND EXAMINATION OVERVIEW

A. Examinations under Section 15E(p)(3)

Generally, the purpose of NRSRO examinations is to monitor compliance with federal securities laws and rules, identify conduct or insufficient policies and procedures or internal controls that potentially violate such laws and rules, and encourage remedial action. Examinations also serve to inform the Commission and the NRSROs’ compliance personnel of regulatory obligations and noteworthy industry developments. If the examination staff identifies potential violations of federal securities laws or rules, the Staff may refer the matter to the Commission’s Division of Enforcement, which is responsible for further investigation of these potential violations.

Section 15E(p)(3)(A) requires OCR to conduct an examination of each NRSRO at least annually. Section 15E(p)(3)(B) provides that the examination shall include a review of the following eight topic areas (“Section 15E Review Areas”): (i) whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest by the NRSRO; (iii) the implementation of ethics policies by the NRSRO; (iv) the internal supervisory controls of the NRSRO; (v) the governance of the NRSRO; (vi) the

¹¹ Orders granting registration can be found at: <http://www.sec.gov/about/offices/ocr.shtml>. Paragraph (i) of Rule 17g-1 requires an NRSRO to make its current Form NRSRO and Exhibits 1 through 9 to Form NRSRO publicly available on its website, or through another comparable, readily accessible means within 10 business days after the date the Commission grants an initial application for registration as an NRSRO or registration for an additional class of credit ratings, and within 10 business days after updating its registration, furnishing its annual certification, or withdrawing from registration.

¹² Formerly known as LACE Financial Corp.

¹³ Formerly known as Realpoint LLC.

activities of the designated compliance officer (“DCO”) of the NRSRO; (vii) the processing of complaints by the NRSRO; and (viii) the policies of the NRSRO governing the post-employment activities of its former personnel.

Section 15E(p)(3)(C) requires the Commission to make publicly available an annual report summarizing: (i) the essential findings of all Section 15E examinations, as deemed appropriate by the Commission; (ii) the NRSROs’ responses to any material regulatory deficiencies identified by the Commission; and (iii) whether the NRSROs have appropriately addressed the recommendations of the Commission contained in previous annual reports on examinations.¹⁴

B. Examination Overview

The 2014 examinations generally focused on NRSROs’ activities for the period covering January 1, 2013 through December 31, 2013 (the “Review Period”). The examinations also reviewed certain activities or credit rating actions from outside of the Review Period.

The 2014 examinations reviewed the Section 15E Review Areas and examined how each NRSRO adhered to Section 15E and Rules 17g-1 through 17g-7. Each of the NRSRO examinations was based upon an individualized risk assessment by the Staff that determined which of the Section 15E Review Areas to emphasize particularly and the issues to focus on within the Section 15E Review Areas. The individualized risk assessments took into account a number of factors, including the NRSRO’s credit rating activities and operations, the Staff’s findings and other observations from prior examinations, the impact of an internal control or compliance failure by the NRSRO, recent industry developments affecting NRSROs and the asset classes in which the NRSRO is registered, the NRSRO’s filings with the SEC and public disclosures, and relevant tips, complaints, and referrals received by the Commission. As a result of these individualized risk assessments, the 2014 examinations included a review of each of the Section 15E Review Areas while also being tailored to the specific risk profile of each NRSRO.

The 2014 examinations also focused on multiple NRSROs’ activities and ratings concerning certain issues that the Staff’s risk assessments determined to be relevant at these NRSROs. Three examples are summarized in this paragraph. First, the Staff reviewed multiple NRSROs’ written policies and procedures, controls, and documentation, if any, related to Information Technology (“IT”) and cybersecurity. In addition, the Staff conducted more focused assessments of certain IT and cybersecurity issues at these NRSROs; these assessments leveraged the knowledge of and personnel from the SEC’s Office of Information Technology, and such personnel participated in portions of the onsite examinations of some of the NRSROs. Second, the Staff reviewed multiple NRSROs’ ratings activity or rating files related to government securities. Third, the Staff reviewed some NRSROs’ ratings-related activities and publications concerning certain new types of asset-backed securities. Any findings by the Staff concerning NRSROs’ IT and cybersecurity or their ratings activity related to government securities or these

¹⁴ This report does not cover examinations or reviews that may be conducted outside the scope of Section 15E.

new types of asset-backed securities are addressed in this Report in the Sections concerning the relevant Review Areas.

The operations of many NRSROs are international or global in scale, and such NRSROs have one or more credit rating affiliates located outside the United States which are included in their NRSRO registration. Such foreign credit rating affiliates and some of their personnel may participate in ratings activities, including determination of particular ratings, related to U.S.-based entities or to foreign entities that Americans invest in or that otherwise affect the U.S. capital markets. Based on these factors, the 2014 examinations included additional focus on the operations and rating activity by certain NRSROs' foreign credit rating affiliates beyond that conducted by OCR in years prior. The Staff assessed whether NRSROs applied rating policies and procedures, methodologies, criteria, and models consistently in their different offices, whether these NRSROs exercised sufficient compliance oversight of their foreign credit rating affiliates, and whether deficiencies at these foreign credit rating affiliates could pose risks to these NRSROs' U.S. operations. This additional focus included the Staff's onsite visits to offices of certain NRSROs' credit rating affiliates located in countries other than the United States. The Staff reviewed files of selected rating actions that personnel in these foreign offices were involved in determining, and during the onsite visits interviewed analytical personnel concerning these rating files and other personnel who worked in or had responsibilities related to these NRSROs' foreign offices. The Staff's findings and recommendations related to its onsite visits and related examination activities of the foreign credit rating affiliates of these NRSROs are addressed in this Report in the Sections concerning the relevant Review Areas.

For purposes of this report only, we will refer to Fitch, Moody's, and S&P as larger NRSROs and the seven other NRSROs (AMB, DBRS, EJRB, HR, JCR, KBRA, and Morningstar) as smaller NRSROs.

III. SUMMARY OF RESPONSES TO RECOMMENDATIONS FROM PREVIOUS REPORTS AND NOTED INSTANCES OF REMEDIAL ACTION

The Staff's determination that an NRSRO appropriately addressed a recommendation does not constitute the Staff's endorsement of that NRSRO or its policies, procedures, or operations. In a future examination, the Staff may check the NRSRO's response to recommendations that it previously deemed to be appropriately addressed. The Staff may also review and make recommendations concerning the NRSRO's policies, procedures, or operations related to the general subject matter of a recommendation that it previously deemed to be appropriately addressed. The Staff's assessment of whether an NRSRO appropriately addressed a recommendation reflects solely the Staff's view and does not necessarily reflect the views of the Commission.

The Staff's assessment of whether an NRSRO has appropriately addressed a recommendation depends on the specific facts and circumstances of each recommendation, including the promptness of the NRSRO's response, the severity of the conduct at issue, and whether the remedial action undertaken by the NRSRO is expected to fully resolve the Staff's concerns. To assess whether NRSROs appropriately addressed findings from the 2013 examinations, the Staff reviewed each NRSRO's written submissions that responded to the Staff's findings and recommendations and described its planned remedial measures, and participated in a follow-up

call in 2013 with each NRSRO to discuss its written response. During the 2014 examinations, the Staff assessed each NRSRO's progress in implementing planned remedial measures and tested the existence or effectiveness of such remedial measures where possible.

NRSROs responded to the 2013 recommendations with remedial measures such as adopting new or revising existing policies or procedures, enhancing or implementing new internal controls, implementing new software systems, and conducting compliance and analytical training. Based on the Staff's 2014 examinations, the Staff has determined that all recommendations from the 2013 examinations have been appropriately addressed.

Since the Section 15E examinations began in 2010, all of the NRSROs have increased their understanding of their obligations as regulated entities. The frequency of communications between NRSROs and the Staff has increased, and there have been enhancements in the nature of the information provided by NRSROs to the Staff during examinations. In addition, at many of the NRSROs, improvements that were initiated or implemented in previous years have been enhanced or become embedded in their operations and culture.

During the 2014 examinations, the Staff observed improvements at one or more NRSROs concerning: (i) compliance resources, monitoring, and culture; (ii) documentation and resources for criteria and model development and validation; (iii) document retention; and (iv) board of directors or governing committee ("Board" or "Boards") oversight and documentation.

The Staff's observations of these improvements do not constitute its endorsement of any NRSRO or its particular policies and procedures or operations. The Staff will continue to evaluate and test the sufficiency of some of these NRSROs' improvements in future examinations, and may make findings and recommendations related to these improvements if appropriate.

IV. SUMMARY OF ESSENTIAL FINDINGS

Section 15E(p)(3)(C)(i) requires this Report to contain a summary of the essential findings of the annual examinations, as deemed appropriate by the Commission.

For purposes of this Report, "essential findings" are all findings from the 2014 examinations that were included with one or more recommendations in an exam summary letter sent to an NRSRO. "Essential findings" do not include the Staff's general observations that are not included in an exam summary letter to an NRSRO. These essential findings are not findings of the Commission. In this Report, essential findings are organized by the applicable Section 15E Review Areas. The Commission has not determined whether any finding discussed in this report constitutes a "material regulatory deficiency," but may do so in the future.

In the following Sections of this Report, the numbered headers identify in general terms the Staff's findings concerning one or more NRSROs, and the paragraph or paragraphs following each numbered header provide additional NRSRO-level detail concerning these findings and the Staff's corresponding recommendations.

A. Review Area: Adherence to Policies, Procedures, and Methodologies

Section 15E and Commission rules require that NRSROs maintain and enforce various written policies and procedures. Section 15E(c)(3)(A) requires NRSROs to 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. A general description of the procedures and methodologies used by the NRSRO to determine credit rating must be included in Exhibit 2 to Form NRSRO.

The Staff reviewed ratings actions of each NRSRO for certain issuers to determine whether the NRSRO conducted business in accordance with its policies, procedures, methodologies, and criteria. In addition, the Staff reviewed NRSROs' other ratings-related activities such as the development and review of methodologies, criteria, and models. The Staff also reviewed rating files and documentation of other ratings-related activities to evaluate whether each NRSRO adhered to recordkeeping requirements. To select rating files to review, the Staff used a risk-based sampling process that considered issues such as the significance of the rated asset class to the financial markets and the NRSRO's business, the NRSRO's activity in the rated asset class, the likelihood of harm if a rating was not determined in accordance with the NRSRO's methodologies and procedures, news reports and developments concerning NRSROs or particular asset classes, and information the Staff learned during examinations.

The Staff's reviews of the Section 15E Review Areas included testing whether each NRSRO operated in accordance with its policies, procedures, and methodologies. The Staff's essential findings regarding NRSROs conducting ratings-related activities in accordance with their policies, procedures, methodologies, and criteria are discussed in this Section of this Report. The Staff's essential findings regarding NRSROs' adherence to policies and procedures related to other Review Areas are generally discussed in later Sections of this Report. Instances where policies, procedures, and methodologies needed to be established or improved are also generally discussed in later Sections of this Report.

The Staff's essential findings regarding whether each NRSRO has conducted its business in accordance with its policies, procedures and methodologies are as follows:

1. There were several instances where one larger NRSRO and four smaller NRSROs did not apply their rating policies and procedures or did not apply or make required disclosures concerning their methodologies or criteria.

At one smaller NRSRO, a substantial number of rating actions did not adhere to certain policies and procedures concerning disclosure of methodologies applied to ratings, conducting timely surveillance, or implementation of issuer-requested edits to rating releases. Another smaller NRSRO did not appear to adhere to its rating definitions for one surveillance rating by assigning a rating that did not appear to reflect this NRSRO's internal analysis concerning this issuer. In addition, the rating publication did not explain all of the key reasons for this rating action. Another rating file from this NRSRO's foreign credit rating affiliate implemented an issuer-requested edit to a rating release that was not permitted by its policies and procedures. Several rating publications of one larger NRSRO did not clearly explain how this NRSRO applied its

criteria to these ratings or did not describe criteria deviations made for these ratings, as required by its policies and procedures.

The Staff recommended various corrective measures to these three NRSROs to ensure that they adhere to their rating policies and procedures and correctly apply and make required disclosures concerning their rating definitions, methodologies, and criteria.

Another smaller NRSRO did not downgrade certain classes of mortgage-backed securities after these securities experienced temporary interest shortfalls, which appeared to be inconsistent with its published methodology and ratings definitions. This NRSRO also did not update its surveillance ratings of some mortgage-backed securities on a monthly basis as required by its methodology. The Staff recommended that this NRSRO review its ratings policies and procedures, methodologies, and ratings definitions, as well as related disclosures, to ensure they reflect its actual practices. At another smaller NRSRO, it was unclear whether rating committee members applied its published methodology. The Staff recommended that this NRSRO ensure that it applies its published methodology and documents its application of this methodology.

2. One larger NRSRO and one smaller NRSRO did not adhere to some of their policies and procedures concerning timely dissemination of accurate ratings.

At one larger NRSRO, there were a notable number of instances where the credit officer was not promptly notified of errors in a rating publication or an analyst did not document the plan to correct these errors, in contravention of its policies and procedures. There were also a few instances where this NRSRO's public website was not promptly updated to reflect rating changes.

At one smaller NRSRO, actual practices for dissemination of ratings on the NRSRO's website and other sources did not adhere to its written policies and procedures, one rating action was published after a significant delay, and there were weaknesses in this NRSRO's policies and procedures concerning timely publication of ratings.

The Staff recommended that these two NRSROs review and enhance or revise their policies and procedures and internal controls concerning timely publication and updating of ratings information.

3. One larger NRSRO and three smaller NRSROs did not adhere to some of their policies and procedures when developing or reviewing certain methodologies, criteria, or models.

One larger NRSRO issued a rating using a model that its model review committee had previously determined was no longer suitable, and adopted a replacement model several months after the timeframe set by this committee. The Staff recommended that this larger NRSRO ensure it has sufficient internal controls for the review and application of criteria and models.

One smaller NRSRO published a methodology that was not approved by the responsible committee, in contravention of its policies and procedures. Another smaller NRSRO did not

review many of its methodologies within the timeframe required by its policies and procedures. A third smaller NRSRO did not review its rating model as required by its policies and procedures. The Staff recommended that these three NRSROs ensure they adhere to their policies and procedures concerning reviewing rating methodologies or models.

4. One larger NRSRO and one smaller NRSRO did not adhere to several of their policies and procedures concerning access to and protection of confidential information and Material Non-Public Information.

One larger NRSRO provided non-employee members of its Board with information regarding future changes in rating methodologies; it was unclear whether this NRSRO's providing this information was permissible, because its policies and procedures regarding non-employee Board members' access to confidential information and Material Non-Public Information ("MNPI") were not sufficiently clear. The Staff recommended that this NRSRO clarify its policies and procedures and ensure it has adequate internal controls concerning its governing body's access to confidential information and MNPI. One smaller NRSRO did not review some personnel's permissions to access MNPI or confidential information as required by its policies and procedures, and some of this NRSRO's analysts sent MNPI or confidential information to their personal email accounts in contravention of its policies and procedures. The Staff recommended that this NRSRO adhere to and enforce such policies and procedures.

5. Certain rating files and rating publications of two larger NRSROs and four smaller NRSROs that were reviewed by the Staff did not adhere to document retention requirements and other operational policies and procedures.

Rule 17g-2(a)(2) requires NRSROs to make and retain certain information for each rating it issues, including the identities of certain personnel who participated in determining or approved the credit rating and a record of whether the credit rating was solicited or unsolicited. Rule 17g-2(b) requires an NRSRO to retain certain books and records related to its rating business. For example, Rule 17g-2(b)(2) requires an NRSRO to retain internal records and work papers used to form the basis of a rating it issues, and Rule 17g-2(b)(7) requires the NRSRO to retain its external and internal communications, including electronic communications, related to initiating, determining, maintaining, monitoring, changing, or withdrawing a rating. Rule 17g-2(f) requires an NRSRO to promptly furnish to the Commission or its representatives copies of required records, including English translations of those documents upon request.

Several rating files at one smaller NRSRO contained incomplete or inaccurate information in rating committee memos or were missing documents in its document retention system. This smaller NRSRO also had weaknesses in its email retention practices, and did not promptly produce certain email communications and rating file materials requested by the Staff. The Staff recommended that this NRSRO ensure it makes and retains required records, enhance its document retention practices, and comply with its obligations under Rule 17g-2(f).

At one larger NRSRO, several rating files and rating publications were missing required documents, did not adhere to operational policies and procedures, or did not make certain required disclosures. At another larger NRSRO and two smaller NRSROs, some rating files did not contain complete and accurate documentation related to rating committee presentations and records or the methodology, criteria, or models applied. Another smaller NRSRO's press releases for unsolicited ratings did not make disclosures required by its policies and procedures. The Staff recommended that these five NRSROs enhance their internal controls to ensure that they comply with Rule 17g-2 and their policies and procedures concerning determining ratings, creation and retention of ratings-related records, and disclosures on rating publications.

B. Review Area: Management of Conflicts of Interest

Section 15E(h)(1) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage conflicts of interest. Rule 17g-5(b) identifies certain types of conflicts of interest that an NRSRO must disclose in Exhibit 6 to Form NRSRO and establish, maintain, and enforce written policies and procedures to address and manage. The NRSRO's written policies and procedures to address and manage these conflicts must be disclosed in Exhibit 7 to Form NRSRO. For example, Rules 17g-5(b)(1) and (2) concern the conflicts of interest related to being paid by issuers, underwriters, or obligors to determine ratings with respect to securities that they issue or underwrite or with respect to the obligor. Similarly, Rule 17g-5(b)(9) concerns the conflict of interest related to issuing or maintaining a rating for certain securities or instruments that was paid for by the issuer, sponsor, or underwriter of the security or instrument. Rule 17g-5(c) lists certain conflicts of interest that are strictly prohibited. For example, Rule 17g-5(c)(5) prohibits an NRSRO from issuing or maintaining a rating for an obligor or security where the NRSRO made recommendations to the issuer or obligor about its corporate or legal structure, assets, liabilities, or activities.

The Staff's essential findings regarding the management of conflicts of interest are as follows:

1. All three larger NRSROs and one smaller NRSRO had weaknesses concerning access to market-share and revenue information by certain personnel who participate in ratings and criteria development activities.

As discussed above, Rules 17g-5(b)(1), (2), and (9) require NRSROs to disclose and have policies and procedures sufficient to manage conflicts of interest related to being paid by issuers, underwriters, obligors, or sponsors.

The Staff's review of one larger NRSRO's revisions to one of its rating criteria, including extensive review of its emails, suggests that this NRSRO's business and market-share concerns influenced the substance of the criteria. Some of this NRSRO's business personnel engaged in a concerted effort to address concerns raised by a trade association about this NRSRO's contemplated revisions to the criteria report, and this criteria report was changed in a manner that addressed the business personnel's concerns and was advantageous to the trade group. Also, documentation to support this change was lacking. The Staff recommended that this NRSRO enforce its policies and procedures and internal controls to separate the analytical process from commercial influence and ensure that the analytic justification of its criteria is adequately

recorded and maintained. The Staff also recommended that this NRSRO's Board retain an independent auditor, to be approved by OCR, to conduct a review of the development of the criteria and provide a written report summarizing the review to this NRSRO's Board and compliance group as well as OCR.

At another larger NRSRO, the chief credit officer and certain other credit officers reviewed non-public information concerning the NRSRO's revenue, financial performance, and market share even though its policies and procedures prohibit credit officers from accessing such information. The Staff recommended that this NRSRO ensure it adheres to its policies and procedures that restrict specified personnel, including credit officers, from accessing certain revenue, financial, and market-share information.

One larger NRSRO and one smaller NRSRO permitted some senior officers to access non-public information concerning their financial performance and market share and to participate in rating committees and other ratings activities. However, the larger NRSRO did not have sufficient policies and procedures to manage this conflict of interest, and the smaller NRSRO did not clearly disclose this conflict of interest on Exhibit 6 to Form NRSRO. The Staff recommended that this larger NRSRO enhance its policies and procedures to manage this conflict of interest, and that this smaller NRSRO enhance its disclosure concerning this conflict on Exhibit 6 to Form NRSRO. In addition, neither of these NRSROs sufficiently disclosed on Exhibit 7 to Form NRSRO their policies and procedures to manage this conflict of interest related to the involvement in ratings activities of personnel with access to non-public financial and market-share information, and the Staff recommended that both of these NRSROs enhance such disclosures on Exhibit 7 to Form NRSRO.

2. One larger NRSRO lacked sufficient policies and procedures related to anticompetitive practices that are prohibited by Rule 17g-6 and some of its activities may be inconsistent with Rule 17g-6.

Rule 17g-6(a)(4) prohibits an NRSRO from issuing or threatening to issue a lower credit rating or refusing to issue a credit rating of certain securities issued by an asset pool or as part of an asset-backed securities transaction unless the NRSRO rates all or a portion of the assets in the pool or the transaction, where this conduct has an anticompetitive purpose. Rule 17g-2(b)(9) requires an NRSRO to retain internal information and analysis used to develop a procedure or methodology to treat another NRSRO's ratings when issuing a rating for a security or money market instrument issued by an asset pool or part of an asset-backed securities transaction.

Several of this larger NRSRO's criteria notched other NRSROs' ratings below the equivalent of its rating and required a rated pool of securities to contain a minimum percentage of securities that it rates. This NRSRO lacked sufficient documentation of the analytic purposes for these criteria's notching and minimum inclusion requirements, and also lacked sufficient policies and procedures to ensure its treatment of other NRSROs' ratings complied with Rules 17g-6 and 17g-2. The Staff recommended that this NRSRO enhance its internal controls and policies and procedures to ensure that the analytic justification of its criteria is sufficient and documented and that its criteria are not influenced by commercial considerations. The Staff also recommended that this NRSRO retain all records related to its development of criteria.

In addition, Rule 17g-6(a)(1) prohibits an NRSRO from conditioning the issuance of a credit rating on the purchase by an issuer or obligor of any other services or products of the NRSRO. Language in this larger NRSRO's engagement letters and policies and procedures suggested that it is mandatory or automatic for the NRSRO to issue solicited ratings of all debt of an issuer that it rates. During the Review Period, there were numerous instances where this NRSRO rated an issuance and charged the issuer even though the issuer did not request that this NRSRO rate the issuance. The Staff recommended that this NRSRO review and revise its engagement letters and policies and procedures regarding its automatic treatment of additional debt ratings as solicited and ensure that issuers fully understand their options regarding its ratings of future debt issuances.

3. One larger NRSRO and six smaller NRSROs had weaknesses in their policies and procedures and controls governing employee securities ownership.

Pursuant to Rule 17g-5(b)(6), it is a conflict of interest if an NRSRO allows its personnel to directly own securities or money market instruments or have direct ownership interests in issuers or obligors subject to a credit rating determined by that NRSRO. This conflict of interest is permitted if an NRSRO discloses it in Exhibit 6 to Form NRSRO and has sufficient written policies and procedures to manage it. Rule 17g-5(c)(2) prohibits an NRSRO from issuing or maintaining a rating with respect to a person where the NRSRO or certain personnel that participated in determining or approving a rating directly owns securities of or has a direct ownership in the person that is subject to the rating.

At one smaller NRSRO, an analyst participated in determining or approving the ratings of two issuers in which that analyst owned securities, in violation of Rule 17g-5(c)(2). Moreover, this NRSRO did not have policies and procedures for reviewing a prior rating if a conflict is discovered or for employee divestiture of securities. There were also weaknesses in this smaller NRSRO's policies and procedures regarding pre-clearance of securities trading by certain non-analytical personnel. The Staff recommended that this NRSRO enhance its securities ownership policies and procedures, including establishing policies and procedures for the review of a prior rating where a conflict of interest is discovered and for securities divestiture.

At one larger NRSRO, some existing policies and procedures concerning prohibited securities holdings and documentation of securities ownership were not sufficiently detailed. There were also weaknesses in this NRSRO's policies and procedures to prevent a recused analyst from participating in the rating committee and to prevent it from publishing a rating where a recused analyst participated in the rating committee. At the foreign credit rating affiliate of another smaller NRSRO, several employees did not report their securities purchases through the NRSRO's electronic system, as required by its policies and procedures. There were weaknesses in four other smaller NRSROs' monitoring of employees' securities ownership. The Staff recommended that these six NRSROs enhance their policies and procedures and controls concerning securities ownership, including improving monitoring of employees' securities holdings and handling of recusals.

4. All seven of the smaller NRSROs had weaknesses in policies and procedures concerning certain conflicts of interest or did not sufficiently disclose certain conflicts of interest.

Two smaller NRSROs' policies and procedures did not address the full scope of conduct prohibited by Rule 17g-5. The Staff recommended that both of these smaller NRSROs establish or revise conflicts of interest policies and procedures to sufficiently prohibit the conflicts of interest covered by Rule 17g-5(c).

Two smaller NRSROs did not have sufficient policies and procedures concerning certain conflicts of interest, including those addressed by Rules 17g-5(b)(1), (2), and (9). One of these smaller NRSROs lacked sufficient policies and procedures or internal controls to screen rating committee participants for conflicts of interest, and did not sufficiently disclose some conflicts of interest on Exhibit 6 to Form NRSRO. At the other smaller NRSRO, an internal questionnaire and a certification form that it used to manage conflicts of interest related to its issuer-paid business model were insufficient and were not completed promptly and accurately on some occasions.

Three smaller NRSROs did not have sufficient controls and procedures to identify and monitor conflicts of interest. At one of these smaller NRSROs, one manager did not complete a required conflicts-of-interest questionnaire and another manager did not comply with policies and procedures concerning receipt of a gift from a person that does business with the NRSRO. Two other smaller NRSROs did not sufficiently monitor outside business activities of its employees or associated persons, and one of these smaller NRSROs also did not completely and accurately disclose on Exhibit 6 to Form NRSRO certain conflicts of interest that it had identified.

The Staff recommended that these five smaller NRSROs review and enhance their policies and procedures, as well as controls such as regular monitoring activities and certifications, to manage conflicts of interest. The Staff also recommended that two of the smaller NRSROs review and revise their disclosures on Exhibit 6 and Exhibit 7 to Form NRSRO.

5. Four smaller NRSROs did not sufficiently separate analytical activity from business activity.

Rule 17g-5(c)(6) prohibits an NRSRO from issuing a rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who had responsibility for determining ratings or for developing or approving procedures, methodologies, or models used to determine ratings. To facilitate compliance with this Rule or as a best practice, some NRSROs established controls to separate analytical functions from business development.

At one smaller NRSRO, an analytical supervisor appeared to have participated in sales and marketing activity concerning certain ratings issued out of this NRSRO's regional office while also participating in determining these ratings. Another smaller NRSRO did not have policies and procedures to handle inadvertent access to fee information by personnel with analytical responsibilities. Another smaller NRSRO permitted analytical personnel to give gifts to issuers and did not have any controls related to such gift-giving. At one office of another smaller NRSRO, there was insufficient physical separation of analytical personnel and business

personnel. The Staff recommended that three of these NRSROs establish or enhance and enforce written policies and procedures to sufficiently separate analytical activity from business activity, and recommended that the other NRSRO enhance the physical separation of analytic and business personnel at its offices.

C. Review Area: Implementation of Ethics Policies

Section 15E(a)(1)(B)(v) requires that an application for registration as an NRSRO include information regarding whether or not the NRSRO has in effect a code of ethics, and if not, the reasons it does not have a code of ethics. An NRSRO must provide a copy of its written code of ethics or a statement of the reasons it does not have such a code in Exhibit 5 to Form NRSRO.

Each NRSRO has implemented written ethics policies and procedures. During the 2014 examinations, the Staff reviewed each NRSRO's ethics policies and procedures, as well as a sample of each NRSRO's employee certifications or monitoring activities concerning their code of ethics. Much of the content of these policies and procedures addresses other related review areas under Section 15E(p)(3)(B). As such, to the extent that the Staff made essential findings related to the implemented ethics policies and procedures, those findings are addressed in other sections of this report.

D. Review Area: Internal Supervisory Controls

Section 15E(c)(3)(A) requires that each NRSRO 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. Rule 17g-2(a)(6) requires an NRSRO to make and retain a record documenting its established procedures and methodologies used to determine credit ratings. The Staff reviewed each NRSRO's overall control structure, including the internal control structure related to determining credit ratings.

Section 15E(g)(1) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by the NRSRO or any person associated with the NRSRO. Rule 17g-4(a)(3) provides that these written policies and procedures must include policies and procedures reasonably designed to prevent the inappropriate dissemination of pending credit rating actions within and outside the NRSRO before issuing the rating on the Internet or through another readily accessible means.

The Staff's essential findings regarding internal supervisory controls are as follows:

1. There were some weaknesses in two larger NRSROs' and five smaller NRSROs' policies and procedures or controls concerning the determination or review of ratings.

It appears that one larger NRSRO deviated from its criteria and rating policies and procedures by publishing ratings for a transaction using unreliable valuations data. This NRSRO subsequently withdrew these ratings because of concerns about the data it used, and the transaction was

removed from the market. The Staff recommended that this NRSRO establish, maintain, enforce, and document an effective internal control structure for its rating process.

There were weaknesses in internal controls related to the rating committee process at two smaller NRSROs and one larger NRSRO. One of these smaller NRSROs did not have sufficient internal controls concerning analysts participating in multiple roles at rating committees and exceptions to rating committee policies and procedures. Another smaller NRSRO did not have sufficient controls for documenting rating committee members and rating committees' consideration of all ratings. The larger NRSRO did not sufficiently document that its rating committee meetings satisfied certain requirements concerning rating committee eligibility and voting. The Staff recommended that these three NRSROs enhance their internal controls over or documentation of the rating committee process. This larger NRSRO also did not have clear policies and procedures concerning the process and documentation for certain rating opinions, and the Staff recommended that it establish sufficient written policies procedures for rating opinions.

There were multiple weaknesses in two smaller NRSROs' documentation of or controls related to some of their methodologies. One smaller NRSRO did not have a sufficient system to track or update credit ratings that it determined to be dependent on the credit rating of another entity, and one of this NRSRO's rating methodologies did not sufficiently document its use of base case and stress case scenario tests when determining ratings. In addition, this NRSRO established a methodology for cured defaults during the Review Period and did not disclose or describe this methodology in Exhibit 2 to Form NRSRO or appear to sufficiently inform analytical personnel of this methodology. The Staff recommended that this NRSRO establish a system to track dependent ratings, ensure that its methodologies sufficiently document the use of base case and stress case scenario tests, and establish policies and procedures for methodology development and disclosure. This smaller NRSRO also did not have a sufficient system to furnish requested records to the Staff within the timeframe and in the format requested, and the Staff recommended that this NRSRO enhance its internal controls to ensure it complies with Rule 17g-2(f). At another smaller NRSRO, the methodology for an ABS asset class did not sufficiently document committee membership, issuers' review of pre-sale reports, and the timeframe for surveillance. The Staff recommended that this NRSRO revise its rating methodology for this ABS asset class to adequately reflect its actual practices.

At one smaller NRSRO, there were weaknesses in its policies and procedures concerning the timing and documentation of its reviews of significant rating changes. In addition, this smaller NRSRO's policies and procedures did not require each rating release to disclose the specific criteria that it applied to the rating. The Staff recommended that this NRSRO develop and enhance policies and procedures for its reviews of significant rating changes, and consider revising its policies and procedures to require each rating release to disclose the criteria that it applied to the rating.

2. Two larger NRSROs and two smaller NRSROs lacked sufficient policies and procedures and controls concerning contractors' or non-NRSRO affiliates' access to information and involvement in ratings activities.

At one larger NRSRO, employees of a non-NRSRO affiliate participated in the rating process, including presenting analysis at rating committees. There were weaknesses in this NRSRO's training, monitoring, and conflicts-of-interest screening of this affiliate's employees. Also, employees of a third-party IT vendor that provided services to this NRSRO were not subject to sufficient controls concerning securities ownership and outside business activities. The Staff recommended that this NRSRO ensure that it has sufficient internal controls over personnel of non-NRSRO affiliates and third-party contractors, and that third-party vendors implement effective internal controls to address identified weaknesses and adhere to the NRSRO's policies and procedures as required by applicable service agreements.

At one smaller NRSRO, certain employees of a non-NRSRO affiliate participated in determining the NRSRO's ratings, including voting at rating committees. Because these individuals were employed by the non-NRSRO affiliate, they may not have been subject to the same oversight by the DCO. Another smaller NRSRO lacked written policies and procedures concerning the use of non-employee consultants and it is unclear whether consultants were subject to this NRSRO's policies and procedures. At another larger NRSRO, there were weaknesses in internal controls over access to the NRSRO's confidential information by a non-NRSRO affiliate and this affiliate's subcontractors. The Staff made various recommendations to these three NRSROs to establish or enhance their internal controls concerning non-NRSRO personnel's and consultants' involvement in the ratings process and access to confidential information.

3. One larger NRSRO and three smaller NRSROs did not sufficiently review their policies and procedures, criteria, methodologies, or models.

One larger NRSRO lacked effective internal controls related to models that were developed by a non-NRSRO affiliate and other third parties and used by the NRSRO in its credit rating process. This larger NRSRO's policies and procedures did not require it to independently verify such models or test the third-parties' quality controls. Errors in these third-party models resulted in changes to a substantial number of this NRSRO's outstanding ratings. The Staff recommended that this NRSRO establish, document, and enforce effective internal controls for independent verification of models provided by its non-NRSRO affiliate and for periodic testing of this non-NRSRO affiliate's quality controls over the models. The Staff also recommended that this NRSRO ensure that its non-NRSRO affiliate promptly and sufficiently remediates weaknesses in its quality controls for models, and that this NRSRO present to its Board a written plan to remediate certain model errors and address the risk of other model errors. In addition, this larger NRSRO's model review group did not verify whether model specifications appropriately reflected the applicable methodology requirements. The Staff recommended that this NRSRO establish policies and procedures to review and verify that the specifications for all models appropriately reflect the applicable methodology requirements.

At one smaller NRSRO, there were often delays in the Board's approval of new methodologies and in applying new methodologies to outstanding ratings. The Staff recommended that this NRSRO establish, maintain, enforce, and document procedures for the timely review and implementation of methodology changes and for the disclosure of potential rating changes resulting from a change in methodology. Another smaller NRSRO did not have a policy concerning correction of errors in its rating model or in its ratings. At another smaller NRSRO,

there were no written policies and procedures or insufficient documentation concerning its annual reviews of policies and procedures and methodologies, criteria, and models. The Staff recommended that these two NRSROs establish or enhance policies and procedures and documentation concerning such activities.

4. All three of the larger NRSROs and two of the smaller NRSROs did not have sufficient policies and procedures or controls related to IT or cybersecurity.

IT and cybersecurity are increasingly significant components of an NRSRO's internal control structure, which is subject to the requirements of Section 15E(c)(3)(A), and facilitate an NRSRO's timely issuance and monitoring of ratings with integrity. IT and cybersecurity policies and procedures and controls are also integral to an NRSRO's compliance with Section 15E(g) and Rule 17g-4 concerning the protection and prevention of the misuse or inappropriate dissemination of MNPI. They also often affect an NRSRO's capacity to publish accurate ratings in a timely fashion and in compliance with Rule 17g-4(a)(3).

Two of the smaller NRSROs had insufficient written policies and procedures and controls regarding IT and cybersecurity. One of these smaller NRSROs did not have written policies and procedures concerning cybersecurity and management of access to its network, systems, applications, and files, did not test its disaster recovery system, and did not address IT-related risks identified in audits. At the other smaller NRSRO, there were no policies and procedures and weak controls governing its electronic document retention system and access to this system. Also, this smaller NRSRO did not document its IT system tests or responses to findings of these tests. The Staff recommended that these two NRSROs establish or enhance written IT and cybersecurity policies and procedures and internal controls, and enhance their IT testing and responses to IT-related tests.

All three of the larger NRSROs had weaknesses in their IT policies and procedures or controls concerning personnel's access to information that is confidential, MNPI, or otherwise restricted. One larger NRSRO did not have written policies and procedures concerning the use of and access to shared drives that contained confidential information, and its controls over granting, reviewing, and changing access to such drives were not sufficient. At another larger NRSRO, some IT systems and applications allowed ratings personnel improperly broad access to confidential ratings information, and the IT access rights of an employee who transferred from an analytical group to a business group were not changed in a sufficient timeframe. At the other larger NRSRO, there were weaknesses in controls over access to web-based applications and some network files. The Staff recommended that all three of the larger NRSROs enhance their internal controls governing access to IT networks, systems, applications, and file shares.

5. There were weaknesses in one larger NRSRO's and two smaller NRSROs' internal controls to protect MNPI and confidential information.

Rule 17g-4 provides that NRSROs must establish, maintain, and enforce policies and procedures to prevent the misuse of MNPI. This Rule further provides that these procedures must be reasonably designed to prevent inappropriate dissemination of MNPI, including pending rating

actions, both within and outside the NRSRO, and to prevent a person within the NRSRO from trading on material non-public information.

One smaller NRSRO had not established sufficient controls over its employees' use of personal email accounts to send, receive, and store MNPI and confidential information. This NRSRO's policies and procedures prohibited employees from sending MNPI or confidential information to their personal email accounts, but the Staff's review of emails of some of this NRSRO's employees revealed several instances of such conduct. This NRSRO did not have comprehensive controls to prevent such conduct and did not discipline employees who engaged in such conduct. The Staff recommended that this NRSRO enhance its controls to ensure that personnel comply with its policies and procedures concerning IT and protection of MNPI, and that it enforce such policies and procedures.

One larger NRSRO lacked sufficient written policies and procedures concerning the protection of confidential information or MNPI in certain types of publications and restricting personnel's access to information that they need to know. At one smaller NRSRO, the office layout did not sufficiently restrict personnel employed by its non-NRSRO affiliates from accessing ratings-related MNPI or confidential information. The Staff recommended that these NRSROs take measures, such as establishing and enhancing written policies and procedures and controls, to sufficiently protect MNPI and confidential information.

6. One larger NRSRO and three smaller NRSROs did not have sufficient policies and procedures and controls concerning the dissemination of credit ratings.

At one larger NRSRO, there were multiple instances where erroneous ratings releases were published or the website was inoperable due to its IT weaknesses. One smaller NRSRO did not promptly revise an erroneous rating publication, and there were other weaknesses in this NRSRO's ratings dissemination policies and procedures. The Staff recommended that these two NRSROs enhance their policies and procedures and systems concerning ratings dissemination and error prevention or correction.

Another smaller NRSRO did not have sufficient controls over or documentation of its process for approving the publication of ratings. At another smaller NRSRO, the policies and procedures did not require sufficient documentation of instances where publication of ratings is delayed beyond a specified time period. The Staff recommended that these NRSROs establish or enhance their policies and procedures and documentation concerning publication of ratings.

7. There were weaknesses in compliance training or analytical training at four of the smaller NRSROs.

One smaller NRSRO did not provide timely compliance training to new employees and did not appear to provide training regarding its methodology to new analysts. Another smaller NRSRO did not provide sufficient analytical training to personnel in one of its offices. At another smaller NRSRO, some personnel did not complete mandatory compliance training. At another smaller NRSRO, training concerning some compliance issues was insufficient or too infrequent. The

Staff recommended that these four NRSROs take measures to ensure that all personnel complete sufficient compliance training and that analytical personnel complete sufficient analytical training.

8. All three of the larger NRSROs and four of the smaller NRSROs made inaccurate or incomplete public disclosures in their Form NRSRO filings or on their websites.

Section 15E(a)(1)(B) requires an application for NRSRO registration to disclose certain information, including information concerning the rating agency's performance measurement statistics and its procedures and methodologies to determine ratings. Section 15E(b) requires NRSROs to file updates and annual certifications of their Form NRSRO registrations and the information therein. Rule 17g-1 also contains requirements concerning the initial application for NRSRO registration and updating NRSRO registration. Section 15E(f)(2) prohibits any credit rating agency that is not registered as an NRSRO from stating that it is registered as an NRSRO.

The Form NRSRO filings and Exhibits of one larger NRSRO and four smaller NRSROs did not contain complete and accurate information as required by Sections 15E(a)(1) and 15E(b) and Rule 17g-1. One smaller NRSRO's Form NRSRO Exhibits included several methodologies that it no longer used and incorrect descriptions of its rating process and rating definitions. The Form NRSRO filing and Exhibits of another smaller NRSRO did not disclose several criteria that this NRSRO used to determine ratings and appeared to contain inaccurate information concerning the number of its outstanding ratings. Another smaller NRSRO's Form NRSRO and Exhibit 2 did not disclose or describe one of the rating methodologies that it applied when determining NRSRO ratings. At one larger NRSRO and another smaller NRSRO, the transition and default information and other Form NRSRO Exhibits were misleading or inaccurate. The Staff acknowledges that four of these five NRSROs had already filed revised Form NRSROs and Exhibits after they learned of the missing or inaccurate information but prior to the Staff's conclusion of its examinations. The Staff recommended that all five of these NRSROs implement or enhance internal controls to ensure the accuracy and completeness of all information they submit in Form NRSRO filings and Exhibits. The Staff also recommended that the one NRSRO which had not updated its Form NRSRO and Exhibits file an updated Form NRSRO and Exhibits which include required information concerning all procedures and methodologies it uses to determine NRSRO credit ratings.

All three larger NRSROs' websites did not clearly identify which of their offices and affiliates are included in their Form NRSRO registration and which ones are not. One of these larger NRSROs also made inaccurate public disclosures concerning some of its rating committee and surveillance practices. The Staff recommended that the three larger NRSROs ensure their websites and other public disclosures concerning its offices and affiliates and the rating process are accurate and sufficiently clear.

E. Review Area: Governance

Section 15E(t) requires that each NRSRO have a board of directors or governing committee (hereinafter, collectively the "Board" or "Boards") and establishes certain requirements

concerning the composition and conduct of each NRSRO's Board. Section 15E(t)(3)(A) through (D) identifies four areas over which an NRSRO's Board must exercise oversight. For example, Section 15E(t)(3)(C) requires an NRSRO's Board to oversee the effectiveness of the NRSRO's internal control system with respect to policies and procedures for determining credit ratings and 15E(t)(3)(D) requires an NRSRO's Board to oversee the NRSRO's compensation and promotion policies and practices. Section 15E(t)(B)(ii) requires that an NRSRO's independent director be disqualified from any deliberation involving a specific rating in which the independent board member has a financial interest in the outcome of the rating.

During the 2014 examinations, the Staff interviewed each NRSRO's Board and reviewed minutes and other documentation related to the activities of each NRSRO's Board. The Staff's 2014 examinations focused on the oversight function performed by the NRSRO's Board.

The Staff's essential findings relating to the NRSROs' compliance with the governance provisions of Section 15E(t) are as follows:

1. The Board of one larger NRSRO and four smaller NRSROs were not in full compliance with some requirements of Section 15E(t), including exercising the required oversight of certain areas or documenting their exercise of such oversight.

At one smaller NRSRO, the rules establishing the Board and its responsibilities did not specifically include the four duties required by Section 15E(t)(3). Also, this NRSRO's Board did not appear to be fulfilling all of these statutory duties, particularly oversight of compensation and promotion as required by Section 15E(t)(3)(D), and this NRSRO did not sufficiently document its process for disqualifying a Board member from participating in a deliberation where that member has a financial or other interest. At one smaller NRSRO, the materials for Board meetings were not consistently distributed to Board members sufficiently in advance of Board meetings to provide time for the members to review them, and one independent Board member did not exercise adequate oversight as required by Section 15E(t)(3). The Staff recommended that these two NRSROs revise their Board rules or take other measures to ensure that their Boards and the members thereof exercise the oversight required by Section 15E(t)(3), and also recommended that one of these smaller NRSROs consider enhancing its documentation of its process for disqualifying a Board member because of a financial or other interest.

At one of the larger NRSROs, the minutes of Board meetings were not sufficiently detailed to demonstrate that Board members are actively overseeing the areas required by Section 15E(t)(3). At two smaller NRSROs, the Boards were not sufficiently exercising oversight of the NRSROs' compensation and promotion policies and practices as required by Section 15E(t)(3)(D). In addition, the Board of one of these smaller NRSROs did not sufficiently document its oversight of the NRSRO's internal control system as required by Section 15E(t)(3)(C). The Staff recommended that these two smaller NRSROs ensure that their Boards are sufficiently performing the duties required by Section 15E(t)(3). The Staff also recommended that this larger NRSRO and one of these smaller NRSROs ensure that their minutes and other records demonstrate sufficient performance of these duties.

F. Review Area: DCO Activities

Section 15E(j)(1) requires each NRSRO to designate an individual responsible for administering the policies and procedures established to prevent the misuse of MNPI and management of conflicts of interest, and for ensuring compliance with the securities laws. Under Section 15E(j)(3), the DCO is responsible for establishing procedures for the receipt, retention, and treatment of complaints. Under Section 15E(j)(5), the DCO must submit an annual report to the NRSRO on the compliance of the NRSRO with the securities laws and the NRSRO's policies and procedures, and the NRSRO must file the report with the Commission. Rule 17g-2(b)(4) requires an NRSRO to retain compliance reports and compliance exception reports. Rule 17g-2(b)(5) requires an NRSRO to retain internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the NRSRO's internal auditors as necessary to audit the NRSRO's credit rating business.

Section 15E(j)(4) requires that the DCO be compensated in a manner not linked to the NRSRO's financial performance and must be arranged to ensure the DCO's independence.

The DCO role is a critical element in helping to ensure an NRSRO's compliance with securities laws. The DCO at each NRSRO should have sufficient resources, institutional support, and independence to effectively carry out the DCO's statutory obligations. The Staff reviewed the role and activities of each NRSRO's DCO. This review included interviews with each DCO.

The Staff's essential findings regarding DCOs are as follows:

1. The number of compliance personnel at one larger NRSRO and one smaller NRSRO was not sufficient.

The larger NRSRO did not have a permanent compliance presence in or exercise sufficient compliance oversight of one of its largest offices and of a global region where it has multiple NRSRO credit rating affiliates. At the smaller NRSRO, it appeared that the number of compliance personnel was not sufficient to meet the requirements of Section 15E(j). During the Review Period, this smaller NRSRO employed only a few compliance personnel while it substantially expanded its operations and non-compliance personnel.

The Staff recommended that these NRSROs add or consider adding compliance personnel to ensure they maintain sufficient compliance presence in all regions or offices where they operate.

2. There were weaknesses in compliance oversight and monitoring at four of the smaller NRSROs.

One smaller NRSRO did not have sufficient policies and procedures for, and documentation of, the DCO's and compliance personnel's responsibilities such as email reviews, compliance monitoring activities, compliance risk assessments, and periodic reviews of rating files. At another smaller NRSRO, weaknesses concerning the DCO and compliance oversight included insufficient scope and documentation of email and rating file reviews and insufficient responses to personnel's compliance violations. At another smaller NRSRO, the DCO did not document

certain instances of non-compliance by its personnel and the DCO's handling of employee non-compliance may not have been sufficiently independent from the NRSRO's management. The Staff recommended that these three NRSROs establish sufficient compliance policies and procedures, enhance monitoring activities such as email reviews and violation tracking, and prepare and retain sufficient documentation of compliance activities. The Staff also recommended that one of these smaller NRSROs review its policies and procedures to ensure the DCO is sufficiently independent from its senior management.

Also at one of these smaller NRSROs, the practices concerning DCO compensation may have been inconsistent with Section 15E(j)(4), which requires that the DCO's compensation is arranged to ensure the DCO's independence and is not linked to the NRSRO's financial performance. In addition, this smaller NRSRO did not exercise oversight of the DCO in the manner required by its policies and procedures. The Staff recommended that this NRSRO ensure that its actual practices do not link DCO compensation to its financial performance, review activities performed by an individual who served as the DCO for a certain time period to ensure that these activities were not influenced by its financial performance, and ensure that the DCO's duties are conducted consistently with its policies and procedures.

At another smaller NRSRO, continuing turnover in the identity of the individual serving as DCO limited the DCO's effectiveness and the continuity of compliance operations. The Staff recommended that this NRSRO establish a compliance staffing and succession plan to ensure that the individual serving as DCO is sufficiently capable and independent.

3. There were weaknesses in compliance investigations at two of the larger NRSROs.

Some NRSROs conducted routine compliance reviews or audits to identify instances of non-compliance and investigations in response to particular potential compliance violations. While this is a positive practice, there were shortcomings in some of these compliance activities at two larger NRSROs. At both of these larger NRSROs, the personnel who had substantial responsibility for a compliance investigation concerning particular conduct also substantially participated in the conduct being investigated. The Staff recommended that these NRSROs ensure that investigations regarding compliance or conflicts of interest are conducted by personnel who are sufficiently impartial.

Also at one of these larger NRSROs, the scope of a compliance audit was too narrow and the responses to several compliance audits were insufficient or untimely. The Staff made recommendations to this NRSRO concerning the scope of its compliance audits and the sufficiency and timeliness of its responses to compliance audits, and recommended that this NRSRO conduct a risk-based review of whether certain conduct identified by one of its compliance audits impacted its ratings.

G. Review Area: Complaints

Section 15E(j)(3) states that an NRSRO's DCO must establish procedures for the receipt, retention, and treatment of (i) complaints regarding credit ratings, models, methodologies, and compliance with the securities laws and the NRSRO's policies and procedures developed under Section 15E; and (ii) confidential, anonymous complaints by employees or users of credit ratings. Rule 17g-2(b)(8) requires an NRSRO to retain any written communications received from persons not associated with the NRSRO that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating. Rule 17g-2(c) requires that such communications be retained for a period of three years after the date the record is made or received. Rule 17g-2(d) concerns the manner of retention and Rule 17g-2(e) governs the use of third party custodians for retention. The Staff reviewed each NRSRO's policies and procedures for complaints and tested the policies and procedures by reviewing the files of certain complaints submitted to the NRSRO.

All the NRSROs have written policies and procedures to address complaints.

The Staff's essential findings regarding complaints are as follows:

1. Complaint policies and procedures at two larger NRSROs and one smaller NRSRO did not address all of the statutory requirements concerning complaints.

The definition of complaint in one larger NRSRO's policies and procedures did not include all types of complaints covered by Section 15E(j)(3), and there were weaknesses concerning this NRSRO's determinations whether external communications constituted a complaint. At another larger NRSRO, written complaint policies and procedures did not address complaints submitted by employees and did not establish a prompt timeframe for logging a complaint. At one smaller NRSRO, complaint policies and procedures did not address handling of verbal complaints and retention of complaint-related documents. The Staff recommended that these three NRSROs revise and enhance their complaint policies and procedures to comply with Section 15E(j) and Rule 17g-2, and also recommended other improvements concerning complaint handling to the two larger NRSROs.

2. There were weaknesses in some complaint policies and procedures and treatment of certain complaints at two smaller NRSROs.

At one smaller NRSRO, policies and procedures contained inconsistent provisions concerning treatment of complaints. Also, in one of this NRSRO's offices, some employees were unaware of the complaint policies and procedures and did not report communications that may have constituted complaints. At another smaller NRSRO, there were weaknesses in the logging and review of external communications that may have constituted complaints, and insufficient systems for external parties to submit complaints. The Staff recommended that these NRSROs revise and enhance their complaint policies, procedures, and controls, and enhance their systems for external parties to submit complaints.

H. Review Area: Post-Employment

Section 15E(h)(4)(A) requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that it will review a former employee's involvement in the determination of credit ratings for a person or an issuer, underwriter, or sponsor of a security or money market instrument if the former employee is now employed by such person or entity to determine whether any conflicts of interest of the employee influenced the rating. Section 15E(h)(5) requires each NRSRO to report to the Commission any instance where the NRSRO knows or can reasonably expected to know that certain specified persons who were associated with the NRSRO within the previous five years obtain employment with any obligor, issuer, underwriter, or sponsor of a security or money market instrument for which the organization issued a credit rating during the twelve-month period prior to such employment.

The Staff reviewed each NRSRO's "look-back" policies and procedures to assess whether they satisfy the statutory requirements. The Staff also requested information from each NRSRO concerning personnel that departed the NRSRO during the Review Period, and in some instances tested, on a selected and randomized basis, documentation related to such personnel to assess whether the NRSRO adhered to its lookback policies and procedures and satisfied the statutory obligations with respect to such personnel.

The Staff's essential findings regarding NRSRO look-back policies and procedures are as follows:

1. There were weaknesses in two smaller NRSROs' lookback policies and procedures.

One smaller NRSRO did not record sufficient documentation related to its lookback review and its policies and procedures did not specify a timeframe for completing a lookback review. The Staff recommended that this NRSRO enhance its recordkeeping of lookback review activities and revise its policies and procedures to state a timeframe for completing the review. Another smaller NRSRO did not conduct periodic post-employment searches regarding one former analyst as required by its policies and procedures to comply with Section 15E(h)(5). The Staff recommended that this NRSRO ensure it applies its post-employment policies and procedures to all covered former employees.

V. **CONCLUSION**

The Staff has identified findings and recommendations for the NRSROs. In future examinations, the Staff will continue to refine its risk assessment to maintain a balance between verifying compliance with key laws and regulations and identifying and examining emerging risk areas. In addition, the Staff will expand the scope of its future examinations to include the new and amended SEC Rules concerning NRSROs.