

***AUGUST 2014
FOIA FILE***

***86
TOTAL DOCUMENTS***

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for August 2014 with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY L. SCHAPIRO, CHAIRMAN

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(4 Documents)

*Commissioner Walter
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 9626 / August 6, 2014

SECURITIES EXCHANGE ACT OF 1934

Release No. 72780 / August 6, 2014

In the Matter of

CITIGROUP INC.

Respondent.

**ORDER UNDER SECTION 27A(b) OF THE
SECURITIES ACT OF 1933 AND SECTION
21E(b) OF THE SECURITIES EXCHANGE
ACT OF 1934, GRANTING WAIVERS OF
THE DISQUALIFICATION PROVISIONS OF
SECTION 27A(b)(1)(A)(ii) OF THE
SECURITIES ACT OF 1933 AND SECTION
21E(b)(1)(A)(ii) OF THE SECURITIES
EXCHANGE ACT OF 1934 AS TO
CITIGROUP INC. AND ITS AFFILIATES**

Citigroup Inc. ("Citigroup") has submitted a letter on behalf of itself and any of its current and future affiliates, dated October 17, 2011, requesting a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from its settlement of an injunctive action filed by the Commission.

On October 19, 2011, the Commission filed a civil injunctive action in the United States District Court for the Southern District of New York, alleging that Citigroup Global Markets, Inc. ("CGMI"), an affiliate of Citigroup, violated Sections 17(a)(2) and (3) of the Securities Act. In its complaint, the Commission alleged that the marketing materials for a CDO structured and marketed by CGMI were misleading because they suggested that CGMI, along with certain of its affiliates, was acting in the traditional role of an arranging bank, when in fact CGMI had allegedly exercised influence over the selection of the assets and had retained a proprietary short position of the assets it had helped select, which gave CGMI allegedly undisclosed economic interests adverse to those of the investors in the CDO. On August 5, 2014, pursuant to CGMI's consent, the United States District Court for the Southern District of New York entered a Final Judgment as to Defendant Citigroup Global Markets Inc. ("Final Judgment") permanently enjoining CGMI from violating Sections 17(a)(2) and (3) of the Securities Act [15 U.S.C. §77q(a)(2) and (3)], among other relief.

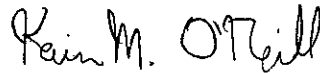
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The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in Citigroup's letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Final Judgment is appropriate and should be granted solely as to an exclusion that would result from the entry of the Final Judgment, and not as to any previously existing and ongoing exclusion.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Citigroup and any current or future affiliates resulting from the entry of the Final Judgment is hereby granted with respect to any exclusion resulting from the entry of the Final Judgment.

By the Commission.



Kevin M. O'Neill
Deputy Secretary

*Commissioner Walter
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9627 / August 6, 2014

In the Matter of

CITIGROUP GLOBAL
MARKETS INC.

Respondent.

ORDER UNDER RULE 602(e) OF THE
SECURITIES ACT OF 1933 GRANTING A
WAIVER OF THE RULE 602(b)(4) and
602(c)(2) DISQUALIFICATION PROVISIONS

I.

Respondent Citigroup Inc. ("Citigroup") has submitted a letter, dated October 13, 2011, requesting a waiver of the Rule 602(b)(4) and 602(c)(2) disqualifications from the exemption from registration under Regulation E arising from Citigroup Global Markets Inc.'s settlement of an injunctive action commenced by the Commission.

II.

On October 19, 2011, the Commission filed a civil injunctive action in the United States District Court for the District of Columbia, charging Citigroup Global Markets Inc. ("CGMI") with violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"). In its complaint, the Commission alleged that CGMI misrepresented key deal terms, namely the process by which the investment portfolio was selected and Citigroup's financial interest in the transaction, in connection with a \$1 billion collateralized debt obligation known as Class V Funding III. On August 5, 2014, pursuant to CGMI's consent, the Court entered a Judgment permanently enjoining Citigroup from violating Sections 17(a)(2) and (3) of the Securities Act ("Final Judgment").

III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if the issuer or any of its affiliates is subject to any order, judgment, or decree of a court "temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security." See Rule 602(b)(4) of the Securities Act. The Regulation E exemption is also not available for the

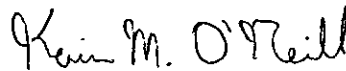
securities of an issuer if a director, officer, principal security holder, investment adviser or underwriter of the securities to be offered, or any partner, director or officer of such investment adviser or underwriter, is temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser. See Rule 602(c)(2) of the Securities Act. Rule 602(e) provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in Citigroup's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rule 602(b)(4) and 602(c)(2) under the Securities Act resulting from the entry of the Final Judgment is hereby granted.

By the Commission.



Kevin M. O'Neill
Deputy Secretary

*Commissioner Walter
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9627 / August 6, 2014

In the Matter of

CITIGROUP GLOBAL
MARKETS INC.

Respondent.

ORDER UNDER RULE 602(e) OF THE
SECURITIES ACT OF 1933 GRANTING A
WAIVER OF THE RULE 602(b)(4) and
602(c)(2) DISQUALIFICATION PROVISIONS

I.

Respondent Citigroup Inc. ("Citigroup") has submitted a letter, dated October 13, 2011, requesting a waiver of the Rule 602(b)(4) and 602(c)(2) disqualifications from the exemption from registration under Regulation E arising from Citigroup Global Markets Inc.'s settlement of an injunctive action commenced by the Commission.

II.

On October 19, 2011, the Commission filed a civil injunctive action in the United States District Court for the District of Columbia, charging Citigroup Global Markets Inc. ("CGMI") with violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"). In its complaint, the Commission alleged that CGMI misrepresented key deal terms, namely the process by which the investment portfolio was selected and Citigroup's financial interest in the transaction, in connection with a \$1 billion collateralized debt obligation known as Class V Funding III. On August 5, 2014, pursuant to CGMI's consent, the Court entered a Judgment permanently enjoining Citigroup from violating Sections 17(a)(2) and (3) of the Securities Act ("Final Judgment").

III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if the issuer or any of its affiliates is subject to any order, judgment, or decree of a court "temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security." See Rule 602(b)(4) of the Securities Act. The Regulation E exemption is also not available for the

3 of 4

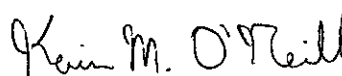
securities of an issuer if a director, officer, principal security holder, investment adviser or underwriter of the securities to be offered, or any partner, director or officer of such investment adviser or underwriter, is temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser. See Rule 602(c)(2) of the Securities Act. Rule 602(e) provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in Citigroup's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rule 602(b)(4) and 602(c)(2) under the Securities Act resulting from the entry of the Final Judgment is hereby granted.

By the Commission.



Kevin M. O'Neill
Deputy Secretary

*Commissioner Walter
Not participating*

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-31199; File No. 812-13970]

Citigroup Global Markets Inc., et al.; Notice of Application and Temporary Order

August 6, 2014

Agency: Securities and Exchange Commission ("Commission").

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against Citigroup Global Markets Inc. ("CGMI") on August 5, 2014 by the United States District Court for the Southern District of New York ("Injunction"), until the Commission takes final action on an application for a permanent order. Applicants also have applied for a permanent order.

Applicants: CGMI, CEFOF GP I Corp. ("CEFOF"), CELFOF GP Corp. ("CELFOF"), Citibank, N.A. ("Citibank"), Citigroup Alternative Investments LLC ("Citigroup Alternative"), Citigroup Capital Partners I GP I Corp. ("CCP I"), Citigroup Capital Partners I GP II Corp. ("CCP II"), Citigroup Private Equity (Offshore) LLC ("CPE (Offshore)"), Citigroup First Investment Management Americas LLC ("CFIMA," and along with CGMI, CEFOF, CELFOF, Citibank, Citigroup Alternative, CCP I, CCP II, and CPE (Offshore), the "Applicants").¹

Filing Date: The application was filed on October 20, 2011 and amended on August 5, 2014.

¹ Applicants request that any relief granted pursuant to the application also apply to any other company of which CGMI is or may become an affiliated person within the meaning of section 2(a)(3) of the Act (together with the Applicants, the "Covered Persons").

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on September 2, 2014, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: CGMI, CEFOF, CELFOF, CCP I, CCP II, CPE (Offshore), CFIMA, 388 Greenwich Street, New York, NY 10013; Citibank, Citigroup Alternative, 399 Park Avenue, New York, NY 10043.

For Further Information Contact: Jill Ehrlich, Senior Counsel, at (202) 551-6819, or Mary Kay Frech, Branch Chief, at (202) 551-6821 (Division of Investment Management, Chief Counsel's Office).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's website by searching for the file number, or an applicant using the Company name box, at <http://www.sec.gov/search/search.htm>, or by calling (202) 551-8090.

Applicants' Representations:

1. Each of the Applicants is an indirect wholly-owned subsidiary of Citigroup Inc. ("Citigroup"), a diversified financial services company. CGMI is a full service investment banking firm that engages in securities underwriting, sales and trading,

investment banking, financial advisory and investment research services. CGMI is registered as a broker-dealer under the Securities Exchange Act of 1934 and as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act"). It currently does not serve as principal underwriter or investment adviser of any Funds, but it may seek to do so in the future.² CFIMA is registered as an investment adviser under the Advisers Act and serves as investment adviser for one or more Funds. CEFOF, CELFOF, Citibank, Citigroup Alternative, CCP I, CCP II, and CPE (Offshore) ("ESC Advisers") serve as investment advisers to certain employees' securities companies within the meaning of section 2(a)(13) of the Act, which provide investment opportunities for certain eligible employees, officers, directors and persons on retainer of Citigroup and its affiliates ("ESCs" and included in the term "Funds").³

2. On August 5, 2014, the United States District Court for the Southern District of New York entered a judgment, which included the Injunction, against CGMI ("Final Judgment") in a matter brought by the Commission.⁴ The conduct of CGMI, along with certain of its affiliates, (together, "Citi") alleged in the complaint ("Complaint") involved Citi's role in the structuring and marketing of a largely synthetic collateralized debt obligation ("CDO") whose investment portfolio consisted primarily of credit default swaps referencing other CDO securities with collateral consisting primarily of residential mortgage-backed securities. The Complaint alleged that the marketing materials for the

² "Funds" refers to any registered investment company, business development company, or ESC (as defined herein) for which a Covered Person serves as an investment adviser, sub-adviser, general partner or depositor, or any registered open-end investment company, registered unit investment trust or registered face amount certificate company for which a Covered Person serves as principal underwriter.

³ Greenwich Street Employees Fund, L.P., et al., Investment Company Act Release Nos. 25324 (Dec. 21, 2001) (notice) and 25367 (Jan. 16, 2002) (order) ("ESC Order").

⁴ Securities and Exchange Commission v. Citigroup Global Markets Inc., 11-CV-7387 (S.D.N.Y. Aug. 5, 2014).

CDO were materially misleading because they suggested that Citi was acting in the traditional role of an arranging bank, when in fact Citi had allegedly exercised influence over the selection of the assets and had retained a proprietary short position of the assets it had helped select, which gave Citi allegedly undisclosed economic interests adverse to those of the investors in the CDO. The Final Judgment would restrain and enjoin CGMI from violating sections 17(a)(2) and (3) of the Securities Act of 1933. Without admitting or denying any of the allegations in the Complaint, except as to personal and subject matter jurisdiction, CGMI consented to the entry of the Final Judgment and other equitable relief, including certain undertakings and the payment of a civil penalty.

Applicants' Legal Analysis:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of a security, or in connection with activities as an underwriter, broker or dealer, from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company. Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that CGMI is an affiliated person of each of the other Applicants within the meaning of section 2(a)(3) of the Act. Applicants state that the entry of the Injunction results in Applicants being subject to the disqualification provisions of section 9(a) of the Act.

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to the applicants, are unduly or disproportionately severe or that the applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a temporary and permanent order exempting them and other Covered Persons from the disqualification provisions of section 9(a) of the Act.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of the Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the alleged conduct giving rise to the Injunction did not involve any of the Applicants acting in the capacity of investment adviser, sub-adviser or depositor for any Fund (including as general partner providing investment advisory services to ESCs) or as principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company. Applicants also state that, to the best of their knowledge, none of the current directors, officers, or employees of the Applicants that are involved in providing services as investment adviser or sub-adviser of the Funds (including as general partner providing investment advisory services to ESCs) or principal underwriter for any registered open-end company (or any other persons in such roles during the time period covered by the Complaint) participated in the conduct alleged in the Complaint to have constituted the violations that provide a

basis for the Injunction. Applicants further represent that the personnel at CGMI who participated in the conduct alleged in the Complaint to have constituted the violations that provided a basis for the Injunction have had no, and will not have any, involvement in providing advisory or depositary services (including as general partner providing investment advisory services to ESCs) to the Funds or principal underwriting services to any registered open-end company, registered unit investment trust, or registered face-amount certificate company on the behalf of the Applicants or other Covered Persons. Applicants also represent that because the personnel of the Applicants (other than those at CGMI) did not participate in the conduct alleged in the Complaint to have constituted the violations that provide a basis for the Injunction, the shareholders of those Funds were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser or principal underwriter. Applicants state that the alleged conduct did not involve any Fund or the assets of any Fund.

5. Applicants state that their inability to continue to provide investment advisory and subadvisory services to the Funds (including as general partner providing investment advisory services to ESCs) and principal underwriting services to any registered open-end company would result in potential hardship for some of the Funds and their shareholders. Applicants state that they will, as soon as reasonably practicable, distribute written materials, including an offer to meet in person to discuss the materials, to the boards of directors of the Funds ("Boards") (excluding, for this purpose, the ESCs) for which the Applicants serve as investment adviser, investment sub-adviser or principal underwriter, including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Funds, and their independent legal counsel, if any, describing the circumstances that led to the Injunction and any impact on the Funds, and the

application. Applicants state they will provide the Boards with the information concerning the Injunction and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

6. Applicants also state that, if they were barred from providing services to the Funds, the effect on their businesses and employees would be severe. Applicants state that they have committed substantial resources to establishing an expertise in providing advisory and distribution services to Funds. Applicants further state that prohibiting them from providing such services would not only adversely affect their businesses, but would also adversely affect numerous employees who are involved in those activities. Applicants also state that disqualifying the ESC Advisers from continuing to provide investment advisory services to the ESCs is not in the public interest or in the furtherance of the protection of investors. Because the ESCs have been formed for certain key employees, officers and directors of Citigroup and its affiliates, it would not be consistent with the purposes of the ESC provisions of the Act or the terms and conditions of the ESC Order to require another entity not affiliated with Citigroup to manage the ESCs. In addition, participating employees of Citigroup and its affiliates likely subscribed for interests in the ESCs with the expectation that the ESCs would be managed by an affiliate of Citigroup.

7. Certain of the Applicants previously have applied for and received exemptions under section 9(c) as the result of conduct that triggered section 9(a) of the Act, as described in greater detail in the application.

Applicants' Condition:

Applicants agree that any order granting the requested relief will be subject to the following condition:

Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the condition in the application, from August 5, 2014, until the Commission takes final action on their application for a permanent order.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for August 2014, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(82 Documents)

*Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72738 / August 1, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15810

In the Matter of

The Phoenix Companies, Inc.
and PHL Variable Insurance
Company

Respondents.

ORDER AMENDING
ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER AND REVISED
UNDERTAKINGS

I.

On March 21, 2014 the U. S. Securities and Exchange Commission ("Commission") issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order against The Phoenix Companies, Inc. and PHL Variable Insurance Company (the "March 2014 Order"). The March 2014 Order found that since PHL Variable Insurance Company's September 18, 2012 restatement announcement and The Phoenix Companies, Inc.'s November 8, 2012 restatement announcement, each company had failed to file any quarterly or annual reports as required by Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder and Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder, and each had missed five separate filing deadlines as of December 31, 2013, four pertaining to quarterly reports and one pertaining to an annual report.

The March 2014 Order ordered The Phoenix Companies, Inc. ("Phoenix") to: (1) cease and desist from committing or causing any violations or any future violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder; (2) comply with undertakings to file its: (a) 2012 Form 10-K by no later than March 31, 2014, (b) third quarter 2012 Form 10-Q by no later than April 15, 2014, (c) 2013 Form 10-K by no later than June 4, 2014, (d) first quarter 2013 Form 10-Q by no later than July 15, 2014, (e) first quarter 2014 Form 10-Q by no later than July 15, 2014, (f) second quarter 2013 Form 10-Q by no later than August 11, 2014, and (g) third quarter 2013 Form 10-Q by no later than November 10, 2014; and (3) pay a civil money penalty in the amount of \$375,000.

1 of 82

The March 2014 Order ordered PHL Variable Insurance Company ("PHL Variable") to: (1) cease and desist from committing or causing any violations or any future violations of Section 15(d)(1) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder; (2) comply with undertakings to file its: (a) 2012 Form 10-K by no later than April 15, 2014, (b) third quarter 2012 Form 10-Q by no later than April 30, 2014, (c) 2013 Form 10-K by no later than July 3, 2014, (d) first quarter 2013 Form 10-Q by no later than August 4, 2014, (e) first quarter 2014 Form 10-Q by no later than August 4, 2014, (f) second quarter 2013 Form 10-Q by no later than September 8, 2014, (g) second quarter 2014 Form 10-Q by no later than September 8, 2014, and (h) third quarter 2013 Form 10-Q by no later than November 14, 2014; and (3) pay a civil money penalty in the amount of \$375,000.

II.

Phoenix and PHL Variable ("Respondents") have submitted an Amended Offer of Settlement ("Amended Offer") which the Commission has determined to accept, in which they consent to the entry of an Order that amends the March 2014 Order by providing for revised undertakings, additional payments by Respondents, and a \$100,000 penalty to be paid by each Respondent for delinquencies beyond the filing dates specified in the March 2014 Order. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Amending Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Revised Undertakings ("Amended Order"), as set forth below.

III.

On the basis of this Amended Order and Respondents' Amended Offer, the Commission finds¹ that:

Respondents

1. The Phoenix Companies, Inc. ("Phoenix") is a Delaware corporation located in Hartford, Connecticut with equity securities and bonds registered with the Commission pursuant to Section 12(b) of the Exchange Act. Phoenix is a holding company with three insurance company subsidiaries, Phoenix Life Insurance Company ("PLIC"), Phoenix Life and Annuity Company, and PHL Variable, which sell life insurance and annuity products. Phoenix is delinquent in its periodic filings with the Commission. Phoenix common stock trades on the New York Stock Exchange

¹ The findings herein are made pursuant to Respondents' Amended Offer and are not binding on any other person or entity in this or any other proceeding

(symbol "PNX") and Phoenix bonds trade on the New York Stock Exchange (symbol "PFX"). Phoenix qualifies as an "accelerated filer" as defined in Rule 12b-2 of the Exchange Act.

2. PHL Variable Insurance Company ("PHL Variable") is a Connecticut corporation located in Hartford, Connecticut and is a wholly owned indirect subsidiary of Phoenix. PHL Variable's stock does not trade on an exchange. PHL Variable is delinquent in its periodic filings with the Commission. PHL Variable qualifies as a "non-accelerated filer" as defined in Rule 12b-2 of the Exchange Act.

Facts

3. Phoenix filed its 2012 Form 10-K on April 1, 2014, a day after the March 31, 2014 requirement in the March 2014 Order. Phoenix filed its third quarter 2012 Form 10-Q on April 23, 2014, eight days after the April 15, 2014 requirement in the March 2014 Order. PHL Variable filed its 2012 Form 10-K on April 25, 2014, ten days after the April 15, 2014 requirement in the March 2014 Order. PHL Variable filed its third quarter 2012 Form 10-Q by April 30, 2014, the date required in the March 2014 Order.

4. On June 3, 2014, Phoenix issued a Form 8-K indicating it would not file its 2013 Form 10-K by June 4, 2014 as required by the March 2014 Order, and indicated instead that it would file its 2013 Form 10-K by August 6, 2014, and that it expected to be current on all its filings by December 12, 2014. The August 6, 2014 anticipated filing date is more than two months after June 4, 2014, the date Phoenix originally agreed to in the March 2014 Order.

5. On June 3, 2014, PHL Variable issued a Form 8-K indicating it would not file its 2013 Form 10-K by July 3, 2014 as required by the March 2014 Order, and indicated instead that it would file its 2013 Form 10-K by August 22, 2014, and that it expected to be current on all its filings by December 12, 2014. The August 22, 2014 anticipated filing date is more than seven weeks after July 3, 2014 the date PHL Variable originally agreed to in the March 2014 Order.

6. As a result of the conduct described above, Phoenix and PHL Variable are in violation of the March 2014 Order.

Revised Undertakings

As part of the Amended Offer, Respondent Phoenix has undertaken to:

7. By no later than August 6, 2014, file its Form 10-K for the fiscal year ended December 31, 2013.

8. By no later than September 10, 2014, file its Form 10-Q for the quarterly period ended March 31, 2013.

9. By no later than September 10, 2014, file its Form 10-Q for the quarterly period ended June 30, 2013.

10. By no later than September 10, 2014, file its Form 10-Q for the quarterly period ended September 30, 2013.

11. By no later than October 17, 2014, file its Form 10-Q for the quarterly period ended March 31, 2014.

12. By no later than October 24, 2014, file its Form 10-Q for the quarterly period ended June 30, 2014.

13. By no later than December 5, 2014, file its Form 10-Q for the quarterly period ended September 30, 2014.

As part of the Amended Offer, Respondent PHL Variable has undertaken to:

14. By no later than August 22, 2014, file its Form 10-K for the fiscal year ended December 31, 2013.

15. By no later than September 12, 2014, file its Form 10-Q for the quarterly period ended March 31, 2013.

16. By no later than September 12, 2014, file its Form 10-Q for the quarterly period ended June 30, 2013.

17. By no later than September 12, 2014, file its Form 10-Q for the quarterly period ended September 30, 2013.

18. By no later than October 21, 2014, file its Form 10-Q for the quarterly period ended March 31, 2014.

19. By no later than October 28, 2014, file its Form 10-Q for the quarterly period ended June 30, 2014.

20. By no later than December 12, 2014, file its Form 10-Q for the quarterly period ended September 30, 2014.

Additional Payments

Phoenix

21. In lieu of the Commission seeking money penalties pursuant to Section 21(d)(3) of the Exchange Act for violations of this Amended Order, Respondent Phoenix agrees that if it fails to meet any deadline in paragraphs 7 through 13 above, it will make additional payments (the "Phoenix Additional Payments") for each week in which a filing is delinquent. The amount shall be \$20,000 per filing for the first week in which a filing is delinquent, plus, for each week or

partial week thereafter an additional amount equal to the sum of a) \$20,000 and b) \$5,000 multiplied by the number of complete weeks that the filing has been delinquent before that week.² Respondent Phoenix shall, within 30 days of being current in its SEC periodic reporting obligations, pay the Phoenix Additional Payments as calculated in this paragraph to the Securities and Exchange Commission. If timely payment is not made, interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Phoenix as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

PHL Variable

22. In lieu of the Commission seeking money penalties pursuant to Section 21(d)(3) of the Exchange Act for violations of this Amended Order, Respondent PHL Variable agrees that if it fails to meet any deadline in paragraphs 14 through 20 above, it will make additional payments (the "PHL Variable Additional Payments") for each week in which a filing is delinquent. The amount shall be \$20,000 per filing for the first week in which a filing is delinquent, plus, for each week or partial week thereafter an additional amount equal to the sum of a) \$20,000 and b) \$5,000 multiplied by the number of complete weeks that the filing has been delinquent before that week.³ Respondent PHL Variable shall, within 30 days of being current in its SEC periodic reporting obligations, pay the PHL Variable Additional Payments as calculated in this paragraph to the Securities and Exchange Commission. If timely payment is not made, interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

² For example, if a delinquent filing is three weeks late, Respondent Phoenix agrees to pay \$75,000 (\$20,000 for the first week, \$25,000 for the second week, and \$30,000 for the third week).

³ For example, if a delinquent filing is three weeks late, Respondent PHL Variable agrees to pay \$75,000 (\$20,000 for the first week, \$25,000 for the second week, and \$30,000 for the third week).

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying PHL Variable as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

23. The Phoenix Additional Payments and the PHL Variable Additional Payments shall not exceed \$750,000 in the aggregate.

24. In determining whether to accept the Amended Offer, the Commission has considered Respondents' offer to pay these payments.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Amended Offer.

Accordingly, it is hereby ORDERED that:

A. Respondent Phoenix shall comply with the undertakings in Section III paragraphs 7 through 13 above; provided, however, that solely for the purpose of complying with those undertakings, Phoenix shall not be deemed to have violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

B. Respondent PHL Variable shall comply with the undertakings in Section III paragraphs 14 through 20 above; provided, however, that solely for the purpose of complying with those undertakings, PHL Variable shall not be deemed to have violated Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder.

C. Respondent Phoenix shall, within 30 days of the entry of this Amended Order, pay a civil money penalty in the amount of \$100,000 to the Securities and Exchange Commission. If

timely payment is not made, interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Phoenix as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

D. Respondent PHL Variable shall, within 30 days of the entry of this Amended Order, pay a civil money penalty in the amount of \$100,000 to the Securities and Exchange Commission. If timely payment is not made, interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying PHL Variable as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

E. Except as amended by this Amended Order, the March 2014 Order remains in effect and binding on Respondents.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72744 / August 1, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-11771

In the Matter of

KNIGHT SECURITIES L.P.,

Respondent.

**ORDER AUTHORIZING THE TRANSFER
OF REMAINING FUNDS AND ANY
FUTURE FUNDS RETURNED TO THE
FAIR FUND TO THE U.S. TREASURY,
DISCHARGING THE FUND
ADMINISTRATOR, AND TERMINATING
THE FAIR FUND**

On December 16, 2004, the Commission instituted and simultaneously settled public administrative and cease-and-desist proceedings against Knight Securities L.P. ("Knight") ("Order").¹ The Order established a Fair Fund, comprised of \$66,841,731.50 in disgorgement, prejudgment interest and penalties, which was paid by Respondent, and provided that the Fair Fund was to be distributed pursuant to a plan developed by an Independent Distribution Consultant. On March 26, 2007, the Commission approved the Distribution Plan ("Plan").² An amended plan was approved on January 29, 2008.³

On January 29, 2008, the Commission issued its first order to disburse in the amount of \$53,217,351.28.⁴ On March 5, 2009 the Commission issued a second order to disburse in the amount of \$1,645,441.31.⁵ All distributions have been made and \$17,598,457.08 remains in the Fair Fund.

¹ See Exchange Act Release No. 50867 (Dec. 16, 2004).

² See Exchange Act Release No. 55530 (Mar. 26, 2007).

³ See Exchange Act Release No. 57222 (Jan. 29, 2008).

⁴ See Exchange Act Release No. 57222 (Jan. 29, 2008).

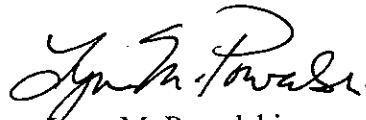
⁵ See Exchange Act Release No. 59512 (Mar. 5, 2009).

The Independent Distribution Consultant and Administrator submitted a Final Accounting of the Fair Fund pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans. The Final Accounting was approved by the Commission. The Administrator has fully implemented the Plan in accordance with the Commission's orders and the distribution has been completed, all taxes, fees, and expenses have been paid, and an amount of \$17,598,457.08 remains in the Fair Fund. The Plan provides that all undistributed funds be transferred to the U.S. Treasury. According to the Final Accounting, all liabilities have been satisfied and an amount of \$17,598,457.08 remains in the Fair Fund.

Accordingly, IT IS ORDERED that:

- A. The \$17,598,457.08 balance in the Fair Fund and any future funds received by the Fair Fund shall be transferred to the U.S. Treasury;
- B. The Administrator, Heffler, Radetich & Saitta, LLP, is discharged; and
- C. The Fair Fund is terminated.

By the Commission.


Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72737 / August 1, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15999

In the Matter of

DERL H. KNARR,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Derl H. Knarr ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Knarr was a former registered representative who, from November 18, 2002 to June 23, 2009, and from August 20, 2009 to January 31, 2013, was associated with Allstate Financial Services, LLC, a registered broker-dealer with the Commission. Knarr obtained his

3 of 82

Financial Industry Regulatory Authority Series 6, 26, and 63 licenses between 1983 and 1998. Knarr, 55 years old, is a resident of Herndon, Pennsylvania.

2. On February 7, 2014, Knarr pled guilty to one count of theft of insurance funds in violation of Title 18 United States Code, Section 1033(b) before the United States District Court for the Middle District of Pennsylvania, in United States v. Derl H. Knarr, Case Number 4:14-cr-00044-MWB.

3. The one count included in the criminal information to which Knarr pled guilty stated that from in or about 2006 and continuing up to on or about January 31, 2012, Knarr willfully embezzled, abstracted, purloined and misappropriated money, funds, premiums, credits and other property of his insurance business, in excess of \$5,000, namely approximately \$630,836.72, entrusted to Knarr's care and custody as part of his business.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Knarr's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Knarr be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72735 / August 1, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15997

In the Matter of

KEITH WELLNER, Esq.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO RULE
102(e) OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Keith Wellner ("Respondent" or "Wellner") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

4 of 82

1. Wellner, age 47, is a resident of New York, New York. Wellner is a member of the New York State Bar. From 2007 through 2012, he was the general counsel, chief compliance officer, and chief operating officer of Weston Capital Asset Management, LLC ("Weston"), an investment adviser previously registered with the Commission.

2. On July 7, 2014, a judgment was entered by consent against Wellner, providing permanent injunctive relief under Section 10(b) of the Securities Exchange Act of 1934, and Rules 10b-5(a) and (c) thereunder, and Sections 206(1), 206(2) and 206(4) and Rule 206(4)-8(a)(2) of the Investment Advisers Act of 1940 in the civil action entitled Securities and Exchange Commission v. Weston Capital Asset Management, LLC, et al., Civil Action Number 14-CV-80823-COHN, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that from at least August 2011 through June 2012, Wellner aided and abetted Weston's and Weston's president's violations of Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c), and Sections 206(1), 206(2) and 206(4) and Rule 206(4)-8(a)(2) of the Advisers Act resulting from Wellner's facilitation of Weston and its president's misappropriation of hedge fund client assets in contravention of fund offering documents.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Wellner's Offer.

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

A. Wellner is suspended from appearing or practicing before the Commission as an attorney for 1 year from the date of the Order.

B. After 1 year from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order;
2. that Respondent:

- a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and
 - b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;
- 3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and
- 4. that Respondent, since the entry of the Order:
 - a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;
 - b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;
 - c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and
 - d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3887 / August 1, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15998

In the Matter of

KEITH WELLNER,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS,
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), against Keith Wellner ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

5 of 82

1. From 2007 through 2012, Wellner was the general counsel, chief compliance officer, and chief operating officer of Weston Capital Asset Management, LLC ("Weston"), an investment adviser previously registered with the Commission. Wellner, 47 years old, is a resident of New York, New York.

2. On July 7, 2014, a judgment was entered by consent against Wellner, providing permanent injunctive relief under Section 10(b) of the Securities Exchange Act of 1934, and Rules 10b-5(a) and (c) thereunder, and Sections 206(1), 206(2) and 206(4) and Rule 206(4)-8(a)(2) of the Advisers Act in the civil action entitled Securities and Exchange Commission v. Weston Capital Asset Management, LLC, et al., Civil Action Number 14-CV- 80823-COHN, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that from at least August 2011 through June 2012, Wellner aided and abetted Weston's and Weston's president's violations of Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c), and Sections 206(1), 206(2) and 206(4) and Rule 206(4)-8(a)(2) of the Advisers Act resulting from Wellner's facilitation of Weston and its president's misappropriation of hedge fund client assets in contravention of fund offering documents.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Wellner's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Wellner be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization with the right to apply for reentry after 1 year to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Rawson
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9621 / August 4, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72749 / August 4, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16000

In the Matter of

HOUSTON AMERICAN
ENERGY CORP.,
JOHN F. TERWILLIGER,
JR., UNDISCOVERED
EQUITIES INC., and
KEVIN T. McKNIGHT

Respondents.

ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION 8A
OF THE SECURITIES ACT OF 1933 AND 21C OF
THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Houston American Energy Corp., John F. Terwilliger, Jr., Undiscovered Equities Inc., and Kevin T. McKnight.

II.

After investigation, the Division alleges that:

A. RESPONDENTS

1. Respondent Houston American Energy Corp. ("Houston American") is a Delaware corporation headquartered in Houston, Texas. It was incorporated in 2001, and its common stock is registered pursuant to Section 12(b) of the Exchange Act. Between July 2007 and July 2010, its common stock was listed on the Nasdaq Capital Market under the ticker symbol "HUSA." It is currently listed on the NYSE MKT.

6 of 82

2. Respondent John F. Terwilliger, Jr. ("Terwilliger" or collectively with Houston American, the "Houston American Respondents") resides in Houston, Texas and Palm Beach, Florida. Terwilliger has been Houston American's President and Chief Executive Officer since the company was formed in 2001. At all relevant times, Terwilliger was Houston American's largest individual shareholder, and his shares were pledged as collateral on a margin trading account.

3. Respondent Undiscovered Equities Inc. ("Undiscovered Equities") is a Florida corporation based in Boca Raton, Florida. It provides public relations and other promotional services to small-cap publicly-traded companies. In November 2009, Houston American retained Undiscovered Equities to, among other things, "implement . . . an ongoing program to increase the investment community's awareness of [Houston American]."

4. Respondent Kevin T. McKnight ("McKnight" or collectively with Undiscovered Equities, the "Undiscovered Equities Respondents") resides in Boca Raton, Florida. McKnight is the President and owner of Undiscovered Equities.

B. OTHER RELEVANT ENTITIES

1. The entity described herein as the "Investment Bank" is a full-service investment bank and registered broker-dealer with a principal place of business in New Orleans, Louisiana. The Investment Bank acted as the placement agent for Houston American's December 2009 registered offering.

2. The individual identified herein as the "Independent Research Analyst" is an independent equity research analyst who owns and operates an entity that publishes, markets, and distributes the Independent Research Analyst's research reports.

3. The entity described herein as the "Operator" is a division of a South Korean conglomerate based in Seoul, South Korea. During the relevant time period, the Operator had offices in Seoul and in Bogotá, Colombia.

C. FALSE AND MISLEADING STATEMENTS CONCERNING THE CPO-4 BLOCK

Overview of Houston American's Misrepresentations and Omissions Concerning the CPO-4 Block

1. In late 2009, Houston American announced that it had entered a farm-out agreement with the Operator, pursuant to which Houston American obtained a 25% non-operating interest in a 345,452 acre oil and gas exploration and production area in Colombia's Llanos Basin. The exploration and production area is known as the "CPO-4 block."

2. In the months that followed, Houston American, Terwilliger, and their agents promoted Houston American's interest in the CPO-4 block with a series of fraudulent statements and omissions that materially exaggerated the block's value to Houston American and downplayed any associated risks. Among other things, Houston American and Terwilliger, directly and through their agents or other third parties, fraudulently asserted that the block contained "estimated recoverable reserves of 1 to 4 billion barrels" of oil, that the oil was worth between \$20 and \$25 per barrel "in the ground," and thus that the block was worth more than \$3 billion—the equivalent of at least \$100 per share—to Houston American.

3. Houston American's reserve estimates lacked any reasonable basis in fact. Terwilliger admitted in sworn testimony that he knew the CPO-4 block had no reserves at all and that the Operator's volume estimates, which conveyed a much greater degree of risk than Houston American's reserve estimates, ranged only from 300 million barrels to approximately one billion barrels. Terwilliger further admitted that, unlike the Operator's volume estimates, which were drawn from extensive regional well data and seismic information for the CPO-4 block, Houston American's multi-billion-barrel reserve estimates were not based on a technical evaluation at all.

4. Terwilliger and Houston American nonetheless based their multi-billion-barrel reserve estimates on, at most, Terwilliger's recklessly wishful thinking. They also failed to disclose, or else baldly mischaracterized, the Operator's volume estimates, and used the fraudulently exaggerated estimates to lay the groundwork for their claims about the block's value.

5. Similarly, Terwilliger and Houston American knew or were reckless in not knowing that the \$20 to \$25 per barrel valuation, which Terwilliger used to support his claim that the CPO-4 block was worth upwards of \$100 per share to Houston American, referred to quantities of oil that were in production from commercially viable wells (*i.e.*, to *reserves*) and not to quantities of oil on speculative plays like the CPO-4 block. Yet Terwilliger and Houston American knowingly or recklessly claimed that the valuation was appropriate for the CPO-4 block.

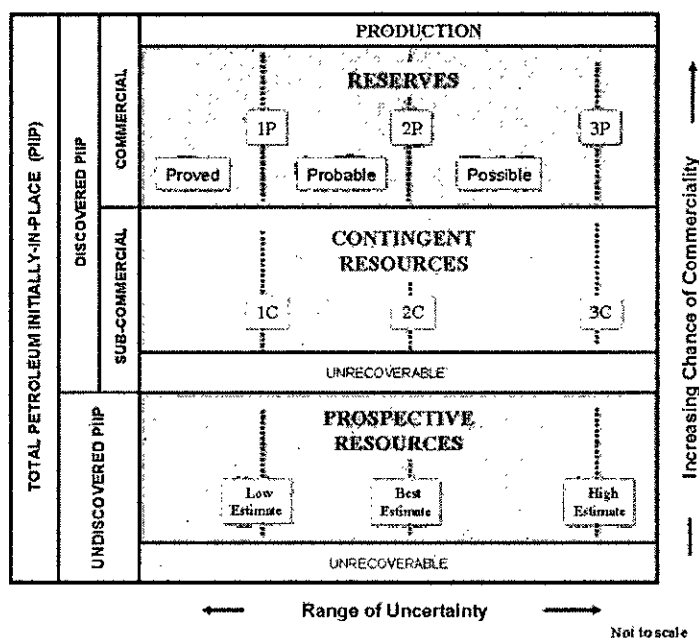
6. Between November 2009 and April 2010, a period during which Houston American and Terwilliger employed multiple fraudulent statements and omissions in connection with their efforts to promote the company's interest in the CPO-4 block, Houston American's stock price increased from approximately \$4.00 per share to \$20.00 per share, and its market capitalization increased from less than \$150 million to more than \$600 million.

7. As the truth about the CPO-4 block emerged, Houston American's stock price plummeted. In 2013, Houston American withdrew from its participation in the CPO-4 block after the Operator drilled three dry wells on, and produced no oil from, the block.

8. Houston American now trades for approximately \$0.40 per share, which represents a market capitalization loss of \$600 million since the April 2010 high.

Common Industry Practices and Terminology

9. In the oil and gas industry, the term “resources” is the principal catch-all term used to describe a quantity of petroleum, whether such quantity is discovered or undiscovered, recoverable or unrecoverable, or conventional or unconventional. The term encompasses four commonly-recognized classes of potentially recoverable petroleum quantities: oil in production, reserves, contingent resources, and prospective resources. The table below, which is taken from the Petroleum Resource Management System (“PRMS”), illustrates the relationship between the various classes of recoverable resources:



10. As shown by the horizontal rows on the PRMS table, the term “prospective resources” describes a quantity of *undiscovered* petroleum, and thus a quantity with the lowest chance of ultimate commerciality (*i.e.*, the class with the highest degree of risk). The term “contingent resources” describes a quantity of discovered but sub-commercial petroleum. The term “reserves” describes an estimated petroleum quantity that has been *discovered* and deemed to be *commercial*, and thus a quantity with the greatest chance of commerciality (*i.e.*, the class with the lowest degree of risk).

11. Ordinarily, a petroleum quantity must meet four criteria in order to qualify as a reserve: it must be discovered, technically recoverable, commercial, and remaining.

12. Reading from left to right, the table uses modifiers to indicate progressively increasing levels of uncertainty that the estimated quantities will actually be recovered. For

reserves, the modifiers are “proved,” “probable,” and “possible”; for prospective resources, they are “low estimate,” “best estimate,” and “high estimate.” Under the rules of the Commission, a “*proved* reserve” is a reserve that “by analysis of geoscience and engineering data, can be estimated *with reasonable certainty* to be economically producible.” Both the PRMS guidelines and the Commission rules define “reasonable certainty” as a “high degree of confidence that the quantities will be recovered.” A “probable reserve” is “less certain to be recovered than proved reserves” but is “*as likely as not* to be recovered.” A “possible reserve” is a reserve quantity that is less certain to be recovered than a probable reserve.

13. While each of the modifiers expresses a different degree of uncertainty, the modifiers do not alter the underlying definition of the relevant class: unlike recoverable resources, all categories of reserves—whether proved, probable, or possible—are quantities that are recoverable from *known accumulations* under existing economic conditions. By contrast, all categories of prospective resources are *undiscovered*.

14. In the oil and gas industry, commonly-used analytical procedures for estimating recoverable quantities of petroleum in exploration-stage projects draw on a wide range of geological and other physical characteristics of the target reservoir and analog wells, including the approximate depth, pressure, temperature, reservoir drive mechanism, original fluid content, reservoir fluid gravity, reservoir size, gross thickness, pay thickness, net-to-gross ratio, lithology, heterogeneity, porosity, permeability, and development plan.

The Operator Evaluates the CPO-4 Block

15. In late 2008, the Operator obtained from the Colombian government exploration and production rights on the CPO-4 block in exchange for a work commitment. The Operator’s work commitment required it to shoot and process additional seismic data on the CPO-4 block and to drill multiple exploration wells within a six-year period. The agreement also required the Operator to pay the Colombian government a royalty for any oil that the Operator successfully produced on the CPO-4 block.

16. Before entering the agreement with the Colombian government, the Operator spent several months evaluating the CPO-4 block’s oil-bearing potential. As part of that process, the Operator reviewed well log data from the only well that had been drilled on the CPO-4 block and also reviewed well log data from multiple wells drilled on adjacent blocks (the “well log data”). The Operator also analyzed approximately 1,825 kilometers of two-dimensional seismic data that previously had been shot over the block, and it evaluated comprehensive reports of the known geological formations in the Llanos Basin.

17. The Operator based its evaluation of the CPO-4 block on an analysis of well log and seismic data, which provided important technical information about the block’s subsurface structure and its geological characteristics.

18. Well log data, which is collected from an array of tests conducted in a drilled well bore, includes, among other things, data and information about the porosity of potential reservoirs (*i.e.*, the percentage of the total rock or reservoir taken up by "pore" space, and thus the percentage that has the ability to hold a fluid) and the fluid saturation of potential reservoirs (*i.e.*, the percentage of the pore space that holds water, and thus displaces oil). Seismic data allows geoscientists to estimate the size and location of potential oil-bearing reservoirs based on features of the subsurface geology.

19. The Operator used the seismic and well log data, in conjunction with standard analytical procedures for estimating volumes of potentially recoverable petroleum, in its evaluation the CPO-4 block.

20. Based on the geological properties of the CPO-4 block, as discerned in part from its evaluation of well log data, the Operator estimated that it could expect to recover approximately 150 barrels of oil from each "acre foot" (*i.e.*, an area one acre square and one foot deep) of the CPO-4 block's potential accumulations. By analyzing the seismic data, the Operator further estimated that the CPO-4 block had approximately 6.5 million acre feet of potential oil-bearing sands at three different depth horizons.

21. On the basis of those data points, the Operator estimated that the CPO-4 block's potential ranged from 300 million barrels of oil to a "total potential" of 974 million barrels. The Operator further estimated that the block had a "high potential" of approximately 639 million barrels.

22. The Operator did not publicly disclose its estimates for the CPO-4 block, but did share them with Houston American and Terwilliger in late 2009. At no time did the Operator share with Houston American an estimate of more than one billion barrels.

Houston American Farms In to the CPO-4 Block

23. In April 2009, the Operator sought a minority, non-operating farm-in partner on the CPO-4 block in order to offset costs associated with the exploration program for the CPO-4 block. As part of the search, the Operator created a three-page summary document that described the CPO-4 block and depicted the nature and extent of the Operator's evaluation. Among other things, the summary document stated that the CPO-4 block had "Total 1 Billion [Barrels of Oil] Potential" and "300 [Million Barrels of Oil] Risked Reserve Potential."

24. Houston American and Terwilliger received and reviewed a copy of the summary document in April 2009.

25. Shortly thereafter, Terwilliger met with the Operator's representatives to discuss the potential farm-in opportunity.

26. In addition to the summary document, the Operator compiled a 55-page slide deck that provided information about the basis of the Operator's estimates for the CPO-4 block and about the process it had used to evaluate the block's potential.

27. Among other things, the slide deck depicted the process by which the Operator came to estimate of the block's "total potential" of 974 million barrels and its "high potential" estimate of 639 million barrels.

28. The slide deck included information that was sufficient to show that the Operator's estimates were based on its evaluation of, among other things, block-specific data about the subsurface structure and geological characteristics of potential oil-bearing sands on the CPO-4 block.

29. The slide deck also included information that was sufficient to show that the Operator had arrived at its estimates of the CPO-4 block's "total potential" and "high potential" by using standard analytical procedures for estimating quantities of potentially recoverable oil

30. Terwilliger received and reviewed a copy of the Operator's slide deck.

31. According to Terwilliger's sworn testimony, Houston American and Terwilliger understood that the Operator's estimates were based on "a lot of good work" and that they conformed to "traditional industry practices."

32. Terwilliger and Houston American also understood that the Operator's estimates were based on an extensive evaluation of the regional well log data and seismic data for the CPO-4 block. Terwilliger stated in sworn testimony that "[the Operator] acquired all the available seismic data from the government that they could get They then reprocessed all the seismic data using . . . their geophysicist, and then they brought together a team of interpreting geoscientists and geologists to interpret the data and identify potential closures within the block."

33. However, Terwilliger admitted that he was not conversant in the technical aspects of the Operator's estimates. When asked in testimony about the key geological inputs that the Operator had used to derive its volume estimates (*i.e.*, porosity, saturation, formation volume factor, recovery factor), Terwilliger stated that he was "not sure of all these designations" and "I'm not a petroleum engineer, so I'd have to refer to one. . . ."

34. Terwilliger and Houston American did not independently evaluate relevant geological or seismic data for the CPO-4 block or analyze analogous well log data.

35. After reviewing the Operator's slide deck, Houston American submitted a firm offer to acquire a 25% non-operating farm-in interest on the CPO-4 block. The Operator and

Houston American entered a farm-in agreement in July 2009, and the Colombian government approved Houston American's participation in October 2009.

Houston American's November 2009 Investor Presentation Uses False and Misleading Statements to Publicize Its Interest in the CPO-4 Block

36. On October 16, 2009, Houston American publicly announced that it had finalized the farm-in agreement with the Operator. The announcement described the CPO-4 block in general terms, but did not include estimates of the block's potential.

37. On October 29, 2009, the Operator delivered to Houston American the 2010 development budget for the CPO-4 block, which included \$31 million of expenses heavily concentrated in the first quarter of 2010. Houston American's obligations for the first quarter of 2010 alone were approximately \$5 million. At the time, Houston American's public filings showed it to have less than \$5 million in cash, and only \$5.8 million in total current assets.

38. On November 10, 2009, Houston American publicly released an investor presentation that included 16 slides about the CPO-4 block and the Operator. According to Terwilliger, Houston American created the investor presentation because the "acquisition of the interest in CPO-4 Block . . . was a transitional moment for Houston American. So we took that moment to put a brochure together and go out and try to tell the story."

39. The investor presentation, which was furnished as an exhibit to a Form 8-K that Houston American filed with the Commission, described the CPO-4 block, and, as shown on the slide below, stated that the block "consists of 345,452 net acres and contains over 100 identified leads or prospects with estimated recoverable reserves of 1 to 4 billion barrels."

- Farmout Agreement and JOA – CPO 4

- Contract entered between National Hydrocarbon Agency of Colombia and  a leading Korean conglomerate
- Right to earn an undivided 25% of the rights of the CPO 4 Contract located in the Western Llanos Basin in the Republic of Colombia
- CPO 4 Block consists of 345,452 net acres and contains over 100 identified leads or prospects with estimated recoverable reserves of 1 to 4 billion barrels
- The Block is located along the highly productive western margin of the Llanos Basin and is adjacent to Apiay field which is estimated to have in excess of 610 million barrels of 25-33 API oil recoverable. On the CPO 4 Block's Northeast side lies the Corcel Block where well rates of 2,000 to 14,000 barrels of initial production per day have been announced for recent discoveries.
- In addition, the CPO 4 Block is located nearby oil and gas pipeline infrastructure.
- The Company has agreed to pay 25% of all past and future cost related to the CPO 4 block as well as an additional 12.5% of the seismic acquisition costs incurred during Phase 1 Work Program
- All future cost and revenue sharing (excluding the phase 1 seismic cost) will be on a heads up basis; 75%  and 25% HUSA - no carried interest or other promoted interest on the block

12

 HOUSTON AMERICAN ENERGY CORP.

40. Houston American's reserve estimate, as reflected in the November 2009 Investor Presentation, was materially false and misleading in a number of respects.

41. By using the term "reserves," the investor presentation implied that Houston American's multi-billion-barrel estimate was supported by project-specific data and that it referred to discovered, commercially producible petroleum accumulations. However, Houston American's estimate was not in fact supported by such data and analysis, did not refer to discovered, commercially producible petroleum accumulations, and was in fact more than three times larger than the Operator's volume estimates.

42. Despite the clear language of the investor presentation, Terwilliger admitted under oath that "[t]here are no reserves on the CPO-4 block," and that Houston American's widely-disseminated, multi-billion-reserve estimate had "*nothing to do with reserves.*" (Emphasis added.)

43. Houston American's investor presentation also implied that the multi-billion-barrel reserve estimate was derived from "100 identified leads or prospects." Because leads or prospects are ordinarily identified through an evaluation of seismic data, the use of "leads and prospects" in the context of Houston American's multi-billion-barrel reserve estimate gave the misleading impression that the estimate was grounded in a technical evaluation of the block.

44. In addition to the false and misleading reserve estimates, the investor presentation also included a number of slides that highlighted the Operator's size and expertise, and the extent

of its work in evaluating of the CPO-4 block. Among other things, those slides, which immediately preceded the slide depicted above:

- stated that the Operator was the “undisputed leader” in the petrochemical business in South Korea;
- claimed that the Operator participated in 34 oil and gas blocks and four liquefied natural gas blocks, including 11 blocks in South America;
- depicted some of the wells the Operator had evaluated in its study of the CPO-4 block, including the well previously drilled on the CPO-4 block and approximately 14 others on adjacent blocks;
- summarized the Operator’s assessment of seismic and well log data on the block; and
- expressly referred to six months of work that the Operator had spent evaluating data relevant to the CPO-4 block.

45. The investor presentation failed to disclose that Houston American’s multi-billion-barrel reserve estimate was much larger than the Operator’s volume estimates. By describing the Operator’s size, sophistication and expertise, as well as the extent of its evaluation of the CPO-4 block, the investor presentation misleadingly implied that the multi-billion-barrel reserve estimate was backed by the Operator, that it had been drawn from the Operator’s analysis of the block, and that it was appropriately characterized as a “reserve.”

Houston American And Terwilliger Disseminate False And Misleading Information About The CPO-4 Block Through A Paid Stock Promoter

46. Shortly before releasing the investor presentation, Houston American retained Undiscovered Equities, a marketing firm operated by Kevin McKnight that specialized in small-cap stock promotion. According to Terwilliger, Houston American retained Undiscovered Equities in order to “create more investor awareness using [Undiscovered Equities’] sources.”

47. The consulting agreement between Houston American and Undiscovered Equities stated that Undiscovered Equities would assist in “the implementation and maintenance of an ongoing program to increase the investment community’s awareness” of Houston American. In exchange, Houston American paid Undiscovered Equities \$20,000 per month for at least six months.

48. Beginning in November 2009, Undiscovered Equities posted to its website and distributed to its subscribers a series of promotional articles about Houston American and the CPO-4 block. On November 29, 2009, Undiscovered Equities posted its list of “Top Picks for

2010," which included Houston American. The posting falsely stated that "[the Operator] believes the CPO 4 Block has over 100 viable drilling locations with estimated recoverable reserves of 1-4 billion barrels." (Emphasis added.)

49. Terwilliger and Houston American intentionally or recklessly provided McKnight and Undiscovered Equities with the false and misleading statements about the Operator's "belief" concerning the CPO-4 block. They knew or were reckless in not knowing that McKnight and Undiscovered Equities would use the false and misleading statements in connection program to "increase the investment community's awareness" of Houston American.

50. Undiscovered Equities repeated identical claims about the Operator's "belief" in a series of posts over the course of the next three months. Undiscovered Equities also posted anonymous messages to internet message boards for Houston American that directed potential investors back to the articles about Houston American on Undiscovered Equities' website.

51. On its website, Undiscovered Equities and McKnight disclosed that Undiscovered Equities was compensated by Houston American but did not disclose the amount of compensation it received. Neither the promotional articles, in the form distributed to the subscribers, nor the anonymous posts to internet message boards disclosed any information about the fact or amount of compensation that Undiscovered Equities received from Houston American.

***Houston American Disseminates False and Misleading Information
About the CPO-4 Block During Meetings With Potential Investors***

52. In November 2009, Houston American and Terwilliger used the investor presentation in a series of in-person roadshow meetings with institutional investors in Dallas, Detroit, and Chicago. During those meetings, Terwilliger repeated and embellished Houston American's false and misleading claims about the CPO-4 block.

53. At a November 20, 2009 roadshow meeting with a portfolio manager for an institutional investor, Terwilliger said that:

- the CPO-4 block was "Mr. Big for us";
- *the Operator* believed the block had between *three and four billion* barrels of recoverable oil; and
- Houston American believed that the block had between one and five billion barrels.

54. A few days later, Terwilliger met in Dallas with a different institutional investor. During that meeting, Terwilliger said that *the Operator's estimate* for the CPO-4 block was 3.5 billion barrels and that Houston American "used a range" of one to five billion barrels.

55. Terwilliger's statements during the roadshow meetings misrepresented the Operator's actual estimates for the CPO-4 block, and omitted to state that, unlike the Operator's estimates, Houston American's multi-billion-barrel estimate was not based on block-specific data and was not calculated in accordance with standard analytical procedures.

***Houston American's Agents Disseminate False
And Misleading Information About The CPO-4 Block***

56. Houston American raised approximately \$13 million in a December 1, 2009 public offering, for which the Investment Bank acted as placement agent.

57. Prior to the offering, Terwilliger met with the Investment Bank's Sales & Trading group and discussed the November 2009 investor presentation. One member of the Sales & Trading group, Sales Representative 1, recalled attending the presentation and hearing the "eye-popping" reserve estimates.

58. After the meeting, and in connection with the public offering, the Investment Bank's Sales & Trading group sent dozens of its institutional clients e-mail messages based on Terwilliger's and Houston American's false and misleading claims about the CPO-4 block.

59. On the morning of the offering, two members of the Sales & Trading group sent e-mail messages about Houston American to more than fifty of the bank's clients. In one such message, a sales representative for the Investment Bank, Sales Representative 2, stated:

The key is the CPO 4 property that they are partnering on with [the Operator] (largest player in Korea and one of largest in all Asia). The CEO truly believes the potential of the property is 3-5 billion barrels of oil but if we assume it's 1 billion barrels here is some quick math: . . . \$4.725bil and with 24mil shares out for HUSA we get \$195/share value. This seems ridiculous since the stock is under \$5 but that's the math.

60. Sales Representative 1 also sent an e-mail to his clients and to the entire Sales & Trading group under the subject line "HUSA-some crazy math." The e-mail stated:

I will go through the most sexy property first. . . . [the Operator] has estimated potential of 3-5 Billion barrels of oil under [the CPO-4 block]. . . . I would like to lay out what this would mean to HUSA: Let's say there are only 1 Billion barrels of oil in the ground:
The Colombian government gets 30% off the top (country standard)
Leaves 700MM barrels of oil, x .25 (HUSA WI)=175MM barrels of oil
175MM barrels x \$27 (this was the price for Cara-Cara, based at \$85 price

deck=\$4.725B to HUSA

\$4.725B/24MM shares out=~\$200/share to HUSA.

61. The Investment Bank sold 490,000 shares in the offering to investors who received Sales Representative 1's e-mail message.

62. Together, the e-mail messages of Sales Representative 1 and Sales Representative 2 incorporated and repeated at least four fraudulent misrepresentations and omissions made by Houston American and Terwilliger:

- *the Operator*, not Houston American, was the source of the multi-billion-barrel estimate ("[The Operator] has estimated potential of 3-5 Billion barrels of oil");
- one billion-barrels was a conservative estimate, rather than the high end of the Operator's range ("if we assume it's 1 billion barrels" and "Let's say there are only 1 Billion barrels of oil in the ground");
- the putative reserves were worth more than \$20 per barrel in the ground;
- the CPO-4 block was worth in excess of \$100 per share to Houston American's investors.

63. In the days after the offering, several members of the Investment Bank's Sales & Trading team reiterated similar statements about the CPO-4 block in a series of communications with potential investors.

64. Houston American and Terwilliger knew or were reckless in not knowing that members of the Sales & Trading group would repeat the false and misleading statements and omissions about the CPO-4 block in communications with potential investors.

Houston American Disseminates False and Misleading Statements Through An Independent Research Analyst

65. On February 15, 2010, the Independent Research Analyst published a report on Houston American that repeated the company's the multi-billion-barrel estimate and that assigned a price target of \$168 per share to Houston American's common stock. In a section entitled "CPO-4: 'Mind-Boggling,'" the research report stated that the CPO-4 block was worth between \$67 and \$269 per share to Houston American.

66. The valuation in the Independent Research Analyst's report was premised on two assumptions: that the CPO-4 block held between one and four billion barrels of oil and that the oil was worth between \$20 and \$25 per barrel in the ground. The report expressly attributed the

latter assumption to Houston American: "HUSA believes CPO 4 oil in the ground is worth \$20/25/bbl."

67. The content of the research report is directly attributable to Houston American and Terwilliger. In the days before the report was published, Terwilliger spoke with the Independent Research Analyst by phone and stated that:

- the CPO-4 block contained between one and four billion barrels of oil;
- the Operator believed the CPO-4 block contained "up to 3.5 billion barrels" of "recoverable" oil; and
- oil on the CPO-4 block was worth between \$20 and \$25 per barrel in the ground and had a value of at least \$3 billion, or \$100 per share, to Houston American.

68. Consequently, the report's valuation of the CPO-4 block was based on false and misleading statements that Terwilliger made to the Independent Research Analyst. Terwilliger and Houston American knew or were reckless in not knowing that the Independent Research Analyst would repeat the false and misleading statements and omissions about the CPO-4 block in subsequent communications with potential investors.

69. The Independent Research Analyst distributed the report to certain of his clients. In addition, a member of Houston American's board of directors, who is an Executive Vice President of a financial services firm based in New York, disseminated the report to the sales force at the financial services firm. One investor reported back to him that the report had become the subject of "cocktail party chatter."

70. The next day, on February 16, 2010, an article published by Dow Jones Newswires noted a spike in Houston American's stock price.

Houston American's and Terwilliger's Multi-Billion-Barrel Estimates Were Not Reasonably Based In Fact

71. Terwilliger and Houston American knowingly or recklessly tripled the Operator's estimates for the CPO-4 block and knowingly or recklessly assigned a valuation of between \$20 and \$25 per barrel for oil in the ground.

72. The document below is a page from the Operator's slide deck. The version of the page below contains Terwilliger's handwritten notes, which he made in November 2009. The notes reflect Terwilliger's contemporaneous assertion that the Operator's "recovery" *should be* ("S/B") 500 barrels per acre foot rather than 150, and thus that the estimate of recoverable oil *should be* ("S/B") 3.246 billion barrels.

#2
A, B

Total Potential

Layer	Area Milli-acre	Unit	Unit B.R.	Net Pay (C=100%)	Recoverable (B=100%)	Recovery	Unit P.R.
1	1000	724	800	154	300000000	28	Synthetic
2	1000	212	413	150	300000000	13	Synthetic
3	426	725	0	250	300000000	8	Synthetic
4	4016	4244	8476	154	300000000	165	Thrust
5	3414	7112	14376	150	300000000	58	Thrust
6	152	114	348	100	300000000	10	Inversion
7	1087	457	813	150	300000000	23	Inversion
8	1508	3074	6048	150	300000000	36	Inversion
9	2842	3087	4320	150	300000000	139	Inversion
10	484	0	0	150	300000000	4	Inversion
11	445	423	1000	150	300000000	14	Inversion
12	164	855	0	150	300000000	14	Inversion
13	2445	454	744	150	300000000	40	Inversion
14	302	2383	3632	150	300000000	75	Displacement
15	98	1682	800	150	300000000	48	Inversion
16	224	843	452	150	300000000	28	Inversion
17	0	420	220	150	300000000	19	Inversion
18	0	300	0	150	300000000	13	Inversion
19	0	0	1245	150	300000000	34	Inversion
20	3526	4016	7544	150	300000000	117	Thrust
21	2514	2514	3144	150	300000000	94	Thrust
22	780	1107	0	150000000	32	Thrust	
Total Potential					574		

Unit P.R.

Perosity : 28 %
 We : 80 %
 Stabio : 4.5
 GP : 30 %
 RP : 10 %

Net Pay

- Avg. Thickness
 - From Net Bld Rk

Unit P.R.
Perosity : 28 %
Se : 80 %
So : 80 %
G : 8.7
R : 30 %

Net Pay
Avg. Thickness
From Net Rd Map

1.341
Recovery 5/6
500

3.246
Billion

EXHIBIT
90
8-2/1981

HALLOW

73. At no time did Terwilliger and Houston American disclose that they had arrived at their multi-billion-barrel reserve estimate by doing nothing more than tripling the Operator's estimates.

74. Nor did Terwilliger and Houston American disclose that their multi-billion-barrel reserve estimate was based on Terwilliger's beliefs about what the estimates "should be," rather than on an analysis of the geological data pertinent to the CPO-4 block.

75. As alleged above, Terwilliger knew that the Operator's estimates were based on its extensive evaluation of the CPO-4 block and that its evaluation of the block conformed to standard industry practices. Moreover, Houston American and Terwilliger had not independently evaluated the well log or seismic data.

76. During the Division's investigation, Terwilliger sought to defend his and Houston American's decision to more than triple the Operator's estimates, testifying under oath that:

- "[I]n the Llanos Basin, throughout the entire basin, we use 500 barrels per acre-foot recovery. Everyone else does."

- “[the Operator] just stuck 150 barrels. They just applied some very conservative worldwide assumptions;”
- “150 barrels per acre-foot is not recoveries for Colombia, so [the Operator’s] report is really a three billion barrel estimate;” and
- “I’m only saying that in ten years in Colombia being involved in over 130 wells and looking at assets all over the basin, I’ve never seen 150 barrels per acre-foot. Even in the worst wells . . . 300 is probably . . . the lowest I can ever remember seeing. So I discounted [the Operator’s] assumptions and said, you know, I’m not going to go through all the engineering models to get there. It’s just very unrealistic.”

77. However, based on his review of the Operator’s slide deck in 2009, Terwilliger knew or was reckless in not knowing that the Operator’s estimate was based on its extensive evaluation of the CPO-4 block, and therefore was not drawn from “some very conservative worldwide assumptions” and was not “really a three billion barrel estimate.”

78. Terwilliger also knew or was reckless in not knowing that a recovery rate of 150 barrels per acre foot (“BAF”) was consistent with rates seen in other parts of the Llanos Basin, and thus could not be disregarded on the grounds that 150 BAF was “not recoveries for Colombia.”

79. Terwilliger likewise knew or was reckless in not knowing that Houston American and “everyone else” did not “use 500 barrels per acre-foot” throughout the Llanos Basin.

80. In 2009, Houston American had an interest in a total of 32 wells or potential wells on five different exploration and production concessions in the Llanos Basin, including concessions known the Las Garzas, La Cuerva, and Leona. Of the 32 prospects, 11 were estimated by oil and gas reserve engineers retained by Houston American’s business partners to have recoveries of between 100 and 200 BAF. Thirteen others were estimated to have recoveries of between 200 and 300 BAF, and only three were estimated to have recoveries of more than 400 BAF.

81. Accordingly, Terwilliger knew or was reckless in not knowing that the Operator’s estimate of 150 BAF was consistent with the rates of recovery for Llanos Basin wells in which Houston American owned an interest in 2009.

82. When presented with evidence about estimated recoveries from those wells, Terwilliger admitted under oath that, of the five exploration and production concessions in Colombia in which Houston American held an interest in 2009 other than the CPO-4 block, he simply did not pay attention to two, and one was a disappointment.

83. Terwilliger testified that:

- "I didn't really pay attention" to Houston American's interest in the 103,000 acre Las Garzas concession, where resource engineers retained by Houston American's partner estimated recovery rates to be as low as 177 BAF;
- "I really wasn't paying attention to" Houston American's interest in the 47,950 acre La Cuerva concession, where resource engineers retained by Houston American's partner estimated recovery rates to be as low as 183 BAF; and
- "We had high hopes for the [70,343 acre] Leona Block. It didn't work out. And as a result, we got a well with recoveries a little over 200 barrels per acre foot. We would have liked 500. . . ." Resource engineers retained by Houston American's partner estimated recovery rates on the Leona Block to be as low as 117 BAF.

84. Accordingly, Houston American's and Terwilliger's decision to triple the Operator's estimates to conform to his "hopes," rather than to data and information about the CPO-4 block itself, intentionally or recklessly distorted the nature and extent of the Operator's evaluation and of Houston American's actual experience in the Llanos Basin.

Houston American's and Terwilliger's Assertions That the Putative Reserves Were Worth Between \$20 and \$25 Per Barrel "In the Ground" Were Not Reasonably Based In Fact

85. Terwilliger's assertion that the putative reserves on the CPO-4 block were worth between \$20 and \$25 "in the ground"—which assertion was reflected in Terwilliger's own statements as well as in the statements of Houston American's agents and other third parties—lacked a reasonable basis in fact. Terwilliger admitted as much during the Division's investigation, when he testified under oath that such a valuation was "totally incorrect" because it described a valuation for proved reserves, and there were no proved reserves on the CPO-4 block.

86. Terwilliger and Houston American, as well as their agents, paired misleading statements about the value of the oil "in the ground" with misleading statements about the reserves on the CPO-4 block in support of their misleading claim that the CPO-4 block was worth more than \$100 per share to Houston American.

87. An oil and gas reserve engineer retained by Houston American in connection with the Division's investigation made a similar admission in a report submitted to the Commission staff, which stated that "possible reserves were valued at averages ranging from \$0.65 to \$2.23 per barrel."

Subsequent History

88. In the course of Houston American's promotional efforts, the price of its common stock increased from close to \$4 per share to more than \$20 per share. In April 2010, two blog posts raised questions about the integrity of Houston American's management and the validity of its estimates. Houston American's stock price promptly fell to \$14 per share and, over the next two weeks, it reached a low of approximately \$9.00 per share.

89. Since 2010, the Operator and Houston American drilled three non-productive wells on the CPO-4 block, and Houston American's share price has since fallen to approximately \$0.40 per share.

90. On March 28, 2013, Houston American announced that it was withdrawing from its farm-in agreement and transferring its interest in the CPO-4 block back to the Operator. In exchange, the Operator released Houston American from past and future funding obligations for the CPO-4 block. Houston American's press statement quoted Terwilliger as stating that "[w]hile the [CPO-4 block] offered exciting potential for Houston American, the complexity and cost of drilling the prospects and the disappointing test wells clearly pointed our company in a different direction."

91. Over the life of the project, Houston American raised and spent more than \$20 million to fund its share of expenses on the CPO-4 block without producing a single barrel of oil.

92. Between 2010 and 2012, Terwilliger received cash bonuses of \$914,287, stock awards of \$247,800, and options valued at \$177,049, in addition to a total salary of \$1,043,083.

93. During the relevant period, Terwilliger's shares were pledged as collateral on a margin account maintained at Morgan Stanley Smith Barney. In April 2012, Terwilliger sold 985,519 shares for \$1,816,509, at an average price of \$1.84 per share in order to cover margin calls on the account.

D. VIOLATIONS

1. As a result of the conduct described above, Terwilliger and Houston American violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

2. Section 20(b) of the Exchange Act makes it unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the Exchange Act or any rule or regulation thereunder through or by means of any other person.

3. As a result of the conduct described above, Terwilliger and Houston American acted through or by means of other persons to make material misstatements and omissions, and as a result, violated Section 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

4. As a result of the conduct described above, Terwilliger caused Houston American's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

5. As a result of the conduct described above, McKnight and Undiscovered Equities violated Section 17(b) of the Securities Act, which prohibits the publication of any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received from an issuer, without fully disclosing the receipt of such consideration and the amount thereof.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that cease-and-desist proceedings be instituted to determine:

A. Whether the foregoing allegations are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations; and

B. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, the Houston American Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, including committing any such violations directly or indirectly through or by means of any other person, as prohibited by Section 20(b) of the Exchange Act, and Section 17(a) of the Securities Act; whether the Houston American Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act; and whether the Houston American Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act;

C. Whether, pursuant to Section 8A(f) of the Securities Act and Section 21C(f) of the Exchange Act, Respondent Terwilliger should be prohibited from acting as an officer and director; and

D. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, the Undiscovered Equities Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(b) of the Securities Act, whether the Undiscovered Equities Respondents should be ordered to pay a civil penalty pursuant to

Section 8A(g) of the Securities Act, and whether the Undiscovered Equities Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 5, 2014

In the Matter of

Green and Hill Industries, Inc.

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Green and Hill Industries, Inc., d/b/a Ross' Gold, because of questions regarding the accuracy of publicly available information about the company's operations. Green and Hill Industries, Inc. is a Nevada corporation with its principal place of business located in Toronto, Ontario, Canada. Its stock is quoted on OTC Link, operated by OTC Markets Group Inc., under the ticker: GHIL.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on August 5, 2014, through 11:59 p.m. EDT on August 18, 2014.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

*Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72767 / August 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16001

In the Matter of

ROBERT B. COOK, Esq.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO RULE
102(e) OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Robert B. Cook ("Respondent" or "Cook") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice¹.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

¹ Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

8 of 82

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Cook, age 72, has been a lawyer licensed to practice in the State of Florida. During the relevant time period, he served as general counsel to E-Monee.com, Inc.

2. E-Monee was a Nevada corporation with principal offices in Ft. Lauderdale, FL. During the relevant time period, E-Monee's common stock was quoted on the OTC Link operated by OTC Markets Group Inc. under the symbol "EMNC." E-Monee has never registered an offering of securities under the Securities Act or a class of securities under the Exchange Act. E-Monee's stock is a "penny stock" as defined by the Exchange Act.

3. On June 5, 2014, a Judgment was entered against Cook, permanently enjoining him from future violations of Section 17(a)(1) and (3) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77q(a)(1) and 77q(a)(3), in the civil action entitled Securities and Exchange Commission v. E-Monee.Com, Inc., et al., Civil Action Number 13-CV-60637-ZLOCH, in the United States District Court for the Southern District of Florida. Cook was also barred from participating in any offering of a penny stock and ordered to pay a civil money penalty with the amount to be determined at a later date.

4. The Commission's Complaint alleged, among other things, that from approximately January 2010 through at least May 2011, E-Monee.Com, its president, and Cook, engaged in the fraudulent offer of E-Monee securities by engaging in a scheme to defraud potential investors by soliciting them to buy shares in E-Monee under false pretenses that the company owned Mexican bonds purportedly worth approximately \$5 billion that the Central Bank of Mexico had validated. The Complaint further alleged that they also misrepresented that E-Monee's shares would substantially increase in value. In reality, the Mexican bonds the company owned were essentially worthless and there was no valid basis for the claims that E-Monee's shares would substantially increase in value.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Cook's Offer.

Accordingly, it is hereby ORDERED, pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

A. Cook is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Gallagher
Not Participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
RELEASE NO. 9622 / August 5, 2014

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 72764 / August 5, 2014

INVESTMENT ADVISERS ACT OF 1940
RELEASE NO. 3888 / August 5, 2014

INVESTMENT COMPANY OF 1940
RELEASE NO. 31198 / August 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15826

In the Matter of

KEIKO KAWAMURA,

Respondent.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTION
21C OF THE SECURITIES EXCHANGE
ACT OF 1934, SECTIONS 203(f) AND
203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, AND SECTION
9(b) OF THE INVESTMENT COMPANY
ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Keiko Kawamura ("Respondent" or "Kawamura").

II.

9 of 82

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 as to Respondent ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

SUMMARY

1. This proceeding involves schemes to defraud and fraudulent misrepresentations and omissions by Keiko Kawamura in connection with money she raised for a self-described hedge fund that she purportedly managed, and money she obtained from subscribers to a website she operated to provide investment advice.

2. From December 2011 through June 2012, Kawamura raised approximately \$200,000 from at least seven investors for a hedge fund that she purportedly managed. Kawamura falsely told investors, among other things, that she had substantial experience in the financial industry (including in the trading of stocks and options), and that she had achieved outstanding returns trading stocks and options in her own accounts. Despite her promises to invest the funds she obtained, Kawamura misappropriated much of the money. Of the funds she did invest, Kawamura lost everything in risky options trading.

3. In August 2012, Kawamura started a website – kawamurafinancial.com – where she provided investment advice for a monthly subscription fee until February 2014. Kawamura solicited subscribers through a number of misrepresentations, including falsely claiming that she obtained an annual return in excess of 800% in her personal brokerage account (in fact, she lost all of the money invested in the account), that she had managed millions of dollars, and that she had nearly ten years of experience in the financial industry. Kawamura made approximately \$50,000 in subscription fees from approximately 70 different subscribers to her website.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

RESPONDENT

4. **Kawamura** (d/b/a Kawamura Financial) is a resident of Honolulu, Hawaii. From December 2011 through June 2012, Kawamura acted as an investment adviser to a self-described hedge fund in which she pooled and managed monies she raised from at least seven investors for a purported performance fee of 20% of any profits achieved. In August 2012, Kawamura established a website that she operated until February 2014 and on which she provided investment advice to subscribers for a monthly fee.

BACKGROUND

5. Beginning in December 2011 and continuing through the present, Kawamura (d/b/a Kawamura Financial) engaged in two separate fraudulent schemes in connection with the purchase and sale of securities, made material misrepresentations and omissions in connection with money she raised directly from investors, and made material misrepresentations and omissions in connection with a website she operated to provide investment advice.

6. From December 2011 through June 2012, Kawamura offered and sold interests in a self-described hedge fund. Kawamura told investors that she would pool their funds in a single brokerage account in which Kawamura would invest in stocks and options. Kawamura told investors that she would be compensated by receiving 20% of any profits achieved in the account. In total, Kawamura raised approximately \$200,000 from at least seven investors.

7. In soliciting investors for her "hedge fund," Kawamura told investors that she had extensive experience trading stocks and options and was managing millions of dollars in what she referred to as a hedge fund. In fact, as Kawamura knew, her only prior trading experience had been placing a small number of trades over the preceding few months in an account held in her boyfriend's name and less than \$10,000 traded in brokerage accounts held in her name. At no time did her boyfriend's account in which she made trades hold more than \$300,000 and at no time did accounts that she controlled and/or managed hold more than approximately \$55,000.

8. Contrary to Kawamura's representations to investors that she would invest all of the funds she raised in stocks and options, she misappropriated much of the hedge fund's money to pay for her living expenses and for luxury vacations to Miami and London. Of the approximately \$55,000 Kawamura did invest, she pooled the money in one brokerage account and lost it all in highly risky options trades.

9. Kawamura posted screenshots of portions of a brokerage account statement on her Twitter account, which many of her investors followed, that suggested that she was obtaining incredible returns in her own brokerage accounts. In fact, the screenshots reflected particular returns on unusually successful trades and/or trading days from her boyfriend's brokerage account and were not indicative of the performance of the

trading in her account. At the time she posted the screenshots, Kawamura knew that her trading had not performed at the level indicated by the screenshots.

10. Kawamura's misrepresentations and omissions were material. The investors she solicited would not have invested in her hedge fund had Kawamura not misrepresented or otherwise failed to accurately disclose, among other things, her prior experience trading in the stock market and managing investor money, the true amount of money she was actually "managing," her prior trading performance, and/or the intended use of investor funds.

11. After raising money from investors through her misrepresentations and omissions, Kawamura engaged in further manipulative and deceptive acts as part of her scheme to defraud investors. Despite losing the money she invested, Kawamura repeatedly told investors that she was achieving excellent returns on their investments. Kawamura also created, and provided to certain investors, false tax documents that purported to show that she had invested all of the money she had raised when, in fact, she had misappropriated much of it. Despite losing the money she invested, Kawamura repeatedly assured investors seeking to withdraw their investments that she was achieving excellent returns on their investments and that she just needed additional time before she could process any withdrawals.

12. In August 2012, Kawamura started a website called kawamurafinancial.com. Kawamura promoted her website primarily through social media, including Twitter and Facebook. Kawamura used the website to provide investment advice to members who paid a monthly fee of between \$94.95 and \$174.95. The subscription fee varied based on the level of access granted to Kawamura's website. All subscribers received access to, among other things, a locked Twitter account that Kawamura used to provide recommendations on when to sell or purchase particular stocks and options.

13. Kawamura's website contained numerous material misrepresentations and omissions that she acknowledges were intended to attract subscribers. Kawamura claimed on the site that she had "been in the Investment banking industry for nearly a decade, specializing in Wealth Management for a major Financial Institution." At the time she created her website, Kawamura knew this was false. She has never worked in the investment banking industry and has never worked for any financial institutions.

14. Kawamura also falsely claimed on her site that "Her Personal IRA account is up almost 800% YTD (2012)." In fact, as Kawamura knew at the time she created her website, she lost all of the money in her personal IRA brokerage account over a period of about two months in 2012.

15. Kawamura also provided all subscribers to her website with access to one-on-one advice over Skype's instant message service in which she would provide specific recommendations regarding stocks and options to the subscriber. Subscribers that paid \$174.95 a month were also provided access to Kawamura's trades in "real-time." Kawamura received nearly \$50,000 from approximately 70 subscribers to her website.

16. These misrepresentations and omissions were material. The subscribers to Kawamura's website would not have subscribed had Kawamura not misrepresented, among other things, her prior experience trading in the stock market and managing investor money, and/or her prior trading performance.

VIOLATIONS

17. As a result of the conduct described above, Kawamura willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

18. As a result of the conduct described above, Kawamura willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit fraudulent conduct by an investment adviser.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Kawamura's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Kawamura cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent Kawamura be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any

arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of \$275,117.78 and prejudgment interest of \$14,644.41 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Keiko Kawamura as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine B. Echavarria, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., 11th Floor, Los Angeles, CA 90036.

E. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Keiko Kawamura as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine B. Echavarria, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., 11th Floor, Los Angeles, CA 90036.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 6, 2014

In the Matter of

Conquest Petroleum Inc. and
Nexaira Wireless Inc.,

File No. 500-1

ORDER OF SUSPENSION OF
TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Conquest Petroleum Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Nexaira Wireless Inc. because it has not filed any periodic reports since the period ended July 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

10 of 82

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 6, 2014, through 11:59 p.m. EDT on August 19, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: **Kevin M. O'Neill**
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72772 / August 6, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16002

In the Matter of

**Conquest Petroleum Inc. and
Nexaira Wireless Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Conquest Petroleum Inc. and Nexaira Wireless Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Conquest Petroleum, Inc. (CIK No. 1422220) is a forfeited Texas corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Conquest Petroleum is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011, which reported a net loss of \$4,773,279 for the prior nine months. As of July 29, 2014, the company's stock (symbol "CQPT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

11 of 82

2. Nexaira Wireless Inc. (CIK No. 1445625) is a revoked Nevada corporation located in Burnaby, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Nexaira Wireless is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2011, which reported a net loss of \$2,994,018 for the prior nine months. As of July 29, 2014, the company's stock (symbol "NXWI") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further

order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72770 / August 6, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16003

In the Matter of

**Amico Games Corp.,
Andina Group Inc.,
Cougar Oil & Gas Canada Inc.,
Encorium Group, Inc., and
Waccamaw Bankshares, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Amico Games Corp., Andina Group Inc., Cougar Oil & Gas Canada Inc., Encorium Group, Inc., and Waccamaw Bankshares, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Amico Games Corp. (CIK No. 1435772) is a Nevada corporation located in Guangzhou, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Amico Games is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2011, which reported a net loss of \$119,359 for the prior nine months. As of July 29, 2014, the company's stock (symbol "AMCG") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

12 of 82

2. Andina Group Inc. (CIK No. 1419260) is a Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Andina Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2011, which reported a net loss of \$113,583 from the company's June 17, 2004 inception to March 31, 2011. As of July 29, 2014, the company's stock (symbol "AAUI") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Cougar Oil & Gas Canada Inc. (CIK No. 1427645) is an Alberta corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cougar Oil & Gas Canada is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the fiscal year ended December 31, 2010, which reported a net loss of \$1,127,354 (Canadian) for the prior five months. As of July 29, 2014, the company's stock (symbol "COUGF") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Encorium Group, Inc. (CIK No. 856569) is a void Delaware corporation located in Wayne, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Encorium Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2010, which reported a net loss of \$9,088,038 for the prior twelve months. As of July 29, 2014, the company's stock (symbol "ENCO") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Waccamaw Bankshares, Inc. (CIK No. 1144686) is a North Carolina corporation located in Whiteville, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Waccamaw Bankshares is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2010, which reported a net loss of \$15,237,685 for the prior twelve months. As of July 29, 2014, the company's stock (symbol "WBNK") was quoted on OTC Link, had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

8. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 6, 2014

In the Matter of

Amico Games Corp.,
Andina Group Inc.,
Cougar Oil & Gas Canada Inc.,
Encorium Group, Inc., and
Waccamaw Bankshares, Inc.,

File No. 500-1

ORDER OF SUSPENSION OF
TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Amico Games Corp. because it has not filed any periodic reports since the period ended May 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Andina Group Inc. because it has not filed any periodic reports since the period ended March 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cougar Oil & Gas Canada Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

13 of 82

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Encorium Group, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Waccamaw Bankshares, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 6, 2014, through 11:59 p.m. EDT on August 19, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72776 / August 6, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16005

In the Matter of

Global Stevia Corp.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Global Stevia Corp. ("Global Stevia" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Global Stevia (CIK No. 0001492135) is a revoked Nevada corporation located in Hammonds Plains, Nova Scotia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

2. Global Stevia is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2013.

3. The Commission issued a trading suspension in the securities of Global Stevia that began at 9:30 a.m. EDT on May 16, 2014, and terminated at 11:59 p.m. EDT on May 30, 2014.

14 of 82

B. DELINQUENT PERIODIC FILINGS

4. As discussed above, the Respondent is delinquent in its periodic filings with the Commission, having repeatedly failed to meet its obligation to file timely periodic reports.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

6. As a result of the foregoing, Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of

which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72774 / August 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16004

In the Matter of

**Datascension, Inc.,
Here Enterprises, Inc.,
Metaswarm, Inc., and
Statmon Technologies Corp.**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF
HEARING PURSUANT TO
SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS¹

1. Datascension, Inc. ("DSEN") (CIK No. 795824) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DSEN is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2010, which reported a net loss of \$840,290 for the prior six months. As of August 4, 2014, the common stock of DSEN was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹The short form of each issuer's name is also its stock symbol.

15 of 82

2. Here Enterprises, Inc. ("HRTE") (CIK No. 1411846) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HRTE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 29, 2012, which reported a net loss of \$611,995 for the prior nine months. As of August 4, 2014, the common stock of HRTE was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Metaswarm, Inc. ("MSWM") (CIK No. 1410730) is a Florida corporation located in Pasadena, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MSWM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it registered its securities by filing a Form 10-12G on October 4, 2007, which included financial statements reporting a net loss of \$371,186 for the six months ended June 30, 2007. As of August 4, 2014, the common stock of MSWM was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Statmon Technologies Corp. ("STCA") (CIK No. 319008) is a Nevada corporation located in Long Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). STCA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2010. As of August 4, 2014, the common stock of STCA was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 9628 / August 7, 2014

SECURITIES EXCHANGE ACT OF 1934

Release No. 72788 / August 7, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3890 / August 7, 2014

INVESTMENT COMPANY ACT OF 1940

Release No. 31200 / August 7, 2014

Admin. Proc. File No. 3-15514

In the Matter of

DONALD J. ANTHONY, JR.,
FRANK H. CHIAPPOINE,
RICHARD D. FELDMANN,
WILLIAM P. GAMELLO,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER,
PHILIP S. RABINOVICH, and
RYAN C. ROGERS

ORDER GRANTING
EXTENSION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),¹ for a 150-day extension to issue the initial decision in this proceeding. For the reasons set forth below, we grant her motion.

On September 23, 2013, we issued an Order Instituting Proceedings ("OIP") against ten persons associated with McGinn, Smith & Co., Inc. ("MS & Co."), a former registered broker-

¹ 17 C.F.R. § 201.360(a)(3).

16 of 82

dealer and investment adviser.² The OIP alleges that nine of MS & Co.'s top-selling brokers ignored numerous red flags in selling millions of dollars of securities in private placement offerings created and controlled by the founders of MS & Co. It alleges that these respondents willfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 by offering and selling securities for which no registration statements were in effect.³ It further alleges that these respondents willfully violated the antifraud provisions in Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder by making misrepresentations and omissions about the securities and recommending the securities to customers without a reasonable basis.⁴ The OIP also alleges that Andrew G. Guzzetti, a managing director of MS & Co., violated Section 15(b) of the Exchange Act by failing reasonably to supervise the other respondents with a view towards detecting and preventing these violations.⁵

The OIP directs the presiding law judge to issue an initial decision within 300 days of the date of service of the OIP. On July 16, 2014, Chief Judge Murray filed a motion stating that the initial decision is due on August 28, 2014, and requesting an extension pursuant to Commission Rule of Practice 360(a)(3).

We adopted Rules of Practice 360(a)(2) and 360(a)(3) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of initial decisions.⁶ The rules further provide for extensions under certain circumstances, if supported by a motion from the Chief Administrative Law Judge and we determine that "additional time is necessary or appropriate in the public interest."⁷

In her motion, Chief Judge Murray states that it will not be possible to issue an initial decision by the due date in light of the workload in the Office of Administrative Law Judges. She further notes that the hearing took place over eighteen days and involved eight respondents,⁸ and that the final brief was filed on June 13, 2014. Under the circumstances, it is appropriate in the public interest to grant the Chief Administrative Law Judge's request and to extend the deadline for issuance of a decision.

² *Donald J. Anthony, Jr.*, Securities Exchange Act Release No. 70473, 2013 WL 5306694 (Sept. 23, 2013).

³ 15 U.S.C. §§ 77e(a), 77d(c).

⁴ *Id.* § 78j(b); 17 C.F.R. § 240.10b-5.

⁵ 15 U.S.C. §§ 78o(b)(4), 78o(b)(6).

⁶ *See Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003).

⁷ 17 C.F.R. § 201.360(a)(3).

⁸ Of the ten respondents named in the OIP, one settled and another was found to be in default. *See Exchange Act Release No. 71864* (Apr. 3, 2014) (Richard D. Feldmann settlement); Admin. Proceeding Rulings Release No. 1081 (Dec. 4, 2013) (finding default as to Donald J. Anthony).

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this proceeding is extended to January 26, 2015.

By the Commission.



Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72797 / August 8, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31201 / August 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16008

In the Matter of

**CRUCIBLE CAPITAL
GROUP, INC. and
CHARLES MOORE,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 against Crucible Capital Group, Inc. ("Crucible") and Charles Moore ("Moore") (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

1. This action arises out of extensive failures by Crucible, a registered broker-dealer, to maintain minimum net capital and to accurately make and preserve certain required records. These violations occurred between December 2012 and September 2013 (the "relevant period").

RESPONDENTS

2. Crucible, located in New York, New York, was formed in 2003 and has been registered with the Commission as a broker-dealer since September 2005. Crucible's business consists of assisting microcap issuers in raising capital. Crucible is wholly owned by Moore, its

17 of 82

founder, president, and sole shareholder. The firm has been subject to several disciplinary actions, including two for net capital and books-and-records violations. In August 2008, the Financial Industry Regulatory Authority ("FINRA") approved a Letter of Acceptance, Waiver, and Consent, under which Crucible consented to findings that it maintained inaccurate financial books and records and filed inaccurate FOCUS Reports in each of six months in 2006. In January 2011, Crucible was assessed a \$10,000 fine and consented to findings that it, acting through Moore, maintained inaccurate financial books and records and filed inaccurate FOCUS Reports in each of three months in 2008. Finally, in April 2013, FINRA approved a settlement in which Crucible was censured and fined \$12,500 and Moore was censured and fined \$10,000 for, among other things, maintaining inaccurate financials and books and records and filing inaccurate FOCUS Reports.

3. Moore, age 62, resides in East Brunswick, New Jersey. He is the founder, president, and sole shareholder of Crucible and Angelic Holdings LLC ("Angelic"). He holds Series 7, 24, 28, 62, and 63 licenses and at all relevant times has been a registered representative of Crucible. As noted above, Moore has been censured by FINRA and has settled charges with FINRA relating to Crucible's maintenance of inaccurate books and records.

OTHER RELEVANT ENTITIES

4. Angelic, located in New York, New York, is an unregistered entity wholly owned by Moore. Angelic is party to an expense-sharing agreement with Crucible.

FACTUAL BACKGROUND

Crucible's Business and Its Relationship to Angelic

5. Since 2009, Crucible's business has consisted of assisting clients, which appear to primarily if not exclusively be microcap issuers, with their long-term capital-structure plans and capital-raising activities. Crucible's claimed capital-raising services include arranging private equity financing and debt facilities; private debt and bank debt via unsecured loans and/or credit facilities; and bank debt, including but not limited to revolving lines of credit, asset-based loans, and other types of credit facilities.

6. Angelic is a shell company wholly owned by Moore. Angelic purportedly performs due-diligence reviews of the entities that hire Crucible to assist them in raising capital. But it performs those services in name only: the services are performed by Crucible employees (Angelic has no employees independent of Crucible's), and Angelic has no operations or sources of revenue independent of the fees that Crucible's clients pay Angelic for the due-diligence services.

7. During the relevant period, Angelic was thinly capitalized. It purportedly had net income of \$178 in January 2013; (\$13,067) in February 2013; \$78 in March 2013; (\$6,517) in April 2013; \$27 in May 2013; \$2,795 in June 2013; (\$9,732) in July 2013; and (\$9,507) in August 2013. The balance in Angelic's bank accounts as of August 31, 2013 was \$3,252, and Angelic had no other known assets.

8. Throughout the relevant period, Moore caused Crucible and Angelic to enter into an Expense Sharing Agreement (the "Agreement") by signing the Agreement on both parties' behalf. Moore had the parties enter into the Agreement so that Crucible's vendors would issue their invoices to Angelic for the services they performed for Crucible. Crucible's primary vendors were the firm that supplied its Financial and Operations Principal (FINOP), its outside law firm, and its e-mail archivist. Moore separately caused Crucible to tell these vendors that they should not send their invoices to Crucible through the firm's e-mail system.

Crucible Consistently Operated While Out of Net Capital During the Relevant Period

9. Rule 15c3-1 under the Exchange Act [17 CFR 240.15c3-1] requires broker-dealers generally effecting transactions in securities to "at all times have and maintain net capital" no less than the greatest of the highest minimum requirement applicable to its business. Under Rule 15c3-1(c)(2) [17 CFR 240.15c3-1(c)(2)], a broker-dealer's "net capital" is defined to mean its "net worth," subject to certain adjustments. A broker-dealer's net worth, in turn, is calculated by subtracting its liabilities from its assets.

10. The net capital rule requires broker-dealers to maintain different minimum amounts of net capital based on the nature of a firm's business. The minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule or an amount determined by applying one of two financial ratios. The minimum fixed dollar amount for Crucible was \$5,000.¹ Based on the application of this rule, Crucible's required net capital amount from December 2012 through September 2013 ranged from \$5,000 to \$5,396 as set forth in paragraph 14 below.

11. The net capital rule requires a broker-dealer to perform two calculations: (i) a computation of the minimum amount of net capital the broker-dealer must maintain; and (ii) a computation of the amount of net capital the broker-dealer is maintaining.

12. Generally, a broker-dealer computing net capital first calculates its net worth, computed in accordance with generally accepted accounting principles; deducts the value of certain illiquid assets; and also takes haircuts from the market value of certain securities it holds. The resulting figure must be above the firm's required minimum net capital to comply with the net capital rule.

13. From December 2012 through September 2013, Crucible operated with significant net capital deficiencies.

¹ Under Rule 15c3-1(a)(2)(vi), a broker-dealer, such as Crucible, "that does not receive, directly or indirectly, or hold funds or securities for, or owe funds or securities to, customers and does not engage in any of the activities described in paragraphs (a)(2)(i) through (v) of this rule shall maintain net capital of not less than \$5,000."

14. In its FOCUS Reports, Crucible reported that its actual net capital substantially exceeded its required net capital at month end, as shown below.

Dec. 2012	\$5,199	\$81,084
Jan. 2013	\$5,000	\$53,961
Feb. 2013	\$5,000	\$26,670
Mar. 2013	\$5,000	\$21,504
Apr. 2013	\$5,000	\$21,707
May 2013	\$5,000	\$41,358
June 2013	\$5,016	\$15,117
July 2013	\$5,282	\$10,882
Aug. 2013	\$5,396	\$8,039
Sept. 2013	\$5,089	\$8,911

Crucible substantially overstated its net capital, however, and in fact had a net capital deficiency on each of those reporting dates. Crucible overstated its net capital as a result of several improper practices.

15. First, Crucible improperly failed to include as its own liability the outstanding amount that its FINOP provider had invoiced to Angelic for services performed for Crucible. Between December 31, 2012 and September 31, 2013, that outstanding liability was between approximately \$50,783 and \$60,875. Crucible's failure to treat that liability as its own caused it to operate without adequate net capital from January 2013 through September 2013.

16. Crucible's failure to include the outstanding balance invoiced to Angelic as its own liability was improper because the FINOP provider furnished a FINOP to Crucible and not Angelic. In addition, and as described at Paragraph 7 above, Angelic did not have adequate resources independent of Crucible to pay its obligations to the FINOP provider or the other vendors. As Angelic's sole officer and shareholder, Moore knew or recklessly disregarded the fact that Angelic did not have adequate resources independent of Crucible to pay its obligations to those vendors.

17. The Commission staff and FINRA have provided guidance that for a broker-dealer to be relieved, for net capital purposes, of liabilities as a result of an expense sharing agreement with a third party, the third party must have adequate resources. In a July 11, 2003 letter, the Commission's then-Division of Market Regulation offered guidance on the application of the financial responsibility rules (that is, the net capital rule, Rule 15c3-1, and the reporting and recordkeeping requirements under Rules 17a-3 through 17a-5) when a broker-dealer has a third party, which may be a parent, holding company, or affiliate, assume responsibility for paying the broker-dealer's expenses. In October 2003, the National Association of Securities Dealers ("NASD") issued Notice to Members 03-63 (the "NASD Notice"), which commented on the Division of Market Regulation's letter. Both the Division of Market Regulation's letter and the NASD Notice stated that for a broker-dealer to be relieved, for net capital purposes, of liabilities as

a result of an expense sharing agreement with a third party, certain conditions must be met, including that the broker-dealer can demonstrate that the third party has adequate resources independent of the broker-dealer to pay the liability or expense. Because the debt to the FINOP provider was for services performed for Crucible, and because Angelic did not have adequate resources independent of Crucible to pay its obligations to the FINOP provider, Crucible was required to, but did not, treat that obligation as its own liability.

18. The improper practice described above in paragraphs 15, 16, and 17 caused Crucible to operate without sufficient net capital from January through September 2013.

19. In addition, Crucible employed a second improper practice that separately caused it to operate without sufficient net capital throughout December 2012 and until at least January 21, 2013. For example, at the end of December 2012, Crucible included as an allowable asset 3 million shares of common stock of a microcap issuer that Crucible valued at \$110,000. However, it was not until at the earliest January 21, 2013, that Crucible obtained a letter required by the transfer agent, opining that the transfer agent could remove the restrictive legend from the certificate representing these shares. Accordingly, the shares were subject to a restriction and thus non-marketable and should not have been included as an allowable asset until at least January 21, 2013.

Books-and-Records and Financial Reporting Failures

20. As a result of the above-described errors in calculating its net capital, Crucible failed to make and keep accurate records of its net capital calculation and filed ten FOCUS Reports during the relevant period that contained its inaccurate asset, liability, and net capital computations.

21. In addition, during an examination conducted by the Commission's Broker-Dealer Examination staff ("exam staff"), Crucible, acting at Moore's direction, provided the exam staff with falsified documents that substantially understated Angelic's, and therefore Crucible's, liabilities to vendors.

22. In addition, in 2013, Crucible, acting at Moore's direction, arranged to have some of its vendors send their invoices to Crucible staff at their personal email addresses. Accordingly, Crucible failed to keep certain records relating to its business as a broker-dealer and FINRA member.

VIOLATIONS

23. A broker-dealer violates Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder when it uses the mails, or any means or instrumentality of interstate commerce, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than exempt securities) while not maintaining its required minimum net capital.

24. A broker-dealer violates Section 17(a)(1) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder when it fails to make and keep current, and preserve, certain books and records and when those records are not accurate. *See In the Matter of the Application of PennMont*

Securities, Exchange Act Release No. 54434 (Sept. 13, 2006). Rule 17a-3(a)(2) requires every broker-dealer to, among other things, make and keep ledger accounts (or other records) reflecting all assets and liabilities. The rule requires that such computations shall be prepared currently at least once a month. Rule 17a-4(b)(3) requires a broker-dealer to preserve for at least three years "[a]ll bills receivable or payable . . . paid or unpaid, relating to the business of such member, broker, or dealer" and Rule 17a-4(j) requires a broker-dealer to promptly give to a representative of the Commission, upon its request, "legible, true, complete, and current copies of those records . . . that are required to be preserved under this section." Rule 17a-5(a) requires certain broker-dealers to file FOCUS Reports that, among other things, contain a net capital computation. Rule 17a-11(b)(1) requires every broker-dealer registered with the Commission under Section 15 of the Exchange Act whose net capital declines below the minimum amount required to notify the Commission of that deficiency the same day.

25. As a result of the conduct described above, Crucible willfully violated Sections 15(c)(3) and 17(a)(1) of the Exchange Act and Rules 15c3-1, 17a-3(a)(2), 17a-4(b)(3), 17a-4(j), 17a-5(a), and 17a-11(b)(1) thereunder.

26. As a result of the conduct described above, including by causing Crucible and Angelic to enter into the Agreement when he knew or recklessly disregarded the fact that the FINOP was actually performing its services for Crucible and not Angelic, and Angelic did not have adequate resources independent of Crucible to pay the amounts owed its vendors, Moore willfully aided and abetted and caused Crucible's violations of Sections 15(c)(3) of the Exchange Act and Rule 15c3-1, which require broker-dealers to maintain minimum net capital. As a result of the conduct described above, including by causing Crucible to calculate its net capital improperly when he knew or recklessly disregarded the fact that the erroneous net capital computation would be included in Crucible's FOCUS Reports, and by directing a Crucible employee to falsify documents to substantially understate Angelic's, and therefore, Crucible's, liabilities to vendors and provide those documents to representatives of the Commission and by ensuring in 2012 that vendor invoices would not be sent to Crucible through the firm's email system, Moore willfully aided and abetted and caused Crucible's violations of Section 17(a)(1) of the Exchange Act and Rules 17a-3(a)(2), 17a-4(b)(3), 17a-4(j), 17a-5(a), and 17a-11(b)(1) thereunder, which require broker-dealers to make and keep current and preserve books and records, and to make certain reports and filings with the Commission.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent Moore pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

D. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 15(c)(3) and 17(a)(1) of the Exchange Act and Rules 15c3-1, 17a-3(a)(2), 17a-4(b)(3), 17a-4(j), 17a-5(a), and 17a-11(b)(1) thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Aguilar
Commissioner Pivovar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72795 / August 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16007

In the Matter of

BRET A. GROVE,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Bret A. Grove ("Grove").

II.

In anticipation of the institution of these proceedings, Grove has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Grove consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

18 of 82

III.

On the basis of this Order and Grove's Offer, the Commission finds that:

1. Grove, age 34, resides in Delray Beach, Florida. Grove is vice president of DBBG, a corporation that, among other things, offered and sold TDI stock. Grove passed his Series 63 Exam and was a registered representative formerly associated with the Minneapolis Company, Salomon Grey Financial Corp. and Sharpe Capital, Inc.

2. On July 31, 2014, a final judgment was entered by consent against Grove, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. DDBO Consulting, Inc., et al, 0:14-cv-61685-MGC, Civil Action Number, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, in connection with the offer and sale of unregistered Thought Development, Inc. ("TDI") stock, Grove solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. The complaint also alleged Grove sold unregistered securities. The complaint also alleged that Grove made representations to investors about the use of investor funds raised for TDI's business that were materially misleading because they failed to disclose 50% or more of the total funds raised would be used to pay commissions or other fees. At the time of the offer or sale of TDI stock, Grove was not registered or affiliated with a registered broker dealer. In addition, Grove recruited others to act as sales agents and paid them transaction-based compensation.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Grove's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Grove be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Grove will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Grove, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72804; File No. SR-OCC-2014-804)

August 11, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice to Permit OCC to Adjust the Size of its Clearing Fund Intra-Month and Clearing Member's Clearing Fund Contributions Intra-Month

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")¹ and Rule 19b-4(n)(1)(i) of the Securities Exchange Act of 1934² notice is hereby given that on July 22, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.³ The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change that would permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure and on an emergency basis. In addition, the proposed change provide [sic] that under certain circumstances OCC will increase a clearing member's required contribution to OCC's clearing fund intra-month.

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ OCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. See SR-OCC-2014-17; 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4.

19 of 82

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

The proposed change would permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure or on an emergency basis as well as permit adjustments to a clearing member's required contribution to the clearing fund at any time, including between regular monthly calculations, under certain circumstances. OCC is filing this advance notice pursuant to Section 806(e)(1) of the Clearing Supervision Act⁴ because the change could be deemed to materially affect the nature or level of risks presented by OCC. The proposed change will also be filed as a proposed rule change filing.

⁴ 12 U.S.C. 5465(e)(1).

PURPOSE OF THE PROPOSED CHANGE

OCC is proposing to modify Rule 1001, which concerns the sizing of OCC's clearing fund and the allocation of clearing member contributions thereto. First, by adding Interpretation and Policy .05, Rule 1001 would be revised to permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure or on an emergency basis. Second, by adding Interpretation and Policy .06, Rule 1001 would be revised to permit increases to a clearing member's required contribution to the clearing fund at any time, including between regular monthly calculations, under certain circumstances. Rule 1001(b) and 1001(f) would also be revised to clarify certain terminology relating to the calculation of clearing fund contributions, and an Interpretation and Policy would be added to Article VIII, Section 2 of the By-Laws to clarify that this section, which addresses rule changes that increase a clearing member's required clearing fund contributions, does not apply to actions taken under Interpretations and Policies .05 or .06 to Rule 1001.

Background

The primary purpose of OCC's clearing fund is to provide a high degree of assurance that market integrity will be maintained in the event that one or more clearing members fails to meet its obligations to OCC.⁵ The clearing fund can also be used to meet the obligations resulting from the default of any bank or securities or commodities clearing organization to which OCC is exposed. The clearing fund supplements the financial safeguards afforded by OCC's membership standards and margin requirements.

⁵ See, Article VIII, Section 1 of OCC's By-Laws which sets forth the purpose of the clearing fund.

Currently, the size of the clearing fund is adjusted monthly. On each business day OCC calculates its hypothetical exposure, at a confidence level of at least 99%, under simulated default scenarios that include an "idiosyncratic default" of a single clearing member group⁶ and a "minor systemic event" involving the near-simultaneous default of two random clearing members. OCC then treats the greater of these two hypothetical exposures as that day's projected peak exposure. OCC also computes the projected draws from the clearing fund that would be necessary in connection with each business day's projected peak exposure. To determine the overall size of the clearing fund, on the first business day of each month, OCC averages these daily projected clearing fund draws over the prior month and uses that average as the required size of the clearing fund for that month. However, notwithstanding this calculation, in no event will the size of the clearing fund be set at less than 110% of the size of OCC's committed credit facilities secured by the clearing fund, in order to assure that at all times OCC will have collateral to pledge sufficient to draw the entire amount of such facilities. OCC publishes the new clearing fund requirement on the first business day of each month and clearing members have five business days to meet the new requirement.⁷

The foregoing calculations and the allocations among clearing members are based on the prescribed formulas included in Rules 1001(a) and 1001(b), respectively, as supplemented by Interpretation and Policy .01 to Rule 1001. These formulas were

⁵ A Clearing Member Group is a clearing member and any other clearing member that is affiliated with such clearing member. See Article 1, Section 1, C. (15) of OCC's By-Laws.

⁷ See OCC Rules 1002 and 1003, respectively.

adopted pursuant to a change effective April 18, 2013.⁸ The Rules do not, however, provide for increases to the overall size of the clearing fund between such monthly adjustments, nor do the Rules provide for adjustments to a clearing member's required contribution between such monthly calculations.

Proposed Change to Authorize Certain Adjustments to the Total Size of the Clearing Fund and Individual Clearing Members' Required Contributions

In order to mitigate the risks of an underfunding of the clearing fund, the proposed changes to the Rules would provide OCC with the authority to increase the total size of the clearing fund intra-month upon a significant and sustained increase in exposure based on daily projected clearing fund draw calculations, as described above, and on an emergency basis for the protection of OCC or in the public interest. The proposed changes would also provide OCC with the authority to increase a clearing member's required clearing fund contribution under certain circumstances reflecting a change in the clearing member's financial condition or risk profile.

Adjustments to the Overall Size of the Clearing Fund

OCC would have the authority to increase the overall size of the clearing fund intra-month in the event that the five-day rolling average of the projected draws against the clearing fund are 150% or more of the size of the clearing fund. This threshold is intended to ensure that intra-month increases in clearing fund size are limited to occasions in which the increase in exposure is significant and prolonged. Based on OCC staff's analysis of historical clearing fund data beginning in July 2011, the use of this 150% threshold would have resulted in only four changes to the clearing fund's size

⁸ Securities Exchange Act Release No. 69403 (April 18, 2013), 78 FR 24257 (April 24, 2013) (SR-OCC-2013-02).

during this period, one of which related to firm-specific changes and three of which related to increased volatility prior to and during the events related to the downgrade of the U.S. Government's credit rating and the ongoing debt crisis of that period. In the event that the 150% threshold is exceeded over a five-day period, OCC's Executive Chairman or President would have the authority to approve an increase in the clearing fund's size. The Risk Committee of OCC's Board would be informed of such officer's determination as soon as practicable. OCC would also provide notification to the SEC and CFTC in the same manner as if an emergency waiver or suspension of OCC's Rules occurred.⁹

The Risk Committee would also be permitted to approve an increase in the clearing fund's size on an emergency basis upon its determination that such action is necessary for the protection of OCC or in the public interest, and OCC would then provide notification to the Board of Directors, SEC and CFTC in the same manner as if an emergency waiver or suspension of OCC's Rules occurred.¹⁰ OCC believes that these processes ensure proper management and board-level oversight regarding decisions to increase the clearing fund size.

⁹ See OCC's By-Laws Article IX, Section 14.

¹⁰ In recommending that the Risk Committee approve an emergency increase in the size of the clearing fund, OCC would follow the process set forth in OCC's By-Laws Article IX, Section 14 in that the Executive Chairman, Management Vice Chairman or President, in his, her or their judgment, would determine that: (1) an emergency exists, and (2) such an increase is necessary or advisable for the protection of OCC or otherwise in the public interest.

Upon an intra-month increase in the clearing fund's size, clearing members would generally be given two business days to satisfy any deficit,¹¹ and the increase would generally remain in effect until the next regular monthly calculation occurs unless the Risk Committee determines that a further increase is warranted or the 150% threshold is triggered more than once during the same month. The foregoing changes to OCC's Rules would not affect the basic clearing fund methodology as previously approved by the SEC, nor would they affect allocation of the clearing fund among clearing members.¹² OCC has discussed the proposed changes with its Financial Risk Advisory Council, a working group consisting of representatives of clearing members and exchanges formed by OCC to review and comment on various risk management proposals. They additionally were discussed with the OCC Operations Roundtable, also consisting of representatives of clearing members and exchanges, which considers operational efficiencies and improvements. No concerns were raised by either working group during the course of these discussions.

Adjustments to Individual Clearing Members' Required Contributions

The proposed change would also permit OCC to increase individual clearing members' required clearing fund contributions in three circumstances. The first

¹¹ Intra-month clearing fund adjustments will only occur in limited circumstances and will be due to certain events that could materially affect the overall liquidity of OCC. Based on feedback OCC received from clearing members, OCC believes that providing a clearing member with one day to absorb the increase, including determining the most effective manner in which to collateralize the increase, and a second day to fund the increase strikes the proper balance between effective risk management and not causing material disruptions to a clearing member's business.

¹² In particular, the contributions of futures-only affiliated clearing members and clearing members depositing the required minimum clearing fund contribution, respectively, would not be adjusted in connection with any increase in the clearing fund size.

circumstance exists when a clearing member's required clearing fund contribution exceeds its net capital.¹³ In this situation, the clearing member is placed on OCC's "Watch Level III" surveillance, which is used to assess a clearing member's ability to meet a call to replenish its clearing fund contribution and requires certain OCC executive officers to consider protective measures with respect to such clearing member. One such protective measure would be to add the amount of such excess to the clearing member's required clearing fund contribution, thereby funding such difference in advance of the regular monthly calculation.¹⁴ No subsequent adjustment thereunder would be permitted under the applicable Rule provision until the earlier of the next adjustment of the clearing fund (either as a result of the next monthly adjustment or as a result of an increase in the total clearing fund pursuant to the changes described above) or the next required reporting of the clearing member's net capital.

The second circumstance is the merger or consolidation of two or more clearing members, in which case the variable amount of the required clearing fund contribution for the surviving clearing member would be adjusted so that it equals the sum of such amount for the surviving clearing member and the total of such amounts for all other clearing members involved in the transaction. Such adjusted amount would be

¹³ In this context, and for clearing members that are registered broker-dealers, net capital means net capital computed in accordance with Securities Exchange Act Rule 15c3-1. For clearing members that are futures commission merchants, net capital means adjusted net capital computed in accordance with CFTC Regulation Section 1.17 and for Canadian clearing members, net capital means risk-adjusted capital computed in accordance with Investment Industry Regulatory Organization of Canada Rule 17.1.

¹⁴ Pursuant to Interpretation and Policy .01 to Article VIII, Section 5 of OCC's By-Laws, a clearing member's clearing fund contribution is used to determine the clearing member's share of any clearing fund deficiency resulting from a clearing member insolvency.

substituted for the variable amount previously calculated for the surviving clearing member.

The third circumstance is the transfer of positions between clearing members, in which case OCC would be able to adjust the clearing fund contributions of the transferor clearing member and the transferee clearing member after giving effect to the transfer, subject to the agreement of the two clearing members. The amount of such adjustment would affect the variable amount of each clearing member's required clearing fund contribution and, irrespective of the amount or size of the positions transferred, each clearing member would continue to be required to maintain OCC's minimum clearing fund contribution.

Proposed Changes to By-Laws and Rules

OCC is proposing to add an Interpretation and Policy .05 under Rule 1001 to provide for the authority to increase the size of the clearing fund on an intra-month basis. Subparagraph (a) of proposed Interpretation and Policy .05 would authorize OCC's Executive Chairman or President, or the Risk Committee, to increase the clearing fund size as described above (*i.e.*, based on the daily calculations or by the Risk Committee on an emergency basis). Proposed Interpretation and Policy .06 under Rule 1001 would provide for the authority to increase individual clearing members' required clearing fund contributions in certain circumstances. Subparagraph (a) would provide for an increase when a clearing member's required clearing fund contribution exceeds its net capital, subparagraph (b) would provide for an increase in the event of a merger or consolidation involving clearing members and subparagraph (c) would provide for an increase in the

event of a transfer of positions between clearing members, in each case as described above.

Subparagraph (b) of proposed Interpretation and Policy .05 and subparagraphs (a), (b) and (c) of proposed Interpretation and Policy .06 would provide that if the total size of the clearing fund size or an individual clearing member's required contribution is increased, as applicable, the variable amount would be increased accordingly for each clearing member, and this increase would be effective for all purposes under OCC's By-Laws and Rules, including each clearing member's required contribution in the event the clearing fund is fully depleted in connection with the insolvency of a clearing member.¹⁵ However, subparagraph (b) of proposed Interpretation and Policy .05 and subparagraphs (a), (b) and (c) of proposed Interpretation and Policy .06 would specify that the variable amount would remain subject to nonstandard calculations for futures-only affiliated clearing members and clearing members that have deposited the minimum required clearing fund contribution.

An example will illustrate the manner in which the total size of the clearing fund and individual clearing members' contributions could be adjusted pursuant to Interpretation and Policy .05 to Rule 1001. The example assumes that OCC's total clearing fund requirement is \$1 million divided among five clearing members. Member One has the minimum requirement of \$150,000, Member Two has a requirement of \$212,500 and the other three comprise the remainder in differing amounts. If OCC determined, based on the most recent five-day rolling average of clearing fund draws, that it should resize the fund to \$1.5 million, Member One would maintain the minimum

¹⁵ See Interpretation and Policy .01 to Article VIII, Section 5 of OCC's By-Laws.

requirement of \$150,000 and the other four members would be assessed the incremental amount totaling \$500,000. Member Two would be assessed \$125,000 because the firm's *pro rata* share of the original clearing fund requirement excluding Member One's minimum requirement equaled 25%, *i.e.*, \$212,500 divided by \$850,000. Member Two's new clearing fund requirement would be \$337,500 until the next clearing fund sizing calculation. The other three members would be assessed their share of the remaining \$375,000 (using a denominator of \$850,000 as with Member Two) so that the total clearing fund requirement of \$1.5 million is satisfied.

Subparagraph (c) of proposed Interpretation and Policy .05 and subparagraph (d) of proposed Interpretation and Policy .06 would provide that as soon as practicable after any increase in the total size of the clearing fund size or an individual clearing member's required contribution, as applicable, OCC would provide notice to the affected clearing members, and such clearing members would be required to satisfy their deficits within two business days of such notice in the case of adjustments pursuant to Interpretation and Policy .05 and one business day in the case of adjustments pursuant to Interpretation and Policy .06. If, however, any deficit would be required to be satisfied on the first, second, third or fourth business day of a calendar month, it may instead be satisfied by the fifth business day of the calendar month. These subparagraphs also set forth that a resulting change in a clearing member's contribution to the clearing fund due to an increase in the clearing fund's size or an individual adjustment will be reflected on one or more reports made available by OCC, but that OCC will not revise the clearing member's Clearing Fund Statement.

Subparagraph (d) of proposed Interpretation and Policy .06 would further specify that OCC may require any deficit resulting from a merger of clearing members or the transfer of positions between clearing members to be satisfied prior to the occurrence of the merger or transfer. Moreover, subparagraph (e) of proposed Interpretation and Policy .06 would clarify that the individual adjustments under subparagraphs (a), (b), and (c) of proposed Interpretation and Policy .06 may result in an adjustment to the total size of the clearing fund.

To enhance the readability of the new Interpretations and Policies added to Rule 1001, the term "fixed amount" would be used to refer to the portion of a clearing member's clearing fund contribution calculated pursuant to clause (x) of Rule 1001(b), and the term "variable amount" would be used to refer to the portion of a clearing member's clearing fund contribution calculated pursuant to clause (y) of Rule 1001(b). Rule 1001(b) and 1001(f) would be amended solely for the purpose of introducing these defined terms.

Article VIII, Section 2(b) of OCC's By-Laws provides, among other things, that if a clearing member's clearing fund contribution is increased as a result of an amendment of the Rules, the increase will not be effective until the clearing member is given five business days' notice of the amendment. OCC proposes to add Interpretation and Policy .01 to Article VIII, Section 2 to clarify that such section shall not apply to increases in the total size of the clearing fund pursuant to Interpretation and Policy .05 of Rule 1001, nor to an increase in an individual clearing member's contribution pursuant to Interpretation and Policy .05 or .06 of Rule 1001.

While the proposed change may require clearing members to increase their clearing fund contributions at any time during a month, any such increase in the overall size of the clearing fund would correspond to a material change in OCC's projected exposure and would affect all clearing members proportionally in the same manner as a monthly adjustment, and any such increase in an individual clearing member's required contribution would correspond to a material change in the clearing member's business or financial condition, as well as use of OCC's resources. OCC therefore does not believe that clearing members will have significant problems in complying with the change. In addition to the prior communications with clearing members described above, in connection with the filing of this change, OCC will inform clearing members of the proposed change via an information memorandum, in order to advise clearing members of the procedures OCC intends to implement in support of the proposed change, including notice procedures to advise clearing members of any increases in contribution amounts.

STATUTORY BASIS FOR THE PROPOSED CHANGE

OCC believes that the proposed change to OCC's Rules is consistent with Section 805(b) of the Clearing Supervision Act¹⁶ because the proposed change will reduce systemic risk.¹⁷ OCC believes that the proposed changes to its clearing fund sizing, as described above, will reduce the risk that the size of OCC's clearing fund would be insufficient should OCC need to use clearing fund assets to close-out positions of a defaulted clearing member. For the same reasons, the proposed change will reduce

¹⁶ 12 U.S.C. 5464(b).

¹⁷ 12 U.S.C. 5464(b)(3).

systemic risk because it will promote confidence that OCC will be able to timely meet its settlement obligations because the proposed change will diminish the likelihood that OCC's clearing fund would be insufficient in the event of a clearing member default. The proposed change is not inconsistent with the existing Rules of OCC, including any other Rules proposed to be amended or any advance notice filings pending with the Commission.

ANTICIPATED EFFECT ON AND MANAGEMENT OF RISK

OCC believes that the proposed change will reduce OCC's overall level of risk because the proposed change makes it less likely that OCC's clearing fund would be insufficient should OCC need to use its clearing fund to manage a clearing member default. As described above, the proposed change would provide OCC with the ability to increase the overall size of its clearing fund as result of a projected increase in anticipated draws or for the protection of OCC. In addition, OCC would have the ability to increase individual clearing member's clearing fund contribution as a result of certain events such as a change in net capital, a merger or a transfer of positions. This flexibility will allow OCC to adjust the size of its clearing fund in response to events that may occur in between normal monthly clearing fund calculations, and therefore makes it less likely that OCC's clearing fund would be insufficient should OCC need to use its clearing fund to manage a clearing member default. Accordingly, OCC's overall level of risk will be reduced as a result of this proposed change. Moreover, and for the same reasons, the proposed change will facilitate OCC's ability to manage risk.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension. The designated clearing agency may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Commission, or the date the Commission receives any further information it requested, if the Commission notifies the designated clearing agency in writing that it does not object to the proposed change and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.

The designated clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.¹⁸

¹⁸ OCC also filed the the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. *See supra* note 3.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-804 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

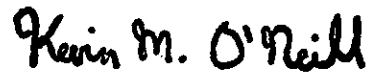
All submissions should refer to File Number SR-OCC-2014-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of

the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_804.pdf.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-804 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

A handwritten signature in black ink that reads "Kevin M. O'Neill". The signature is written in a cursive, slightly slanted style.

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72803; File No. SR-OCC-2014-803)

August 11, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice to Better Manage Risks Concentration and Other Risks Associated with Accepting Deposits of Common Stocks for Margin Purposes

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")¹ and Rule 19b-4(n)(1)(i)² of the Securities Exchange Act of 1934 notice is hereby given that on July 16, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.³ The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change that would permit OCC to better manage concentration and other risks (i.e., wrong-way risk) associated with accepting deposits of common stock for margin purposes. In order to manage such risks, OCC proposes to add an proposed Interpretation and Policy that will

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ OCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. See SR-OCC-2014-14.

20 of 82

provide OCC with discretion with respect to giving value to margin collateral deposited by a single clearing member.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

1. Purpose

The purpose of the proposed change is to permit OCC to better manage concentration risk and other risks (i.e., wrong-way risk) associated with accepting deposits of common stock for margin purposes.⁴ Accordingly, in order to manage such risks, OCC proposes to add an Interpretation and Policy to Rule 604, which specifies the forms of margin assets accepted by OCC, that will provide OCC with discretion with respect to giving value to assets deposited by a single clearing member to satisfy its margin requirement(s). In addition, OCC proposes to make clarifying amendments to an existing Interpretation and Policy under Rule 604 that gives OCC discretion to not give value to a particular type of margin collateral across all clearing members.

⁴ This proposed change has also been filed as a proposed rule change filing (SR-OCC-2014-14).

Background

OCC Rule 604 lists the types of assets that clearing members may deposit with OCC to satisfy their margin requirement(s) as well as sets forth eligibility criteria for such assets. Common stocks, including Exchange Traded Funds (“ETFs”) and Exchange Traded Notes (“ETNs”), are the most common form of margin assets deposited by clearing members and currently comprise 68% of the \$60.6 billion in clearing member margin deposits held by OCC (not including deposits in lieu of margin). Since 2009, OCC has used STANS, its daily automated Monte Carlo simulation-based margining methodology, to value common stocks deposited by clearing members as margin.⁵ The value given to margin deposits depends on factors that include the price volatility and the price correlation relationship of common stock collateral to the balance of the cleared portfolio. The approach used by STANS incentivizes clearing members who chose to meet their margin obligations with deposits of common stocks to choose common stocks that hedge their related open positions.

Notwithstanding the value STANS gives to deposits of common stocks, certain factors warrant OCC adjusting the value STANS gives to all clearing member margin deposits of a particular type of margin collateral. Such factors are set forth in Rule 604, Interpretation and Policy .14, and include the number of outstanding shares, number of outstanding shareholders and overall trading volume. OCC is proposing to add a new Interpretation and Policy to Rule 604 (the “Interpretation”) so that OCC has discretion to not give margin credit to a particular clearing member when such clearing member deposits a concentrated amount of any common stock and when a common stock,

⁵ See Securities Exchange Act Release No. 58158 (July 15, 2008), 73 FR 42646 (July 22, 2008) (SR-OCC-2007-20).

deposited as margin, presents “wrong-way risk” to OCC. In addition, the Interpretation will provide OCC discretion to grant margin credit to a clearing member when it deposits shares of common stock that serve as a hedge to the clearing member’s related open positions and would otherwise be not be given margin credit.⁶

Concentrated Deposits of Common Stock

OCC has determined that in the event it is necessary to liquidate a clearing member’s positions (including the clearing member’s margin collateral), OCC may be exposed to risk arising from a large quantity of a particular common stock deposited as margin by a clearing member. Specifically, depending on the relationship between the average daily trading volume of a particular security and the number of outstanding shares of such security deposited by a clearing member as margin, it is possible that the listed equities markets may not be able to quickly absorb all of the common stock OCC seeks to sell, or OCC may not be able to auction such securities, without an appreciable negative price impact. This occurrence, referred to as “concentration risk,” is greatest when the number of shares being sold is large and the average daily trading volume is low.

⁶ Consistent with the language contained in existing Interpretation & Policy .14, the Interpretation provides OCC with discretion in determining the amount of margin credit given to deposits of common stock by an individual clearing member as such determination would be based on positions held and common stock deposits made by such clearing member on a given business day. However, as discussed in the following two sections, OCC also has developed certain automated processes as well as additional internal policies that describe how OCC presently intends to exercise such discretion. These additional internal policies are included in OCC’s collateral risk management policy, which will not be implemented until approval of this rule change with changes thereto being subject to additional rule filings.

OCC's existing authority to not give value to otherwise eligible forms of margin is broad in its application since such authority only provides OCC with the discretion to not give value across all clearing member deposits of a particular common stock. However, concentration risk may be a clearing member and account-specific risk. In order to mitigate the concentration risk of a single clearing member, OCC plans to implement automated processes to monitor the composition of a clearing member's margin deposits. Such processes will identify concentration risk at both an account level and across all accounts of a clearing member. OCC proposes to add the Interpretation so that OCC has discretion to limit the margin credit granted to an individual clearing member that maintains a concentrated margin deposit of otherwise eligible common stock.

For the reasons stated above, OCC considers a common stock's average daily trading volume and the number of shares a clearing member deposited as margin to be the two most significant factors when making a decision to limit margin credit due to concentration risk. Accordingly, OCC will not give margin credit to clearing member margin deposits of a particular common stock in respect of a particular account when the deposited amount of such common stock is in excess of two times the average daily trade volume of such common stock over the most recent three month period. OCC's systems will continually assess the composition of clearing member margin deposits for each account maintained by the clearing member, including intra-day collateral substitutions in such accounts, to determine if a clearing member has a margin deposit with a concentrated amount of common stock. With respect to a given account, OCC's systems will automatically set appropriate limits on the amount of a particular common stock for

which a clearing member may be given margin credit for any one of its tier accounts. In addition, and with respect to all of a clearing member's accounts, OCC will impose an add-on margin charge if, in aggregate, a clearing member deposits a concentrated amount of a particular common stock as margin across all of its accounts.⁷ The add-on margin charge will operate to negate the margin credit given to the concentrated margin deposit, and will be collected, when applicable, as part of OCC's standard morning margin process.⁸ OCC will assess the add-on margin charge across all of a clearing member's accounts on a pro-rata basis (based on the amount of the particular common stock in each of a clearing member's accounts).

OCC staff has been monitoring concentrated common stock positions, assessing the impact of the proposed change described in this filing and contacting clearing members affected by the proposed change. OCC believes that clearing members will be able to comply with the proposed change without making significant changes to their day-to-day business operations. In December 2013, an information memo was posted to inform all members of the upcoming change. Since January 2014, staff has been in contact with any clearing member that would be affected by the proposed change. On a

⁷ OCC believes that this policy is consistent with proposed Rule 17Ad-22(e)(5), which requires covered clearing agencies to set and enforce concentration limits to manage its or its participant's credit exposure. *See* 79 FR 16866, 16972 (March 26, 2014).

⁸ Since the 2-day limit is first checked at each account, it is possible that a clearing member with multiple accounts may have more than 2-days of a given common stock on deposit in aggregate. To control this condition, a final check is done on the aggregate amount of shares held by a clearing member across all of its accounts. For example, if a particular clearing member has three accounts each holding 2-days volume of a specific common stock, the clearing member check would identify that the member was holding six days of volume in aggregate. To mitigate this risk, an add-on charge equal to the market value of four days of volume would be applied to all accounts holding that security on a pro-rata basis.

weekly basis, any clearing member that would see a reduction of 10% or more of its collateral value is contacted and provided an explanation of the policy and a list of concentrated positions observed in this analysis. On a monthly basis, all clearing members exhibiting any concentration risk are contacted to provide an explanation of the proposed policy and a list of concentrated positions. In both cases, clearing members are encouraged to proactively reduce concentrated positions to conform to the proposed policy. As of June 2014, twenty-five members would be affected. Implementation of the Interpretation would result in disallowing \$1.2 billion in collateral value and result in margin calls for six members totaling \$710 million. Moreover, in July 2014, OCC made an automated report concerning concentrated margin deposits of common stock available to all clearing members.

Wrong-Way Risk

OCC is also proposing to use the Interpretation to address the risk that the common stock a clearing member has deposited as margin and which is issued by the clearing member itself or an affiliate of the clearing member will lose value in the event the clearing member providing such margin defaults, which is known as "wrong-way risk." Wrong-way risk occurs when a clearing member makes a deposit of common stock issued by it or an affiliate and, in the event the clearing member defaults, the clearing member's common stock margin deposit will also be losing value at the same time because there is likely to be a strong correlation between the clearing member's creditworthiness and the value of such common stock. In order to address wrong-way risk, the Interpretation will implement automated systems that will not give margin credit to a clearing member that deposits common stock issued by such clearing member or an

affiliate as margin collateral. OCC proposes to define "affiliate" broadly in the Interpretation to include any entity with direct or indirect equity ownership of 10% of the clearing member, or any entity for which the clearing member holds 10% of the direct or indirect equity ownership.⁹

OCC has addressed the impact of the change designed to address wrong-way risk. As of June 2014, there were 73 clearing members whose parent or an affiliate has issued securities trading on U.S. exchanges. There are six clearing members that would be affected by virtue of having made margin deposits of their own or an affiliate's common stock. In total, these shares equaled \$132 million and accounted for less than one half of one percent of the total market value of valued securities pledged as margin at OCC. In July 2014, OCC made information available to each clearing member that indicates which of its deposits of common stock would not receive margin credit due to wrong-way risk considerations, as described above.¹⁰

Deposits That Hedge Open Positions

In addition to the above, OCC also proposes to include language in the Interpretation so that it has discretion to give margin credit to common stock deposited as margin that would otherwise not be given margin credit in circumstances when such common stock acts as a hedge (i.e., the member holds an equivalent short position in cleared contracts on the same underlying security). This condition will be checked in both the account and clearing member level. For example, if a clearing member deposits

⁹ This standard is based on the provisions of OCC Rule 215(a)(5).

¹⁰ OCC believes that by providing such information clearing members will be better able to adjust their margin deposits at OCC to conform to the proposed change once it is approved.

the common stock of an affiliate as margin collateral, which, pursuant to the above, would ordinarily not be given value for the purposes of granting margin credit, OCC may nevertheless give value to such common stock for the purposes of granting margin credit to the extent such common stock acts as a hedge against open positions of the clearing member. In this case, a decline in the value of the margin deposit would be wholly or partially offset by an increase in the value in the open position. Moreover, in such a situation, OCC will systematically limit the margin credit granted to the lesser of a multiple of the daily trading volume or the "delta equivalent position"¹¹ for the particular common stock, taking into account the hedging position.¹² OCC believes that this policy will further encourage clearing members to deposit margin collateral that hedges their related open positions and is in line with the valuation methods within STANS. This

¹¹ The "delta equivalent position" is the equivalent number of underlying shares represented by the aggregation of cleared products on that same underlying instrument. This value is calculated using the "delta" of the option or futures contract, which is the ratio between the theoretical change in the price of the options or futures contract to the corresponding change in the price of an underlying asset. Thus, delta measures the sensitivity of an options or futures contract price to changes in the price of the underlying asset. For example, a delta of +0.7 means that for every \$1 increase in the price of the underlying stock, the price of a call option will increase by \$0.70. Delta for an option or future can be expressed in shares of the underlying asset. For example, a standard put option with a delta of -.45 would have a delta of -45 shares, because the unit of trading is 100 shares.

¹² Assume, for example, an average daily trade volume of 250 shares, a threshold of 2 times the average daily trade volume, and a delta of -300 shares for the options on a particular security in a particular account. A position of 700 shares that did not hedge any short options or futures would receive credit for only 500 shares (*i.e.*, 2 times the average daily trade volume). If the net long position in the account, when combined with the delta of short option and futures position, were only 400, credit would be given for the entire 700 shares since the delta equivalent position is below the 500 share threshold. However, if the option delta were +300, the net long position would be 1000, and credit would only be given for 500 shares because the delta equivalent position would exceed the 500 share threshold.

policy will also facilitate OCC's management of its and its participants' credit exposure¹³ as well as the liquidation of a clearing member's portfolio should the need arise.

Other Proposed Changes

OCC is also proposing to make certain clarifying changes in order to accommodate the adoption of the Interpretation into its Rules. Primarily, OCC proposes to add language to OCC Rule 604, Interpretation and Policy .14, to clarify that such Interpretation and Policy concerns OCC's authority to not give value to certain margin deposits for all clearing members (whereas the Interpretation applies to particular clearing member(s)). In addition, OCC proposes to remove language from OCC Rule 604, Interpretation and Policy .14, to improve readability as well as to remove "factors" concerning number of shares and affiliates since OCC's authority with respect to such factors will be more clearly described in the Interpretation. Finally, OCC proposes to renumber the Interpretations and Policies of Rule 604 in order to accommodate the adoption of the Interpretation.

2. Statutory Basis

OCC believes that the proposed change to OCC's Rules is consistent with Section 805(b) of the Clearing Supervision Act¹⁴ because the proposed change will reduce systemic risk.¹⁵ OCC believes that the proposed changes to its margin policy, as described above, will reduce the risk that clearing member margin assets would be insufficient should OCC need to use such assets to close-out positions of a defaulted

¹³ OCC also believes that this policy is consistent with proposed Rule 17Ad-22(e)(5). *See* Fn. 6, *supra*.

¹⁴ 12 U.S.C. 5464(b).

¹⁵ 12 U.S.C. 5464(b)(3).

clearing member. For the same reasons, the proposed change will reduce systemic risk because it will promote confidence that OCC will be able to timely meet its settlement obligations because the proposed change will diminish the likelihood that a large percentage of a defaulting clearing member's margin assets would not be available to OCC in the event of a clearing member default. The proposed change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended or any advance notice filings pending with the Commission.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(C) Advance Notices Filed Pursuant to Section 806(e) of the Clearing Supervision Act

The proposed change would provide OCC with additional discretion with respect to giving value to clearing member deposits of margin collateral. OCC is filing this advance notice pursuant to Section 806(e)(1) of the Clearing Supervision Act¹⁶ because the change could be deemed to materially affect the nature or level of risks presented by OCC.

As described above in Paragraph II.A, OCC proposes to add the Interpretation so that it has discretion to not give value to concentrated equity security margin deposits and deposits of margin collateral that present wrong-way risk to OCC. In addition, the Interpretation will provide OCC with discretion to give value to securities deposited as margin that would otherwise not be given margin credit in circumstances when such

¹⁶ 12 U.S.C. 5465(e)(1).

securities act as a hedge against open positions held in the same account. Paragraph II.A also discusses how OCC presently intends to exercise such discretion through the implementation of automated systems and additional internal policies. This proposed change will facilitate OCC's liquidation of a clearing member's margin collateral should such clearing member default and thereby promote robust risk management, safety and soundness and reduce systemic risk because the proposed change will increase the likelihood that OCC will maintain uninterrupted operations notwithstanding the clearing member default. Accordingly, OCC believes that these changes will reduce risks to OCC and its participants.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension. The designated clearing agency may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Commission, or the date the Commission receives any further information it requested, if the Commission notifies the designated clearing agency in writing that it does not object to the proposed

change and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.

The designated clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.¹⁷

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-803 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

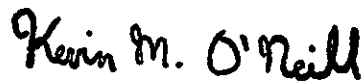
All submissions should refer to File Number SR-OCC-2014-803. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission

¹⁷ OCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. *See supra* note 3.

will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website (http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_803.pdf).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-803 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.



Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9629 / August 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16009

In the Matter of

THE STATE OF KANSAS,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), against the State of Kansas ("Respondent" or the "State").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

21 of 82

1. From August 2009 through July 2010, the Kansas Development Finance Authority ("KDFA") raised \$273 million through eight series of bonds on behalf of the State and its agencies without disclosing in the bond offering documents (the "Official Statements") the existence of the significant unfunded liability in the State's pension system, known as the Kansas Public Employees Retirement System ("KPERS"), or the effect of such unfunded liability on the risk of non-appropriation of debt service payments by the State Legislature. At the time, according to one study, KPERS was the second-most underfunded statewide public pension system in the nation.² The failure to disclose this material information in the Official Statements resulted from insufficient procedures and poor communications between KDFA and the Kansas Department of Administration ("KDA"), which provided information to KDFA for inclusion in the Official Statements, including preparing the State's financial statements that were included as part of the Official Statements.

Respondent

2. Kansas possesses all powers, functions, rights, privileges and immunities authorized by the United States Constitution, the Kansas Constitution and the State's laws, including the power to issue debt.

a. KDFA is an independent instrumentality of the State created in 1987 by the State Legislature for the primary purposes of enhancing the ability of the State to finance capital improvements and improving access to long-term financing for State agencies, political subdivisions, and public and private organizations and businesses. As a conduit issuer, KDFA offers municipal securities on behalf of underlying borrowers, including the State.

b. KDA, a component of the State, provides essentially all financial and administrative services for the State. KDA's Division of Budget was responsible for overseeing the incurrence of debt, including the review of certain disclosure documents drafted by KDFA, while KDA's Division of Accounts and Reports ("Division of Accounts") was responsible for preparing the Comprehensive Annual Financial Reports, or CAFRs, for the State.

KPERS Was Significantly Underfunded

3. KPERS, an independent instrumentality of the State, is a multi-employer pension system administering various defined benefit pension plans covering substantially all governmental employers and public employees in the State. The State is the largest of the approximately 1,400 employers that participate in KPERS, and directly or indirectly contributes approximately 70% of all employer contributions to KPERS, although more than half of KPERS's 155,000 active members are employed by local school districts. KPERS annually prepares and publicly releases an actuarial valuation as of the end of each calendar year and a Comprehensive Annual Financial Report for each 12-month period ended June 30 ("KPERS CAFR").

² Only Illinois had a lower funded ratio for its state pension fund system than Kansas. See *"The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform,"* Pew Center on the States (February 2010).

4. For years, KPERS was significantly underfunded. Specifically, the State's statutory maximum annual contribution rates were insufficient to cover both (a) the cost of pension benefits earned by public employees by virtue of their service in the current year, known as the normal cost, and (b) a payment to amortize the accumulated amount of pension liabilities that have been deemed earned, but are not funded, known as the unfunded actuarial accrued liability, or UAAL. At the end of the 2008 calendar year, KPERS had a total retirement system UAAL of \$8.3 billion and a 59% funded ratio.³ This liability was substantial - by comparison, in 2008, the State's tax-supported debt was \$3.1 billion.

5. The State was not the only obligor of the total retirement system UAAL. Other obligors included, but were not limited to, local school districts and local governments. The State Group of KPERS (State employees) had a 72% funded ratio and represented \$1.0 billion of the \$8.3 billion total retirement system UAAL at the end of 2008. The School Group of KPERS (local school district employees) had a 52% funded ratio and represented \$5.2 billion of the \$8.3 billion total retirement system UAAL at the end of 2008. Although technically an obligation of the local school districts, historically the State appropriated from its general fund an amount sufficient to cover the entire cost of those school districts' contributions to KPERS's School Group. By the end of 2009, KPERS had a total retirement system funded ratio of 64% and UAAL of \$7.7 billion, which included a State Group funded ratio of 78%, representing a \$0.8 billion UAAL, and a School Group funded ratio of 56%, representing a \$5.0 billion UAAL.

The State's Debt is Subject to a Risk of Non-Appropriation

6. The Kansas Constitution substantially limits the State's ability to directly issue general obligation debt, and consequently the State borrows money through the issuance of revenue obligations subject to annual appropriation, including certain bonds issued by KDFA. Moreover, unlike many states that provide significant legal protections regarding the repayment of their debt, in Kansas the Legislature must annually appropriate money to pay the principal and interest on the debt issued by the KDFA on its behalf.⁴ Because of this requirement for annual appropriation, bond holders are at risk that the Legislature may choose, for any reason, to not appropriate funds for debt service over other competing budget demands, such as state services, school funding, or pension obligations. The major credit rating agencies routinely reduce the credit rating assigned to these bonds by one level in order to reflect the risk of non-appropriation.

³ The funded ratio, which is one measure of the financial health of a pension plan, is the actuarial value of assets expressed as a percentage of the actuarial accrued liability. A 100% funded ratio means that the existing assets cover the present value of the future benefits to be paid by the system.

⁴ The annual debt service on the State's bond debt payable from appropriations from the State General Fund is less than two percent of the State General Fund budget.

The CAFRs Did Not Disclose KPERS's Underfunded Status

7. The State, by and through the KDA's Division of Accounts, issues CAFRs purportedly in accordance with standards promulgated by the Governmental Accounting Standards Board ("GASB"). Beginning with the 2004 CAFR, on the advice of outside accountants, the State changed the way the pension liabilities of KPERS were reported. The outside accountants concluded that GASB did not require a detailed disclosure of KPERS in the State's CAFR as long as KPERS made such disclosure in its own CAFR, which it did.

8. As a result of this change, for the 2004 through 2009 fiscal years, the State's CAFRs did not provide any information regarding KPERS's UAAL or funded ratio. Instead, the CAFR simply provided certain information regarding KPERS and the State's expenditures to fund employer contributions to KPERS, and listed the mailing address and telephone number for KPERS (but not an internet website, email address, or contact person), should someone want additional information. As a result, the State's CAFRs from 2004 through 2009 made no reference to the State's substantially underfunded pension plan.

The Failure to Disclose KPERS's Underfunding

9. From 2004 on, the underfunding of KPERS was repeatedly discussed in various local newspapers, and by credit rating agencies. In several reports issued by Moody's during this time period, the rating agency noted that the State faced budgetary pressures by virtue of KPERS's underfunded status, including both statutorily scheduled increases in pension fund contributions and the debt service payable on the State's pension obligation bonds, and that the State's debt ratings could go up if there was strong improvement in pension funding.

10. Kansas's practice of not disclosing the underfunded status of KPERS became increasingly inconsistent with the practice of most states issuing municipal securities, which generally provided disclosure in their CAFRs or the body of their Official Statements regarding the financial health of their pension funds. By 2008, with the exception of Kansas, the overwhelming majority of the Official Statements for state-level bond issuances at a minimum disclosed the UAAL or funded ratios of the associated state-level pension plans, particularly if those plans were significantly underfunded.

KDFA and KDA's Disclosure Practices and Procedures

11. KDFA took the lead in preparing the three Official Statements for the eight series of bonds issued on behalf of the State from August 2009 through July 2010, including the retention of disclosure counsel. Each of the Official Statements made repeated boldface disclosures regarding the possibility of non-appropriation. The Official Statements also contained sections reporting on appropriations and budget processes for the State, and on current State budget issues such as revenue estimates, general fund receipts and pending school finance litigation, as well as long-term economic, income, and demographic trends. Each Official Statement included as an appendix the most recent State CAFR and identified the amount of other State indebtedness payable from appropriations from the State General Fund, but none of

the relevant Official Statements (or appendices thereto) specifically mentioned the underfunded status of KPERS.

12. In the course of preparing each Official Statement, KDFA routinely asked KDA, and in particular KDA's Division of Budget, to advise it of, among other things, material adverse changes in the State's overall financial condition, or of any liabilities not reflected in the most recent CAFR that had a material adverse effect on the State's financial condition. Moreover, at each closing, KDA executed a certificate to the effect that the information in the Official Statement set forth under certain captions and in specific appendices, which corresponded to information regarding the State, was true in all material respects, and insofar as such matters were concerned, did not omit to state a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which the statements were made, not misleading. At each closing, KDFA also executed a certificate stating that, in the Official Statement, the KDFA had not made an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

13. These queries and certifications did not trigger the inclusion of any additional information regarding KPERS's unfunded liability to any of the August 2009 to July 2010 Official Statements. Furthermore, although KDFA, KDA, and other members of the working group had an informal process for the development and review of official statements, neither KDFA nor KDA had any formal written policies or procedures for addressing trends or risk factors that might be material to bondholders. KDFA operated with the understanding that KDA was responsible for providing the information and disclosures in the Official Statements relating to financial issues impacting the State. Conversely, KDA understood that KDFA was responsible for such disclosure. This lack of clear communication, together with the absence of effective written policies or procedures in either organization, meant that neither KDA nor KDFA identified the absence of the KPERS unfunded liability, or discussed the need to add such disclosure to the Official Statements.

KPERS's 2008 Investment Losses Highlighted the Materiality of its Underfunded Status

14. By the summer of 2009, the impact of KPERS's 2008 investment losses was becoming clear. A draft actuarial report provided to the KPERS Board in mid-July 2009 spelled out that KPERS's UAAL had jumped from \$5.6 billion in 2007 to \$8.3 billion in 2008, a 49% increase, and its aggregate funded ratio dropped from 71% to 59%.

15. The State was contemporaneously preparing for a large multipurpose \$127 million bond offering through KDFA. A portion of this offering, approximately \$40 million, was sold primarily to out of state investors. At meetings or on telephone conferences with S&P and Moody's regarding the credit rating of this bond offering at the end of July, the Secretary of Administration raised as a topic the financial health of KPERS, and in particular the possible need for legislative action to increase the statutory annual contribution rate so as to provide for additional State funding to KPERS. KDFA emailed the draft actuarial report to the relevant

rating agency analysts the following week. KPERS's underfunded status was explicitly referenced in each firm's credit rating report.

Omitted Language Made the Official Statements Materially Misleading

16. These credit rating agency discussions led to further discussions by the working group to consider possible changes to the draft August 2009 Preliminary Official Statement. Proposed language was circulated to the working group setting forth a warning that future State expenditures could be affected by various unpredictable circumstances or events beyond the control of the State, including the need for additional state funding of KPERS and/or gains or losses on KPERS's investments.

17. Notwithstanding the renewed focus on the financial health of KPERS, no one at KDA or KDFA raised a concern that the proposed language was inadequate or that additional disclosure regarding KPERS should be added to the Official Statements. Rather, KDFA's proposed language was adopted following review, but without comment, and incorporated into both the Preliminary and final Official Statement for the August 2009 offering. At the closing, KDFA and KDA signed without objection the certifications regarding the accuracy and completeness of the Official Statement as more fully described in paragraph 12.

18. The added language was materially misleading in that it omitted any information regarding KPERS's financial health, or the associated risks created by the State's underfunding of its pension obligations. As the actuarial report detailed, and the Secretary of Administration highlighted, KPERS's financial difficulties were the result of years of statutory maximum contribution rates insufficient to cover both KPERS's normal costs and UAAL. The need for increased funding for KPERS was both reasonably predictable and within the control of the State. The three Official Statements for the eight series of bonds offered by KDFA in August 2009 through 2010 omitted this language rendering them materially misleading.

19. Respondent should have known the Official Statements were deficient, and that the absence of any disclosure concerning KPERS's finances and underfunding within the Official Statements rendered the disclosure materially misleading.

Prompt Remedial Measures

20. Respondent adopted new disclosure policies and procedures prior to the November 2011 offering of bonds payable from appropriations from the State's general fund. Among other things, these new procedures designated responsible parties in critical State agencies, mandated closer communication and cooperation among those agencies, established a State Disclosure Committee, and required annual training of key personnel. Moreover, the State's fiscal year 2010 CAFR resumed including information regarding KPERS contributions and a schedule of funding progress. Additionally, Official Statements for the State's most recent revenue bond offerings included a separate appendix discussing KPERS and, among other things, its underfunded status.

Legal Discussion

21. Issuers of municipal securities must ensure that financial information contained in their disclosure documents is not materially misleading. Proper disclosure allows investors to understand and evaluate the financial health of the municipality in which they invest.

22. The antifraud provisions of Section 17(a) of the Securities Act prohibit fraudulent or deceptive practices in the offer or sale of securities by the issuers of municipal securities. Section 17(a)(2) of the Securities Act prohibits obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Section 17(a)(3) of the Securities Act prohibits engaging in any transaction, practice, or course of business which operates, or would operate as a fraud or deceit upon the purchaser. A misstatement or omission is material if there is a substantial likelihood that a reasonable investor would have viewed the information as "having significantly altered the 'total mix' of information available." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). To the extent the omitted information relates to contingent future events, materiality depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of circumstances." Basic, Inc. v. Levinson, 485 U.S. 224, 238 (1988). Cautionary words about future risk cannot insulate one from liability for the failure to disclose actual material facts regarding that risk. Dolphin and Bradbury v. SEC, 512 F.3d 634, 640 (DC Cir. 2008). Negligence is sufficient to prove violations of Section 17(a)(2) or (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 696-97 (1980).

Violations

23. As a result of the conduct described above, Respondent violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

24. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by the State, as described in Paragraph 20, and KDFA's and KDA's substantial cooperation afforded the Commission staff during the investigation.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 8A of the Securities Act, the State shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3892 / August 11, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31202 / August 11, 2014

Admin. Proc. File No. 3-15519

In the Matter of

TIMBERVEST, LLC, JOEL BARTH SHAPIRO,
WALTER WILLIAM ANTHONY BODEN, III,
DONALD DAVID ZELL, JR., and
GORDON JONES II

ORDER EXTENDING
DEADLINE FOR FILING
INITIAL DECISION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),¹ for an extension of thirty days to file the initial decision in this proceeding. For the reasons set forth below, we grant her motion.

We issued an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") against Timbervest, LLC, a registered investment adviser that manages approximately \$1.2 billion in timber-related investments, and its Chief Executive Officer, Joel Barth Shapiro; Chief Investment Officer, Walter William Anthony Boden, III; Chief Operating Officer, Donald David Zell, Jr.; and President, Gordon Jones II.² Shapiro, Boden, Zell, and Jones also are Timbervest's Managing Partners. The OIP alleges that Timbervest willfully violated the antifraud provisions of the Investment Advisers Act of 1940 by engaging in the unauthorized and undisclosed sale of assets to an affiliated fund.³ The OIP also alleges that Shapiro, Boden, Zell, and Jones willfully aided and abetted or caused Timbervest's violation of the antifraud provisions by collecting unauthorized and undisclosed real estate commissions.

¹ 17 C.F.R. § 201.360(a)(3).

² *Timbervest, LLC*, Advisers Act Release No. 3678, 2013 WL 5320976 (Sept. 24, 2013).

³ The OIP specifically alleges violations of Advisers Act Sections 206(1) and 206(2), 15 U.S.C. § 80b-6(1), (2).

The OIP directs the presiding law judge to file an initial decision within 300 days of the date of service of the OIP. Chief Judge Murray seeks an extension of this deadline. She notes that the law judge "has held hearings in three other proceedings," and that work in the office "has been at an all-time high." Chief Judge Murray asserts that the law judge has made "considerable progress" on the initial decision and that she is requesting an extension "out of an abundance of caution."

We adopted Rule of Practice 360(a) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for filing an initial decision.⁴ That rule provides, however, for deadline extensions under certain circumstances if supported by a motion from the Chief Administrative Law Judge and if it appears, as here, that "additional time is necessary or appropriate in the public interest."⁵

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this proceeding is extended to August 21, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

⁴ See *Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003) ("[T]he Commission has determined that timely completion of proceedings can be achieved more successfully through the adoption of mandatory deadlines and procedures designed to meet these deadlines.").

⁵ 17 C.F.R. § 201.360(a)(3).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3893; File No. S7-23-07

RIN 3235-AL56

Temporary Rule Regarding Principal Trades With Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing to amend rule 206(3)-3T under the Investment Advisers Act of 1940, a temporary rule that establishes an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Investment Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The amendment would extend the date on which rule 206(3)-3T will sunset from December 31, 2014 to December 31, 2016.

DATES: Comments must be received on or before [insert date 30 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-23-07 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

23 of 82

Paper Comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-23-07. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Melissa S. Gainor, Senior Counsel, Sarah A. Buescher, Branch Chief, or Daniel S. Kahl, Assistant Director, at (202) 551-6787 or IARules@sec.gov, Investment Adviser Regulation Office, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is proposing an amendment to temporary rule 206(3)-3T [17 CFR 275.206(3)-3T] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] that would extend the date on which the rule will sunset from December 31, 2014 to December 31, 2016.

I. Background

On September 24, 2007, we adopted, on an interim final basis, rule 206(3)-3T, a temporary rule under the Investment Advisers Act of 1940 (the "Advisers Act") that provides an

alternative means for investment advisers that are registered with us as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients.¹ The purpose of the rule was to permit broker-dealers to sell to their advisory clients, in the wake of *Financial Planning Association v. SEC* (the “FPA Decision”),² certain securities held in the proprietary accounts of their firms that might not be available on an agency basis — or might be available on an agency basis only on less attractive terms³ — while protecting clients from conflicts of interest as a result of such transactions.⁴

As initially adopted on an interim final basis, rule 206(3)-3T was set to sunset on December 31, 2009. In December 2009, however, we adopted rule 206(3)-3T as a final rule in the same form in which it was adopted on an interim final basis in 2007, except that we extended the rule’s sunset date by one year to December 31, 2010.⁵ We deferred final action on rule

¹ Rule 206(3)-3T [17 CFR 275.206(3)-3T]. All references to rule 206(3)-3T and the various sections thereof in this release are to 17 CFR 275.206(3)-3T and its corresponding sections. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) [72 FR 55022 (Sep. 28, 2007)] (“2007 Principal Trade Rule Release”).

² 482 F.3d 481 (D.C. Cir. 2007). In the FPA Decision, handed down on March 30, 2007, the Court of Appeals for the D.C. Circuit vacated (subject to a subsequent stay until October 1, 2007) rule 202(a)(11)-1 under the Advisers Act. Rule 202(a)(11)-1 provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. For further discussion of fee-based brokerage accounts, *see* 2007 Principal Trade Rule Release, Section I.

³ *See* 2007 Principal Trade Rule Release at nn.19-20 and Section VI.C.

⁴ As a consequence of the FPA Decision, broker-dealers offering fee-based brokerage accounts with an advisory component became subject to the Advisers Act with respect to those accounts, and the client relationship became fully subject to the Advisers Act. These broker-dealers — to the extent they wanted to continue to offer fee-based accounts and met the requirements for registration — had to: register as investment advisers, if they had not done so already; act as fiduciaries with respect to those clients; disclose all material conflicts of interest; and otherwise fully comply with the Advisers Act, including the restrictions on principal trading contained in section 206(3) of the Act. *See* 2007 Principal Trade Rule Release, Section I.

⁵ *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) [74 FR 69009 (Dec. 30, 2009)] (“2009 Extension

206(3)-3T in December 2009 because we needed additional time to understand how, and in what situations, the rule was being used.⁶

In both December 2010 and December 2012, we further extended the rule's sunset date, in each case for an additional two-year period.⁷ We deferred final action on rule 206(3)-3T in 2010 in order to complete a study required by section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").⁸ In 2012, we deferred final action on rule

Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965A (Dec. 31, 2009) [75 FR 742 (Jan. 6, 2010)] (making a technical correction to the 2009 Extension Release).

⁶ See 2009 Extension Release, Section II.c.

⁷ See *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3118 (Dec. 1, 2010) [75 FR 75650 (Dec. 6, 2010)] (proposing a two-year extension of rule 206(3)-3T's sunset provision) ("2010 Extension Proposing Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3128 (Dec. 28, 2010) [75 FR 82236 (Dec. 30, 2010)] (extending rule 206(3)-3T's sunset provision from December 31, 2010 to December 31, 2012) ("2010 Extension Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3483 (Oct. 9, 2012) [77 FR 62185 (Oct. 12, 2012)] (proposing a two-year extension of rule 206(3)-3T's sunset provision); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3522 (Dec. 20, 2012) [77 FR 76854 (Dec. 31, 2012)] (extending rule 206(3)-3T's sunset provision from December 31, 2012 to December 31, 2014) ("2012 Extension Release").

⁸ Public Law 111-203, 124 Stat. 1376 (2010). Under section 913 of the Dodd-Frank Act, we were required to conduct a study and provide a report to Congress concerning the obligations of broker-dealers and investment advisers, including standards of care applicable to those intermediaries and their associated persons. Section 913 also authorizes us to promulgate rules concerning the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries for providing personalized investment advice about securities to retail customers, taking into account the findings, conclusions, and recommendations of the study.

The study mandated by section 913 of the Dodd-Frank Act was prepared by the staff and delivered to Congress on January 21, 2011. See *Study on Investment Advisers and Broker-Dealers* ("913 Study") (Jan. 21, 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>. For a discussion regarding principal trading, see section IV.C.1.(b) of the 913 Study. See also Commissioners Kathleen L. Casey and Troy A. Paredes, *Statement by SEC Commissioners: Statement Regarding Study on Investment Advisers and Broker-Dealers* (Jan. 21, 2011), available at <http://www.sec.gov/news/speech/2011/spch012211klctap.htm> (opposing the release of the 913 Study to Congress and stating that more rigorous analysis is required before the Commission engages in any follow-on rulemaking).

206(3)-3T to further consider the findings, conclusions, and recommendations of the 913 Study and the comments we had received from interested parties.⁹ In connection with each extension, we noted that our consideration of the regulatory requirements applicable to broker-dealers and investment advisers was ongoing and that an extension would allow the Commission to consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to sunset.¹⁰

We have continued to consider the regulatory requirements applicable to broker-dealers and investment advisers. In 2013, we issued a request for data and other information, including quantitative data and economic analysis, relating to the benefits and costs that could result from alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers.¹¹ The staff has received over 200 comment letters in response to the Request, several of which discussed rule 206(3)-3T, and Commissioners and the staff have held numerous meetings with interested parties.¹² None of the comment letters provided quantitative or qualitative information regarding the effects of the temporary rule.

⁹ See 2012 Extension Release, Section II.

¹⁰ See *id.*; 2010 Extension Release, Section II.

¹¹ *Duties of Brokers, Dealers, and Investment Advisers*, Investment Advisers Act Release No. 3558 (Mar. 1, 2013) [78 FR 14848 (Mar. 7, 2013)] (the “Request”).

¹² See *Comments on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, File No. 4-606, available at <http://sec.gov/comments/4-606/4-606.shtml>. See e.g., Comment Letter of Consumer Federation of America (Jul. 5, 2013) (“[B]y considering revisions to the principal trading rules as part of the fiduciary rulemaking, the Commission could arrive at a workable approach that is consistent for brokers and investment advisers and provides improved protections for investors.”); Comment Letter of North American Securities Administrators Association, Inc. (Jul. 5, 2013) (“[T]he Commission should consider SEC Rule 206(3)-3T as part of future fiduciary standard rulemaking.”); Comment Letter of Securities Industry and Financial Markets Association (“SIFMA”) (Jul. 5, 2013) (“SIFMA 2013 Letter”) (including survey results regarding the dollar amount of principal transactions engaged in with retail clients during 2012).

II. Discussion

We are proposing to amend rule 206(3)-3T to extend the rule's sunset date by two additional years.¹³ Absent further action by the Commission, the rule will sunset on December 31, 2014. We are proposing this extension because we continue to believe that the issues raised by principal trading, including the restrictions in section 206(3) of the Advisers Act and our experiences with, and observations regarding, the operation of rule 206(3)-3T, should be considered as part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.¹⁴

¹³ The rule includes a reference to an "investment grade debt security," which is defined as "a non-convertible debt security that, at the time of sale, is rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations (as defined in section 3(a)(62) of the Exchange Act)." Rule 206(3)-3T(a)(2) and (c). Section 939A of the Dodd-Frank Act requires that we "review any regulation issued by [us] that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and any references to or requirements in such regulations regarding credit ratings." Once we have completed that review, the statute provides that we modify any regulations identified in our review to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness" as we determine to be appropriate. We believe that the credit rating requirement in the temporary rule would be better addressed after the Commission completes its review of the regulatory standards of conduct that apply to broker-dealers and investment advisers. Therefore, we are not proposing any substantive amendments to the rule at this time. *See generally Report on Review of Reliance on Credit Ratings* (July 21, 2011), available at <http://www.sec.gov/news/studies/2011/939astudy.pdf> (staff study reviewing the use of credit ratings in Commission regulations).

¹⁴ The 913 Study is one of several studies relevant to the regulation of broker-dealers and investment advisers mandated by the Dodd-Frank Act. *See, e.g., Study on Enhancing Investment Adviser Examinations* (Jan. 19, 2011), available at <http://sec.gov/news/studies/2011/914studyfinal.pdf> (staff study required by section 914 of the Dodd-Frank Act, which directed the Commission to review and analyze the need for enhanced examination and enforcement resources for investment advisers); Commissioner Elisse B. Walter, *Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act)* (Jan. 19, 2011), available at <http://sec.gov/news/speech/2011/spch011911ebw.pdf>. *See also Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-Dealers* (Jan. 26, 2011), available at <http://sec.gov/news/studies/2011/919bstudy.pdf> (staff study required by section 919B of the Dodd-Frank Act, that directed the Commission to complete a study, including recommendations (some of which have been implemented) of ways to improve investor access to registration information about investment advisers and broker dealers, and their associated persons); *United States Government Accountability Office Report to Congressional Committees on Private Fund*

As noted above, section 913 of the Dodd-Frank Act authorizes us to promulgate rules concerning, among other things, the legal or regulatory standards of conduct for broker-dealers, investment advisers, and persons associated with these intermediaries when providing personalized investment advice about securities to retail customers. Since the completion of the 913 Study in 2011, we have been considering the findings, conclusions, and recommendations of the study and the comments we have received from interested parties.¹⁵ The Commission and its staff have continued to focus on evaluating options regarding regulatory requirements applicable to broker-dealers and investment advisers, taking into account the 913 Study's recommendations, the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to the Request in 2013. Staff has also been engaged in examinations of dual registrants and is assessing the impact to investors of the different supervisory structures and legal standards of conduct that govern the provision of brokerage and investment advisory services, which may help inform our considerations.¹⁶ At this time, our consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing. We do not expect to complete our consideration of these issues before December 31, 2014, the current sunset date for rule 206(3)-3T.

If we permit rule 206(3)-3T to sunset on December 31, 2014, after that date investment advisers registered with us as broker-dealers that currently rely on rule 206(3)-3T would be required to comply with section 206(3)'s transaction-by-transaction written disclosure and

Advisers (July 11, 2011), available at <http://www.gao.gov/new.items/d11623.pdf> (study required by section 416 of the Dodd-Frank Act, which directed the Comptroller General of the United States to study the feasibility of forming a self-regulatory organization to oversee private funds).

¹⁵ Section 913(f) of the Dodd-Frank Act requires us to consider the 913 Study in any rulemaking authorized by that section of the Dodd-Frank Act.

¹⁶ See National Exam Program, Office of Compliance Inspections and Examinations, *Examination Priorities for 2014* (Jan. 9, 2014), available at <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf>.

consent requirements without the benefit of the alternative means of complying with these requirements currently provided by rule 206(3)-3T. This could limit the access of non-discretionary advisory clients of advisory firms that are registered with us as broker-dealers to certain securities.¹⁷ In addition, firms may be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems.

We believe that the requirements of rule 206(3)-3T, coupled with regulatory oversight, will adequately protect advisory clients for an additional limited period of time while we consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers.¹⁸ Since its adoption and throughout the period of the proposed extension, the staff has examined and would continue to examine firms that engage in principal transactions and will take appropriate action to help ensure that firms are complying with section 206(3) or rule 206(3)-3T (as applicable), including possible enforcement action.¹⁹ Since the last extension, examination staff also requested and received materials from a sample of dual registrants in 2014 to observe the use of the rule by these firms.²⁰ This examination showed that a number of the

¹⁷ For a discussion of the costs and benefits underlying rule 206(3)-3T, see 2007 Principal Trade Rule Release, Section VI.C.

¹⁸ In addition, rule 206(3)-3T(b) provides that the rule does not relieve an investment adviser from acting in the best interests of its clients, or from any obligation that may be imposed by sections 206(1) or (2) of the Advisers Act or any other applicable provisions of the federal securities laws.

¹⁹ In the 2010 Extension Proposing Release, we discussed certain compliance issues identified by the Office of Compliance, Inspections and Examinations. See 2010 Extension Proposing Release, Section II. One matter identified in the staff's review resulted in a settlement of an enforcement proceeding and other matters continue to be reviewed by the staff. See *In the Matter of Felth & Company, Inc.*, Investment Advisers Act Release No. 3325 (Nov. 28, 2011) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for certain principal transactions and section 206(4) of the Advisers Act and rule 206(4)-7 thereunder for failure to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules).

²⁰ Staff identified a representative sample set of dual registrants based on Form ADV data, including firm disclosures on Form ADV Part 2A, and requested materials from the firms that included compliance policies and procedures, sample disclosures, and data regarding the firm's principal transactions with advisory accounts. See also *infra* note 27.

firms that were contacted by staff relied on the rule and that those firms had adopted written policies and procedures under rule 206(4)-7 that are designed to comply with the requirements of the temporary rule.²¹ Based on the review, it appeared to the staff that the firms relying on the rule had processes in place for the purpose of effecting principal transactions in compliance with the requirements of the temporary rule.

In light of these considerations, we believe that it is not appropriate to require firms currently relying on the rule to restructure their operations and client relationships before we complete our consideration of the standards of conduct and regulatory requirements applicable to broker-dealers and investment advisers. To the extent our consideration of these issues leads to new rules concerning principal trading, these firms would be required to restructure their operations and client relationships, potentially at substantial expense.

As part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, we intend to carefully consider principal trading by advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to sunset. In making these determinations, we will consider, among other things: the 913 Study; relevant comments and information received in connection with the 913 Study, the Request, and any rulemaking that may follow; the results of our staff's evaluation of the operation of rule 206(3)-3T; the information received in connection with the review of dual registrants; and comments we receive on rule 206(3)-3T in connection with this proposed extension.

²¹ 17 CFR 275.206(4)-7. *See also* 2007 Principal Trade Rule Release (noting that an adviser relying on rule 206(3)-3T as an alternative means of complying with section 206(3) must have adopted and implemented written policies and procedures reasonably designed to comply with the requirements of the rule).

III. Request for Comment

We request comment on our proposal to extend rule 206(3)-3T's sunset date for two additional years.

- Should we allow the rule to sunset?
- If so, what costs would advisers that currently rely on the rule incur? What would be the impact on their clients?
- If we allow the rule to sunset, should we consider exemptive requests from investment advisers that are registered with us as broker-dealers for exemptive orders providing an alternative means of compliance with section 206(3)?
- Are there any developments since the last extension that would make an extension not appropriate?
- If we extend the rule's sunset date, is two years an appropriate period of time to extend the sunset date? Or should we extend the rule's sunset date for a different period of time? If so, for how long?
- Is it appropriate to extend rule 206(3)-3T's sunset date for a limited period of time in its current form while we complete our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers?

IV. Paperwork Reduction Act

Rule 206(3)-3T contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.²² The Office of Management and Budget ("OMB") last approved the collection of information with an expiration date of July 31, 2017. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information

²² 44 U.S.C. 3501 *et seq.*

unless it displays a currently valid OMB control number. The title for the collection of information is: "Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T" and the OMB control number for the collection of information is 3235-0630.

The amendment to the rule we are proposing today – to extend rule 206(3)-3T's sunset date for two years – does not affect the current annual aggregate estimated hour burden of 139,358 hours.²³ Therefore, we are not revising the Paperwork Reduction Act burden and cost estimates submitted to OMB as a result of this proposed amendment.

We request comment on whether the estimates continue to be reasonable. Have circumstances changed such that these estimates (or the underlying assumptions embedded in these estimates) should be modified or revised? Persons submitting comments should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-23-07.

V. Economic Analysis

A. Introduction

The Commission is sensitive to the economic effects, including the benefits and costs and the effects on efficiency, competition, and capital formation, that would result from extending rule 206(3)-3T's sunset date for two years.²⁴ The economic effects considered in proposing this extension are discussed below.

²³ See *Proposed Collection; Comment Request*, 78 FR 72932 (Dec. 4, 2013); *Submission for OMB Review; Comment Request*, 79 FR 7481 (Feb. 7, 2014).

²⁴ 15 U.S.C. 80b-2(c). Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Rule 206(3)-3T provides an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with their non-discretionary advisory clients. Other than proposing to extend rule 206(3)-3T's sunset date for two years, we are not otherwise proposing to modify the rule from its current form. We are proposing to extend rule 206(3)-3T in its current form to avoid disruption to firms and clients that rely on the rule while the Commission continues its ongoing consideration of the regulatory requirements applicable to broker-dealers and investment advisers and the recommendations from the 913 Study. In particular, an extension of the current rule would permit firms to continue to offer, and clients to have access to, certain securities on a principal basis without being required to restructure their operations and client relationships, adjust to a new set of rules, or abandon the operational systems established to comply with the current rule – potentially only to have to do so again when the rule expires or is modified, and once more if the Commission adopts a new approach to principal trading in connection with the broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. We previously considered and discussed the economic effects of rule 206(3)-3T in its current form in the 2007 Principal Trade Rule Release, the 2009 Extension Release, the 2010 Extension Release, and the 2012 Extension Release.²⁵

At the outset, the Commission notes that, where possible, it has sought to quantify the costs, benefits, and effects on efficiency, competition, and capital formation expected to result from extending rule 206(3)-3T and its reasonable alternatives. In many cases, however, the Commission is unable to quantify the economic effects because it lacks the information

²⁵ See 2007 Principal Trade Rule Release, Sections VI-VII; 2009 Extension Release, Sections V-VI; 2010 Extension Release, Sections V-VI; 2012 Extension Release, Sections V-VI.

necessary to provide a reasonable estimate.²⁶ The staff has also not found other information, including through examinations and comment letters, which impacts the discussion of economic effects in previous releases. We will continue to assess the rule's operation and impacts along with intervening developments during the period of the proposed extension.

The temporary rule currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the amendment are discussed. The proposed amendment, which will extend rule 206(3)-3T's sunset date by an additional two years, will affect investment advisers that are registered with the Commission as broker-dealers and engage in, or may consider engaging in, principal transactions with non-discretionary advisory clients, as well as the non-discretionary advisory clients of these firms that engage in, or may consider engaging in, principal transactions.

Although the extent to which firms currently rely on the rule is unknown, based on IARD data as of June 1, 2014, there are 97 dual registrants that may rely on the rule.²⁷ Past comment letters also have indicated that since its implementation in 2007, both large and small advisers have relied upon the rule.²⁸ Additionally, one comment letter to the Request in 2013 provided

²⁶ In previous releases, the Commission has requested comment on the economic effects of rule 206(3)-3T, the economic effects of extending the rule, and the economic effects of alternatives. The Commission has not received comments providing quantitative data regarding the economic effects of extensions of rule 206(3)-3T, or to alternatives of the rule.

²⁷ Based on IARD data as of June 2, 2014, there are 290 SEC-registered advisers that are also registered as broker-dealers that have non-discretionary accounts who could potentially rely on the rule; however, only 97 of these dual registrants indicate they currently engage in principal transactions on Form ADV. The actual number of advisers that engage in principal transactions in reliance on the temporary rule is likely smaller. The staff's recent outreach to observe the use of the rule by firms found that some of the dual registrants in the sample, which was derived based on Form ADV data, did not rely on the rule.

²⁸ For example, SIFMA's 2012 comment letter included survey results from seven dual-registrant firms that, in the aggregate, manage over \$325 billion of assets in over 1.1 million non-discretionary advisory accounts. The firms indicated that 459,507 non-discretionary advisory accounts (with aggregate assets of over \$125 billion) were eligible to engage in principal trading in reliance on the rule. These firms also indicated that, during 2010-2012, the firms engaged in

survey results regarding the dollar amount of principal transactions that a small number of firms engaged in with retail clients in 2012.²⁹ Because the economic effects of extending the rule and its reasonable alternatives will depend on the extent to which eligible firms rely on the rule to engage in principal transactions with non-discretionary advisory clients, the economic effects could vary significantly among firms and their clients.

B. Analysis of the Proposed Extension and Alternatives

As noted above, the temporary rule currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the amendment are discussed. Because the extension of the sunset date in the temporary rule maintains the status quo, we do not expect additional costs or benefits to result from the extension. For the same reason, we also do not expect the extension to have additional effects on efficiency, competition or capital formation. Extending the current rule would provide the Commission with additional time to consider principal trading as part of the broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

Two reasonable alternatives to extending the current rule include allowing the rule to expire and adopting the rule on a permanent basis. If the rule is allowed to expire, then an adviser that is registered as a broker-dealer would no longer have a lower cost and more efficient

principal trades in reliance on Rule 206(3)-3T with respect to 106,682 accounts and executed an average of 12,009 principal trades per month in reliance on the rule. Comment letter of SIFMA (Nov. 13, 2012). See also Comment Letter of Wells Fargo Advisors (Nov. 13, 2012) (noting that the firm managed 232,437 non-discretionary advisory accounts in which hundreds of principal trades are made on a monthly basis for the benefit of investors).

²⁹ See SIFMA 2013 Letter, *supra* note 12. Ten firms responded to SIFMA's survey and reported that they relied on the temporary rule for \$8 billion in principal transactions across 163,000 retail non-discretionary advisory accounts. In comparison, the ten firms engaged in \$36 billion in principal transaction with 498,000 retail advisory accounts under section 206(3) of the Advisers Act and \$809 billion in principal transactions with 2,480,000 retail brokerage accounts.

alternative to the requirements under section 206(3) of the Advisers Act like that provided by the temporary rule,³⁰ and consequently non-discretionary advisory account clients could lose access to the principal accounts of firms that rely on the rule. As noted in the 2012 Extension Release, greater access to a wider range of securities may allow non-discretionary advisory clients to more efficiently allocate capital and, in the long term, the more efficient allocation of capital may lead to an increase in capital formation.³¹ If the rule expires, the loss of access by non-discretionary advisory clients to a wider range of securities would reduce the ability of these investors to efficiently allocate capital and therefore could reduce any resulting long-term gains to capital formation. Allowing the rule to expire also would reduce the ability of investors to choose between brokerage accounts and advisory accounts if the investor wishes to maintain access to securities held in firm principal accounts, and may force non-discretionary advisory account clients to bear the costs associated with transferring accounts (or lose access to a firm's principal accounts). Firms may also bear the potentially substantial costs associated with restructuring their operations and client relationships. On the other hand, if the rule is allowed to expire, and firms engage in principal transactions with advisory account clients pursuant to the requirements of section 206(3) of the Act, investors will be able to more fully evaluate the conflicts of the principal transactions prior to the trades.

³⁰ Section 206(3) of the Advisers Act requires an investment adviser to provide written conflict-of-interest disclosure describing its role as principal when transacting securities from its own account and obtain client consent prior to transaction completion. Rule 206(3)-3T provides a dual registrant firm the option of providing transaction-by-transaction disclosures verbally instead of in writing when engaging in principal transactions with non-discretionary advisory clients as long as the firm satisfies additional requirements before and after the transactions. Additional requirements of the temporary rule include the provision of a written prospective disclosure to clients describing the conflicts arising from principal transactions, acquisition of written revocable client consent prospectively authorizing such transactions, the provision of transaction-by-transaction confirmations, and the provision of annual reports itemizing the clients' principal transactions thereafter.

³¹ 2012 Extension Release, Section V.B.

We continue to believe that non-discretionary advisory client access to a wider range of securities is beneficial.³² Many clients wish to access securities held in firm inventory of a diversified broker-dealer, and clients may wish to access these securities through their non-discretionary advisory accounts.³³ We believe that it is appropriate to preserve investors' access to the securities available through principal transactions made in reliance on rule 206(3)-3T while consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing.

In connection with the 2010 extension of the rule, a commenter argued that rule 206(3)-3T would impede, rather than promote, capital formation because it would lead to "more numerous and more severe violations...of the trust placed by individual investors in their trusted investment adviser", but did not provide any specific data, analysis, or other information in support of its comment.³⁴ While we understand the view that numerous and severe violations of trust could impede capital formation, we have not seen any evidence that rule 206(3)-3T has caused this result. The staff has not identified instances where an adviser has used the temporary rule to "dump" unmarketable securities or securities that the adviser believes may decline in value into an advisory account, a harm that section 206(3) and the conditions and limitations of

³² *But see* Comment Letter of fi360, Inc. (Nov. 13, 2012) ("fi360 Letter") (questioning the importance of investor choice as the principal benefit of Rule 206(3)-3T); Comment Letter of National Association of Personal Financial Advisors (Dec. 20, 2010) ("NAPFA Letter") (questioning the benefits of the rule in: (1) Providing protections of the sales practice rules of the Exchange Act and the relevant self-regulatory organizations; (2) allowing non-discretionary advisory clients of advisory firms that are also registered as broker-dealers to have easier access to a wider range of securities which, in turn, should continue to lead to increased liquidity in the markets for these securities; (3) maintaining investor choice; and (4) promoting capital formation).

³³ *See* 2007 Principal Trade Rule Release, Section I.B.

³⁴ *See* NAPFA Letter.

rule 206(3)-3T are designed to redress.³⁵ In addition, non-discretionary advisory account clients benefit from the protections of sales practice rules under the Exchange Act and of relevant self-regulatory organizations, and the fiduciary duty and other obligations imposed by the Advisers Act.

We also received comments on the 2007 Principal Trade Rule Release from commenters who opposed the limitation of the temporary rule to investment advisers that are registered with us as broker-dealers, as well as to accounts that are subject to both the Advisers Act and Exchange Act as providing a competitive advantage to investment advisers that are registered with us as broker-dealers.³⁶ Based on our experience with the rule to date, and as we noted in previous releases, we have no reason to believe that broker-dealers (or affiliated but separate investment advisers and broker-dealers) are put at a competitive disadvantage to advisers that are themselves also registered as broker-dealers.³⁷ We intend to continue to evaluate the effects of the rule on efficiency, competition, and capital formation in connection with our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

If the Commission allowed the rule to expire, firms would no longer incur the costs associated with rule 206(3)-3T, including the operational costs associated with complying with the rule.³⁸ In the 2007 Principal Trade Rule Release, we presented estimates of the costs of each

³⁵ See 2010 Extension Proposing Release, Section II (noting that the staff did not identify instances of “dumping” in connection with OCIE’s examinations regarding compliance with the temporary rule).

³⁶ See Comment Letter of the Financial Planning Association (Nov. 30, 2007); Comment Letter of the American Bar Association, section of Business Law’s Committee on Federal Regulation of Securities (Apr. 18, 2008). See also 2009 Extension Release, Section VI.

³⁷ See 2009 Extension Release, Section VI; 2010 Extension Release, Section VI; 2012 Extension Release, Section V.

³⁸ See *supra* n. 25.

of the rule's disclosure elements, including: prospective disclosure and consent; transaction-by-transaction disclosure and consent; transaction-by-transaction confirmations; and the annual report of principal transactions. We also provided estimates for the following related costs of compliance with rule 206(3)-3T: (i) the initial distribution of prospective disclosure and collection of consents; (ii) systems programming costs to ensure that trade confirmations contain all of the information required by the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. Although one commenter on the 2012 extension noted that the Commission's cost analysis had remained unchanged since 2007, the commenter did not provide any supporting information discrediting the cost analysis we presented in the 2007 Principal Trade Rule Release.³⁹ We do not believe the extension we are proposing today would affect the cost estimates associated with the rule.⁴⁰ Furthermore, we believe that an eligible adviser that begins to rely on Rule 206(3)-T today would bear the same upfront and ongoing cost estimates set forth in the 2007 Principal Trade Rule Release.⁴¹

If the rule is adopted on a permanent basis, then there may be additional economic effects. We recognize that a temporary rule, by nature, creates uncertainty, which in turn, may result in a reduced ability of firms to coordinate and plan future business activities. The uncertainty with respect to rule 206(3)-3T would be reduced if either the rule was allowed to

³⁹ See fi360 Letter. See also 2012 Extension Release, Section V.B.

⁴⁰ In the 2007 Principal Trade Rule Release, we estimated the total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)-3T to be \$37,205,569. See 2007 Principal Trade Rule Release, Section VI.D.

⁴¹ See *id.*

expire or the rule was adopted on a permanent basis.⁴² Nonetheless, we believe that it would not be appropriate to adopt the rule on a permanent basis (with any necessary substantive amendments) while consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing.

Another reasonable alternative would be to extend the rule for a period other than two years. For example, extending the rule for greater than two years would provide the Commission with additional time to evaluate the impact of any potential rulemaking or other process that may emerge from the broader consideration of fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers. Should our consideration of the fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers extend beyond the proposed sunset date of the temporary rule, such a longer period may be appropriate for the Commission to consider. On balance, however, we believe that the proposed two-year extension of rule 206(3)-3T appropriately addresses the concerns of firms and clients relying on the rule while the Commission continues its ongoing consideration of the standards applicable to investment advisers and broker-dealers.

C. Request for Comment

We request comment on all aspects of the economic analysis, including the accuracy of the potential costs and benefits identified and assessed in this release and the prior releases and information on any other costs or benefits that may result from the proposal and from alternatives to the proposal, and whether the proposal, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide quantitative and

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We received several comments in connection with prior extensions of the rule urging us to make the rule permanent to avoid such uncertainty. *See e.g.*, Comment Letter of Winslow, Evans & Crocker (Dec. 8, 2009); Comment of Bank of America Corporation (Dec. 20, 2010).

qualitative data and other information and economic analysis about the costs or benefits to support their views.

VI. Initial Regulatory Flexibility Act Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis (“IRFA”) regarding the proposed amendment to rule 206(3)-3T in accordance with section 3(a) of the Regulatory Flexibility Act.⁴³

A. Reasons for Proposed Action

We are proposing to extend rule 206(3)-3T’s sunset date for two years because we believe that it would not be appropriate to require firms relying on the rule to restructure their operations and client relationships before we complete our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

B. Objectives and Legal Basis

The objective of the proposed amendment to rule 206(3)-3T, as discussed above, is to permit firms currently relying on rule 206(3)-3T to limit the need to modify their operations and relationships on multiple occasions, both before and potentially after we complete any regulatory actions regarding the standards of conduct and other obligations applicable to broker-dealers and investment advisers.

We are proposing to amend rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 15 U.S.C. 80b-11(a)].

C. Small Entities Subject to the Rule

Rule 206(3)-3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) Are registered as broker-dealers under the

⁴³ 5 U.S.C. 603(a).

Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment adviser, including small entities. Under Advisers Act rule 0-7, for purposes of the Regulatory Flexibility Act an investment adviser generally is a small entity if it: (i) Has assets under management of less than \$25 million; (ii) did not have total assets of \$5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of \$25 million or more, or any person (other than a natural person) that had total assets of \$5 million or more on the last day of its most recent fiscal year.⁴⁴

We estimate that as of June 1, 2014, 464 SEC-registered investment advisers were small entities.⁴⁵ As discussed in the 2007 Principal Trade Rule Release, we opted not to make the relief provided by rule 206(3)-3T available to all investment advisers, and instead have restricted it to investment advisers that are registered as broker-dealers under the Exchange Act.⁴⁶ We therefore estimate for purposes of this IRFA that 12 of these small entities (those that are both investment advisers and registered broker-dealers) could rely on rule 206(3)-3T.⁴⁷

D. Reporting, Recordkeeping, and other Compliance Requirements

The provisions of rule 206(3)-3T impose certain reporting or recordkeeping requirements, and our proposal, if adopted, would extend the imposition of these requirements for an additional two years. We do not, however, expect that the proposed two-year extension of the rule's sunset date would alter these requirements.

⁴⁴ See 17 CFR 275.0-7.

⁴⁵ IARD data as of June 1, 2014.

⁴⁶ See 2007 Principal Trade Rule Release, Section VIII.B.

⁴⁷ IARD data as of June 1, 2014.

Rule 206(3)-3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts would be required to make certain disclosures to clients on a prospective, transaction-by-transaction and annual basis.

Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client a confirmation statement for each principal trade that discloses the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

Our proposed amendment, if adopted, only would extend the rule's sunset date for two years. Advisers currently relying on the rule already should be making the disclosures described above.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no rules that duplicate or conflict with rule 206(3)-3T, which presents an alternative means of compliance with the procedural requirements of section 206(3) of the Advisers Act that relate to principal transactions.

We note, however, that rule 10b-10 under the Exchange Act is a separate confirmation rule that requires broker-dealers to provide certain information to their customers regarding the transactions they effect, including whether the broker or dealer is acting as an agent or as a principal for its own account in a given transaction. Furthermore, FINRA rule 2232 requires broker-dealers that are members of FINRA to deliver a written notification in conformity with rule 10b-10 under the Exchange Act containing certain information. Rule G-15 of the Municipal Securities Rulemaking Board also contains a separate confirmation rule that governs transactions in municipal securities, and requires brokers, dealers and municipal securities dealers to disclose, among other things, the capacity in which the firm effected a transaction (*i.e.*, as an agent or principal). In addition, investment advisers that are qualified custodians for purposes of rule 206(4)-2 under the Advisers Act and that maintain custody of their advisory clients' assets must send quarterly account statements to their clients pursuant to rule 206(4)-2(a)(3) under the Advisers Act.

These rules overlap with certain elements of rule 206(3)-3T, but we designed the temporary rule to work efficiently together with existing rules by permitting firms to incorporate the required disclosure into one confirmation statement.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.⁴⁸ Alternatives in this category would include: (i) Establishing different compliance or reporting standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small

⁴⁸ See 5 U.S.C. 603(c).

entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

We believe that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities. Further consolidation or simplification of the proposals for investment advisers that are small entities would be inconsistent with the Commission's goals of fostering investor protection.

We have endeavored through rule 206(3)-3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from the Commission's approach to the rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered with us as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker-dealer is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor

protection objectives.⁴⁹ Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. Solicitation of Comments

We solicit written comments regarding our analysis. We request comment on whether the rule will have any effects that we have not discussed. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

Do small investment advisers believe an alternative means of compliance with section 206(3) should be available to them?

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"⁵⁰ we must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in: (1) An annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed amendment on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

⁴⁹ See 2007 Principal Trade Rule Release, Section II.B.7 (noting commenters that objected to this condition as disadvantaging small broker-dealers (or affiliated but separate investment advisers and broker-dealers)).

⁵⁰ Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

VIII. Statutory Authority

The Commission is proposing to amend rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 80b-11(a)].

List of Subjects in 17 CFR Part 275

Investment advisers, Reporting and recordkeeping requirements.

Text of Proposed Rule Amendment

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

§275.206(3)-3T [Amended]

2. In § 275.206(3)-3T, amend paragraph (d) by removing the words "December 31, 2014" and adding in their place "December 31, 2016."

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Dated: August 12, 2014

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72818 / August 12, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16010

In the Matter of

**Bering Growth Corp.,
Constellation Growth Corp.,
Emerging Acquisition Corp.,
Evolution Acquisition Corp.,
Formative Growth Corp., and
Global Growth Corp.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Bering Growth Corp., Constellation Growth Corp., Emerging Acquisition Corp., Evolution Acquisition Corp., Formative Growth Corp., and Global Growth Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Bering Growth Corp. (CIK No. 1381786) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bering Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$4,631 for the prior nine months.

24 of 82

2. Constellation Growth Corp. (CIK No. 1505368) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Constellation Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

3. Emerging Acquisition Corp. (CIK No. 1505363) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Emerging Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

4. Evolution Acquisition Corp. (CIK No. 1505362) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Evolution Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

5. Formative Growth Corp. (CIK No. 1505369) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Formative Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

6. Global Growth Corp. (CIK No. 1381804) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Global Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$4,631 for the previous nine months.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

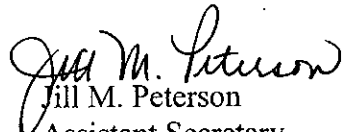
If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72819 / August 12, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16011

In the Matter of

**IPKV Holdings, Inc.,
Pan Asian Corp.,
Seven Seas Acquisition Corp.,
Southern Growth Corp.,
Superior Growth Corp., and
Transatlantic Acquisition Corp.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents IPKV Holdings, Inc., Pan Asian Corp., Seven Seas Acquisition Corp., Southern Growth Corp., Superior Growth Corp., and Transatlantic Acquisition Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. IPKV Holdings, Inc. (CIK No. 1368194) is a forfeited Delaware corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IPKV Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2012, which reported a net loss of \$6,057 for the prior six months.

25 of 82

2. Pan Asian Corp. (CIK No. 1381798) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pan Asian is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$4,631 for the prior nine months.

3. Seven Seas Acquisition Corp. (CIK No. 1381795) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Seven Seas Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$4,631 for the prior nine months.

4. Southern Growth Corp. (CIK No. 1505370) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Southern Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

5. Superior Growth Corp. (CIK No. 1505371) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Superior Growth is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012 which reported a net loss of \$3,047 for the prior twelve months.

6. Transatlantic Acquisition Corp. (CIK No. 1505361) is a Cayman Islands corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Transatlantic Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2012, which reported a net loss of \$3,047 for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

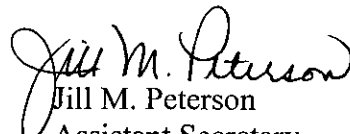
If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72827 / August 12, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31208 / August 12, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16012

In the Matter of

FRED GOLT,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934 AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

26 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

Summary

These proceedings arise out of the Respondent's actions as an unregistered broker. During the relevant period, Golt participated in the solicitation of investors by hiring, training and supervising sales people, and received transaction-based compensation related to the offer and sale of securities in the form of investment contracts offered by Mutual Entertainment, LLC. Golt's conduct violated Section 15(a) of the Exchange Act.

Respondent

1. Fred Golt was the sole owner and operator of Mutual Entertainment Ventures, Inc., which has never been registered with the Commission as a broker or dealer. Golt has never been registered with the Commission as a broker or dealer, and he has never been associated with a registered broker or dealer. Golt, age 51, is a resident of Pebble Beach, California.

Other Relevant Entities

2. Mutual Entertainment Ventures, Inc. ("MEV") was a California corporation formed on September 21, 2010 and headquartered in Aptos, California. It is now dissolved.

3. Mutual Entertainment, LLC ("Mutual Entertainment") was a California limited liability company formed on December 16, 2010 and headquartered in Beverly Hills, California. Mutual Entertainment, LLC merged with Film Shoot, LLC in March 2012 and ceased operations shortly thereafter.

Background

4. From April 2011 through February 2012 (the "Relevant Period"), Mutual Entertainment issued securities in the form of investment contracts used to finance the production of a feature-length motion picture to be titled "Marcel" after a short story by the same name.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. In April 2011, Mutual Entertainment commenced to offer and sell up to \$7.5 million of its securities to the public.

6. Mutual Entertainment's fundraising efforts were undertaken by MEV, which Golt owned and operated.

7. As the owner of MEV, Golt hired, trained, and supervised salespeople known as "fronters" and assisted in drafting a sales script that the fronters used. The fronters' job was to make initial contact with prospective investors from lead lists that Respondent and others purchased from lead list brokers. Contact information of potential investors who were interested in purchasing Mutual Entertainment's securities was passed along by the fronters to other salespeople known as "closers." The closers were hired and supervised by other individuals working from a different sales office.

8. Golt, through MEV, received transaction-based compensation totaling \$337,825 from Mutual Entertainment in connection with the offer and sale of Mutual Entertainment securities.

9. Golt, through MEV, used the transaction-based compensation he received to pay the fronters (on an hourly basis) and several closers (on a fixed percentage basis).

10. Although he could have realized substantial personal gain if MEV's operations had been more profitable after payments to sales people and office expenses, Golt's personal financial benefit from his and MEV's sales of Mutual Entertainment securities was negligible.

11. At no time during the Relevant Period was either Golt or MEV registered as or associated with a broker or dealer registered with the Commission.

12. As a result of the conduct described above, Golt willfully violated Section 15(a) of the Exchange Act, which, unless an exception or exemption applies, makes it unlawful for any broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless such broker or dealer is registered as a broker or dealer or, if a natural person, associated with a registered broker or dealer other than a natural person.

IV.

In view of the foregoing, the Commission deems it appropriate, to impose the sanctions agreed to in Respondent Golt's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Golt shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Golt be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay a civil money penalty of \$25,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: Respondent Golt shall, within 30 days of the entry of this Order, pay \$7,500. The remaining balance of \$17,500 shall be paid in three (3) equal installments of \$5,833.33. Each installment shall be due within ten (10) days after the end of the quarter for the three (3) quarters following the entry of the Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Fred Golt as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine Echavarria, Associate Regional Director, Securities and Exchange Commission, 5670 Wilshire Boulevard, Suite 1100, Los Angeles, California 90036.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.


Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72820; File No. SR-OPRA-2013-03)

August 12, 2014

Options Price Reporting Authority; Notice of Filing of Proposed Amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information to Amend Sections 5.4 and 7.1 of the OPRA Plan

Pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")¹ and Rule 608 thereunder,² notice is hereby given that on October 21, 2013, the Options Price Reporting Authority, LLC ("OPRA") submitted to the Securities and Exchange Commission ("Commission") an amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("OPRA Plan").³ The proposed amendment would modify Sections 5.4 and 7.1 of the OPRA Plan as they pertain to operations of OPRA outside of its regular hours of operations. The Commission is publishing this notice to solicit comments from interested persons on the proposed OPRA Plan amendment.

I. Description and Purpose of the Plan Amendment

The purpose of the proposed amendment is to amend the OPRA Plan so that it provides for the aggregation of costs for operations of OPRA outside of its regular hours of operations

¹ 15 U.S.C. 78k-1.

² 17 CFR 242.608.

³ The OPRA Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Act and Rule 608 thereunder (formerly Rule 11Aa3-2). See Securities Exchange Act Release No. 17638 (March 18, 1981), 22 S.E.C. Docket 484 (March 31, 1981). The full text of the OPRA Plan is available at <http://www.opradata.com>. The OPRA Plan provides for the collection and dissemination of last sale and quotation information on options that are traded on the participant exchanges. The twelve participants to the OPRA Plan are BATS Exchange, Inc., BOX Options Exchange, LLC, Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, International Securities Exchange, LLC, Miami International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, NASDAQ Stock Market LLC, NYSE MKT LLC, NYSE Arca, Inc., and the Topaz Exchange, LLC (d/b/a ISE Gemini).

("after-hours operations") with costs for operations of OPRA during its regular hours of operations ("regular-hours operations") and states expressly that OPRA may establish separate fees for access to OPRA data during periods of after-hours operations.

One of OPRA's member exchanges has indicated that it is planning to initiate after-hours trading and to request OPRA to operate during the after-hours period when its market is open for trading.⁴ No exchange has previously made such a request, and as a result OPRA currently does not operate outside of its regular hours of operations.

Currently, the OPRA Plan provides that the costs of OPRA's after-hour operations are to be allocated separately from the costs of OPRA's regular-hour operations and in a somewhat different manner. In essence, the Plan currently provides that the costs of OPRA's regular-hour operations below a specified ceiling⁵ and OPRA's revenues from regular-hour operations are both to be allocated among the OPRA member exchanges on the basis of the relative number of compared trades in options contracts traded on each of the OPRA member exchanges.⁶

⁴ The OPRA Plan provides that the OPRA System will operate outside of its regular hours of operation at the request of any one or more of its member exchanges. See Section 5.3 of the OPRA Plan (available on the OPRA website, www.opradata.com, under the "OPRA Plan" tab). OPRA is not proposing to amend Section 5.3 of the OPRA Plan.

⁵ Clause 7.1(a)(iii)(2) of the Plan provides that costs above a "specified ceiling" are to be allocated in accordance with OPRA's Capacity Guidelines. (OPRA's Capacity Guidelines are available on the OPRA website, also under the "OPRA Plan" tab.) The "ceiling" is described in Guideline 7 of the Capacity Guidelines. OPRA is not proposing any change in the allocation of costs that is described in the Capacity Guidelines.

⁶ Section 7.1 of the Plan provides for three "accounting centers": the foreign currency option or "FCO" accounting center, the index option accounting center and the "basic" accounting center – the accounting center for all options other than foreign currency and index options. Section 7.1 describes the allocation of revenues and expenses associated with OPRA's regular-hour operations first among these three accounting centers and then within each of these accounting centers. OPRA does not currently incur costs specifically attributable to either the FCO accounting center or the index option accounting center, and does not allocate revenues to either of these accounting centers. Both the allocation of costs among the accounting centers and the allocation of costs within each accounting center are therefore on the basis of the relative number of compared trades in options

The current provisions of the Plan state that, if the OPRA System operates outside of OPRA's regular hours, any costs attributable to such operation will be allocated to the exchange or exchanges that are actually operating during the after-hours period. The Plan does not make any special provision for the allocation of revenues resulting from fees for access to OPRA data generated in the course of after-hours operations, and the Plan therefore provides that these revenues will be allocated among the OPRA member exchanges in the same way that revenues derived from regular-hours operations are allocated. The result is that the Plan currently provides for the allocation of costs of after-hours trading only to the exchange or exchanges that are actually operating during the after-hours period, but for the allocation of revenues resulting from fees for access to quotation and last sale information generated in the course of after-hours operations to all of the OPRA member exchanges on the basis of the relative number of compared trades in options contracts traded on each of the OPRA member exchanges in trading during both regular hours and outside of regular hours.

OPRA is therefore proposing to revise the Plan to provide that the costs of after-hours operations will be aggregated with the costs of operating the OPRA System during regular hours of operation. The consequence of the revision would be that the aggregated costs of operating the System during all hours of operation would be allocated among all of OPRA's member exchanges, regardless of whether any particular exchange operates its market outside of regular hours. OPRA believes that this amendment will better align the provisions of the Plan relating to the allocation of costs of after-hours operations with the provisions of the Plan relating to the allocation of revenues derived from after-hours trading.

contracts traded on each of the OPRA member exchanges. See, e.g., Section 7.1(a)(iii)(B) of the Plan.

OPRA's Fee Schedule does not currently provide for fees specifically for access to OPRA data during periods of after-hours operations. OPRA believes that, in order to fairly allocate the burden of funding OPRA's after-hours operations to those persons who choose to have access to OPRA information during periods of after-hours operations, it will be appropriate to establish such fees rather than increase its current fees, and OPRA is proposing to add a sentence in Section 5.4(d) to state expressly that it may establish such fees.⁷ However, OPRA is not proposing in this filing to amend its Fee Schedule to establish fees for access to data generated in after-hours trading.

The text of the proposed amendment to the OPRA Plan is available at OPRA, the Commission's Public Reference Room, <http://opradata.com>, and on the Commission's website at www.sec.gov.

II. Implementation of the OPRA Plan Amendment

OPRA will implement the proposed amendment to the OPRA Plan after this filing has been approved by the Commission in accordance with paragraph (b)(1) of Rule 608 of Regulation NMS under the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed OPRA Plan amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

⁷ OPRA is also proposing in this filing to make a non-substantive change to Section 5.4(d) to reflect that the OPRA Fee Schedule is no longer identified as "Exhibit B" to the OPRA Plan but is publicly available on the OPRA website under the "Fees" tab.

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-OPRA-2013-03 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OPRA-2013-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plan amendment that are filed with the Commission, and all written communications relating to the proposed plan amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OPRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-OPRA-2013-03 and should be submitted on or before [insert 21 days from date of publication in the Federal Register].

By the Commission

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72824; File No. SR-OPRA-2014-03)

August 12, 2014

Options Price Reporting Authority; Notice of Filing of Proposed Amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information to Amend OPRA's Definition of the Term "Nonprofessional"

Pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")¹ and Rule 608 thereunder,² notice is hereby given that on March 11, 2014, the Options Price Reporting Authority ("OPRA") submitted to the Securities and Exchange Commission ("Commission") an amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("OPRA Plan").³ The proposed amendment revises definition of the term "Nonprofessional." The Commission is publishing this notice to solicit comments from interested persons on the proposed OPRA Plan amendment.

I. Description and Purpose of the Plan Amendment

The purpose of the proposed amendment is to revise OPRA's definition of the term "Nonprofessional."

¹ 15 U.S.C. 78k-1.

² 17 CFR 242.608.

³ The OPRA Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Act and Rule 608 thereunder (formerly Rule 11Aa3-2). See Securities Exchange Act Release No. 17638 (March 18, 1981), 22 S.E.C. Docket 484 (March 31, 1981). The full text of the OPRA Plan is available at <http://www.opradata.com>. The OPRA Plan provides for the collection and dissemination of last sale and quotation information on options that are traded on the participant exchanges. The twelve participants to the OPRA Plan are BATS Exchange, Inc., BOX Options Exchange, LLC, Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, International Securities Exchange, LLC, Miami International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, NASDAQ Stock Market LLC, NYSE MKT LLC, NYSE Arca, Inc., and the Topaz Exchange, LLC (d/b/a ISE Gemini).

28 of 82

A person may become an OPRA "Subscriber" in one of two ways.⁴ The first way is that the person may sign a "Professional Subscriber Agreement" directly with OPRA. In this case, the person pays fees directly to OPRA on the basis of the number of the person's "devices" and/or "UserIDs."

The second way is that the person may enter into a "Subscriber Agreement," not directly with OPRA, but with an OPRA "Vendor" – an entity that has entered into a "Vendor Agreement" with OPRA authorizing the entity to redistribute OPRA Data to third persons. In this case, OPRA collects fees from the Vendor with respect to the receipt of the OPRA Data by the person entering into the Subscriber Agreement. If the person qualifies as a "Nonprofessional Subscriber," OPRA caps the fee that it charges the Vendor, and the fees that the person is required to pay to the Vendor may be less than they would be if the person is classified as a "Professional Subscriber."⁵

OPRA's definition of the term "Nonprofessional" is set out in an "Addendum for Nonprofessionals" that is attached to its Electronic Form of Subscriber Agreement and its Hardcopy Form of Subscriber Agreement. These two forms, in turn, are Attachments B-1 and B-2 to OPRA's form of Vendor Agreement.⁶

⁴ OPRA defines a "Subscriber," in general, as an entity or person that receives OPRA Data for the person's own use.

⁵ OPRA's Fee Schedule provides that a Vendor may determine the fee that it pays with respect to its distribution of current OPRA data to a Nonprofessional Subscriber in one of two ways: either the Vendor may pay OPRA's flat monthly Nonprofessional Subscriber's Fee (currently \$1.25/month), or the Vendor may count the Nonprofessional Subscriber's queries for OPRA data and pay Usage-based Vendor Fees based on the actual usage of OPRA data by the Nonprofessional Subscriber, subject to a cap that OPRA has always set at the amount of the flat Nonprofessional Subscriber Fee.

⁶ These forms are posted on OPRA's website, www.opradata.com. OPRA most recently amended its Electronic Form of Subscriber Agreement and its Hardcopy Form of Subscriber Agreement in File No. SR-OPRA-2012-03; Release No. 34-67589 (August 2012).

Paragraph (c) of OPRA's current definition of the term "Nonprofessional" specifies that to qualify as a "Nonprofessional" a person must not be: "(i) registered or qualified with the Securities and Exchange Commission, the Commodities Futures Trading Commission, any state securities agency, any securities exchange/association, or any commodities/futures contract market/association, (ii) engaged as an "investment adviser," as that term is defined in the Investment Advisers Act of 1940 (whether or not registered or qualified under that Act); or (iii) employed by a bank or other organization exempt from registration under Federal and/or state securities laws to perform functions that would require you to be so registered or qualified if you were to perform such functions for an organization not so exempt." A narrow literal reading of this language could lead to the conclusion that a person who works outside of the United States as (for example) a securities broker could qualify as a "Nonprofessional," because the person is not literally described by clauses (i), (ii) or (iii) of Paragraph (c).

OPRA is not aware of any instances in which an OPRA Vendor has determined that Subscribers who work outside the United States qualify to be Nonprofessional Subscribers on the basis of reading the definition of the term "Nonprofessional" in this manner.⁷ However, OPRA believes that it is appropriate to modify the language to prevent this reading. OPRA proposes to accomplish this, essentially, by adding a phrase at the beginning of Paragraph (c) to say that the current language is applicable to persons who work in the United States and adding a sentence to Paragraph (c) to say that "For a natural person who works outside of the United States, a 'Professional' is a natural person who performs the same functions as someone who would be considered a 'Professional' in the United States." OPRA believes that the changes that it is

⁷ OPRA is aware that the definition of the term "Nonprofessional Subscriber" used by the Consolidated Tape Association ("CTA"), which is substantively identical to OPRA's definition in almost all respects, prevents a similar literal reading of its definition.

proposing in its definition of the term "Nonprofessional" will add clarity to the definition and make clear that it is intended to generate equivalent results both inside and outside the United States.

The text of the proposed amendment to the OPRA Plan is available at OPRA, the Commission's Public Reference Room, <http://opradata.com>, and on the Commission's website at www.sec.gov.

II. Implementation of the OPRA Plan Amendment

OPRA is proposing to post revised versions of its Electronic Form of Subscriber Agreement and its Hardcopy Form of Subscriber Agreement on its website, and to require Vendors to use the revised versions on a going-forward basis, as soon as this filing has been approved by the Commission in accordance with paragraph (b)(1) of Rule 608 of Regulation NMS under the Securities Exchange Act of 1934. If OPRA becomes aware that a Vendor has been misclassifying Subscribers who work outside the United States as Nonprofessional Subscribers on the basis of a literal reading of the current language of the Addendum for Nonprofessionals, OPRA will bring the matter to the attention of the Vendor and require the Vendor to use the revised Subscriber Agreements and to reclassify the affected Subscribers.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed OPRA Plan amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-OPRA-2014-03 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OPRA-2014-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plan amendment that are filed with the Commission, and all written communications relating to the proposed plan amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OPRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-OPRA-2014-03 and should be submitted on or before [insert 21 days from date of publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72825; File No. SR-OPRA-2014-04)

August 12, 2014

Options Price Reporting Authority; Notice of Filing and Immediate Effectiveness of Proposed Amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information to Amend OPRA's Fee Schedule to Establish Fees for After-Hours Operations

Pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")¹ and Rule 608 thereunder,² notice is hereby given that on April 3, 2014, the Options Price Reporting Authority ("OPRA") submitted to the Securities and Exchange Commission ("Commission") an amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("OPRA Plan").³ The proposed amendment establishes a category of fees for access to OPRA data during periods of after-hours operations. The Commission is publishing this notice to solicit comments from interested persons on the proposed OPRA Plan amendment.

I. Description and Purpose of the Plan Amendment

The purpose of the proposed amendment is to amend the OPRA Fee Schedule to include fees for access to data that OPRA disseminates as a result of trading on the markets of one or more OPRA member exchanges during hours outside of OPRA's regular hours of operations

¹ 15 U.S.C. 78k-1.

² 17 CFR 242.608.

³ The OPRA Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Act and Rule 608 thereunder (formerly Rule 11Aa3-2). See Securities Exchange Act Release No. 17638 (March 18, 1981), 22 S.E.C. Docket 484 (March 31, 1981). The full text of the OPRA Plan is available at <http://www.opradata.com>. The OPRA Plan provides for the collection and dissemination of last sale and quotation information on options that are traded on the participant exchanges. The twelve participants to the OPRA Plan are BATS Exchange, Inc., BOX Options Exchange, LLC, Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, International Securities Exchange, LLC, Miami International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, NASDAQ Stock Market LLC, NYSE MKT LLC, NYSE Arca, Inc., and the Topaz Exchange, LLC (d/b/a ISE Gemini).

("after-hours" operations). One of OPRA's member exchanges has indicated that it is planning to initiate trading during hours outside of OPRA's regular hours of operations and to request OPRA to operate during the after-hours period when its market is open for trading. No exchange has previously made such a request, and as a result OPRA currently does not operate outside of its regular hours of operations.

OPRA's Fee Schedule does not currently provide for fees specifically for access to OPRA data during periods of after-hours operations. OPRA believes that, in order to fairly allocate the burden of funding OPRA's after-hours operations to those persons who choose to have access to OPRA information during periods of after-hours operations, it is appropriate, rather than to increase its current fees, to establish fees specifically for receipt of OPRA information disseminated during after-hours operations.

The after-hours service fees that OPRA is proposing are shown in Exhibit I. In general, with the exception of the Usage-based Vendor Fee and the Voice-Synthesized Market Data Service Fee -- which are described below -- the proposed after-hours service fees are established at approximately twenty percent of their counterparts for regular hours. For example, the after-hours Professional Subscriber Device-Based Fee is proposed to be \$5.00 per device, compared to \$27.00 per device for the regular hours Professional Subscriber Device-Based Fee, and the after-hours Nonprofessional Subscriber Fee is proposed to be \$0.25 per nonprofessional, compared to \$1.25 per nonprofessional for the regular hours Nonprofessional Subscriber Fee.

The proposed after-hours Usage-based Vendor Fees are the same as the Usage-based Vendor Fees during regular hours. The Usage-based Vendor Fees are on a "per quote" basis for either "quote packets" or "options chains," and a quote packet or options chain disseminated during after-hours operations would include the same amount of information as one disseminated

during regular hours. Footnote 8 to the Fee Schedule is amended to apply the same "cap" concept to after-hours Usage-based Vendor Fees that currently applies during regular hours, so that these fees are capped at \$5.00 per device for Professional Subscribers and at \$.25 for nonprofessional subscribers. Footnote 5 to the Fee Schedule is revised to state an "Enterprise Rate Nonprofessional Subscriber Fee" for after-hours service of \$75,000 per month.

The Voice-Synthesized Market Data Service Fee for after-hours service is proposed at the same rate as the Usage-based Vendor Fee, as is the case for regular hours service.

OPRA is not proposing an "Enterprise Fee" alternative at this time for the after-hours Non-Display Application Fee. OPRA believes that Professional Subscribers are unlikely to be interested in an Enterprise Rate alternative for the after-hours Non-Display Application Fee. However, OPRA is prepared to implement an Enterprise Fee alternative for this fee if it becomes apparent that there is any interest in it.

Footnote 12 to the OPRA Fee Schedule provides an example to illustrate the statement in the "Description" of the Non-Display Application Fee that the fee "includes device-based fees with respect to the servers or other devices that comprise the trading engine, up to the amount" of the Non-Display Application Fee. OPRA is proposing to revise the example so that it utilizes the 2014 regular hours Professional Subscriber Device-based Fee of \$27.00 (instead of the now-obsolete 2012 Professional Subscriber Device-based Fee of \$25.00), and provides a parallel example for the after-hours fee using the after-hours "per installation" fee and the proposed after-hours Professional Subscriber Device-based Fee of \$5.00.

OPRA is not establishing an after-hours Control Service Fee or a Television Fee at this time. OPRA does not currently have any authorized control service providers, and believes that the control service provider program is not likely to be of interest during after-hours operations.

Similarly, OPRA does not anticipate that any Vendor is likely to be interested in providing television display of after-hours OPRA information. In each case, however, OPRA is prepared to make the service available if it becomes apparent that there is any interest in it.

Similarly, OPRA believes that Vendors are unlikely to be interested in an after-hours Enterprise Fee for the Hosted Solution Fee. However, OPRA is prepared to implement an Enterprise Fee alternative for this fee if it becomes apparent that there is any interest in it.

It is not possible to estimate with any precision the revenues that these fees may generate. OPRA's best guess is that these fees may generate up to \$100,000 in gross revenues per month a few months after they are first implemented. OPRA and the participant exchanges will incur additional costs associated with OPRA's after-hours operations, and OPRA believes that these fees will represent an appropriate contribution to covering the overall costs of OPRA and its member exchanges to which these fees may properly be applied.

The text of the proposed amendment to the OPRA Plan is available at OPRA, the Commission's Public Reference Room, <http://opradata.com>, and on the Commission's website at www.sec.gov.

II. Implementation of the OPRA Plan Amendment

Pursuant to paragraph (b)(3)(i) of Rule 608 of Regulation NMS under the Act, OPRA designated this amendment as establishing or changing fees or other charges collected on behalf of all of the OPRA participants in connection with access to or use of OPRA facilities. In order to give persons subject to these fees advance notice of the changes, OPRA proposes to provide notice of the changes to OPRA Vendors at least two months before the date on which one or more of OPRA's member exchanges plans to initiate trading during hours outside of OPRA's regular hours of operation, and to put the changes into effect as of the first day of a calendar

month after one or more of OPRA's member exchanges has initiated trading during hours outside of OPRA's regular hours of operation, but no sooner than July 1, 2014.

The Commission may summarily abrogate the amendment within sixty days of its filing and require refiling and approval of the amendment by Commission order pursuant to Rule 608(b)(2) under the Act⁴ if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed OPRA Plan amendment is consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-OPRA-2014-04 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OPRA-2014-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

⁴ 17 CFR 242.608(b)(2).

comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plan amendment that are filed with the Commission, and all written communications relating to the proposed plan amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OPRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OPRA-2014-04 and should be submitted on or before [insert 21 days from date of publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72826; File No. SR-OPRA-2014-06)

August 12, 2014

Options Price Reporting Authority; Notice of Filing and Immediate Effectiveness of Proposed Amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information to Amend OPRA's Fee Schedule

Pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")¹ and Rule 608 thereunder,² notice is hereby given that on July 2, 2014, the Options Price Reporting Authority ("OPRA") submitted to the Securities and Exchange Commission ("Commission") an amendment to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("OPRA Plan").³ The amendment proposes to eliminate a category of fees for access to OPRA data during periods of after-hours operations and amend certain fees for calendar year 2015. The Commission is publishing this notice to solicit comments from interested persons on the proposed OPRA Plan amendment.

I. Description and Purpose of the Plan Amendment

The purpose of the proposed amendment is to amend the OPRA Fee Schedule in two respects: first, to eliminate fees specifically for access to data that OPRA disseminates as a result

¹ 15 U.S.C. 78k-1.

² 17 CFR 242.608.

³ The OPRA Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Act and Rule 608 thereunder (formerly Rule 11Aa3-2). See Securities Exchange Act Release No. 17638 (March 18, 1981), 22 S.E.C. Docket 484 (March 31, 1981). The full text of the OPRA Plan is available at <http://www.opradata.com>. The OPRA Plan provides for the collection and dissemination of last sale and quotation information on options that are traded on the participant exchanges. The twelve participants to the OPRA Plan are BATS Exchange, Inc., BOX Options Exchange, LLC, Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, International Securities Exchange, LLC, Miami International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, NASDAQ Stock Market LLC, NYSE MKT LLC, NYSE Arca, Inc., and the Topaz Exchange, LLC (d/b/a ISE Gemini).

of trading on the markets of one or more OPRA member exchanges during hours outside of OPRA's regular hours of operations (these hours are sometimes referred to in this filing as "after-hours"); and, second, to establish OPRA's Professional Subscriber Device-Based Fee for calendar year 2015 and make conforming changes in OPRA's Enterprise Rate Professional Subscriber Fee.

As described in a recent filing – File No. OPRA-2014-04 – one of OPRA's member exchanges has indicated that it is planning to initiate trading during hours outside of OPRA's regular hours of operations and to request OPRA to operate during the after-hours period when its market is open for trading. No exchange has previously made such a request, and as a result OPRA currently does not operate outside of its regular hours of operations.

OPRA proposed in File No. OPRA-2014-04 to establish fees specifically for receipt of OPRA information disseminated during after-hours operations. The fees established in that filing were based on the premise that OPRA Vendors and Professional Subscribers receiving only regular-hours OPRA data would continue to pay fees only for that data, that OPRA Vendors and Professional Subscribers receiving only after-hours OPRA data would pay fees only for that data, and that OPRA Vendors and Professional Subscribers receiving both regular-hours OPRA data and after-hours OPRA data would pay fees for both data streams. In particular, File No. OPRA-2014-04 provided for an after-hours Professional Subscriber Device-Based Fee of \$5.00 per month, with that fee applicable only to devices⁴ that are entitled for after-hours data.

Several OPRA Vendors and Professional Subscribers have subsequently advised OPRA that it is impractical for them to administer separate entitlements and fees for regular-hours

⁴ OPRA permits the counting of "User IDs" as a surrogate for counting "devices" for purposes of the Professional Subscriber Device-based Fees. See footnote 2 in the OPRA Fee Schedule and OPRA's "Policies with respect to Device-based Fees," which are available on the OPRA website under the "Policies" tab.

OPRA data and after-hours OPRA data, and that if the Fee Schedule proposed in File No. OPRA-2014-04 were to be implemented they would need to apply the fees for both data streams to all of their data distribution activities. This would mean that the after-hours Professional Subscriber Device-Based Fee would in effect be a \$5.00 per month increase for all devices, and that the other fees established in File No. OPRA-2014-04 for after-hours OPRA data would also be applicable to all OPRA data recipients.

OPRA is therefore revising its Fee Schedule to eliminate the fees specifically for access to after-hours OPRA data, and is also revising its Professional Subscriber Device-Based Fee to specify that the fee during year 2015 will be \$28.50 per month, an increase of \$1.50 from the fee during 2014. For the years 2008-2014, OPRA has implemented incremental \$1.00 per month increases in its Professional Subscriber Device-Based Fee.⁵ In effect, for 2015 OPRA is implementing the same \$1.00 per month increase that it has implemented in past years plus an additional \$0.50 per month as a result of dissemination of the after-hours data. OPRA is also proposing to make conforming changes in its Enterprise Rate for 2015 so that it continues in 2015 to be the monthly Professional Subscriber Device-Based Fee times the number of a Professional Subscriber's U.S.-based registered representatives, subject to a minimum rate that is also determined by reference to the monthly Professional Subscriber Device-Based Fee.

The proposed increases in the Professional Subscriber Device-Based Fee and in the Enterprise Rate are intended to generate revenues for OPRA and its member exchanges that are

⁵ OPRA's practice in the recent past has been to establish the Professional Subscriber Device-Based Fee for several years at a time. Most recently, OPRA established the Professional Subscriber Device-Based Fee at \$24.00 per month for the year 2011, \$25.00 per month for the year 2012, \$26.00 per month for the year 2013 and \$27.00 per month for the year 2014. See File No. OPRA-2010-03, Release No. 34-63273 (November 8, 2010). In this filing, OPRA is establishing the Professional Subscriber Device-Based Fee only for the year 2015, since the introduction of after-hours trading makes the forecasting of future OPRA revenues particularly uncertain at this time.

needed to cover actual and anticipated increases in the costs of collecting, consolidating, processing and disseminating options market information and assuring the reliability and integrity of that information, as well as increases in OPRA's administrative costs. These costs include the enhancements to the OPRA system and related exchange systems that are needed in order to enable OPRA and its participant exchanges to handle the continually increasing volume of market information as a result of the continuing expansion of listed options trading, to accommodate the dissemination of after-hours data and to provide a greater degree of redundancy and security in the OPRA system. Assuming that the number of fee-liable devices and registered persons remains the same,⁶ the effect of the increases in these fees would be to increase revenues derived from these fees by approximately 5.6% in the year 2015.

The text of the proposed amendment to the OPRA Plan is available at OPRA, the Commission's Public Reference Room, <http://opradata.com>, and on the Commission's website at www.sec.gov.

II. Implementation of the OPRA Plan Amendment

Pursuant to paragraph (b)(3)(i) of Rule 608 of Regulation NMS under the Act, OPRA designated this amendment as establishing or changing fees or other charges collected on behalf of all of the OPRA participant exchanges in connection with access to or use of OPRA facilities. OPRA proposes to put the elimination of the fees specifically for access to after-hours OPRA data into effect immediately,⁷ and proposes to put the change in the Professional Subscriber

⁶ This assumption may be too optimistic, unless the introduction of after-hours trading results in the dissemination of OPRA data to additional devices and registered persons. Over the past ten years, the number of devices with access to OPRA data has decreased by approximately 32%.

⁷ OPRA stated in File No. OPRA-2014-04 that it would put the revised Fee Schedule into effect as of the first day of a calendar month after one or more of OPRA's member exchanges had initiated after-hours trading. Since no OPRA member exchange is

Device-Based Fee into effect as of January 1, 2015. Implementation of the change in this fee on January 1 is consistent with OPRA's prior practice with respect to changes in its Professional Subscriber Device-Based Fee, and will provide ample opportunity to give persons subject to these fees advance notice of the change.

The Commission may summarily abrogate the amendment within sixty days of its filing and require refiling and approval of the amendment by Commission order pursuant to Rule 608(b)(2) under the Act⁸ if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed OPRA Plan amendment is consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-OPRA-2014-06 on the subject line.

Paper Comments:

planning to provide after-hours trading before October 2014, OPRA has not charged, and will not be charging, fees on the basis of the revised Fee Schedule described in File No. OPRA-2014-04.

⁸ 17 CFR 242.608(b)(2).

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OPRA-2014-06. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plan amendment that are filed with the Commission, and all written communications relating to the proposed plan amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OPRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should

submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OPRA-2014-06 and should be submitted on or before [insert 21 days from date of publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 9630 / August 13, 2014

SECURITIES EXCHANGE ACT OF 1934

Release No. 72836 / August 13, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3895 / August 13, 2014

INVESTMENT COMPANY ACT OF 1940

Release No. 31210 / August 13, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16014

In the Matter of

**KEITH MACDONALD
SUMMERS**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTION 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, SECTIONS 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Keith MacDonald Summers ("Summers" or "Respondent").

31 of 82

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

SUMMARY

1. Respondent Keith M. Summers, a fund manager, who resides in Canada, breached his fiduciary duty and defrauded Tricoastal Capital Partners, LLC ("TCP Fund"), his advisory fund client, and its investors between July 2009 and July 2013. Summers raised \$4,690,000 for TCP Fund, a Delaware LLC, primarily from U.S. investors during the relevant period. As the managing member of TCP Fund, Summers presented himself as a successful fund manager with a model driven investment strategy involving exchange traded funds or ETFs. However, Summers solicited investors by lying to them about TCP Fund's assets under management or AUM, the intended use of its assets and its historic performance. Summers also defrauded TCP investors by concealing trading losses from them. Moreover, Summers fraudulently withdrew and misappropriated \$918,885 of investor funds from TCP Fund to pay for personal living expenses and unreimbursed business expenses throughout the relevant period. In July 2013, Summers reported his misconduct to Canadian authorities. On June 4, 2014, Summers pleaded guilty to criminal fraud charges in a parallel Canadian criminal proceeding in R v. Summers, Information No. 12000143, before the Ontario Court of Justice (Toronto Region). By virtue of the conduct described in this Order, Summers willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder.

RESPONDENT

2. Keith M. Summers, age 49, is a Canadian citizen who resides in Burlington, Ontario, Canada. Summers was the managing member of TCP Fund, an unregistered investment fund, and the sole principal and director of Tricoastal Capital Management Ltd., an unregistered investment advisory firm. Summers directed TCP Fund and managed its investments at all times since its inception. Summers maintained a nominal office presence in Buffalo, New York, but operated TCP Fund from his home office at the time in Burlington, Ontario.

OTHER RELEVANT ENTITIES

3. Tricoastal Capital Partners, LLC, a Delaware limited liability company, is an investment fund excluded from the definition of "investment company" under Section 3(c)(1) of the Investment Company Act. Summers formed TCP Fund in 2004. As its sole officer and director, Summers managed and controlled TCP Fund at all times.

4. Tricoastal Capital Management Ltd. ("TCM"), a Canadian corporation organized under the laws of the province of Ontario, Canada, is an unregistered investment advisory firm. Summers formed TCM in 2007. Summers managed and controlled TCM at all times as its sole principal and director, and its controlling shareholder. TCM has ceased its operations.

FACTS

5. Between July 2009 and April 2012, Summers raised \$4,690,000 for TCP Fund primarily from eight U.S. investors. Summers presented himself to investors as a successful fund manager who used a quantitative model-driven investment strategy involving exchange traded funds ("ETFs") to generate consistent long-term returns. Summers used a model to select a basket of index ETFs in which he invested TCP Fund every month. At the beginning of every month, Summers would invest TCP Fund equally among the ETFs and hold the ETFs until the end of the month at which time he would sell them. Summers then repeated the process the following month by investing in a different basket of ETFs.

6. During the relevant period, Summers intentionally and knowingly solicited potential investors by means of material misrepresentations and omissions. From the very outset, Summers misrepresented, orally and in certain written communications, the size of TCP Fund or its assets under management or AUM to attract investors. In July 2009, Summers told potential investors that he had \$2 million in AUM when in fact he had no assets under management. By November 2009, Summers had raised approximately \$1 million from investors based on those misrepresentations. From 2010 to 2012, Summers continued to overstate TCP Fund's AUM, typically misrepresenting to prospective investors that he managed \$10 million to \$15 million when in fact he had far fewer assets under management at the time.

7. Summers also misrepresented to potential investors the historic performance of TCP Fund in certain marketing materials and then concealed trading losses from them after they invested in TCP Fund. From July 2009 to August 2011, Summers sometimes "smoothed" TCP Fund's reported monthly performance by over-reporting or under-reporting returns to investors. Summers marketed TCP Fund to potential investors based on these smoothed returns instead of the fund's actual returns. While his ETF trading strategy performed relatively well in 2009 and 2010, Summers started to experience significant trading losses in 2011. By August 2011, Summers began to underreport significant losses in certain months to investors on their monthly account statements.

8. In May 2012, Summers experienced at least a 10.46% loss. By then, Summers had lost faith in his ETF trading strategy and abandoned it for a far riskier strategy involving

derivatives, including futures and options on market volatility indices, in an attempt to recover previous losses.

9. TCP Fund suffered over \$1,202,000 in additional trading losses as a result of Summers' riskier investment strategy. Beginning in July 2012, Summers began to conceal his trading losses by preparing and delivering false monthly account statements that reported positive returns in almost every month to investors based on what the performance of TCP Fund would have been if he had maintained the original ETF strategy.

10. In March 2013, the largest fund investor asked Summers for a copy of TCP Fund's audited financial statements. In April 2013, Summers prepared and delivered to the investor forged audited financial statements from a fake audit firm for fiscal year 2012 for TCP Fund which reflected an inflated AUM and false returns for the fund.

11. Meanwhile, from July 2009 until July 2013, Summers also intentionally and knowingly made unauthorized withdrawals and misappropriated \$918,885 from TCP Fund. During the period, unbeknownst to investors, Summers withdrew money from the fund in excess of the management fees and reimbursements to which he was entitled under the terms of the Offering Memorandum or Operating Agreement for TCP Fund. Summers used the money to pay for personal living expenses and unreimbursed business expenses.

12. On July 12, 2013, Summers reported his misconduct to the Ontario Securities Commission when he realized the largest fund investor was on the verge of discovering that he had forged TCP Fund's purported audited financial statements. At the time, there remained approximately \$1,396,000 in assets in the brokerage account that Summers maintained on behalf of TCP Fund at a financial institution in New York, New York. Summers raised \$4,117,685.15 from TCP Fund investors after taking into account approximately \$572,000 in redemptions during the relevant period.

13. On June 4, 2014, Summers pleaded guilty to criminal fraud charges in R. v. Summers, Information No. 12000143, a parallel criminal proceeding before the Ontario Court of Justice (Toronto Region), based upon the misconduct described above.

VIOLATIONS

14. As a result of the conduct described above, Summers willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

15. As a result of the conduct described above, Respondents willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent and deceptive conduct by an investment adviser with respect to any client or prospective client, and Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit making an untrue statement of a material fact or omitting to state any material fact to any investor or prospective

investor in a pooled investment vehicle and engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

IV.

In view of the foregoing, the Commission deems it appropriate in the public interest to impose the sanctions agreed to in Respondent Summers' Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Summers cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder;

B. Respondent Summers be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

C. Any reapplication for association by the Respondent Summers will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent Summers shall pay disgorgement of \$4,117,658.15 to the Securities and Exchange Commission. This disgorgement obligation shall be satisfied in the following manner:

- (1) Within 10 days after entry of this Order, Respondent shall instruct UBS Financial Services, Inc. ("UBS"), the financial institution at which

TriCoastal Capital Partners, LLC maintains its brokerage account and a related commodity futures account, to transfer the entire combined outstanding balance (currently approximately \$1,396,254) in Brokerage Account Number Y1 04593 SH and Commodity Futures Account Number P OF JG83036 (collectively, the "UBS Brokerage Account") to the Securities and Exchange Commission for distribution to the injured investors;

- (2) Within 10 days after entry of this Order, Respondent shall instruct Bank of America, N.A., the financial institution at which Tricoastal Capital Partners, LLC maintains its corporate bank account, to transfer the outstanding balance (currently approximately \$1,396) in Bank Account Number 0037 6656 4955 (the "BOA Bank Account") to the Securities and Exchange Commission for distribution to the injured investors; and
- (3) All of the remaining disgorgement ordered, except for the amounts sent to the Commission formerly held in the UBS Brokerage Account and the BOA Bank Account, referenced immediately above, shall be deemed satisfied by the restitution orders in R v. Summers, Information No. 12000143, provided that Respondent does not withdraw his guilty plea in R v. Summers.

If timely payment of the funds in the UBS Brokerage Account or the BOA Bank Account is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Payment may be transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Payment may be made directly from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Payment may be made by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Summers as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Marshall Sprung, Co-Chief Asset Management Unit, Division of Enforcement, Los Angeles Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, CA 90036-3648.

In the event Respondent withdraws his guilty plea in R v. Summers, he shall be liable for the full amount of disgorgement of \$4,117,658.15, less the amounts sent to the Commission from the UBS Brokerage Account and the BOA Bank Account, plus any accrued interest pursuant to SEC Rule of Practice 600.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72838 / August 13, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3896 / August 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15829

In the Matter of

RICHARD J. BUSWELL,

Respondent.

ORDER MAKING FINDINGS AND IMPOSING
REMEDIAL SANCTIONS PURSUANT TO
SECTION 15(b) OF THE SECURITIES
EXCHANGE ACT OF 1934 AND SECTION 203(f)
OF THE INVESTMENT ADVISERS ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") previously instituted proceedings in this matter on April 8, 2014. The Commission now deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") ("Order") against Richard J. Buswell ("Buswell" or "Respondent").

II.

Buswell has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Buswell admits the Commission's jurisdiction over him and over the subject matter of the proceedings and admits the findings in Section III.2 below. Buswell further consents to the entry of the Order, as set forth below.

III.

On the basis of this Order and Buswell's Offer, the Commission finds that:

32 of 82

1. At the time of the relevant conduct, Buswell was a registered representative at, and a person associated with, Brookstone Securities, Inc., also d/b/a Brookstone Investment Advisory Services, a firm that was located in Lakeland, Florida and was formerly registered with the Commission as a broker-dealer and an investment adviser. Buswell, 45, was a resident of Lafayette, Louisiana; however, he is currently incarcerated at Iberia Parish Jail located in New Iberia, Louisiana pending sentencing.

2. On July 24, 2013, Buswell pleaded guilty to one count of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Western District of Louisiana, in *United States v. Buswell et al*, Crim. No. 6:11-cr00198-RTH-PJH. Buswell is currently awaiting sentencing.

3. The count of the criminal indictment to which Buswell pleaded guilty alleged, among other things, that Buswell defrauded investors and obtained money and property by means of materially false and misleading statements. Pursuant to the plea agreement, Buswell admitted that he engaged in excessive and frequent stock transactions on his clients' accounts for his own benefit. He also admitted that he exaggerated guaranteed rates of returns in communications with his clients. Additionally, he admitted that he placed a number of his clients in Direct Private Placements even though he knew that the investments were unsuitable. He further admitted that he failed to explain the risks of these investments to his clients and falsified Bowman Investment Group LLC account applications to make the clients appear to be accredited investors when, in fact, they were not. The misconduct underlying the criminal charges occurred during the period in which the Respondent was associated with a registered investment adviser and a registered broker-dealer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Buswell's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, Respondent Buswell be, and hereby is: barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order;

and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72840 / August 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16015

In the Matter of

WALTER L. ROSS,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Walter L. Ross ("Ross" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From March 2007 until May 2008 Ross solicited investments in an unregistered offering from at least 51 investors for Fountain Group of Companies of Utah, Inc.

33 of 82

("Fountain Group"). At the time Fountain Group's offer and sale of securities took place, Ross was not an associated person of a registered broker-dealer. However, Ross acted as a broker by: (1) actively soliciting investors; (2) receiving some investment funds; and (3) receiving transaction-based compensation. Ross, 66 years old, is a resident of Cathedral City, California.

2. On August 7, 2014, a final judgment was entered by consent against Ross, permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933, and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Wilson, et al., Civil Action Number 2:13-CV-00188, in the United States District Court for the District of Utah.

3. The Commission's complaint alleged that Ross sold securities, in the form of investment contracts, in transactions that were not registered with the Commission and no exemption from the registration requirements of the Securities Act was available for those sales. The complaint further alleged Ross acted as an as an unregistered broker.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Ross' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Ross be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order;
and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct
that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 9631 / August 13, 2014

SECURITIES EXCHANGE ACT OF 1934

Release No. 72841 / August 13, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3897 / August 13, 2014

INVESTMENT COMPANY ACT OF 1940

Release No. 31211 / August 13, 2014

Admin. Proc. File No. 3-15255

In the Matter of

JOHN THOMAS CAPITAL MANAGEMENT
GROUP LLC d/b/a PATRIOT28 LLC,
GEORGE R. JARKESY, JR.,
JOHN THOMAS FINANCIAL, INC., and
ANASTASIOS "TOMMY" BELESIS

ORDER EXTENDING
DEADLINE FOR FILING
INITIAL DECISION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),¹ for an extension of six months to file the initial decision in this proceeding. For the reasons set forth below, we grant her motion.

We issued an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") against John Thomas Capital Management Group LLC d/b/a Patriot28 LLC ("JTCM"), an unregistered investment adviser that managed two hedge funds ("Funds"); George R. Jarkesy, Jr., the manager of JTCM; John Thomas Financial, Inc. ("JTF"), a registered broker-dealer that served as the Funds' placement agent; and Anastasios "Tommy" Belesis, the founder and chief executive officer of JTF.² The OIP alleges that JTCM and Jarkesy willfully violated the

¹ 17 C.F.R. § 201.360(a)(3).

² *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Exchange Act Release No. 69208, 2013 WL 1180836 (Mar. 22, 2013).

34 of 82

antifraud provisions of the federal securities laws by misrepresenting the valuation of the Funds and the identities of the Funds' auditor and prime broker. The OIP further alleges that JTCM and Jarkesy placed the interests of JTF and Belesis over those of the Funds when they directed millions in fees to JTF for services of dubious value.³ The OIP also alleges that JTCM and Jarkesy willfully aided and abetted and caused the Funds' violations of the Securities Act and Exchange Act antifraud provisions.⁴

The OIP directs the presiding law judge to file an initial decision within 300 days of the date of service of the OIP. On our own motion, we previously granted an extension of time to file the initial decision because we had issued an interim stay of the proceedings to consider a petition filed by JTCM and Jarkesy for interlocutory review of rulings made by an administrative law judge.⁵ Chief Judge Murray asserts that a second extension is necessary "due to the size and complexity of the proceeding, the recent conclusion of the hearing in this proceeding, and this Office's heavy workload." For example, she states that the "twelve-day hearing produced a record of over 3,000 pages of transcript and over 160 exhibits," and that, at about the same time that the initial decision is due, the administrative law judge assigned to preside over this matter also was scheduled to preside over another lengthy hearing.

We adopted Rule of Practice 360(a) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for filing an initial decision.⁶ That rule provides, however, for deadline extensions under certain circumstances if

³ The OIP specifically alleges violations of Securities Act Section 17(a), 15 U.S.C. § 77q(a); Exchange Act Section 10(b), 15 U.S.C. § 78j(b); Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5; Advisers Act Sections 206(1), 206(2), and 206(4), 15 U.S.C. § 80b-6; and Advisers Act Rule 206(4)-8, 17 C.F.R. § 275.206(4)-8.

⁴ The OIP further alleges that JTF and Belesis willfully aided and abetted and caused JTCM's and Jarkesy's violations. We have since issued a settlement order as to JTF and Belesis. *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 70989, 2013 WL 6327500 (Dec. 5, 2013).

⁵ *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 71204, 2013 WL 6858732 (Dec. 30, 2013). We subsequently denied the petition for interlocutory review. *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 71021, 2013 WL 6384275 (Dec. 6, 2013).

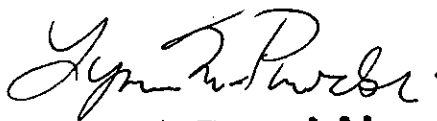
⁶ See *Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003) ("[T]he Commission has determined that timely completion of proceedings can be achieved more successfully through the adoption of mandatory deadlines and procedures designed to meet these deadlines.").

supported by a motion from the Chief Administrative Law Judge and if it appears, as here, that "additional time is necessary or appropriate in the public interest."⁷

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this proceeding is extended to October 17, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary


By: Lynn M. Powalski
Deputy Secretary

*Chair White
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72846 / August 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16017

In the Matter of

LINKBROKERS
DERIVATIVES LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Linkbrokers Derivatives LLC ("Linkbrokers" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Exchange Act, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

35 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. Summary

These proceedings arise out of a fraudulent scheme perpetrated by certain employees at Linkbrokers, a New York based interdealer broker, to unlawfully take secret profits of more than \$18 million at the expense of its customers. From at least 2005 through at least February 2009 (the "relevant period"), on over 36,000 customer transactions, certain employees of Linkbrokers perpetrated the scheme by charging customers false prices in which Linkbrokers embedded hidden markups or markdowns.

Marek Leszczynski, Benjamin Chouchane, Gregory Reyftmann, Henry Condron, and another individual (hereinafter "Middle-Office Assistant 1") (collectively "the Linkbrokers Team") worked on Linkbrokers' "Cash Desk," executing orders to purchase and sell securities on behalf of their customers, primarily large foreign institutions and foreign banks, and purportedly charging small commissions—typically between a fraction of a penny and two pennies per share. Typically, the Cash Desk executed trades for Linkbrokers' customers on a "riskless principal" basis.² That is, the customer gave the Cash Desk the order, the order was filled in the market under Linkbrokers' name, then allocated to the customer. Thus, typically, Linkbrokers facilitated the transactions in exchange for the agreed-upon commission, and, essentially, served as an intermediary for others who assumed the market risk.

The scheme was devious and difficult for Linkbrokers' customers to detect, in part because the Linkbrokers Team selectively engaged in it when the volatility in the market was sufficient to conceal the fraud from the customer. The Linkbrokers Team fraudulently charged customers over \$18 million, representing approximately 40% of the Cash Desk's earnings generated for Linkbrokers during the relevant time period.

After receiving and executing orders on behalf of customers, Reyftmann, Chouchane, or Leszczynski routinely evaluated each transaction to determine whether they could make an additional or "secret" profit for Linkbrokers above the commission to be charged to the customer. Reyftmann, Chouchane, or Leszczynski—with the assistance of Condron or Middle-Office Assistant 1—considered other transactions in the relevant security occurring in the seconds to minutes before and after the actual trade executed. Where the price fluctuated sufficiently to conceal the fraud from customers, Reyftmann, Chouchane, or Leszczynski instructed Condron or Middle-Office Assistant 1 to record, on Linkbrokers' internal records, a false execution price that

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² In general, a "riskless principal" trade occurs when a broker-dealer, after receiving a customer order to buy (or sell) a security, buys (or sells) the security for its own account from (or to) another person in a contemporaneous offsetting transaction and then allocates the shares to the customer order.

included a secret profit for Linkbrokers. Then, Linkbrokers charged the customer the inflated price while also charging the agreed-upon commission. In that way, Linkbrokers received not only the actual commission charged, but also the fraudulent secret profit that Reyftmann, Chouchane, or Leszczynski, with assistance from Condrón or Middle-Office Assistant 1, embedded in the price reported to the customer.

Brokers have a fundamental obligation to treat customers fairly. Customers, even sophisticated entities, rely on their brokers to execute orders at the most favorable terms reasonably available under the circumstances, taking into account the price and the customer's instructions, among other factors. In return for the services provided, the customer pays the broker the agreed upon compensation. When a broker represents that it will act as an agent for the customer and negotiates the compensation the customer will pay on transactions, if the broker then imbeds an undisclosed markup or markdown in the price reported and charged to the customer, it violates the law, injures its customer, unnecessarily increases the customer's costs, and undermines the trust upon which the broker-customer relationship is founded.

Leszczynski, Chouchane, and Condrón have pled guilty to criminal charges arising from the conduct discussed herein. In addition, in *SEC v. Leszczynski, et al.*, Civil Action No. 12-cv-07488 (S.D.N.Y.), the Court entered judgments against Leszczynski, Chouchane, and Condrón, permanently enjoining them from violating Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In the judgments, Leszczynski was ordered to disgorge \$1,500,000; Chouchane was ordered to disgorge \$2,007,408 plus prejudgment interest of \$442,169; and Condrón was ordered to disgorge \$168,336 plus prejudgment interest of \$39,339. The Court reserved the issue of whether to impose a civil penalty on these defendants. Acknowledging the facts to which they have admitted as part of their guilty pleas in parallel criminal cases, Leszczynski, Chouchane, and Condrón consented to the entry of these judgments.

Linkbrokers is liable for the conduct of the members of the Linkbrokers Team. As such, Linkbrokers willfully violated Section 15(c)(1) of the Exchange Act.

B. Respondent

1. Linkbrokers is a limited liability company formed under the laws of Delaware. During the relevant period, Linkbrokers' principal place of business was in New York, New York. It has been registered with the Commission as a broker-dealer since 2003. Linkbrokers ceased acting as a broker-dealer in April 2013 and will withdraw its broker-dealer registration following this settlement.

C. Other Relevant Persons

2. Gregory Reyftmann ("Reyftmann"), age 40, was a sales broker and supervisor at Linkbrokers from February 2005 until June 2010. During that period, Reyftmann was the head of the Cash Desk and responsible for supervising Chouchane, Leszczynski, Condrón,

and others. He is a defendant in the related case *SEC v. Leszczynski, et al.*, No. 12-cv-07488 (S.D.N.Y.). He has not appeared to defend that action.

3. Benjamin Chouchane ("Chouchane"), age 40, was a sales broker at Linkbrokers from February 2005 until December 2010. He pled guilty in a criminal case arising from the same conduct discussed herein, *United States v. Leszczynski*, No. 12-cr-00923 (S.D.N.Y.). He was sentenced to serve two years in prison, serve two years of supervised release, and pay \$5 million in restitution. In addition, he was a defendant in the related case *SEC v. Leszczynski, et al.*, Civil Action No. 12-cv-07488 (S.D.N.Y.).³

4. Marek Leszczynski ("Leszczynski"), age 44, was a sales broker at Linkbrokers from March 2005 until December 2010. He pled guilty in a criminal case arising from the same conduct discussed herein, *United States v. Leszczynski*, No. 12-cr-00923 (S.D.N.Y.). He was sentenced to serve eighteen months in prison, serve two years of supervised release, and pay \$1.5 million in restitution. In addition, he was a defendant in the related case *SEC v. Leszczynski, et al.*, Civil Action No. 12-cv-07488 (S.D.N.Y.).

5. Henry A. Condrón ("Condrón"), age 35, was a sales trader and middle-office assistant at Linkbrokers from February 2005 until October 2010. He pled guilty in a criminal case arising from the same conduct discussed herein, *United States v. Condrón*, No. 12-cr-768 (S.D.N.Y.). He was sentenced to serve eighteen months of probation and pay \$207,675 in restitution. In addition, he was a defendant in the related case *SEC v. Leszczynski, et al.*, Civil Action No. 12-cv-07488 (S.D.N.Y.).

6. Middle-Office Assistant 1 worked at Linkbrokers from November 2004 until April 2011. For most of the relevant period, he worked as a middle office assistant and sales trader on the Cash Desk.

D. Facts

7. During the relevant time period, Linkbrokers acted as an interdealer broker for institutional customers dealing in equities products, both cash and derivatives.

8. Linkbrokers established its Cash Desk in February 2005. The Cash Desk executed trades in U.S. and Canadian stocks. Its customers were primarily large foreign institutions and foreign banks. Typically, Linkbrokers operated as an agent and executed large volumes of securities trades on behalf of customers for low commissions. The Cash Desk typically did not hold any securities itself. The Cash Desk was one of several desks at Linkbrokers.

9. Linkbrokers marketed and advertised itself as an agency-only business. For example, in marketing materials distributed on March 8, 2007, Linkbrokers represented that

³ The judgments against Chouchane, Leszczynski, and Condrón in this civil action will be discussed in more detail below in Section III, part D ("Facts").

"Link acts as a fiduciary in all transactions. Link trades on an agency basis in transactions with the sole purpose of providing best execution." In separate marketing materials distributed on January 4, 2007, Linkbrokers further stated that it provided "unparalleled execution without the conflicts of investment banking and proprietary trading."

10. Linkbrokers' internal records show that, for the majority of its customers, the Cash Desk was to charge its customers flat commission rates between \$0.005 per share and \$0.02 per share.

11. Reyftmann, Chouchane, Leszczynski, Condrón, and Middle-Office Assistant 1, collectively known as the Linkbrokers Team, were employees of Linkbrokers and were acting in the course and scope of their employment when they engaged in the improper conduct described herein. Linkbrokers is liable for the conduct of the members of the Linkbrokers Team.

12. Reyftmann, Chouchane and Leszczynski were "sales brokers" on the Cash Desk and were responsible for finding customers, developing relationships, negotiating commission rates, taking orders from customers, and communicating with customers regarding their orders and Linkbrokers' execution of those orders. Reyftmann also supervised the Cash Desk during the relevant period.

13. Condrón and Middle-Office Assistant 1 were "sales traders" on the Cash Desk who entered orders they received from the sales brokers into systems for execution.

14. Condrón and Middle-Office Assistant 1 also served as "middle-office assistants." As middle-office assistants, Condrón and Middle-Office Assistant 1 maintained and updated Linkbrokers' internal "trade blotter" (hereafter "Trade Blotter"), a spreadsheet generated from Linkbrokers' proprietary software program which contains detailed information about trades executed by the Linkbrokers Team, including the names of the customers and execution prices. The Trade Blotter contained three price fields: (1) the actual "execution price" received by Linkbrokers; (2) the "gross price" – the price that included the undisclosed markup/markdown; and (3) the "net price" – the gross price plus the agreed-upon commission rate. The Linkbrokers Team used the Trade Blotter to record profits from the unlawful scheme.

15. In addition, as middle-office assistants, Condrón and Middle-Office Assistant 1 reported customer trades to Linkbrokers' clearing firm (either through a transfer via Linkbrokers' proprietary software program or directly), reviewed trade settlement by the clearing firm, calculated daily profit and loss, and sent trade recaps and/or trade confirmations via email to customers.

16. Depending on the customer's preference, Linkbrokers, through Reyftmann, Chouchane and Leszczynski, accepted customer orders by telephone, instant message, or email. The Linkbrokers Team also confirmed trades to customers by telephone, instant message, email or mail, depending on the customer's preference.

**Leszczynski, Chouchane, And Condron Have Admitted To Conduct That Violates
The Securities Laws**

17. In *SEC v. Leszczynski, et al.*, Civil Action No. 12-cv-07488 (S.D.N.Y.), the Court entered judgments against Leszczynski, Chouchane, and Condron, permanently enjoining them from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. This action arose from the same conduct at issue in the criminal cases, *United States v. Leszczynski*, No. 12-cr-00923 (S.D.N.Y.) and *United States v. Condron*, No. 12-cr-768 (S.D.N.Y.), in which Leszczynski, Chouchane, and Condron each pled guilty to criminal charges.

18. In *SEC v. Leszczynski*, Leszczynski was ordered to disgorge \$1,500,000; Chouchane was ordered to disgorge \$2,007,408 plus prejudgment interest of \$442,169; and Condron was ordered to disgorge \$168,336 plus prejudgment interest of \$39,339. The Court reserved the issue of whether to impose a civil penalty on these defendants.

19. In consenting to the judgments in *SEC v. Leszczynski*, Leszczynski, Chouchane, and Condron each acknowledged having admitted, in connection with his guilty plea, to certain conduct. That conduct constitutes violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

20. Leszczynski admitted:

- a. He made false statements to customers in connection with purchases and sales of securities;
- b. He added undisclosed markups to customer trades; and
- c. He sent false execution prices to customers and failed to disclose the markups.

21. Chouchane admitted:

- a. He made false statements to customers in connection with purchases and sales of securities;
- b. He caused commissions to be recorded into trading records that were in excess of the commissions agreed-upon by customers;
- c. He caused false trading confirmations to be generated and sent to various customers; and
- d. He enabled Linkbrokers to receive undisclosed trading profits beyond the legitimate trading commissions to which it was entitled, resulting in lucrative performance bonuses for himself and others.

22. Condron admitted:

- a. He caused commissions to be recorded into trading records that were in excess of the commissions agreed upon by customers;
- b. He caused false trading confirmations to be generated and sent to various customers; and
- c. He enabled Linkbrokers to receive undisclosed trading profits beyond the legitimate trading commissions to which it was entitled, resulting in lucrative performance bonuses for him and others.

Linkbrokers Generated Significant Profits Through The Undisclosed Markups/Markdowns

23. During the relevant period, the Cash Desk generated approximately \$47 million in gross revenue for Linkbrokers. Approximately 40% of that revenue—over \$18 million—was attributable to the markups/markdowns that Linkbrokers failed to disclose to its customers. The Linkbrokers Team added undisclosed markups/markdowns to more than 36,000 customer transactions, approximately one-third of the total customer transactions placed through the Cash Desk over a period of at least four years. And more than 3,300 of those transactions were marked up or down so that customers paid 1,000% or more of the disclosed commission charged the customer.

24. During the relevant period, Linkbrokers paid millions of dollars in bonuses to Reyftmann, Chouchane, and Leszczynski based on the revenue derived from the Cash Desk.

The Undisclosed Markups/Markdowns

25. The Linkbrokers Team concealed the markups/markdowns from Linkbrokers' customers by, among other things, misrepresenting execution prices to the customers, and omitting information relating to markups/markdowns.

26. In addition, the Linkbrokers Team opportunistically engaged in adding undisclosed markups/markdowns to trades when they thought the particular customer would not detect it, frequently taking advantage of market volatility to conceal the conduct.

27. The undisclosed markups/markdowns ranged anywhere from a few dollars to \$228,822 per transaction.

28. The markup/markdown scheme worked in the following way:

- a. A sales broker received a customer order either by telephone, instant message, or email.

- b. The sales broker gave the order to a sales trader to execute.
- c. The sales trader executed the trade.
- d. After the order was executed, a middle-office assistant recorded the actual execution price on the Trade Blotter and informed the sales broker of the execution.
- e. Shortly after the trade was executed, the sales broker examined other market executions in or around the time of the actual execution, to determine whether the stock price fluctuated. If the stock price's fluctuation was favorable to Linkbrokers and sufficient to conceal the fraud from Linkbrokers' customer, the sales broker instructed the middle-office assistant to record a false execution price in the gross price field on their internal Trade Blotter.
- f. A member of the Linkbrokers Team reported the false execution price and the commission to the customer, and recorded the total charged to the customer in the net price field on their internal Trade Blotter.

29. Frequently, the Linkbrokers Team provided the false and/or misleading information through trade recaps communicated to customers by telephone, instant message, or email. The Linkbrokers Team also sent, or caused to be sent, trade confirmations containing the false and/or misleading information to some customers.

Examples Of The Markups/Markdowns

30. On September 29, 2008 at 3:54 p.m., a customer placed an order by telephone with Leszczynski to sell 90,000 shares of Citigroup, Inc. ("C"). Linkbrokers executed the trade at 3:56 p.m., selling 90,000 shares of C on the customer's behalf at an average price of \$19.1311 per share. The Trade Blotter reflects an execution price of \$19.1311, a gross price of \$17.7500, and a net price of \$17.7435. At 5:01 p.m., Middle-Office Assistant 1 generated, and emailed to the customer, a trade confirmation containing the false execution price of \$17.7500 per share. The commission for this transaction was \$0.0065 per share, resulting in a total commission of \$585 for the trade, which Linkbrokers charged and disclosed to the customer. However, Linkbrokers, and the Linkbrokers Team, failed to disclose the additional markdown of \$124,299, thereby taking this undisclosed profit for Linkbrokers at the expense of its customer.

31. On February 27, 2007 at 3:36 p.m., a customer emailed Chouchane an order to buy shares of Bristol-Myers Squibb Co. ("BMY"). Linkbrokers executed the trade, purchasing 32,100 shares of BMY stock on the customer's behalf at an average price of \$26.3956 per share. The Trade Blotter reflects an execution price of \$26.3956, a gross price of \$26.4356, and a net price of \$26.4456. At 7:02 p.m., Chouchane emailed the customer a trade recap confirming the trade at the false execution price of \$26.4356 per share. The

commission for this transaction was \$0.01 per share, resulting in a total commission of \$321 for this trade, which Linkbrokers charged the customer. However, Linkbrokers, and the Linkbrokers Team, failed to disclose the additional markup of \$1,284, thereby taking this undisclosed profit for Linkbrokers at the expense of its customer.

32. On September 16, 2008 at 3:23 p.m., a customer placed an order by telephone with Leszczynski to sell 350,000 shares of American International Group, Inc. ("AIG"). Linkbrokers executed the trade, selling 350,000 shares of AIG at an average price of \$4.3709 per share. The Trade Blotter reflects an execution price of \$4.3709, a gross price of \$4.3629, and a net price of \$4.3554. At 3:26 p.m., Leszczynski confirmed the trade by telephone to the customer at the false price of \$4.3629 per share. The commission for this transaction was \$0.0075 per share, resulting in a total commission of \$2,625 for this trade, which Linkbrokers charged the customer. However, Linkbrokers, and the Linkbrokers Team, failed to disclose the additional markdown of \$2,800, thereby taking this undisclosed profit for Linkbrokers at the expense of its customer.

33. On October 8, 2007, Linkbrokers received a customer order to sell shares of Apple, Inc. ("AAPL"). From 9:36 a.m. until 9:45 a.m., Linkbrokers executed the trade, selling 40,000 shares of AAPL on the customer's behalf at an average price of \$164.1475 per share. The Trade Blotter reflects an execution price of \$164.1475, a gross price of \$164.1225, and a net price of \$164.1160. At 4:26 p.m., Condron generated, and emailed to the customer, a trade confirmation containing the false execution price of \$164.1225 per share. The commission for this transaction was \$0.0065 per share, resulting in a total commission of \$260 for the trade, which Linkbrokers charged and disclosed to the customer. However, Linkbrokers, and the Linkbrokers Team, failed to disclose the additional markdown of \$1,000, thereby taking this undisclosed profit for Linkbrokers at the expense of its customer.

**Linkbrokers Generated Additional Profits
By Stealing Portions Of Trades From Its Customers**

34. In addition to the markups/markdowns, at times, the Linkbrokers Team used a second method to secure illicit profits at the expense of Linkbrokers' customers. Specifically, where a customer placed a limit order and there was a favorable intraday price movement in the price of the security, the Linkbrokers Team would sometimes take advantage of that movement to steal a portion of a favorable trade for Linkbrokers.

35. A "limit order" refers to an order to buy or sell a security at a specific price or better. For example, a customer could place a limit order to buy 100 shares of ABC stock at a price not greater than \$10.00 per share. If the broker can fill the order at that price or better, it should do so. But if the price of ABC stock is above the price specified by the customer in the limit order, the shares will not be purchased.

36. On one or more occasions, after accepting and executing a customer's limit order, the Linkbrokers Team did not immediately report the transaction to the customer. Rather, the sales broker then looked for an opportunity to buy or sell that same stock at a lower or higher

price than the price at which the customer's trade was executed. If the opportunity to get a superior execution price existed, the sales broker instructed a middle-office assistant to buy the stock at a lower price than the execution price, or to sell the stock at a higher price than the execution price—taking the difference (or spread) between the two execution prices for Linkbrokers.

37. The middle-office assistant, rather than properly recording the actual execution price and quantity of the customer's original transaction in the Trade Blotter, entered a partial fill into the Trade Blotter.

38. Afterwards, the sales broker and/or the middle-office assistant reported to the customer that only part of the order was executed.

39. In this way, the Linkbrokers Team used the customer's funds to conduct a risk-free transaction profiting Linkbrokers, without the customer being aware of what Linkbrokers was doing.

Example Of A Partially Stolen Trade

40. On April 26, 2007, Linkbrokers received a customer order to sell shares of Qualcomm, Inc. ("QCOM"). From 2:48 p.m. until 2:49 p.m., Linkbrokers executed the trade, selling 22,576 shares of QCOM on the customer's behalf at an average price of \$45.7500. At 3:41 p.m., Linkbrokers bought back 3,000 shares—shares that should have been allocated to the customer—for an average price of \$45.3500. At 4:30 p.m. Leszczynski falsely reported to the customer that Linkbrokers was only able to sell 19,576 shares for the customer and was not able to fill the remaining shares ordered by the customer. Specifically, Leszczynski stated: "Remaining balance cancelled as stock didn't trade @ the limit." At 4:40 p.m., despite having sold 22,576 shares, Linkbrokers allocated sell executions representing only 19,576 shares of QCOM to its customer for a gross execution price of \$45.7500 per share. Linkbrokers kept an additional secret profit of approximately \$1,200 on the purchase of the 3,000 shares for itself. In total, Linkbrokers recognized approximately \$1,335 in profits from the transaction while disclosing a commission of \$135.07 to the customer.

Deceptive Conduct To Facilitate The Scheme

41. In order to perpetuate the scheme described above, the Linkbrokers Team engaged in a range of deceptive conduct. For example, at the inception of the Cash Desk, in February 2005, Condrón and Reyftmann coordinated with employees of Linkbrokers' IT staff to create a function within Linkbrokers' proprietary software to facilitate the deceptive scheme.

42. On February 7, 2005, a Linkbrokers IT specialist emailed Reyftmann, Condrón, and others and informed them that he named the "Extra" field in the Trade Blotter the "gross price" field. He also warned that if they wanted to enter a different gross price than execution

price that the gross price field had to be populated after the execution price field was populated.

43. In other emails, dated February 7, 2005, a Linkbrokers executive described to Condrón and Reyftmann, among others, that Linkbrokers' proprietary software has two different commission fields—one for actual total commission charged and one for the commission amount that would be provided to the customer.

44. Condrón also emailed a Linkbrokers IT Specialist on April 10, 2006, to ask him to fix Linkbrokers' proprietary software system to ensure that the customer will "*never see [the execution price]*" on any customer statements or trade confirmations. (emphasis added). The following day, the Linkbrokers IT Specialist responded to Condrón's email, which included Reyftmann, Middle-Office Assistant 1, Linkbrokers' Chief Compliance Officer, and another Linkbrokers IT specialist, and explained that he "unchecked" the execution price field, but left a check box next to the field "in case you ever might want" to disclose the execution price.

Linkbrokers Acted With Scienter

45. Among other things, Linkbrokers authorized the Linkbrokers Team to interact with customers, agree upon commission rates to be charged for the services provided, and communicate the details of the transactions to the customers.

46. When engaging in the conduct described herein, the members of the Linkbrokers Team were employees of Linkbrokers and acting within the scope of their authority. Linkbrokers is liable for the conduct of the members of the Linkbrokers Team.

47. Reyftmann, Chouchane, and Leszczynski knew that the prices and/or commissions that they and Linkbrokers confirmed to their customers, either orally or in writing, were false because they knew the prices at which the transactions were actually executed and they created the fictitious prices. And, where the Linkbrokers Team stole part or all of the customer's trade, they knew that they were making misrepresentations to the customer when they represented, either orally or in writing, that Linkbrokers had been unable to fill a particular limit order in its entirety.

48. Condrón knew or was reckless in not knowing that the confirmations he, the sales brokers, and Linkbrokers sent to customers contained false and/or misleading information and omitted the markups/markdowns. Condrón received the false prices from the sales brokers and input them into Linkbrokers' internal database and then printed the confirmations or emailed the trade recaps that contained the false prices and intentionally omitted the markups/markdowns. And, where Linkbrokers stole part or all of the customer's trade, Condrón knew that he was making misrepresentations to the customer when he represented, either orally or in writing, that Linkbrokers had been unable to fill a particular limit order in its entirety.

**Linkbrokers Made Material Misrepresentations And Omissions
Regarding Its Execution Of Customers' Orders**

49. The Linkbrokers Team, through telephone conversations, instant messages, emailed trade recaps, and trade confirmations sent to customers, disclosed false execution prices, false order fills, and inaccurate fees charged to customers and omitted to disclose significant markups/markdowns embedded in the execution prices disclosed to the customers and that Linkbrokers stole portions of the customers' trades for itself.

50. In addition, contrary to express and implied representations that it would provide its customers with best execution, Linkbrokers knew or was reckless in not knowing that it failed to provide its customers with best execution because the Linkbrokers Team did not provide its customers with the best available prices. While the Linkbrokers Team executed the trades in the marketplace, they gave their customer a worse price than they had obtained by adding in the undisclosed markup/markdown. Not only did Reyftmann, Chouchane, and Leszczynski know that there were better prices available, they had obtained them. But they gave the fictitious and inferior prices to their customers to take the difference between actual and better execution and the fictitious execution price for Linkbrokers.

51. Finally, the Linkbrokers Team accepted and executed customer orders, then misappropriated a portion of the trade for Linkbrokers' own secret profit. Rather than reporting the full transaction to the customer, the sales brokers looked for an opportunity to buy or sell that same stock at a lower or higher price than the execution. After executing another transaction for Linkbrokers' benefit, the Linkbrokers Team caused false reports to be provided to the customer that only part of the order was executed.

E. Violation

52. As a result of the conduct described above, Linkbrokers willfully violated Section 15(c)(1) of the Exchange Act, which prohibits fraudulent conduct by a broker-dealer in effecting, inducing or attempting to induce any securities transaction.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Linkbrokers cease and desist from committing or causing any violations and any future violations of Section 15(c) of the Exchange Act.

B. Respondent Linkbrokers is censured.

C. Respondent shall, within 14 days of the entry of this Order, pay disgorgement of \$14,000,000 to the Securities and Exchange Commission. If timely payment is not made, interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Linkbrokers as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to G. Jeffrey Boujoukos, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, One Penn Center, 1617 JFK Boulevard, Suite 520, Philadelphia, PA 19103.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72843 / August 14, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16016

In the Matter of

**Black Hawk Exploration,
Composite Technology Corporation,
Forza Environmental Building Products, Inc.,
Hotcloud Mobile, Inc.,
ImmunoBiotics, Inc., and
SpatiaLight, Inc.**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS AND NOTICE
OF HEARING PURSUANT TO
SECTION 12(j) OF THE
SECURITIES EXCHANGE
ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS¹

1. Black Hawk Exploration ("BHWX") (CIK No. 1349371) is a defaulted Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BHWX is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended August 31, 2011, which reported a net loss of \$829,487 for the prior year. As of August 11, 2014, the common stock of BHWX was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹The short form of each issuer's name is also its stock symbol.

2. Composite Technology Corporation ("CPTCQ") (CIK No. 317477) is a revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CPTCQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2011, which reported a net loss from continuing operations of \$9,692,000 for the prior six months. On April 10, 2011, CPTCQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was still pending as of August 11, 2014. As of August 11, 2014, the common stock of CPTCQ was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Forza Environmental Building Products, Inc. ("GUGO") (CIK No. 1393284) is a revoked Nevada corporation located in Carlsbad, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GUGO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2011, which reported a net loss of \$947,605 for the prior nine months. As of August 11, 2014, the common stock of GUGO was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Hotcloud Mobile, Inc. ("HOTM") (CIK No. 1397645) is a dissolved Nevada corporation located in Burbank, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HOTM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2011, which reported a net loss of \$800,311 for the prior nine months. As of August 11, 2014, the common stock of HOTM was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. ImmunoBiotics, Inc. ("IMBI") (CIK No. 1413579) is a Florida corporation located in San Clemente, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IMBI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2010, which reported a net loss of \$1,984,359 for the prior nine months. As of August 11, 2014, the common stock of IMBI was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. SpatiaLight, Inc. ("SPLT") (CIK No. 881468) is a New York corporation located in Novato, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SPLT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2007, which reported a net loss of \$13,847,164 for the prior nine months. As of August 11, 2014, the common stock of SPLT was quoted on OTC Link, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3,

and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 14, 2014

In the Matter of

**Black Hawk Exploration,
Composite Technology Corporation,
Forza Environmental Building Products, Inc.,
Hotcloud Mobile, Inc.,
ImmunoBiotics, Inc., and
SpatiaLight, Inc.**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Black Hawk Exploration because it has not filed any periodic reports since the period ended August 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Composite Technology Corporation because it has not filed any periodic reports since the period ended March 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Forza Environmental Building Products, Inc. because it has not filed any periodic reports since the period ended February 28, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Hotcloud Mobile, Inc. because it has not filed any periodic reports since the period ended July 31, 2011.

37 of 82

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ImmunoBiotics, Inc. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SpatiaLight, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 14, 2014, through 11:59 p.m. EDT on August 27, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31213 / August 15, 2014

In the Matter of	:	ORDER PURSUANT TO
Special Opportunities Fund, Inc.	:	SECTION 554(e) OF THE
	:	ADMINISTRATIVE PROCEDURE
	:	ACT OF 1946

On August 8, 2013, the Commission issued a notice ("Notice") of an application for a declaratory order ("Application") under Section 554(e) of the Administrative Procedure Act of 1946 ("APA") filed by Special Opportunities Fund, Inc. ("SPE"), a closed-end management investment company ("closed-end fund") registered under the Investment Company Act of 1940 ("1940 Act") (Investment Company Act Release No. 30647). Brooklyn Capital Management, LLC ("Adviser") is an investment adviser registered under the Investment Advisers Act of 1940 and currently serves as investment adviser to SPE. SPE seeks to rely on Section 12(d)(1)(F) of the 1940 Act, a conditional exemption from the limits set forth in Section 12(d)(1)(A) of the 1940 Act, to invest its assets in securities of other investment companies registered under the 1940 Act ("underlying funds") that are closed-end funds.

The Notice stated that, absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under Section 554(e) of the APA declaring that SPE's proxy voting procedure, described in the Notice, does not satisfy Section 12(d)(1)(F) of the 1940 Act. On August 28, 2013, SPE filed a request for a hearing ("SPE Hearing Request"). On August 29, 2013, Mr. Robert H. Daniels, a shareholder of SPE, also filed a request for a hearing ("Daniels Hearing Request," and together with the SPE Hearing Request, "Hearing Requests"). The Commission has carefully considered the Hearing Requests and, as explained below, determined that none of the issues raised in the Hearing Requests warrants ordering a hearing on the Application.

BACKGROUND

Sections 12(d)(1)(A) and (F) of the 1940 Act

Section 12(d)(1)(A), in relevant part, makes it unlawful for any registered investment company ("acquiring fund") to purchase or otherwise acquire any security issued by an underlying fund in excess of the limits specified in that section.¹ The legislative history of Section 12(d)(1)(A)

¹ Section 12(d)(1)(A) of the Act provides, in relevant part, that it shall be unlawful for any acquiring fund to purchase or otherwise acquire any security issued by an underlying fund if immediately after such purchase or acquisition: (i) the acquiring company owns more than 3% of the underlying fund's

suggests that these restrictions were designed, in part, to address the concern that an acquiring fund could be used by an investment adviser, among others, as a vehicle to control or unduly influence, through voting, threat of redemption or otherwise, an underlying fund for its own or its affiliates' benefit and to the detriment of the shareholders of both funds.²

Section 12(d)(1)(F) provides a conditional exemption that may be used by an acquiring fund that seeks to invest a greater percentage of its assets in underlying funds than permitted under Section 12(d)(1)(A).³ One of the conditions in Section 12(d)(1)(F) requires that the acquiring fund "shall exercise voting rights by proxy or otherwise with respect to any security acquired pursuant to [Section 12(d)(1)(F)] in the manner prescribed by [Section 12(d)(1)(E)]."

Section 12(d)(1)(E)(iii), in turn, provides, in relevant part, that "the purchase or acquisition is made pursuant to an arrangement with the issuer of, or principal underwriter for, the issuer of the security whereby [the acquiring fund] is obligated either to seek instructions from its security holders with regard to the voting of all proxies with respect to such security and to vote such proxies only in accordance with such instructions, or to vote the shares held by it in the same proportion as the vote of all other holders of such security." We refer to the first alternative as "Pass-Through Voting" or "Pass-Through Voting Condition." We refer to the second alternative as "Mirror Voting."

The conditions contained in the exemption provided by Section 12(d)(1)(F), and in particular the condition requiring voting in accordance with Section 12(d)(1)(E)(iii), attempt to minimize the influence that an acquiring fund's adviser, among others, may exercise over an underlying fund through voting.⁴

total outstanding voting stock; (ii) securities issued by the underlying fund have an aggregate value in excess of 5% of the value of the acquiring fund's total assets ("5% limit"); or if such securities, together with the securities of other investment companies, have an aggregate value in excess of 10% of the value of the acquiring fund's total assets ("10% limit").

² U.S. SECURITIES AND EXCHANGE COMMISSION, INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC NO. 279, 76th Cong., 1st Sess., pt. 3, at 2721-95 (1939).

³ Section 12(d)(1)(F) provides a conditional exemption from the 5% and 10% limits in Section 12(d)(1)(A) and permits an acquiring fund to purchase or otherwise acquire shares of an underlying fund if, immediately after the purchase or acquisition, the acquiring fund and all of its affiliated persons would not own more than 3% of the underlying fund's total outstanding stock.

⁴ See *Fund of Funds Investments*, Investment Company Act Release No. 27399 (June 20, 2006) at n.11 and accompanying text.

The Application

SPE has chosen to invest in the underlying funds in excess of the limits in Section 12(d)(1)(A) by relying on the conditional exemption provided by Section 12(d)(1)(F). On December 7, 2011, SPE's shareholders approved a proposal to "instruct the Adviser to vote proxies received by the Fund from any [underlying fund] on any proposal (including the election of directors) in a manner which the Adviser reasonably determines is likely to favorably impact the discount of such [underlying fund's] market price as compared to its net asset value" ("Voting Procedure").

On December 13, 2011, SPE filed the Application, subsequently amended on November 5, 2012, requesting a declaratory order pursuant to Section 554(e) of the APA stating that the Voting Procedure "does not cause it to be in violation of Section 12(d)(1) of the Act." Section 554(e) of the APA provides that "[t]he agency, with like effect as in the case of other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty."

The Notice

The Notice stated that, "[i]n the Commission's preliminary view, SPE's Voting Procedure does not appear to be consistent with the purposes and policies behind Section 12(d)(1)(F) of the Act, or with the guidance that the Commission articulated in the [1971 Release, as defined below]. The Voting Procedure gives the Adviser broad discretion in voting the underlying funds' proxies and thus presents the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds."⁵

The Commission stated in the 1971 Release that the Pass-Through Voting Condition in Section 12(d)(1)(F) "in effect, requires the fund holding company to make an arrangement with the issuer or principal underwriter of the issuer whereby sufficient proxy solicitation or other material may be transmitted to the fund holding company's security holders so that their instructions may be obtained."⁶ In the Notice, the Commission stated that "[t]his approach addresses the concern underlying the restrictions in Section 12(d)(1)(A) – that the fund of funds' investment adviser or another affiliate not exercise undue influence over the management or policies of an underlying fund – by placing the voting of the underlying fund's proxies in the hands of the fund of funds' shareholders (rather than its investment adviser)."

⁵ The Notice discussed that, shortly after Section 12(d)(1)(F) was enacted in 1970, the Commission issued a release providing guidance on the various provisions enacted by the new legislation, including specifically the Pass-Through Voting Condition. *Changes in the Investment Company Act of 1940 Made by the Investment Company Amendments Act of 1970 (P.L. 91-547) Relating to the Repeal and Modification of Exemptions for Certain Companies; The Pyramiding of Investment Companies and the Regulation of Fund Holding Companies; and Rescission of Rule 11b-1 under the Investment Company Act*, Investment Company Act Release No. 6440 (Apr. 6, 1971) ("1971 Release").

⁶ *Id.* at 4.

The Hearing Requests

The arguments raised in the Hearings Requests and the Commission's responses are discussed below.

Does There Need to Be "An Arrangement"?

The SPE Hearing Request disputes that the condition in Section 12(d)(1)(F) for the acquiring fund to exercise its voting rights "in the manner prescribed by subparagraph (E) of this subsection" includes the provision in Section 12(d)(1)(E)(iii) that the acquiring fund have "an arrangement with [the underlying fund or its principal underwriter] . . . whereby [the acquiring fund] is obligated either to [Pass-Through Vote or Mirror Vote]." The SPE Hearing Request also mischaracterizes the Notice as "stat[ing] that SPE can mirror vote without entering into an arrangement with the issuer."

In the Commission's view, as expressed in the Notice, the better reading of the statute is that Section 12(d)(1)(F)'s requirement to exercise voting rights "in the manner prescribed by [Section 12(d)(1)(E)]" references the entirety of Section 12(d)(1)(E), including the requirement that the acquiring fund have "an arrangement" with the underlying fund (or its principal underwriter) obligating the acquiring fund either to Pass-Through Vote or to Mirror Vote. Such a reading is more consistent with the principal purpose of Section 12(d)(1)(F)'s conditions, which is to maintain Section 12(d)(1)(A)'s protection of the underlying fund from control or influence by the acquiring fund or its affiliates. This purpose is evident in the fact that Section 12(d)(1)(F) prohibits an acquiring fund and its affiliated persons from acquiring more than 3% of the underlying fund's outstanding stock, provides that the underlying fund is not obligated to redeem more than 1% of securities acquired pursuant to Section 12(d)(1)(F) in any 30-day period, and requires the acquiring fund to vote in accordance with Section 12(d)(1)(E). By incorporating the provision in Section 12(d)(1)(E)(iii) that the acquiring fund have "an arrangement with [the underlying fund] whereby the [acquiring fund] is obligated" to Pass-Through Vote or Mirror Vote, Section 12(d)(1)(F) creates an obligation on the part of the acquiring fund to vote in a manner that protects the underlying fund from control or influence by the acquiring fund's adviser, consistent with the intent behind that provision. Reading such an obligation out of Section 12(d)(1)(F), as suggested in the SPE Hearing Request, in contrast, would eliminate that protection.

We note, however, that neither Section 12(d)(1)(E) nor the legislative history prescribes any particular type of "an arrangement." Thus, an acquiring fund that accomplishes either Pass-Through Voting (as interpreted by the Commission) or Mirror Voting with an underlying fund, and otherwise meets the conditions of Section 12(d)(1)(F), is unlikely to violate Section 12(d)(1)(A) due solely to an absence of a particular "arrangement" with the underlying fund.

SPE Shareholders' Support and Public Disclosure

The SPE Hearing Request points out that its Voting Procedure has "almost unanimous support" of its shareholders, who also will "have an opportunity each year to terminate the [Adviser's]

proxy voting discretion.” The SPE Hearing Request also notes that, unlike at the time of the 1971 Release, there is now public disclosure of the manner in which the proxies were voted.

These “salient facts,” as they are described in the SPE Hearing Request, however, do not negate the fact that the Proxy Voting Procedure gives the Adviser broad discretion in voting the underlying funds’ proxies and thus presents the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds. SPE shareholders’ support for such broad discretion and after-the-fact disclosure of how that discretion was exercised do not minimize the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds, which is the principal purpose behind the voting condition in Section 12(d)(1)(F).

The Breadth of the Adviser’s Voting Discretion

The SPE Hearing Request makes a conclusory assertion that “the discretion permitted by SPE’s Proxy Voting Procedure is limited; it is not ‘broad’.” The SPE Hearing Request also suggests that SPE shareholders’ “standing instructions” to the Adviser under the Voting Procedure satisfy the condition in Section 12(d)(1)(F) that the acquiring fund vote in the manner prescribed by Section 12(d)(1)(E).

As noted above, the Voting Procedure enables the Adviser, on any proposal from an underlying fund, to vote “in a manner which the Adviser reasonably determines is likely to favorably impact the discount of such [underlying fund’s] market price as compared to its net asset value.” The Voting Procedure does not limit the Adviser’s ability to vote on proposals from an underlying fund in the manner contemplated by Section 12(d)(1)(E). Rather, it affirms the Adviser’s discretion to decide how to vote on a proposal from an underlying fund without consulting SPE’s shareholders, contrary to the principal purpose of the voting condition in Section 12(d)(1)(F) to limit that discretion. Furthermore, reading Section 12(d)(1)(E)’s provision to “seek instructions” as allowing the “standing instructions” under the Voting Procedure as SPE does, would continue to allow the Adviser discretion to vote on proposals from an underlying fund. This creates a risk that the Adviser would unduly influence the underlying fund and undermine the basic purpose behind the voting condition in Section 12(d)(1)(F).

The Adviser’s Influence Over the Underlying Funds

The Daniels Hearing Request argues that the Adviser’s voting of an underlying fund’s shares held by SPE “to reduce the trading discount of a closed-end [underlying fund] does not constitute ‘undue’ influence” and suggests that the Commission should hold a hearing on this issue. We note, however, that Section 12(d)(1)(F) guards against influence by the acquiring fund’s investment adviser not by drawing any qualitative distinctions between undue and proper influence, but by preventing the adviser from voting in the first place and requiring Pass-Through Voting or Mirror Voting instead.

The Practicality of Pass-Through Voting as Described in the 1971 Release and the Consistency of Mirror Voting with the Adviser's Fiduciary Duty

The Daniels Hearing Request points out that SPE's portfolio consists of, among other things, shares in 46 underlying funds and that using Pass-Through Voting, as described in the 1971 Release, in SPE's situation therefore is "utterly impractical." In this regard, the Daniels Hearing Request says that "most individual investors in SPE would share my dismay at the prospect of constantly receiving [underlying fund] proxy statements at the rate of one per week, together with the obligatory stack of annual reports for these funds. And having received this flood of paper, the shares I hold in SPE would then (on a pro rata basis) allow me to vote 12 shares in the Aberdeen Israel Fund, 37 shares of Adams Express, 88 shares of Alpine Total Dynamic Dividend, and so forth down through the alphabet until I finally arrive at 65 shares of the Zweig Total Return Fund and must then start all over again."

The SPE Hearing Request further argues that "[b]y rejecting any realistic alternative to Mirror Voting, [the Commission's view of Pass-Through Voting as stated in the Notice] effectively prevents [the Adviser] from fulfilling its fiduciary duty to vote proxies in the best interest of SPE. . . . [The Adviser] cannot fulfill its fiduciary duty to vote SPE's proxies in the best interest of SPE by mindlessly Mirror Voting." The Daniels Hearing Request also suggests that Mirror Voting deprives SPE, as a shareholder of an underlying fund, of its right to participate in the management of the underlying fund.

Mirror Voting by the Adviser for the purpose of complying with the condition in Section 12(d)(1)(F) is essentially complying with a regulatory requirement and therefore would not violate the Adviser's fiduciary duty. It may well be, however, that Pass-Through Voting is impractical for SPE and that Mirror Voting is not optimal for SPE and the Adviser. This is not, however, a reason to read the conditions of Section 12(d)(1)(F) in a manner contrary to the purposes and policies underlying them. The conditions of Section 12(d)(1)(F) were intended primarily to protect the underlying fund from control or influence by the acquiring fund and its affiliates, including the acquiring fund's investment adviser. Pass-Through Voting, as interpreted by the Commission, and Mirror Voting guard against influence by the acquiring fund's adviser by placing the voting discretion on proposals from an underlying fund in the hands of someone else (*i.e.*, the acquiring fund's shareholders, in the case of Pass-Through Voting, or the other shareholders of the underlying fund, in the case of Mirror Voting). SPE's Voting Procedure, on the other hand, leaves the voting discretion with the Adviser and therefore operates contrary to the purpose of the voting condition in Section 12(d)(1)(F).

The Commission also notes that Section 12(d)(1)(F) is not an affirmative regulatory requirement, but a conditional exemption from the statutory limits of Sections 12(d)(1)(A) that any acquiring fund may or may not choose to use. To the extent that SPE and its shareholders believe that SPE should be permitted to invest in the underlying funds in excess of the limits in Section 12(d)(1)(A) of the 1940 subject to conditions different from those set forth in Section 12(d)(1)(F), SPE may seek an exemptive order pursuant to Sections 6(c) and 12(d)(1)(J) of the 1940 Act.⁷ The Daniels Hearing Request noted these provisions and requested that the

⁷ Section 12(d)(1)(J) provides that "[t]he Commission, by rule or regulation, upon its own motion or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or

Commission "grant an appropriate exemption." Such an exemption is not, however, what SPE is seeking in the Application.⁸

THEREFORE, IT IS ORDERED that the requests for a hearing are denied.⁹

IT IS FURTHER ORDERED that SPE's Voting Procedure is declared not to satisfy Section 12(d)(1)(F) of the 1940 Act.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

any class or classes of persons, securities, or transactions from any provision of [Section 12(d)(1)], if and to the extent that such exemption is consistent with the public interest and the protection of investors." Section 6(c) of the 1940 Act provides that "[t]he Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter."

⁸ Sections 6(c) and 12(d)(1)(J) provide for a Commission "order upon application." The requirements for applications under the 1940 Act are set forth in Rule 0-2 under the 1940 Act. Any such order may or may not be granted based on the standards for exemption in Sections 6(c) and 12(d)(1)(J).

⁹ In a letter to the Secretary of the Commission, dated September 9, 2013, SPE requested that, should the Commission deny its hearing request, a stay be issued foreclosing any enforcement action pending the outcome of an appeal of the proposed order. Because there is no enforcement action on the issue currently pending, the Commission does not believe a stay is appropriate at this time.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72859 / August 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16019

In the Matter of

MATTHEW P. IONNO,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Matthew P. Ionno ("Ionno" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2 and III.4 below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

39 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Ionno, age 35, was a managing member/manager of Traders Café, LLC until he resigned on October 4, 2013. Ionno and his business partner established Traders Café, LLC in July 2012 to act as a broker-dealer for day-trading customers. Ionno and his business partner touted Traders Café's software trading platform, low commissions and fees, high leverage, and the safety and use of investors' assets and raised more than \$500,000 from investors. Instead of using these funds for their intended purpose, Ionno and his business partner misappropriated a majority of investors' funds for personal use. Ionno has never been registered with the Commission in any capacity.

2. On June 10, 2014, Ionno pled guilty to one count of conspiracy to commit wire fraud in violation of Title 18 United States Code, Section 371 before the United States District Court for the Middle District of Florida, in United States v. Matthew Pasquale Ionno, Case No. 8:14-cr-251-T-35TBM.

3. The count of the criminal information to which Ionno pled guilty alleged, inter alia, that in connection with Traders Café, Ionno conspired to devise a scheme and artifice to defraud and for obtaining money and property by means of materially false and fraudulent pretenses, representations, and promises, utilizing transmission by means of wire and radio communications in interstate commerce.

4. On June 30, 2014, a judgment was entered by consent against Ionno, permanently enjoining him from future violations of Sections 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Matthew P. Ionno, Civil Action Number 8:14-cv-1488-T-35TBM, in the United States District Court for the Middle District of Florida.

5. The Commission's complaint alleged, inter alia, that, in connection with the purchase and sale of securities through Traders Café and the offer and sale of securities in Traders Café, Ionno misused and misappropriated investor funds, made material misrepresentations to customers and an investor, and unlawfully operated an unregistered broker-dealer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Ionno's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b) of the Exchange Act Respondent Ionno be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Ianno be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72858 / August 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16018

In the Matter of

**Bellavista Capital, Inc.,
Bow Valley Ventures Inc.,
Desert Capital REIT, Inc.,
Kore Nutrition, Inc.,
Lakeside Ventures, Inc., and
Oban Industries, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Bellavista Capital, Inc., Bow Valley Ventures Inc., Desert Capital REIT, Inc., Kore Nutrition, Inc., Lakeside Ventures, Inc., and Oban Industries, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Bellavista Capital, Inc. (CIK No. 1086670) is a Maryland corporation located in Los Gatos, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bellavista Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended September 30, 2011, which reported a net loss of \$2,376,778 for the prior twelve months.

40 of 82

2. Bow Valley Ventures, Inc. (CIK No. 1402394) is a revoked Nevada corporation located in Edmonton, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bow Valley Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2010, which reported a net loss of \$144,124 from the company's December 20, 2006 inception to November 30, 2010.

3. Desert Capital REIT, Inc. (CIK No. 1274055) is a forfeited Maryland corporation located in Henderson, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Desert Capital REIT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2011, which reported a net loss of \$1,975,000 for the prior three months. On April 29, 2011, an involuntary Chapter 11 petition was filed against the company in the U.S. Bankruptcy Court for the District of Nevada, and the case was still pending as of April 24, 2014.

4. Kore Nutrition, Inc. (CIK No. 1444064) is a revoked Nevada corporation located in Beverly Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Kore Nutrition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2011, which reported a net loss of \$13,791,334 from the company's May 24, 2007 inception to June 30, 2011. As of August 5, 2014, the company's stock (symbol "KORE") was traded on the over-the-counter markets.

5. Lakeside Ventures, Inc. (CIK No. 1508102) is a revoked Nevada corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lakeside Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2011, which reported a net loss of \$2,074 from the company's October 18, 2010 inception to February 28, 2011. Moreover, the company has never filed a Form 10-K since it was registered on December 23, 2010.

6. Oban Industries, Inc. (CIK No. 1514158) is a dissolved Delaware corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Oban Industries is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2011, which reported a net loss of \$11,057 from the company's January 28, 2011 inception to July 31, 2011. Moreover, the company has never filed a Form 10-K since it was registered on March 2, 2011.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic

filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72861 / August 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16020

In the Matter of

SCOTT ASHTON RIGGS,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), against Scott Ashton Riggs ("Respondent" or "Riggs").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Scott Ashton Riggs ("Riggs"), a resident of Irving, Texas, is the CEO and/or otherwise controls a variety of entities, including Ashton Oilfield Services, LLC ("Ashton Oilfield")

41 of 82

and Ashton Equipment, LLC ("Ashton Equipment"). Ashton Oilfield served as the general partner of two limited partnerships known as AOS 1-A, L.P. and AOS 1-B, L.P. From 2005 to 2006, Riggs was associated with a Commission-registered broker-dealer, holding Series 22 and 63 licenses.

2. On July 11, 2014, a final judgment was entered by consent against Riggs, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a)(2) of the Securities Act of 1933 and Section 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in a civil action titled *Securities and Exchange Commission v. Scott Ashton Riggs, et al.*, Civil Action Number 3:13-CV-4403, in the United States District Court for the Northern District of Texas. In addition, the final judgment ordered Riggs, Ashton Oilfield, Ashton Equipment, and the two limited partnerships AOS 1-A, L.P. and AOS 1-B, L.P., to pay, on a joint and several basis, disgorgement in the amount of \$12,445,327.33, representing profits gained as a result of the conduct alleged in the Complaint, together with prejudgment interest thereon in the amount of \$943,697.49. The final judgment further ordered Riggs, Ashton Oilfield, and Ashton Equipment to pay a civil penalty in the amount of \$150,000.

3. The Commission's Complaint alleged that between December 2007 and May 2011, Riggs, his entities, and two associates raised more than \$12 million from approximately 300 investors nationwide in two fraudulent and unregistered securities offerings. Riggs represented to investors that he was raising funds to buy oil and gas drilling equipment, which would then be leased to exploration and production companies. Returns to investors were to be paid from the leasing of this drilling equipment. The Commission alleged that the offerings were based on a variety of material misrepresentations and omissions of material fact. For example, as alleged in the Complaint, Riggs spent relatively little of the investors' money to purchase the drilling equipment. Instead, he diverted the majority of investor funds to personal and non-equipment business expenses. According to the Complaint, the squandering of investor funds by Riggs was so extravagant and continuous that more than two and one-half years passed before he purchased a single drilling rig, even though Riggs had raised several times the cost of that rig from investors during that time. Even after leasing that first rig, Riggs failed to pay investors the returns he had promised. Instead, Riggs spent those leasing revenues on personal expenses and on compensating a separate group of investors from one of Riggs's earlier failed oil and gas offerings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Riggs's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Riggs be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Riggs be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 19, 2014

In the Matter of

**Balaton Power, Inc. and
Flying Eagle PU Technical Corp. (f/k/a
Sooner Holdings, Inc.),**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Balaton Power, Inc. because it has not filed any periodic reports since the period ended December 31, 2011.

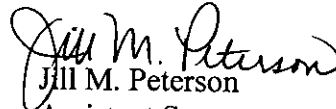
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Flying Eagle PU Technical Corp. (f/k/a Sooner Holdings, Inc.) because it has not filed any periodic reports since the period ended December 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

42 of 82

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 19, 2014, through 11:59 p.m. EDT on September 2, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72863 / August 19, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16021

In the Matter of

**Balaton Power, Inc. and
Flying Eagle PU Technical Corp.
(f/k/a Sooner Holdings, Inc.),**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Balaton Power, Inc. and Flying Eagle PU Technical Corp. (f/k/a Sooner Holdings, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Balaton Power, Inc. (CIK No. 1132704) is a British Columbia corporation located in Langley, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Balaton Power is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A for the period ended December 31, 2011, which reported a net loss of \$228,984 for the prior twelve months. As of August 5, 2014, the company's stock (symbol "BPWRF") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

43 of 82

2. Flying Eagle PU Technical Corp. (f/k/a Sooner Holdings, Inc.) (CIK No. 861370) is an Oklahoma corporation located in ShiShi City, Fujian, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Flying Eagle is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2011. As of August 5, 2014, the company's stock (symbol "FEPU") was quoted on OTC Link, had five market makers, and was eligible for the piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further

order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

美利坚合众国
之
证券交易监督委员会

《1934 年证券交易法》

发行号 72863 / August 19, 2014

行政程序

备案号 3-16021

就以下相对人之事项:

Balaton Power, Inc. 和
飞鹰塑胶有限公司 (Flying Eagle PU
Technical Corp.)
(原 Sooner Holdings, Inc.)

依据《1934 年证券交易法》第 12(j) 条，
送达行政程序启动
暨听证通知令

I.

证券交易监督委员会（“委员会”）认为，依据《1934 年证券交易法》（“证券法”）第 12(j) 条对相对人 Balaton Power, Inc. 和飞鹰塑胶有限公司 (Flying Eagle PU Technical Corp.)（原 Sooner Holdings, Inc.）特此提起公共行政程序，对保护投资者是必要且适当的。

II.

经调查，执行部诉称：

A. 相对人

1. Balaton Power, Inc. (CIK 号 1132704) 是一家位于加拿大不列颠哥伦比亚省兰利市的英属哥伦比亚公司，依据证券法第 12(g) 条在委员会注册了一类证券。Balaton Power 未按规定向委员会提交定期报告。自提交截至 2011 年 12 月 31 日的 20-F/A 表（称过去十二个月净亏损 228,984 美元）后，Balaton Power 再未提交任何报告。截至 2014 年 7 月 7 日，该公司股票（代码 "BPWRF"）仍在 OTC Link 市场挂牌交易，并拥有八家做市商，且符合证券法 15c2-11 (f) (3) 规则中“捎带” (piggyback) 例外的资格。

2. 飞鹰塑胶有限公司 (Flying Eagle PU Technical Corp.) (原 Sooner Holdings, Inc.) (CIK 号 861370) 是一家位于中国福建省石狮市的俄克拉荷马州公司, 依据证券法第 12(g) 条在委员会注册了一类证券。Flying Eagle 未按规定向委员会提交定期报告。自提交截止 2011 年 12 月 31 日的 10-K 表后, Flying Eagle 再未提交任何报告。截至 2014 年 7 月 7 日, 该公司股票 (代码 "FEPU") 仍在 OTC Link 市场挂牌交易, 并拥有五家做市商, 且符合证券法 15c2-11 (f) (3) 规则中“捎带” (piggyback) 例外的资格。

B. 未按规定提交定期报告

3. 正如上文详述, 所有相对人均未按规定向委员会提交定期报告, 屡次不履行按时提交定期报告的义务, 且在收到企业金融部发出的催告函, 要求其遵守定期申报义务后, 仍不予理会, 或因未按证监会的规定在证监会维护有效备案地址, 从而未收到该等催告函。

4. 根据证券法第 13(a) 条及其发布的规定, 依据证券法第 12 条注册的证券发行者, 即使是根据第 12(g) 条自愿注册, 亦应以定期报告的方式向委员会提交最新且准确之信息。具体而言, 第 13a-1 条规定要求发行者提交年报, 第 13a-13 条规定要求国内发行者提交季报。

5. 由于上述原因, 相对人未遵守证券法第 13(a) 条和根据该法发布的第 13a-1 条和/或 13a-13 条之规定。

III.

鉴于执行部提出的诉称, 委员会认为提起公共行政程序确定以下事项对保护投资者是有必要且适当的:

A. 本命令第 II 部分所包含的诉称是否属实, 就该诉称而言, 给予相对人对该等诉称进行抗辩的机会; 以及

B. 就保护投资者而言, 对本命令第 II 部分所指定相对人、证券法第 12b-2 条或第 12g-3 条规定下的任何继承人、采用新公司名称的相对人采取以下行为是否有必要且适当——暂停 (不超过十二个月) 或撤销其依据证券法第 12 条注册的各类证券;

IV.

特此命令, 为对第 III 部分所述问题进行取证, 应在待定的时间和地点召开公开听证, 并由《美国证监会行为规范》第 110 条规定的进一步命令所指定的行政法法官主持[《美国联邦法规》第 17 编第 201.110 节]。

进一步命令，相对人应在本命令送达后十(10)日内，按《美国证监会行为规范》第220(b)条规定[《美国联邦法规》第17编第201.220(b)节]对本命令中所包含的诉称提交答辩状。

若相对人未提交所规定的答辩状，或在收到通知后未出席听证，则相对人及《美国证监会行为规范》第12b-2条或第12g-3条规定下的任何继承人，以及拥有新公司名称的相对人，将被视为缺席，且将针对其就命令中的事项确定相应程序，根据《美国证监会行为规范》第155(a)、220(f)、221(f)和310条规定[《美国联邦法规》第17编第201.155(a)、201.220(f)、201.221(f)和201.310节]，命令中的诉称将被视为属实。

本命令应以直接送达的方式或通过特快专递或《美国证监会行为规范》允许的其它方式，立即送达相对人。

进一步命令，行政法法官应依据《美国证监会行为规范》第360(a)(2)条规定[《美国联邦法规》第17编第201.360(a)(2)节]，在不晚于本命令送达之日起的120天内做出初始裁决。

如缺少相关弃权，则委员会在本程序或任何事实上相关的程序中从事调查或起诉职能的任何官员或雇员，均不得参加本事项的决策或对本事项的决策提出建议，但依据通知在诉讼中担任证人或律师的除外。因本程序并非《行政诉讼法》第551节定义的“法规制定”，因此不受第553条规定的限制，无须推迟委员会任何最终决议的实行日期。

委员会。

助理秘书
Jill M. Peterson

送达清单

《美国证监会行为规范》第141条规定 秘书或经正式授权的委员会官员 应依据 1934年证券交易法》第12(j)

条 向相对人及其法定代理人送达行政程序启动通知书(“命令”)的副本。

所附命令已送至以下当事人及有权收到通知的其他人:

Brenda P. Murray 法官
首席行政法官
证券交易监督委员会
100 F St., N.E.
Washington, DC 20549-2557

Neil J. Welch, Jr., Esq.
执行部
证券交易监督委员会
100 F St., N.E.
Washington, DC 20549-6010

通过Priority Mail Express International 送达
Balaton Power, Inc.
Suite 206, 20257 54th Ave.
Langley, BC V3A 3W2
Canada

通过《海牙送达公约》送达
飞鹰塑胶有限公司(Flying Eagle PU Technical Corp.)
(原 Sooner Holdings, Inc.)
中华人民共和国
福建省石狮市
蚶江镇
龙山开发区

*Commissioner Prower
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72868 / August 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15888

In the Matter of

DONALD R. FRENCH, JR.,

Respondent.

ORDER MAKING FINDINGS AND IMPOSING
REMEDIAL SANCTIONS PURSUANT TO
SECTION 15(b) OF THE SECURITIES
EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") previously instituted proceedings in this matter on May 27, 2014. The Commission now deems it appropriate and in the public interest to enter this Order Making Findings And Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") ("Order") against Donald R. French, Jr., ("French" or "Respondent").

II.

French has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, French admits the Commission's jurisdiction over him and over the subject matter of the proceedings and admits the findings in Section III.2 below. French further consents to the entry of the Order, as set forth below.

III.

On the basis of this Order and French's Offer, the Commission finds that:

44 of 82

1. At the time of the relevant conduct, French was the owner and principal of D3 Funds LP, a now defunct Delaware limited partnership located in Boca Raton, Florida. French was not registered as a broker-dealer or associated with a registered broker-dealer during the relevant time. French, 26, was a resident of Boca Raton, Florida; however, he is currently imprisoned in Oakdale, Louisiana. French solicited investors to buy securities, advised them on the merits of the investment, and received transaction based compensation.

2. On March 15, 2013, French pleaded guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18, United States Code, Section 1349, before the United States District Court for the Southern District of Florida, in *United States v. French Jr.*, Case No. 12-80212-CR-RYSKAMP/HOPKINS. On June 27, 2013, a judgment in the criminal case was entered against French. French was sentenced to 121 months in prison and 5 years of supervised release. French was ordered to pay restitution in the amount of \$9.1 million.

3. The count of the criminal Information to which French pleaded guilty alleged, among other things, that French and his co-conspirators unlawfully enriched themselves by seeking to obtain millions of dollars through operation of a Ponzi scheme in which victims were falsely and fraudulently promised quick and substantial returns on their investment. Pursuant to the plea agreement, French admitted that he created a false and fraudulent prospectus for investors, supplemented by his false and fraudulent oral representations, which led investors to believe their investments would be invested in legitimate investment vehicles, minus a small management fee. French's false representations included representing a high rate of return, and that investors would be protected or guaranteed against loss. French admitted to providing investors with fraudulent web based monthly account statements, which were also used to solicit further investments. Although French represented to investors that 98% of the monies given to D3 Funds LP were to be invested, French only used a small percentage of that money for actual investment. French admitted to defrauding victims out of more than \$10 million during the course of the scheme, the majority of which was spent on himself and his co-conspirators, including personal living expenses through use of check/debit cards, gambling debts, and cash withdrawals.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent French's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent French be, and hereby is: barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72872 / August 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16024

In the Matter of

**ATP Oil & Gas Corp.,
Cambridge Holdings, Ltd.,
FTE Networks, Inc.,
Raystream, Inc., and
Shelron Group, Inc.**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF
HEARING PURSUANT TO
SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS¹

1. ATP Oil & Gas Corp. ("ATPAQ") (CIK No. 1123647) is a Texas corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ATPAQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$131,521,000 for the prior three months. On August 17, 2012, ATPAQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Texas, which was still pending as of August 18, 2014. As of August 18, 2014, the common stock of ATPAQ was quoted on OTC Link operated by OTC Markets Group Inc. (formerly

¹The short form of each issuer's name is also its stock symbol.

"Pink Sheets") ("OTC Link"), had nineteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Cambridge Holdings, Ltd. ("CDGD") (CIK No. 712757) is a Colorado corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CDGD is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011, which reported a net loss of \$27,298 for the prior three months. As of August 18, 2014, the common stock of CDGD was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. FTE Networks, Inc. ("FTNW") (CIK No. 1122063) is a Nevada corporation located in Naples, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FTNW is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2012, which reported a net loss of \$5,894,000 for the prior nine months. As of August 18, 2014, the common stock of FTNW was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Raystream, Inc. ("RAYS") (CIK No. 1489744) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RAYS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2012, which reported a net loss of \$759,278 for the prior three months. As of August 18, 2014, the common stock of RAYS was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Shelron Group, Inc. ("SRNG") (CIK No. 1125903) is a Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SRNG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2012, which reported a net loss of \$255,653 for the prior year. As of August 18, 2014, the common stock of SRNG was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current

and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

8. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 20, 2014

In the Matter of

**ATP Oil & Gas Corp.,
Cambridge Holdings, Ltd.,
FTE Networks, Inc.,
Raystream, Inc., and
Shelron Group, Inc.**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ATP Oil & Gas Corp. because it has not filed any periodic reports since the period ended March 31, 2012.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cambridge Holdings, Ltd. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of FTE Networks, Inc. because it has not filed any periodic reports since the period ended June 30, 2012.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Raystream, Inc. because it has not filed any periodic reports since the period ended July 31, 2012.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Shelron Group, Inc. because it has not filed any periodic reports since the period ended December 31, 2012.

46 of 82

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 20, 2014, through 11:59 p.m. EDT on September 3, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72870 / August 20, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16023

In the Matter of

**International Building Technologies Group, Inc.,
Regeneca, Inc.,
Retail Pro, Inc.,
Tri-Valley Corporation, and
VECTRA Technologies, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS AND NOTICE
OF HEARING PURSUANT TO
SECTION 12(j) OF THE
SECURITIES EXCHANGE
ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS¹

1. International Building Technologies Group, Inc. ("INBG") (CIK No. 1075993) is a revoked Nevada corporation located in City of Industry, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). INBG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011, which reported a net loss of \$1,506,534 for the prior nine months. As of August 18, 2014, the common stock of INBG was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹The short form of each issuer's name is also its stock symbol.

2. Regeneca, Inc. ("RGNA") (CIK No. 1056598) is a revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RGNA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011, which reported a net loss of \$888,400 for the prior nine months. As of August 18, 2014, the common stock of RGNA was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Retail Pro, Inc. ("RTPRQ") (CIK No. 866535) is a void Delaware corporation located in La Jolla, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RTPRQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2007, which reported a net loss available to common shareholders of \$4,600,000 for the prior nine months. On January 10, 2009, RTPRQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was converted to a Chapter 7 proceeding on December 10, 2009, and was still pending as of August 18, 2014. As of August 18, 2014, the common stock of RTPRQ was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Tri-Valley Corporation ("TVLYQ") (CIK No. 22551) is a delinquent Delaware corporation located in Bakersfield, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TVLYQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$1,483,290 for the prior three months. On August 7, 2012, TVLYQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was converted to a Chapter 7 proceeding on March 25, 2013, and was still pending as of August 18, 2014. As of August 18, 2014, the common stock of TVLYQ was quoted on OTC Link, had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. VECTRA Technologies, Inc. ("VCTRQ") (CIK No. 782379) is an inactive Washington corporation located in San Ramon, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VCTRQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 1997, which reported a net loss of \$4,590,000 for the prior three months. On October 2, 1997, VCTRQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Washington, which was closed on September 8, 2000. As of August 18, 2014, the common stock of VCTRQ was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

6. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

8. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 20, 2014

In the Matter of

**International Building Technologies Group, Inc.,
Regeneca, Inc.,
Retail Pro, Inc., and
Tri-Valley Corporation,**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of International Building Technologies Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Regeneca, Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Retail Pro, Inc. because it has not filed any periodic reports since the period ended December 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tri-Valley Corporation because it has not filed any periodic reports since the period ended March 31, 2012.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the

48 of 82

securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 20, 2014, through 11:59 p.m. EDT on September 3, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72886 / August 20, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16025

In the Matter of

**MONNESS, CRESPI, HARDT
& CO., INC.,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Monness, Crespi, Hardt & Co., Inc. ("MCH" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

49 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. Beginning in at least 2006 until early 2012, MCH, a registered broker-dealer and equity research firm, failed to establish, maintain and enforce written policies and procedures reasonably designed, taking into account the nature of its business, to prevent the misuse of material, nonpublic information, in violation of the Exchange Act or the rules and regulations thereunder. Specifically, MCH failed to enforce two of its written compliance procedures, which required MCH to maintain a restricted list and required employees to submit a report of their securities transactions. Second, MCH did not adopt written policies and procedures to address the potential risk created by the firm's Idea Dinner and Corporate Access programs, which the firm had established and provided as services to its existing and prospective customers. As a result, MCH violated Section 15(g) of the Exchange Act.

2. The Commission's Office of Compliance Inspections and Examinations conducted an examination of MCH in 2011 which initially identified these issues, and MCH promptly undertook remedial measures in response. Among other measures, the firm adopted revised insider trading supervisory procedures which included expanding and formalizing its restricted list procedures, prohibiting trading by its employees in MCH covered securities, and adopting written supervisory procedures for its Corporate Access and Idea Dinner programs.

Respondent

3. Monness, Crespi, Hardt & Co., Inc. is a New York corporation with its principal place of business in New York City. MCH has been registered with the Commission as a broker-dealer since February 11, 1977. MCH's primary business is executing trades for hedge funds and other institutional customers and providing equity research to its customers.

Facts

4. Throughout the relevant period, MCH employed approximately 35-50 associated persons, including about 7 to 8 research analysts. MCH's analyst research covered approximately 60-80 public companies in sectors such as aerospace, chemicals and agriculture, energy, healthcare, housing, construction and real estate, industrials and transportation, retail and consumer products, and technology, telecom and the internet.

5. As part of their duties, certain MCH employees, including the research analysts, had access to material, nonpublic information concerning, among other things, the upcoming publication by MCH of research reports. MCH analysts or other employees also could potentially acquire material, nonpublic information regarding issuers during the course of preparing research reports. In view of the nature of its business, MCH had developed written policies and procedures in a "Compliance Manual" to prevent and detect the misuse of material, nonpublic information. MCH revised and updated its Compliance Manual on a yearly basis.

A. MCH Failed to Enforce its Restricted List and Employee Securities Reporting and Review Procedures

6. The firm's Compliance Manual contained policies and procedures regarding the prohibition on insider trading and the protection of confidential information. The firm failed, however, to enforce two of its insider trading procedures.

(a) Restricted List

7. The "Restricted Securities" provision of MCH's Compliance Manual set forth policies and procedures regarding the confidentiality of information related to MCH analyst research. Prior to the public dissemination of a research report on an issuer, associated persons who learned of or anticipated receiving material, nonpublic information concerning that issuer in the course of compiling a research report were prohibited from trading in that issuer's securities or recommending the purchase or sale of that issuer's securities to any customer. MCH likewise was prevented from purchasing or selling such securities in its accounts.¹ To avoid the risk of trading ahead of a research report (research front running), the research analyst and anyone else aware of an upcoming research report were prohibited from trading in the issuer's securities prior to publication of the research report.

8. To effectuate these policies, the Compliance Manual provided that issuers that were the subject of an upcoming research report would be placed on a restricted list when the research commenced and removed after the report was published. The Compliance Manual mandated that, during this restricted period, MCH would only permit bona fide unsolicited customer orders for trading in the issuer's securities. In addition, MCH had to approve any request to trade in the issuer's securities.

9. MCH did not follow this procedure. It did not place issuers subject to upcoming MCH research reports on a restricted list, or require trading approval of such restricted securities. The only securities that MCH employees were prohibited from trading were securities of two issuers for which the firm's vice president served on the board of directors. Without maintaining a restricted list in accordance with its stated procedures, MCH did not adequately monitor trading activity to prevent or detect potential market violations, including insider trading and trading in advance of material research changes.

(b) Personal Securities Trading

10. MCH's Compliance Manual required all of its employees and their family members to conduct personal securities transactions through accounts held at the firm. Certain MCH employees and analysts traded equities through accounts maintained at the firm, including in securities of issuers covered by MCH analyst research.

¹ The firm did not engage in proprietary trading except for riskless principal transactions in the execution of customer orders.

11. However, MCH failed to enforce its compliance procedure that required all MCH officers, directors, and employees to submit a report of every securities transaction in which they, their families, or their trusts participated.² The firm required this personal securities trading report as part of its insider trading procedures. The Compliance Manual required MCH to review these trading reports, and to coordinate the review of such reports with appropriate MCH personnel. The firm's failure to enforce these procedures, coupled with the firm's failure to maintain a comprehensive restricted list, limited MCH's ability to review adequately employee trading for the misuse of material, nonpublic information. In addition, the firm did not sufficiently document the trading reviews it may have conducted or the outcome of any inquiry or investigation it may have conducted as a result of such reviews.

B. MCH Lacked Written Compliance Policies and Procedures Concerning its Corporate Access and Idea Dinner Programs

12. During the relevant period, MCH did not have written policies and procedures that specifically addressed the risks posed by its "Corporate Access" or "Idea Dinner" programs, two programs that the firm had established and provided as services to its existing and prospective customers. These programs posed the risk that MCH analysts or employees might disclose material, nonpublic information about upcoming research reports or about an issuer learned in the course of an analyst compiling a research report. The Corporate Access program also posed the risk that associated persons of MCH or its customers might have access to material, nonpublic information from issuers' management.

13. MCH's "Corporate Access" program, which began in approximately 2009, provided issuer management with access to investors through non-investment banking road shows and other investor access events. The firm's marketing materials state that, through the program, "MCH provides its clients the opportunity for direct dialogue with corporate management teams and thought leaders across industries." Corporate Access events, which generally took place several times a month, consisted of group meetings and/or one-on-one meetings between management of the issuer, certain MCH employees (including research analysts and sales representatives), and MCH's institutional customers. If MCH covered the issuer in question, an MCH analyst usually attended the events.

14. MCH's "Idea Dinner" program consisted of dinners at which MCH personnel and current and prospective investor clients presented ideas. In its marketing materials, MCH states that it "consistently hosts idea dinners focused on creating a unique forum for experienced investors to share ideas and information on market, sector, and company specific topics."

² During the relevant period, the firm's "Personal Securities Trading" policy and procedure stated:

"[All] officers, directors, and employees of the Firm shall submit to the Firm's President a report of every securities transaction in which they, their families (including the spouse, minor children, and adults living in the same household as the officer, director or employee), and trusts of which they are trustees of in which they have a beneficial interest have participated after such transaction. We do not allow personal accounts outside the Firm you must conduct your equities trading business through the Firm."

Sometimes MCH analysts would attend Idea Dinners and present trading recommendations on stocks that they covered. The Idea Dinners were recorded and after each dinner the firm sent the tape recording to a transcription service to type up the notes regarding each idea presented. Typically a "teaser" summary identifying the ideas presented at the dinner was distributed to certain of the firm's customers, after which detailed notes of the discussions held at the dinner were sent to customers upon request. The firm tracked the performance of the ideas presented and would periodically publish that information to its clients.

15. MCH did not have written policies and procedures that specifically addressed the risks that its Idea Dinner and Corporate Access programs posed for the possible misuse of material, nonpublic information. For example, MCH did not have a policy that specifically prevented an analyst or other associated person from proposing a trading recommendation on a security at an Idea Dinner or Corporate Access event when that security was the subject of an upcoming research report. Although associated persons of MCH were subject to the firm's general prohibition against disclosing material, nonpublic information about an issuer learned while compiling a research report, the only procedure identifying an upcoming research report itself as material, nonpublic information was the restricted list procedure, which the firm failed to follow.

16. Similarly, MCH had no written procedures or controls to specifically address the risk that its analysts or other associated persons were not divulging material, nonpublic information during, or learned as a result of, Corporate Access or Idea Dinner events. For instance, MCH's compliance officer did not attend these events. Nor did MCH monitor the analysts' presentations, conduct trading reviews around these events, or conduct reviews to determine, for example, if ratings or target price changes, or material disclosures by the issuer, took place shortly after an MCH analyst took part in these events.

Legal Analysis

17. Section 15(g) of the Exchange Act requires broker-dealers to establish, maintain and enforce written policies and procedures, reasonably designed, taking into consideration the nature of the broker's or dealer's business, to prevent the misuse, in violation of the Exchange Act or the rules and regulations thereunder, of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.³ "The internal controls requirements imposed by Section 15(g) are essential to protect against the risk of misuse of material, nonpublic information, which can undermine investor confidence in the integrity of the markets. Section 15(g) is intended to guard against a broad range of potential market violations, including insider trading and trading in advance of material research changes." In re Goldman, Sachs & Co., Exch. Act Rel. No. 66791 (Apr. 12, 2012).

³ There is no requirement under Section 15(g) that there be an underlying insider trading violation or any other violation of the Exchange Act or the rules thereunder. In the Matter of New York Stock Exchange LLC, et al., Exchange Act Release No. 72065, 2014 WL 1712113, at *5 n. 13 (May 1, 2014); In the Matter of Certain Market Making Activities on NASDAQ, Exchange Act Release No. 40910, 1999 WL 6716, at *6 n.3 (Jan. 11, 1999). Section 15(g) of the Exchange Act was formerly Section 15(f). The provision was renumbered in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

18. Broker-dealers must be cognizant of their duties under Section 15(g) and the need to tailor their policies to the specific activities of the individual firm, particularly as their businesses evolve. The Commission has long held that the requirement that broker-dealers implement and maintain policies and procedures consistent with the nature of their business "is critical to effectively preventing the misuse of material, nonpublic information." In re Gabelli & Co., Inc., Exchange Act Rel. No. 35057 (Dec. 8, 1994). The Commission also has consistently made clear that broker-dealers must take seriously their responsibilities to design and enforce sufficiently robust policies and procedures to prevent the misuse of material, nonpublic information. See, e.g., In re Goldman Sachs & Co., Exchange Act Rel. No. 48436 (Sept. 4, 2003) (finding Section 15(f) violation where Goldman Sachs failed to prevent the misuse of material, nonpublic information potentially obtained by its paid outside consultants); In re Merrill Lynch, Pierce, Fenner & Smith Inc., Exchange Act Rel. No. 63760 (Jan. 25, 2011) (finding Section 15(g) violation where Merrill Lynch failed to prevent the misuse of customer order information).

19. The mere establishment of policies and procedures alone is not sufficient to prevent the misuse of material, nonpublic information. It also is necessary to implement measures to monitor compliance with and enforcement of those policies and procedures. See, e.g., In re Morgan Stanley & Co. Inc., et al., Exchange Act Release No. 54047 (June 27, 2006) (finding Section 15(f) violation where Morgan Stanley failed to enforce existing policies and procedures concerning surveillance over a four-year period).

20. MCH failed to adequately enforce its policies and procedures designed to prevent or detect the misuse of material, nonpublic information concerning its analysts' research and information its associated persons may have learned in the course of preparing a research report. Specifically, MCH failed to adequately enforce its own policies and procedures with regard to a restricted list and requiring employees to submit personal securities trading reports. Because of these failures, the firm was unable to review adequately employee or customer trading to prevent or detect potential market violations, including insider trading and trading in advance of material research changes.

21. The firm also had no written compliance policies and procedures that specifically addressed the risks posed by its Corporate Access and Idea Dinner programs. Having established these programs, the firm did not directly address the risk of misuse of material, nonpublic information that they posed.

22. Accordingly, beginning in at least 2006 until early 2012, as a result of the above failure to adequately establish, enforce, and maintain written policies and procedures reasonably designed, given the nature of its business, to prevent the misuse of material, nonpublic information, in violation of the Exchange Act or the rules and regulations thereunder, MCH willfully violated Section 15(g) of the Exchange Act.⁴

⁴ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

MCH's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent MCH.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent MCH cease and desist from committing or causing any violations and any future violations of Section 15(g) of the Exchange Act.
- B. Respondent MCH is censured.
- C. Respondent MCH shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$150,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:
 - (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
 - (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
 - (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payment by check or money order must be accompanied by a cover letter identifying MCH as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Stein
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3898 / August 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16026

In the Matter of

KELLY NG,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Kelly Ng ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section

50 of 82

203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Kelly Ng from 2007 through the present was a managing member of The Mortgage Fund, LLC which served as the investment adviser to real estate fund Mortgage Fund '08, LLC ("MF08"). Kelly Ng also served as the Vice President of Bar-K, Inc., a California corporation that serviced the loan portfolios for both MF08 and another real estate fund named R.E. Loans, LLC. He is 57 years old and a resident of Orinda, California, although he currently is incarcerated in federal prison for crimes not arising out of the matters discussed herein.

2. On August 1, 2014, a final judgment was entered by consent against Kelly Ng, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 in the offer or sale of securities, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder in connection with the purchase or sale of securities, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Walter Ng, et al., Civil Action Number 3:13-CV-00895-SC, in the United States District Court for the Northern District of California.

3. The Commission's complaint alleged that, in connection with the offer and sale of securities, Kelly Ng fraudulently pitched MF08 as a conservative investment vehicle that would invest in commercial real estate loans secured by first deeds of trust, when in reality MF08 was simply a mechanism for Kelly Ng to channel money into R.E. Loans, the older fund that he also managed, to continue the illusion that R.E. Loans was profitable. The complaint further alleged that even as R.E. Loans and MF08 experienced dramatic and significant loan delinquencies, Kelly Ng repeatedly lied to investors about the funds' performance in order to continue raising money for MF08 and, ultimately, R.E. Loans.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Kelly Ng's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Kelly Ng be, and hereby is, barred from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served

as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Stein
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3899 / August 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16027

In the Matter of

WALTER NG,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Walter Ng ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section

51 of 82

203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Walter Ng from 2007 through the present was a managing member of The Mortgage Fund, LLC, which served as the investment adviser to real estate fund Mortgage Fund '08, LLC ("MF08"). Walter Ng was also a managing member of B-4 Partners, LLC, which managed another real estate fund named R.E. Loans, LLC. He is 84 years old and a resident of Walnut Creek, California.
2. On August 1, 2014, a final judgment was entered by consent against Walter Ng, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 in the offer or sale of securities; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder in connection with the purchase or sale of securities, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Walter Ng, et al., Civil Action Number 3:13-CV-00895-SC, in the United States District Court for the Northern District of California.
3. The Commission's complaint alleged that, in connection with the offer and sale of securities, Walter Ng fraudulently pitched MF08 as a conservative investment vehicle that would invest in commercial real estate loans secured by first deeds of trust, when in reality MF08 was simply a mechanism for Walter Ng to channel money into R.E. Loans, the older fund that he also managed, to continue the illusion that R.E. Loans was profitable. The complaint further alleged that even as R.E. Loans and MF08 experienced dramatic and significant loan delinquencies, Walter Ng repeatedly lied to investors about the funds' performance in order to continue raising money for MF08 and, ultimately, R.E. Loans.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Walter Ng's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Walter Ng be, and hereby is, barred from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order;
and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct
that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Pivovar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72887 / August 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15890

In the Matter of

RANDI A. BOCHINSKI,

Respondent.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") previously instituted proceedings in this matter on May 27, 2014. The Commission now deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") ("Order") against Randi A. Bochinski ("Bochinski" or "Respondent").

II.

Bochinski has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Bochinski admits the Commission's jurisdiction over him and over the subject matter of the proceedings and admits the findings in Section III.2 below. Bochinski further consents to the entry of the Order, as set forth below.

III.

On the basis of this Order and Bochinski's Offer, the Commission finds that:

52 of 82

1. From at least November 30, 2004 through at least January 2010, Bochinski acted as a broker with respect to the offer and sale of securities. Bochinski was not registered as a broker-dealer or associated with a registered broker-dealer during the relevant time. Bochinski, 49 years old, is a Canadian citizen and was a resident of Kelowna, British Columbia and is currently imprisoned in Taft, California.

2. On May 13, 2013, Bochinski pleaded guilty to three counts of wire fraud (18 U.S.C. §§ 1343 and 2), three counts of mail fraud (18 U.S.C. §§ 1341 and 2), and one count of money laundering (18 U.S.C. §§ 1957 and 2) in the United States District Court for the District of Massachusetts in Boston U.S. v. Bochinski, et. al., Case No.: 1:10-cr-10199-DPW-1 (D. Mass. June 23, 2010). Bochinski was sentenced on October 18, 2013 to 72 months in prison and three years of supervised release. He was ordered to make restitution totaling \$5.2 million, to be paid jointly and severally with another individual. Bochinski is serving his sentence at a correctional institution in Taft, California.

3. As detailed in the plea agreement and indictment, Bochinski and another individual collectively induced at least 12 individuals nationwide to invest more than \$3.5 million in a series of purported high yield investment programs under various names, including Carlant Holdings, Ltd., from at least November 30, 2004 through at least January 2010. Bochinski falsely told investors that their funds would be held collectively in an escrow account as collateral for offshore foreign currency exchange trading or used to invest in communications-related business, timber, and gold, and to secure loans. The proceeds of the loans would purportedly be used for purposes such as trading in the stock of European and Asian banks and making loans to third world countries which purportedly would be guaranteed by the World Bank. Bochinski promised investors returns of at least three to four percent per month, and assured them that their principal would be returned to them within a short amount of time.

4. Bochinski acted as an unregistered broker by selling securities in the form of investment contracts. Bochinski solicited investors in the Carlant Holdings high yield investment program via telephone, e-mail, and in person. Bochinski contacted by telephone prospective investors referred to him by the other or met with them in person in order to sell the investments. He also solicited investors directly for the Carlant Holdings investment program through telephone calls. Bochinski represented himself as a fellow investor and told some investors that he was involved in other investment programs as well. Bochinski sometimes offered investors opportunities in other, purportedly higher yielding investment opportunities.

5. Bochinski provided investors with documents related to the purported investment programs. Bochinski sent some investors fictitious account statements, confirmations, updates, and investment agreements he personally signed. Bochinski collected investor funds directly from investors he solicited, sending them wire and bank instructions for investment. Bochinski made some payments to investors but most of the money came from other investors' funds.

6. Bochinski used some investor funds for personal expenditures.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Bochinski's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Bochinski be, and hereby is: barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Commissioner Aguilar
Commissioner Finowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3900 / August 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16029

In the Matter of

FOUNDING PARTNERS
CAPITAL MANAGEMENT
COMPANY

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(e) OF
THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Founding Partners Capital Management Company ("Founding Partners" or "Respondent").

II.

In anticipation of the institution of these proceedings, Founding Partners has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings and the findings contained in Section III.3 below, which are admitted, Founding Partners consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

53 of 82

III.

On the basis of this Order and Founding Partners' Offer, the Commission finds that:

1. Founding Partners is an investment adviser registered with the Commission since August 1999. The firm's most recent Form ADV indicates it is a Florida corporation with its principal place of business in Naples, Florida. The Form ADV, filed on April 7, 2009, indicates the firm had \$576,200,000 under management and provided investment advisory services to between one and ten clients, consisting of hedge funds, in its most recent fiscal year. William Gunlicks is listed as the President, CEO, and Chief Compliance Officer. The firm was censured, ordered to cease and desist from committing violations of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), and ordered to pay disgorgement and a civil penalty in the administrative action In the Matter of Founding Partners Capital Management Company and William Gunlicks. Administrative Proceeding 3-12896, Advisers Act Release No. 2680, Dec. 3, 2007.

2. In April 2009, the Commission sued Founding Partners and Gunlicks, among others in United States District Court, and sought the appointment of a Receiver over Founding Partners. The Court appointed a Receiver who assumed full control over the company that same month.

3. On August 4, 2014, a final judgment was entered by consent (from the Receiver) against Founding Partners, permanently enjoining it from violations of Sections 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5, and Sections 206(1) and 206(2) and 206(4) of the Advisers Act and Advisers Act Rule 206(4)-8, in the civil action entitled Securities and Exchange Commission v. Founding Partners Capital Management Co., et al., Case No. 2:09-cv-229, in the United States District Court for the Middle District of Florida.

4. The Commission's Complaint alleged that from 2004 until 2009, Founding Partners and Gunlicks solicited investors to invest in the hedge funds it managed and a Cayman Islands mutual fund by falsely representing that two factoring companies the hedge funds loaned money to would use the money to buy short-term, investment grade receivables and that the loans to those companies were fully secured by the receivables. In reality, Founding Partners knew the factoring companies were using the funds in ways that were not disclosed to investors and, in certain instances, in ways contrary to the disclosures Founding Partners made to investors. Founding Partners and Gunlicks further misrepresented the availability of audited financial statements for the hedge funds, misused investor money, and failed to disclose the prior Commission administrative proceeding.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Founding Partners' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(e) of the Advisers Act that Founding Partners' investment adviser registration be, and hereby is, revoked.

By the Commission.


Jill M. Peterson
Assistant Secretary

*Chair White
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72888 / August 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16028

In the Matter of

BANK OF AMERICA
CORPORATION,

Respondent.

ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND
IMPOSING CEASE-AND-DESIST
ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Bank of America Corporation ("Respondent" or "Bank of America").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Bank of America admits the facts contained in Annex A attached hereto and acknowledges that its conduct as set forth in Annex A violated the federal securities law, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order") as set forth below.

54 of 82

III.

On the basis of this Order and the Respondent's Offer, the Commission finds¹ that:

A. SUMMARY

1. This matter involves the failure by Bank of America to make required disclosures in the Management's Discussion and Analysis and Results of Operations ("MD&A") sections of periodic filings. Regulation S-K Item 303 requires a registrant to disclose in its MD&A sections "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material ... unfavorable impact on net sales or revenues or income from continuing operations." The failure to comply with Regulation S-K constitutes a violation of Section 13(a) of the Exchange Act.

2. Between 2004 and the first half of 2008, Bank of America and certain companies that it acquired in the second half of 2008 (the "acquired companies") sold approximately \$2.1 trillion of mortgage loans and residential mortgage backed securities ("RMBS"). Of the \$2.1 trillion total, approximately \$1.1 trillion were mortgage loans sold to Government-Sponsored Enterprises ("GSEs"), primarily the Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac"). The remaining \$963 billion were sold to whole loan investors and into private label securitizations, frequently bought by large institutions. Roughly \$160 billion of mortgage loans were sold into private label securitizations containing a credit enhancement provided by a monoline insurer. Approximately \$1.8 trillion of the overall loan amounts remained outstanding as of December 31, 2009.

3. In connection with the sale of these mortgage loans and RMBS securitizations, and credit enhancements provided by monoline insurers, Bank of America, or the acquired companies, made contractual representations and warranties regarding the underlying mortgage loans. While terms varied by agreement and counterparty, examples of the types of representations and warranties upon which claims could be based included good title, conformity with underwriting guidelines, enforceability of mortgage documents, lien position, and compliance with applicable laws.

4. If a purchaser of these loans or RMBS securitizations determined that there had been a breach of a representation and warranty, the purchaser could assert a claim against Bank of America or the acquired companies and demand that the related mortgage loan be repurchased at its outstanding unpaid principal balance. Bank of America or the acquired companies would review such claims and either agree to repurchase the loan or deny the claim. Pursuant to the review process, Bank of America or the acquired companies might request that the purchaser reconsider that claim. Negotiations could lead

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity, in this or any other proceeding.

the counterparty to rescind the claim. When the parties could not reach an agreement as to the resolution of the claim, the claim was considered to be at an impasse.

5. Following the appointment of a conservator for Fannie Mae in September 2008, Bank of America received information indicating that Fannie Mae may be adopting a more aggressive approach to asserting and contesting repurchase claims. Through the second and third quarters of 2009, Fannie Mae increased its rate and volume of repurchase requests. Fannie Mae submitted a combined \$3 billion of claims during the final quarter of 2008 and the first three quarters of 2009. During this same time period, Fannie Mae's rescission rate (the percentage of claims appealed by Bank of America and subsequently rescinded by Fannie Mae) declined. As a result, the number of "contested" or "impasse" Fannie Mae claims grew from \$41 million at Q3 2008 to \$512 million at Q3 2009 and continued to rise steadily thereafter. During the second and third quarters of 2009, a known uncertainty existed as to whether future repurchase obligations to Fannie Mae would have a material effect on Bank of America's future income from continuing operations.

6. Between 2004 and 2008, Bank of America and the acquired companies sold approximately \$160 billion of RMBS with monoline insurance. Bank of America did not reserve for claims not yet submitted by the monoline insurers, or for claims submitted and rejected by Bank of America, but not rescinded by the monoline insurers. These contested claims increased from \$203 million at September 30, 2008 to nearly \$1.7 billion at September 30, 2009. During the second and third quarters of 2009, there was a known uncertainty as to whether future costs related to loans Bank of America would ultimately be required to repurchase from the monolines would have a material effect on Bank of America's future income from continuing operations.

7. Bank of America failed to disclose these known uncertainties in its Forms 10-Q for the second and third quarters of 2009 (filed on August 7, and November 6, 2009). A Bank of America registration statement supplement effective in December 2009 incorporated by reference the periodic filings. In each of these filings, Bank of America's MD&A failed to comply with the disclosure requirements of Item 303 of Regulation S-K. As a result of its failure to comply with Regulation S-K, Bank of America violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

B. RESPONDENT

8. **Bank of America Corporation**, a Delaware corporation, is a bank holding company and a financial holding company under the Gramm-Leach-Bliley Act. Bank of America's principal offices are located in Charlotte, North Carolina. Bank of America's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange. Bank of America acquired Countrywide Financial Corporation ("Countrywide") in a transaction which was completed as of July 2008.

C. UNCERTAINTIES REGARDING CLAIMS

Fannie Mae

9. Between 2004 and 2008, Bank of America sold approximately \$1.1 trillion of mortgage loans to the GSEs, including Fannie Mae, which purchased \$826 billion or 75% of that amount.

10. The GSEs purchased and securitized mortgage loans as part of their goal to provide government supported funding to the housing market. They were the largest purchasers of mortgage loans and they also had the strongest representations and warranties contact rights. The GSEs had a long history with Countrywide of asserting and resolving repurchase claim requests.

11. Bank of America reserved for GSE repurchase expenses using historical loss experience, including past GSE repurchase rates.

12. From at least 2005 through mid-2008, Fannie Mae served as Countrywide's GSE "alliance partner." Under this arrangement, which Bank of America later continued, Countrywide sold most of its mortgage inventory to Fannie Mae. Based on that relationship, Fannie routinely rescinded certain types of claims rather than fully assert its contractual rights to have the repurchase claims paid.

13. By the time Bank of America completed its Countrywide acquisition in July 2008, housing market conditions had deteriorated. On September 6, 2008, the Federal Housing Finance Agency placed both Fannie Mae and Freddie Mac into conservatorship.

14. Through the first three quarters of 2009, Fannie Mae greatly increased the amount of repurchase claims submitted to Bank of America and increased the claim rate per loan default at which it was submitting claims. The claims continued to increase thereafter. Fannie Mae also became more restrictive in rescinding those requests.

15. In addition, there was a continuing increase in accumulated "contested" or "impassé" claims—Fannie Mae repurchase claims reviewed and denied by Bank of America, but which Fannie Mae did not rescind. The cumulative amount of Fannie Mae contested claims grew from \$41 million at Q3 2008 to \$512 million at Q3 2009 and continued to rise steadily thereafter.

16. Bank of America managers in the Home Loans & Insurance ("HL&I") division, which was responsible for handling the repurchase claims, were aware of other information which also indicated that Fannie Mae might be adopting a more aggressive repurchase policy. During February 2009, Fannie Mae circulated a draft policy to Bank of America, enunciating a more aggressive approach to repurchase claims. Although that policy did not become effective, Fannie Mae conveyed its intention to alter its position on the resolution of certain types of repurchase claims by promulgating and implementing new policies. In the second and third quarter of 2009, Fannie Mae began to promulgate and implement these new policies, which took a harder line and more contractual rights based

approach to certain types of repurchase claims. As a result, Bank of America observed the increase in Fannie Mae contested claims and received reports that detailed the status of representation and warranty repurchase claims.

17. In a letter received by Bank of America on October 20, 2009, Fannie Mae documented its position on “policy misalignments” i.e., disagreements as to the standards which should be applied in resolving claims. The letter stated that Fannie Mae “expects and requires all lenders to honor the terms of their contracts and to abide by the rep and warrant policies.”

Monolines

18. Monoline insurers provided credit enhancement in connection with RMBS in the form of a guarantee to RMBS investors that principal and interest payments would be made in the event there was insufficient cash flow from mortgage payments to meet the RMBS obligations. As part of the insurance agreement, Bank of America or the acquired companies made representations and warranties to the monoline insurance company regarding the mortgage loans that made up each insured securitization.

19. Monoline insurance companies insured approximately 17% of the mortgage loans sold by Bank of America and its acquired companies to private label investors, mostly large financial institutions. Between 2004 and 2008, Bank of America and the acquired companies sold approximately \$160 billion of RMBS with monoline insurance.

20. Managers in the HL&I division, which was responsible for handling the repurchase claims, received reports that detailed the status of representation and warranty repurchase claims and observed the increase in contested monoline claims. By at least as early as November 24, 2008, Bank of America’s internal auditors identified monoline repurchase claims exposure as an “emerging risk.” Bank of America management was aware of the increasing claims. As one example, in June 2009, an internal Bank of America report contained a “Trends Summary” showing monoline claims outstanding trending up from \$326 million in May 2008 to \$2.3 billion in May 2009.

21. Bank of America did not reserve for claims not yet submitted, or for claims submitted and rejected by Bank of America, but not rescinded by monolines. The number of defaulted loans within the securitizations was steadily increasing and was forecasted by Bank of America to continue increasing.

D. BANK OF AMERICA’S REPRESENTATIONS AND WARRANTIES RESERVING PROCESS

22. Bank of America, at all relevant times, established a reserve for its representations and warranties liability. Bank of America calculated its repurchase reserve using default and severity models, past repurchase data and experience relating to sold loans, and various current conditions—home price index, interest rates, and unemployment rates, for example—existing as of the quarter close.

23. The repurchase reserve was calculated by the HL&I line of business, with oversight from the Finance and Accounting team, Risk team, and Internal Audit. Representatives from HL&I and each of these oversight teams participated in twice monthly meetings at which the reserve process and calculation was discussed and evaluated.

24. During the relevant period, Bank of America used one process to calculate a reserve for loans sold to most counterparties and used a different process to calculate its repurchase reserve for the monolines.

GSEs

25. The calculation for the reserve associated with GSEs and private investors, including whole loan sales and securitizations, was based on an estimate of lifetime collateral losses calculated for sold loans based on the probability of default, the probability of repurchase, and expected severity. This calculation of expected lifetime repurchase losses was not based on claims that were actually asserted as of any given point in time, or possible future changes in repurchase or rescission rates, but was based on historical loss experience, including past GSE repurchase rates.

Monolines

26. During the relevant period, the monoline reserve was calculated differently. Bank of America lacked historical repurchase experience with monoline insurers. Moreover, some of the monolines had begun to resort to litigation. As a result, the monoline reserve was calculated by applying the actual experienced repurchase rate to all approved and "under review" repurchase requests. The expected repurchase rate applied was different for each monoline, based upon the actual computed repurchase rate for prior claims reviewed and adjudged. During the relevant period, the monoline reserve did not include a projection of expected losses for "contested" claims, that is, claims that had been reviewed by Bank of America and refused for repurchase, but not rescinded by the monolines; nor did it anticipate future projected losses on monoline repurchase requests not yet received.

E. BANK OF AMERICA'S DISCLOSURE PROCESS

Reporting Structure

27. Bank of America was structured for management and disclosure purposes around its various business units. The business units were supported by enterprise control functions, including Finance, Risk, and Legal, and also by Internal Audit. HL&I was one of Bank of America's business lines. Within the MD&A section of Bank of America's 2008 Form 10-K, Bank of America described how it managed the various types of risks to which it was subject, identifying the line of business as the first line of defense, enterprise control functions as the second line of defense, and Internal Audit, as the third.

28. Each enterprise control organization had its own reporting line, separate and apart from the business it supported. The Risk organization reported up to the Chief Risk

Officer. The Legal Department reported up to the Chief Legal Officer. Each line of business had a Chief Financial Officer and Controller assigned to support the business and those individuals ultimately reported up to Bank of America's Chief Financial Officer and Chief Accounting Officer, respectively.

29. Representatives of the enterprise control functions participated in HL&I business meetings.

Financial Reporting

30. Bank of America had a formal financial reporting process. The financial reporting process began with the preparation of a forecast for the year. Each business line's Finance and Accounting team prepared an annual forecast, and then undertook weekly and monthly re-forecasting based on the actual data. These data were reviewed and/or incorporated in successive processes until they were aggregated at the corporate level.

31. At month-end and at quarter-end, Bank of America closed its books. During this time, data from across Bank of America were collected. Like every other line of business, HL&I provided monthly written financial reports. In addition, at quarter end, each business line presented its financial results, as well as operational activities, opportunities, and risks.

32. Shortly after the quarter close, the Bank reported its earnings and provided information to analysts and interested parties through the earnings release process. Preparation for the earnings release presentation and filing served as the starting place for the quarterly financial disclosure filing process, which followed immediately thereafter. The analysis for these disclosure efforts was based on the actual data gathered in closing the Bank's books.

33. During the Relevant Period, after quarter close, relevant Bank personnel evaluated what the Bank needed to disclose in the upcoming quarterly filing.

F. THE RELEVANT DISCLOSURES

34. The Forms 10-Q for the second and third quarters of 2009 included a Risk Factor addressing the severe downturn in the United States economy and the impact that falling housing prices, unemployment and underemployment levels, and increasing foreclosures was having on the credit performance of mortgage loans generally and on Bank of America's business overall.

35. In addition, those periodic filings included a financial statement disclosure that described the nature of the repurchase liability and the dollar amount of loans repurchased from securitization trusts for the period. (Most of the loans, including loans sold to GSEs, were securitized.) The text of the disclosure during this period stated, in relevant part:

The Corporation sells loans with various representations and warranties related to, among other things, the ownership of the loan, validity of the lien securing the loan,

absence of delinquent taxes or liens against the property securing the loan, the process used in selecting the loans for inclusion in a transaction, the loan's compliance with any applicable loan criteria established by the buyer, and the loan's compliance with applicable local, state and federal laws. Under the Corporation's representations and warranties, the Corporation may be required to either repurchase the mortgage loans with the identified defects or indemnify the investor or insurer. In such cases, the Corporation bears any subsequent credit loss on the mortgage loans. The Corporation's representations and warranties are generally not subject to stated limits. However, the Corporation's contractual liability arises only when the representations and warranties are breached.

A review of the repurchase amounts disclosed each quarter shows that the amount of repurchased loans from all counterparties was \$448 million for 2008 (which comprised only the last two quarters of 2008), reported in the 2008 Form 10-K; \$360 million in the first quarter of 2009, \$222 million in the second quarter of 2009, and \$340 million in the third quarter of 2009.

36. In addition, each quarter's disclosure noted where in Bank of America's consolidated financial statement the repurchase reserve and provision was recorded: "The Corporation records its liability for representations and warranties, and corporate guarantees in accrued expenses and other liabilities and records the related expense through mortgage banking income."

37. The MD&A for the second and third quarter of 2009 included a discussion and table for Mortgage Banking Income, which noted that Mortgage Banking production income included "costs related to representations and warranties given in the sales transaction and other obligations incurred in the sales of mortgage loans."

38. The Forms 10-Q for the second and third quarters of 2009 did not identify or describe uncertainties relating to (1) Fannie Mae's more aggressive approach to asserting and contesting repurchase claims and the increasing number of claims and increasing inventory of contested claims from Fannie Mae; or (2) repurchase claims from monoline insurance companies or the amount of future claims and pending contested claims.

39. Bank of America's 2009 Form 10-K included a Risk Factor relating to the economic conditions, which also added a note disclosing, for the first time, an overall increase in repurchase demands from, and increasing disputes with, loan purchasers and monoline insurers. The same language was included in the MD&A, with the additional bracketed language, which did not appear in the Risk Factor:

We have experienced and continue to experience increasing repurchase and similar demands from, and disputes with buyers and insurers. {We expect to contest such demands that we do not believe are valid.} In the event that we are required to repurchase loans that have been the subject of repurchase demands or otherwise provide indemnification or other recourse, this could significantly increase our losses and thereby affect our future earnings.

G. APPLICABLE LAW

Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978). Rule 12b-20 of the Exchange Act requires an issuer to include in a statement or report filed with the Commission any information necessary to make the required statements in the filing not materially misleading.

Item 303 of Regulation S-K requires MD&A as a part of reports filed pursuant to Section 13(a). Item 303(a) of Regulation S-K requires registrants to disclose in annual filings "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" and "information that the registrant believes to be necessary to an understanding of its financial conditions [or] changes in [its] financial conditions." Instruction 3 to Item 303(a) further provides that "[t]he discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of...matters that would have an impact on future operations and have not had an impact in the past...."

Item 303(b) applies the identical disclosure requirements to interim reports, specifically stating that MD&A relating to interim period financial statements "shall include a discussion of material changes in those items specifically listed in paragraph (a) of this Item, except that the impact of inflation and changing prices on operations for interim periods need not be addressed." The Commission reiterated and emphasized these interim period disclosure requirements in an Interpretive Release issued in 1989, stating: "The second sentence of Item 303(b) states that MD&A relating to interim period financial statements 'shall include a discussion of material changes in those items specifically listed in paragraph (a) of this Item, except that the impact of inflation and changing prices on operations for interim periods need not be addressed.' As this sentence indicates, material changes to *each and every* specific disclosure requirement contained in paragraph (a), with the noted exception, should be discussed (emphasis added). The purpose of MD&A is "to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company." *SEC Interpretation: Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Exchange Act Release No. 26831 (May 18, 1989) ("MD&A Release").

The MD&A Release also sets forth a test concerning these disclosure requirements. If a trend, demand, commitment, event or uncertainty is known, management must make two assessments:

- (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required; and
- (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.

The Commission also has explained that "reasonably likely" is a lower disclosure threshold than "more likely than not." *Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release Nos. 33-8056 and 34-45321 (January 25, 2002).

During the relevant period, Bank of America failed to disclose known material uncertainties relating to (1) whether Fannie Mae had changed their repurchase practices after being put into conservatorship, and the increasing number of claims and increasing inventory of contested claims from Fannie Mae; and (2) the future volume of repurchase claims from monoline insurers and the ultimate resolution of mounting contested monoline claims. With regard to these uncertainties, Bank of America neither determined that they were not reasonably likely to come to fruition, nor determined that, if they came to fruition, they would not have a material impact on income from continuing operations. These uncertainties indicated a material risk to future income from continuing operations. Accordingly, disclosure was required. *See Panther Partners, Inc. v. Ikanos Communications, Inc.*, 681 F.3d 114, 122 (2d Cir. 2012) (concluding that Item 303 required disclosure of known uncertainty regarding potential returns of product and risk to future income).

H. VIOLATIONS

Based on the foregoing conduct, Bank of America violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13.

IV.

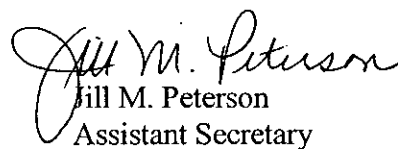
In view of the foregoing, the Commission deems it appropriate, to impose the sanctions agreed to in Respondent Bank of America's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Bank of America cease and desist from committing or causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 promulgated thereunder.

B. Respondent shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$20 million to the Securities and Exchange Commission. Such payment will be deemed satisfied by Respondents' payment in accordance with the terms of the agreement dated August 20, 2014 among Bank of America, the United States Department of Justice, and certain States.

By the Commission.


Jill M. Peterson
Assistant Secretary

ANNEX A

Bank of America admits to the facts set forth below and acknowledges that its conduct violated the federal securities laws.

1. Between 2004 and the first half of 2008, Bank of America and certain companies that it acquired in the second half of 2008 (the "acquired companies") created and sold approximately 1,300 securitizations comprised of first and second lien residential mortgages. Bank of America and the acquired companies also sold whole loans to investors. The total unpaid principal balance of these mortgage loans at securitization and/or sale during the period was approximately \$2.1 trillion. Approximately \$1.8 trillion of the overall loan amounts remained outstanding as of December 31, 2009. In connection with the sale of these mortgage loans and RMBS securitizations, and the obtaining of related credit enhancements provided by monoline insurance companies, Bank of America, or the acquired companies, made contractual representations and warranties regarding the underlying mortgage loans. Generally, in response to a claimed breach of a representation or warranty, Bank of America or the acquired companies evaluated whether to repurchase the related mortgage loan at its outstanding unpaid principal balance.

2. Between 2004 and the first half of 2008, Bank of America and the acquired companies sold approximately \$826 billion of mortgage loans to Fannie Mae. Beginning in the third quarter of 2008, Bank of America recorded an accounting reserve for its expected liability related to future representation and warranty expenses for these loans based, in part, upon its past loss experience, including experienced Fannie Mae repurchase rates. On September 6, 2008, the Federal Housing Finance Agency placed Fannie Mae into conservatorship. Through the second and third quarters of 2009, Bank of America became aware of information creating uncertainty as to whether Fannie Mae was adopting an approach to representation and warranty repurchase claims which would increase the future costs of Bank of America in connection with such claims. During that period, Fannie Mae greatly increased the amount of repurchase claims submitted to Bank of America and began rescinding claims at a lower rate than it had during previous periods.

3. Monoline insurers provided credit enhancement in connection with RMBS in the form of a guarantee to RMBS investors that principal and interest payments would be made in the event there was insufficient cash flow from mortgage payments to meet the RMBS obligations. Monoline insurance companies insured approximately 17% of the mortgage loans sold by Bank of America and the acquired companies to private investors, mostly large financial institutions. During the period from the third quarter of 2008 through at least the third quarter of 2009, Bank of America did not reserve for claims not yet submitted by the monolines, or for claims received, reviewed and rejected by Bank of America but not rescinded by the monolines. As of the second quarter of 2009, Bank of America was aware of an uncertainty regarding the future costs related to monoline repurchase claims alleging breaches of representations and warranties. Bank of America was aware of an increase in contested monoline claims and had identified monoline repurchase claims exposure as an emerging risk. The number of defaulted loans within the securitizations was forecasted by Bank of America to continue increasing.

4. During the second and third quarters of 2009, Bank of America did not disclose that there were known uncertainties relating to (1) whether Fannie Mae had changed its repurchase practices after being put into conservatorship, and the increasing number of overall claims and contested claims from Fannie Mae; and (2) the future volume of repurchase claims from monoline insurers and the ultimate resolution of monoline claims that Bank of America had reviewed and refused to repurchase, but had not been rescinded.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Commissioner Gallagher
Commissioner Stein
Not participating
Commissioner Pinover
Disapproved

SECURITIES ACT OF 1933
Rel. No. 9633 / August 21, 2014

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 72896 / August 21, 2014

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3902 / August 21, 2014

INVESTMENT COMPANY ACT OF 1940
Rel. No. 31220 / August 21, 2014

Admin. Proc. File No. 3-15002

In the Matter of

JAY T. COMEAUX

ORDER REMANDING FOR FURTHER PROCEEDINGS

Jay T. Comeaux appeals from an administrative law judge's initial decision ordering that he disgorge \$3,386,974.50, less the value of his assets under the control of the court-appointed receiver in *SEC v. Stanford*, plus prejudgment interest.¹ The initial decision followed the issuance of an Order Instituting Proceedings, Making Findings, Imposing Remedial Sanctions, and Notice of Hearing ("Order").² The Order accepted Comeaux's offer of settlement, pursuant to which Comeaux consented to (i) the findings of fact and conclusions of law in the Order, but solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party;³ (ii) cease and desist from committing or causing any violations and any future violations of

¹ *Jay T. Comeaux*, Initial Decision Release No. 494, 2013 WL 3327753 (July 2, 2013). The law judge found that Comeaux has \$1,435,236 in assets frozen and subject to the control of the receiver in *SEC v. Stanford*, No. 3-090cv-0298-N (N.D. Tex. 2009), an antifraud action against defendants Robert Allen Stanford; three of his companies, Stanford International Bank, Stanford Group Company, and Stanford Capital Management; and other defendants, concerning a massive Ponzi scheme.

² *Jay T. Comeaux*, Exchange Act Release No. 67768, 2012 WL 3775895, at *1 (Aug. 31, 2012).

³ Comeaux neither admitted nor denied the findings in the Order, except he admitted the findings as to the Commission's jurisdiction over him and the subject matter of these proceedings. *Comeaux*, 2012 WL 3775895, at *1.

55 of 82

Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940; (iii) a bar from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization, from serving or acting as an employee in any capacity of a registered investment company or affiliated person, and from participating in offering of penny stock in any capacity, with any reapplication subject to certain conditions; and (iv) additional proceedings to determine what, if any, disgorgement and civil penalties are in the public interest.⁴ This appeal concerns the additional proceedings.

The parties agreed to have the additional proceedings determined via the Division's motion for summary disposition pursuant to Rule of Practice 250.⁵ In deciding that motion, the law judge ordered Comeaux to disgorge the amounts noted above and found that civil penalties are not in the public interest. Comeaux appealed only the law judge's findings with respect to disgorgement, and the Division of Enforcement did not file a cross-appeal. But upon granting Comeaux's petition for review, we notified the parties that, pursuant to Rule of Practice 411,⁶ we will also "consider whether the sanctions imposed by the law judge adequately serve the public interest."⁷

For the reasons set forth below, we set aside the disgorgement ordered and remand for further proceedings consistent with this order to determine what, if any, disgorgement and civil penalties are in the public interest.⁸

I. Findings of fact and antifraud violations

We presume familiarity with the findings in the Order, which are deemed true for purposes of this proceeding,⁹ and briefly summarize them here.

Comeaux was president of broker-dealer and investment adviser Stanford Group Company ("SGC") from January 1996 until March 2005, and was executive director of SGC between March 2005 and February 2009. He was also a registered representative/advisory representative of SGC. SGC was a wholly owned subsidiary of Stanford Group Holdings, Inc., which in turn was owned and controlled by

⁴ *Comeaux*, 2012 WL 3775895.

⁵ 17 C.F.R. § 201.250.

⁶ 17 C.F.R. § 201.411.

⁷ *Jay T. Comeaux*, Exchange Act Release No. 70328, 2013 WL 4761502, at *1 (Sept. 5, 2013).

⁸ See SEC Rule of Practice 411(a), 17 C.F.R. § 201.411(a) ("The Commission may . . . remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record."); SEC Rule of Practice 452, 17 C.F.R. § 201.452 ("The Commission may . . . remand or refer the proceeding to a hearing officer for the taking of additional evidence, as appropriate."). Our review of the proceeding is *de novo*. *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *9 n.44 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010).

⁹ See *Comeaux*, 2012 WL 3775895.

Robert Allen Stanford.¹⁰ Robert Allen Stanford also owned and controlled Stanford International Bank ("SIB"), a private international bank.

During his tenure at SGC, Comeaux recommended and sold SIB certificates of deposit ("CDs") to brokerage customers and recommended portfolio allocation products that included SIB CDs to advisory clients. Comeaux marketed the SIB CDs using a brochure representing that SIB maintained a "comprehensive insurance program" that provided "depositor security" even though he knew that SIB CDs were not insured. Comeaux also marketed the SIB CDs using materials representing that SIB maintained a "well-diversified portfolio of highly marketable securities issued by stable governments, strong multi-national companies and major international banks." But this representation was not true, and Comeaux (i) had no basis to make this representation other than his reliance on SIB's representations and (ii) knew that SIB would not disclose the details of its investment holdings to him or other SGC executives or representatives.

Comeaux was also responsible for "overall supervision of all" SGC financial advisers, who also recommended and sold SIB CDs. In recommending SIB CDs to their clients, Comeaux and SGC's financial advisers (i) "did not have a reasonable basis to recommend SIB CDs to investors" and (ii) failed to disclose material conflicts of interest because they failed "to fully disclose SGC's and their own financial interest in selling the SIB CDs."¹¹

For these and other reasons set forth in the Order, Comeaux was found to have willfully violated and willfully aided and abetted and caused violations by SIB and SGC of Securities Act Section 17(a), willfully aided and abetted and caused SIB's and SGC's violations of Exchange Act Section 10(b) and Rule 10b-5, and willfully aided and abetted and caused SGC's violations of Investment Advisers Act Sections 206(1) and 206(2).

II. Analysis

A. Standard for Summary Disposition

Pursuant to Rule of Practice 250, the law judge may grant a motion for summary disposition "if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law."¹² Once the moving party has carried its burden of establishing that it is entitled to summary disposition on the factual record, the opposing party may not rely on bare allegations or denials but instead must present specific facts showing a genuine issue of material fact for resolution at a hearing.¹³ The facts on summary disposition must be viewed in the light most favorable to

¹⁰ In March 2012, Robert Allen Stanford was convicted of orchestrating a \$7 billion Ponzi scheme that was funded through the sale of certificates of deposit issued by Stanford International Bank. He was subsequently sentenced to 110 years' imprisonment.

¹¹ In 2007 and 2008, SGC financial advisers sold over \$2 billion in SIB CDs. Throughout Comeaux's tenure with SGC, sales of SIB CDs generated more than half of SGC's total revenues.

¹² 17 C.F.R. § 201.250(b).

¹³ *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *16 (Nov. 4, 2013).

the non-moving party.¹⁴

B. The Division did not support its motion for summary disposition with sufficient evidence on the disgorgement amount.

The Commission may order disgorgement, including reasonable interest, in cease-and-desist proceedings and proceedings in which it may impose civil penalties.¹⁵ Disgorgement is an equitable remedy designed to deprive wrongdoers of their unjust enrichment and to deter others from violating the securities laws by making violations unprofitable.¹⁶

The Division has the initial burden of demonstrating "a reasonable approximation of profits causally connected to the violation."¹⁷ The Division need only show but-for causation between a defendant's violations and profits.¹⁸ The burden then "shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation."¹⁹ Uncertainty as to the amount of unjust enrichment will not prevent disgorgement.²⁰

Here, in support of its summary disposition motion, the Division introduced only the declaration of its accounting expert, Karyl Van Tassel,²¹ setting forth amounts Comeaux purportedly received from SGC

¹⁴ *Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at *9 (Aug. 5, 2011).

¹⁵ 15 U.S.C. §§ 77h-1(e), 78u-2(e), 80b-3(j).

¹⁶ *SEC v. Huffman*, 996 F.2d 800, 802 (5th Cir. 1993); *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1230-31 (D.C. Cir. 1989); *Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *21 (Dec. 15, 2009).

¹⁷ *First City Fin. Corp.*, 890 F.2d at 1231; *SEC v. Halek*, 537 F. App'x 576, 581 (5th Cir. 2013); *Trautman*, 2009 WL 6761741, at *22.

¹⁸ *SEC v. Teo*, 746 F.3d 90, 105-07 (3d Cir. 2014).

¹⁹ *Trautman*, 2009 WL 6761741, at *22; *Halek*, 537 F. App'x at 581; *First City Fin. Corp.*, 890 F.2d at 1232.

²⁰ *First City Fin. Corp.*, 890 F.2d at 1232 ("[T]he risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty."); *SEC v. Razmilovic*, 738 F.3d 14, 31 (2d Cir. 2013) ("[B]ecause of the difficulty of determining with certainty the extent to which a defendant's gains resulted from his frauds . . . the court need not determine the amount of such gains with exactitude."); *SEC v. First Pac. Bancorp.*, 142 F.3d 1186, 1192 n.6 (9th Cir. 1998) ("The district court was not required to trace every dollar of" unjust enrichment.).

²¹ According to her declaration, Van Tassel was a senior managing director of FTI Consulting, Inc., which was retained by the receiver for SIB and the other Stanford entities (the "Stanford Entities") in 2009 to assist "in the capture and safeguarding of electronic accounting and other records of the Stanford Entities and forensic accounting analyses of those records, including cash tracing." The receiver for the Stanford Entities was appointed on February 16, 2009, by the U.S. District Court for the Northern District of Texas in *SEC v. Stanford*, No. 3-090cv-0298-N.

in regular earnings, commissions, bonuses, and other payments.²² Van Tassel states that Comeaux received in total at least \$7,457,985.83 between January 15, 2005 and February 13, 2009,²³ of which \$3,386,974.50 was "directly related to and based only on the sale of SIB CDs by Mr. Comeaux and others at his direction at" SGC.²⁴ Van Tassel bases her findings on her and her "team's review of records from the Stanford Entities that are in possession of the Receiver."

The law judge ordered disgorgement based on Van Tassel's calculation of \$3,386,974.50 Comeaux received "directly related to and based only on the sale of SIB CDs." The law judge rejected the Division's request for disgorgement based on Van Tassel's calculation of the full \$7,457,985.83 Comeaux received, finding that it included payments earned through legitimate activities.²⁵

As discussed above, the Division need not introduce evidence of the precise amount of ill-gotten gains to carry its burden; rather, the risk of uncertainty falls on the wrongdoer.²⁶ But where, as here, the Division's approximation of a respondent's gains from violative conduct is based on an expert's analysis of specific financial records, the Division must submit sufficient evidence for us to assess the reasonableness of that analysis. On the record before us, we cannot meaningfully review the reasonableness of either

²² Van Tassel attaches a summary chart to her declaration, which repeats the total amounts she asserts SGC paid Comeaux. Comeaux contends it was error for Van Tassel's declaration and summary chart to have been admitted into evidence because they are "conclusory, fail[] to adequately explain the source of the funds discussed, and fail[] to explain how the information contained therein is within the personal knowledge of Ms. Van Tassel." Comeaux's objections go to the weight of the Division's evidence and not its admissibility. Because the Division's evidence is relevant to disgorgement, we find that it was properly admitted. See SEC Rule of Practice 320, 17 C.F.R. § 17 C.F.R. § 201.320 ("[T]he hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious.").

²³ Van Tassel states that she and her team did not analyze payments to Comeaux before January 2005 because of the "limited availability of data concerning" that time period and the "difficulty and costs associated with assessing and analyzing such records."

²⁴ In addition, Van Tassel ties "the majority of the payments received by" Comeaux "to the sale of SIB CDs" because, she claims, (i) the majority of SGC's income "from 2004 through 2008 consisted of proceeds from the sale of SIB CDs"; and (ii) SGC would have been "insolvent from at least 2004 forward" if it had not been for the "proceeds from the sale of SIB CDs."

²⁵ The Division did not cross-appeal the law judge's determination not to order \$7,457,985.83 in disgorgement, but its brief on appeal indicates it believes this is the appropriate amount. If the Division determines to pursue the larger disgorgement amount on remand, the parties should consider addressing cases where, as the Division alleges here, the violative conduct allowed the defendant to continue receiving compensation. See, e.g., *First Pac. Bancorp.*, 142 F.3d at 1192; *SEC v. Posner*, 16 F.3d 520, 522 (2d Cir. 1994); *SEC v. Black*, No. 04 C 7377, 2009 WL 1181480, at *3-4 (N.D. Ill. Apr. 30, 2009), *motion for relief from judgment granted in part on other grounds*, No. 04 C 7377, 2012 WL 601858 (N.D. Ill. Feb. 21, 2012); *SEC v. Church Extension of the Church of God, Inc.*, 429 F. Supp. 2d 1045, 1050 (S.D. Ind. 2005); *Trautman*, 2009 WL 6761741, at *22-23.

²⁶ *First City Fin. Corp.*, 890 F.2d at 1232; *Razmilovic*, 738 F.3d at 31; *First Pac. Bancorp.*, 142 F.3d at 1192 n.6.

amount Van Tassel calculated, \$3,386,974.50 or \$7,457,985.83, because the Division did not introduce any of the records on which she relies or explain her methodology in analyzing the underlying data.²⁷

We have additional cause to be concerned about the reasonableness of Van Tassel's findings. Comeaux contends, and the Division does not dispute, that Van Tassel double-counted \$289,010 in calculating the total payments to Comeaux of \$7,457,985.83 by including that amount as an upfront loan in anticipation of his earnings and as a cash payment for his earnings.²⁸ And Comeaux's contention seems correct from our review of the declaration, thus underlining the need for additional evidence to assess the reasonableness of Van Tassel's findings.²⁹

On this record we therefore find that the Division did not meet its burden of showing that there is no genuine issue of material fact, or that it is entitled to summary disposition as a matter of law.³⁰ Had the law judge made such a finding she would have set the matter down for a public hearing as directed by the Order.³¹ Accordingly, we set aside the disgorgement ordered and remand for further proceedings to determine what, if any, disgorgement is in the public interest.

Moreover, because the law judge previously decided not to impose civil penalties based, in part, on her finding that disgorgement and the other sanctions imposed were a sufficient deterrent, she may reconsider on remand whether civil penalties are in the public interest.³² The law judge may, of course, consider any new analysis or evidence presented on this issue.

²⁷ See *SEC v. Seghers*, 404 F. App'x 863, 864 (5th Cir. 2010) (affirming order denying disgorgement where district court found that declaration of accountant supporting disgorgement claim was conclusory and did not explain how the documents submitted therewith supported the accountant's findings).

²⁸ The Division dismisses any error by Van Tassel, asserting that it "does not change the fact that the forensic accountant's work overall provides a reasonable approximation of Comeaux's ill-gotten gains."

²⁹ Comeaux also argues that his tax returns demonstrate that he and his wife's "combined total earnings were a maximum of \$6,264,589" between January 15, 2005 and February 13, 2009. But this goes more to Comeaux's subsequent burden to demonstrate that the Division's estimate is not a reasonable approximation of unjust enrichment, which we need not address because the burden has not yet shifted to Comeaux.

³⁰ We note that, pursuant to SEC Rule of Practice 360(a)(2), 17 C.F.R. 201.360(a)(2), the Order specified a 300-day time period for issuance of the initial decision rather than the shorter 120- or 210-day options. As provided by Rule 360(a)(2), the Commission bases this specification on its consideration of "the nature, complexity, and urgency of the subject matter" We urge parties in the future to consider whether, if the Commission has determined that a particular matter is not an appropriate vehicle for the 120- or 210-day time periods, it is an appropriate vehicle for a motion for summary disposition.

³¹ *Comeaux*, 2012 WL 3775895, at *5.

³² We note that the law judge stated as an additional reason for not imposing civil penalties that "[s]ubstantial penalties" such as disgorgement and cease-and-desist orders "have already been imposed against Comeaux." *Comeaux*, 2013 WL 3327753, at *5. But disgorgement and cease-and-desist orders are not punitive sanctions. *Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 WL 183600, at *11 (Apr. 5, 1999). Civil penalties, on the other hand, serve the "dual goals of punishment of the

C. On remand, disgorgement need not be limited to payments Comeaux received based solely on his own personal sale of SIB CDs.

Comeaux contends that he may not be ordered to disgorge payments he received based on the sale of SIB CDs by other financial advisers. Comeaux argues that any such disgorgement based on imputing the conduct of SIB, SGC, or anyone else to himself would be inappropriate because the Order "is clear as to the violations of Comeaux: (1) Comeaux did not have a reasonable basis to recommend SIB CDs to investors . . . ; and (2) by failing to fully disclose SGC's and his own financial interest in selling the SIB CDs, Comeaux failed to disclose material conflicts of interest."

But Comeaux's violations were related not only to his sale of SIB CDs but also to his role as a president and executive director of SGC with responsibility for the "overall supervision of all" SGC financial advisers. In setting forth Comeaux's violations, the Order stated that "SGC, Comeaux, and the SGC [financial advisers] he supervised did not have a reasonable basis to recommend SIB CDs to investors," and that "[b]y failing to fully disclose SGC's and their own financial interest in selling the SIB CDs, SGC, Comeaux, and SGC's [financial advisers] failed to disclose material conflicts of interest."³³ As a result of this and other conduct described in the Order, Comeaux was found not only to have engaged in direct violations but also to have willfully aided and abetted and caused SIB's and SGC's violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5, and to have willfully aided and abetted and caused SGC's violations of Investment Advisers Act Sections 206(1) and 206(2). Accordingly, we reject Comeaux's contention that any disgorgement must be based solely on receipts from his own personal sales of SIB CDs.

D. Cooperation and settlement are not factors affecting disgorgement.

Comeaux contends that his cooperation with the Commission and other authorities, including his settlement of the underlying proceeding, should be taken into account in determining disgorgement.³⁴ We disagree.³⁵ Disgorgement is not a punitive sanction, but rather "primarily serves to prevent unjust

(...continued)

individual violator and deterrence of future violations." *Montford and Co., Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *25 (May 2, 2014) (quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2d Cir. 2006)); *Bear Wagner Specialists LLC*, Exchange Act Release No. 64553, 2011 WL 2098098, at *8 (May 26, 2011) ("Like disgorgement, penalties serve as a deterrent, but unlike disgorgement, penalties punish individual violators for their wrongdoing.").

³³ *Comeaux*, 2012 WL 3775895, at *3.

³⁴ Comeaux also contends that the law judge should have admitted into evidence the affidavit of Daniel K. Hedges, which details Comeaux's cooperation. While we find that cooperation is irrelevant for purposes of determining disgorgement for the reasons discussed below, we nevertheless admit the Hedges affidavit in an exercise of discretion pursuant to SEC Rule of Practice 452, 17 C.F.R. § 201.452.

³⁵ The cases cited by Comeaux in support of his argument are inapposite because they concern the imposition of suspensions, bars, and civil penalties, and not disgorgement. See *Justin F. Ficken*, Exchange Act Release No. 58802, 2008 WL 4610345, at *3-4 (Oct. 17, 2008); *J.H. Goddard & Co.*, Exchange Act Release No. 7618, 1965 WL 87926, at *4 (June 4, 1965); *Stonegate Sec., Inc.*, Exchange Act Release No. 44933, 2001 WL 1222203, at *4-5 (Oct. 15, 2001).

enrichment."³⁶ For this reason, the federal courts that have addressed this issue have consistently found that a defendant's cooperation is not "sufficient to preclude disgorgement or reduce the disgorgement amount."³⁷

We similarly reject Comeaux's contention that, in determining disgorgement, we should apply the public interest factors set forth in *Steadman v. SEC*, Exchange Act Section 21B(c), Advisers Act Section 203(i)(e), and Investment Company Act Section 9(d)(3). The *Steadman* factors are applied when determining whether a bar is appropriate,³⁸ and the public interest factors in Exchange Act Section 21B(c), Advisers Act Section 203(i)(e), and Investment Company Act Section 9(d)(3) are applied when determining whether civil penalties are appropriate.³⁹ We apply the standard set forth above in section II.B. for determining disgorgement.

Because we have decided to remand this proceeding, we need not address the parties' remaining contentions, including those concerning Comeaux's financial ability to pay disgorgement, interest, or civil penalties. Comeaux may introduce additional evidence or analysis on these issues on remand.⁴⁰

³⁶ *First City Fin. Corp.*, 890 F.2d at 1231; cf. *SEC v. Contorinis*, 743 F.3d 296, 306-07 (2d Cir. 2014) ("As disgorgement is designed to equitably deprive those who have obtained ill-gotten gains of enrichment, it may be imposed upon innocent third parties who have received such ill-gotten funds and have no legitimate claim to them. That is consistent with disgorgement's remedial purpose—disgorgement is imposed not to punish, but to ensure illegal actions do not yield unwarranted enrichment even to innocent parties.").

³⁷ *SEC v. Mortenson*, No. CV-04-2276, 2013 WL 991334, at *5 (E.D.N.Y. March 11, 2013); *SEC v. Reynolds*, No. 3:08-CV-0438-B, 2013 WL 3479825, at *3 (N.D. Tex. July 11, 2013) (finding that cooperation is "largely irrelevant to the disgorgement determination"); *SEC v. Thorn*, No. 2:01-CV-290, 2002 WL 31412440, at *3 (S.D. Ohio Sept. 30, 2002) (granting the SEC's motion to strike the defendant's defense that disgorgement is barred as a result of the defendant's willingness to cooperate because the defendant did not cite, and the court did not find, "any legal authority to support [the defendant's] position that his willingness to cooperate on nonmonetary terms can offset the remedy of disgorgement").

³⁸ *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). These factors include the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations. *Id.*

³⁹ 15 U.S.C. §§ 78u-2(c), 80a-9(d)(3), 80b-3(i)(3). These factors include (1) whether the act or omission involved fraud; (2) whether the act or omission resulted in harm to others; (3) the extent to which any person was unjustly enriched, taking into account restitution made to injured persons; (4) whether the individual has committed previous violations; (5) the need to deter such person and others from committing violations; and (6) such other matters as justice may require. *Id.*

⁴⁰ SEC Rule of Practice 630(a), 17 C.F.R. § 201.630(a) ("In any proceeding in which an order requiring payment of disgorgement, interest or penalties may be entered, a respondent may present evidence of an inability to pay disgorgement, interest or a penalty. The Commission may, in its discretion, or the hearing officer may, in his or her discretion, consider evidence concerning ability to pay in determining whether disgorgement, interest or a penalty is in the public interest."); see also *Trautman*, 2009 WL 6761741, at

We do not suggest any view as to the outcome on remand.

III. Conclusion

Accordingly, IT IS ORDERED that the disgorgement ordered against Respondent Jay T. Comeaux is set aside; and it is further

ORDERED that this proceeding be remanded to the administrative law judge for further proceedings consistent with this order to determine what, if any, disgorgement and civil penalties are in the public interest; and it is further

ORDERED that the administrative law judge shall issue an initial decision no later than 300 days from the date of service of this order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

By the Commission (Chair WHITE and Commissioner AGUILAR); Commissioner PIWOWAR dissenting; Commissioners GALLAGHER and STEIN not participating.

Lynn M. Powalski
Deputy Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

(...continued)

*24 ("Ability to pay, however, is only one factor that informs our determination and is not dispositive. 'Even when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, [disgorgement, or interest,] particularly when the misconduct is sufficiently egregious.'" (quoting *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *4 (Oct. 27, 2006)).

*Commissioner Aguilar
Commissioner Pinowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72900 / August 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16032

In the Matter of

DEMOSTHENES DRITSAS,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Demosthenes Dritsas ("Dritsas").

II.

In anticipation of the institution of these proceedings, Dritsas has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Dritsas admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2. and III.5. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

56 of 82

III.

On the basis of this Order and Dritsas's Offer, the Commission finds that:

1. Dritsas, age 29, resides in Newhall, California. Dritsas is a former managing member of CalPacific Equity Group, LLC. Dritsas has never been registered or associated with a registered broker dealer. Dritsas participated in an offering and sale of Thought Development, Inc. ("TDI"), which is a penny stock.

2. On July 28, 2014, a judgment was entered by consent against Dritsas, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Daniel R. Baker, et al., Civil Action Number 2:14-cv-05754, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, in connection with the offer and sale of unregistered Thought Development, Inc. ("TDI") stock, Dritsas solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. At the time of the offer and sale of TDI stock, Dritsas was not registered or affiliated with a registered broker dealer. In addition, Dritsas recruited others to act as sales agents and paid them transaction-based compensation. The complaint also alleged Dritsas sold unregistered securities.

4. The complaint also alleged that Dritsas made representations to investors about the use of investor funds for TDI's businesses that were materially misleading because they failed to disclose sales commissions and other fees that added up to approximately 50% of the funds raised from investors in connection with the offer and sale of unregistered TDI stock. The complaint further alleged that Dritsas recklessly made specific representations to investors concerning the timing of and expected return on a purported TDI initial public offering and the status of negotiations with the National Football League without taking any basic steps to verify the truthfulness of those representations.

5. On July 7, 2014, Dritsas pled guilty to one count of conspiracy to commit mail fraud in violation of Title 18 United States Code, Section 371 before the United States District Court for the Central District of California, in United States v. Demosthenes Dritsas, Crim. Information No. SACR14-00068.

6. The count of the criminal information to which Dritsas pled guilty alleged, inter alia, that Dritsas defrauded investors and obtained money and property by means of materially false and misleading statements. In connection with that plea, Dritsas admitted that he and co-conspirators:

- (a) contacted prospective investors to solicit them to purchase TDI common stock;
- (b) did not disclose to potential investors that CalPacific was receiving at least a 40% commission on the sales of TDI stock and affirmatively misrepresented that fact;
- (c) received, through CalPacific, investor funds as commissions for selling TDI stock; and
- (d) caused an investor to send, by Federal Express, a cashier's check in the amount of \$10,000 to purchase 4,000 shares of TDI stock on or about November 16, 2011.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Dritsas's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Dritsas be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Dritsas will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Dritsas, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Aguilar
Commissioner Pinowar
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72897 / August 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16030

In the Matter of

DANIEL R. BAKER,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Daniel R. Baker ("Baker").

II.

In anticipation of the institution of these proceedings, Baker has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Baker admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2., and III.5. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

57 of 82

III.

On the basis of this Order and Baker's Offer, the Commission finds that:

1. Baker, age 29, resides in Valley Village, California. Baker is a managing member of CalPacific Equity Group, LLC. From 2003 to 2006, Baker was a registered representative formerly associated with several broker-dealers including Salomon Grey Financial Corp. and L.H. Ross & Company, Inc. Baker participated in an offering and sale of Thought Development, Inc. ("TDI"), which is a penny stock.

2. On July 28, 2014, a judgment was entered by consent against Baker, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Daniel R. Baker, et al., Civil Action Number 2:14-cv-05754, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, in connection with the offer or sale of unregistered TDI stock, Baker solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. In addition, Baker recruited, hired and supervised others to act as sales agents and paid them transaction-based compensation. The complaint also alleged Baker sold unregistered securities. At the time of the offer or sale of TDI stock, Baker was not registered or affiliated with a registered broker dealer.

4. The complaint also alleged that Baker made representations to investors about the use of investor funds for TDI's businesses that were materially misleading because they failed to disclose sales commissions and other fees that added up to approximately 50% of the funds raised from investors in connection with the offer and sale of unregistered TDI stock. The complaint further alleged that Baker recklessly made specific representations to investors concerning the timing of and expected return on a purported TDI initial public offering and the status of negotiations with the National Football League without taking any basic steps to verify the truthfulness of those representations.

5. On June 16, 2014, Baker pled guilty to one count of conspiracy to commit mail fraud in violation of Title 18 United States Code, Section 371 before the United States District Court for the Central District of California, in United States v. Daniel Baker, Crim. Information No. SACR14-00041.

6. The count of the criminal information to which Baker pled guilty alleged, inter alia, that Baker: (a) contacted prospective investors to solicit them to purchase TDI common stock; and (b) did not disclose to potential investors that CalPacific was receiving at least a 40% commission on the sales of TDI stock and affirmatively misrepresented that fact.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Baker's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Baker be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Baker will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Baker, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Commissioner Aguilar
Commissioner Pinover
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72898 / August 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16031

In the Matter of

DEAN R. BAKER,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Dean R. Baker ("Baker").

II.

In anticipation of the institution of these proceedings, Baker has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Baker consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

58 of 82

III.

On the basis of this Order and Baker's Offer, the Commission finds that:

1. Baker, age 33, resides in Coral Springs, Florida. Baker is the President of both DDBO Consulting, Inc. and DBBG Consulting, Inc. Baker was a registered representative formerly associated with the defunct boiler rooms LH Ross & Company, Inc. and Salomon Grey Financial Corp. As a broker, Baker was the subject of two state cease-and-desist orders and 10 customer complaints. While employed at LH Ross, in 2005 and 2006, FINRA charged Baker with two separate actions both alleging violations of the antifraud provisions of the securities laws for, among other things, unauthorized trading in customer accounts, using margin accounts without authorization and soliciting investors to purchase securities without disclosing investment risks. Without admitting or denying the allegations, Baker consented to the sanctions, which included an order to pay \$22,841 plus interest in restitution to customers, and he was barred from association with any broker or dealer. Baker participated in an offering and sale of Thought Development, Inc. ("TDI"), which is a penny stock.

2. On July 31, 2014, a final judgment was entered by consent against Baker, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Dean Baker, et al., Civil Action Number 14-cv-61685, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, in connection with the offer or sale of unregistered TDI stock, Baker solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. At the time of the offer and sale of TDI stock, Baker was not registered or affiliated with a registered broker dealer. In addition, Baker recruited others to act as sales agents and paid them transaction-based compensation. The complaint also alleged Baker sold unregistered securities.

4. The complaint also alleged that Baker made misrepresentations regarding the timing of and expected return on a purported TDI IPO and the use of TDI's First Down Laser system in the Super Bowl. The complaint also alleged that Baker failed to disclose sales commissions and other fees at least 50% or more charged to investors in connection with the offer and sale of unregistered TDI stock.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Baker's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Baker be, and hereby is barred from association with any broker, dealer, investment adviser,

municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Baker will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Baker, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Gallagher
Commissioner Steid
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9634 / August 22, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72904 / August 22, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3576 / August 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16033

In the Matter of

AIRTOUCH COMMUNICATIONS, INC.,
HIDEYUKI KANAKUBO, AND
JEROME KAISER, CPA,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND
CEASE-AND-DESIST
PROCEEDINGS PURSUANT
TO SECTION 8A OF THE
SECURITIES ACT OF 1933
AND SECTIONS 4C AND 21C
OF THE SECURITIES
EXCHANGE ACT OF 1934,
AND RULE 102(e) OF THE
COMMISSION'S RULES OF
PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against AirTouch Communications, Inc., Hideyuki Kanakubo, and Jerome Kaiser, CPA (collectively, "Respondents"), and additionally as to Kaiser, pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This matter involves fraudulent financial disclosures and omissions by AirTouch Communications, Inc. ("AirTouch"), a Newport Beach, California issuer, its founder and former president and CEO Hideyuki Kanakubo ("Kanakubo"), and its former CFO and corporate

59 of 82

secretary Jerome Kaiser, CPA ("Kaiser"), in the company's voluntarily filed Form 10-Q for the third quarter of 2012, and in fraudulent statements and omissions to an investor in connection with a \$2 million loan made to the company in the fall of 2012.

2. In the third quarter of 2012, AirTouch improperly recognized net revenues of \$1.031 million based on \$1.24 million of inventory shipped to a Florida entity. This revenue recognition was improper because, as both Kanakubo and Kaiser knew, or were reckless in not knowing, a fulfillment and logistics agreement executed contemporaneously with the Florida entity's purchase order—and upon which the purchase order was conditioned—relieved that entity of any obligation to pay AirTouch unless and until an AirTouch customer purchased the inventory. Kanakubo and Kaiser also knowingly, recklessly or negligently made false representations and omissions about this revenue to an AirTouch investor and lender. Their conduct in inflating the revenues and obtaining financing was also deceptive and constituted a scheme to defraud.

3. In early 2013, AirTouch filed a Form 8-K disclosing its intention to restate net revenues for the third quarter of 2012, based on erroneous revenue recognition.

B. RESPONDENTS

4. **AirTouch Communications, Inc.** is a Delaware corporation with its principal place of business in Newport Beach, California. AirTouch's common stock is quoted on the OTC Pinks under the symbol "ATCH." AirTouch develops and sells telecommunications equipment designed to integrate mobile telephones into landline telephone systems within a consumer's home.

5. **Hideyuki Kanakubo** resides in Irvine, California. He is AirTouch's founder and former president, CEO, director, and chief technology officer. At all relevant times, Kanakubo was responsible for the management of AirTouch's business. As of May 31, 2014, Kanakubo beneficially owned or controlled 1,858,143 shares of AirTouch common stock, or 9% of the company's total outstanding shares. Kanakubo resigned as president and CEO in March 2013. He resigned as chief technology officer in April 2013.

6. **Jerome Kaiser, CPA** resides in Chowchilla, California. Kaiser is a licensed Certified Public Accountant and an active member in the AICPA and California Society of Public Accountants. Kaiser holds a BS in Accounting and an MS in Business Taxation. He is AirTouch's former CFO and corporate secretary. At all relevant times, Kaiser was responsible for the management of AirTouch's business. As of May 31, 2014, Kaiser owned options to acquire 520,096 shares of AirTouch common stock at a strike price of \$2 per share. He resigned from AirTouch in April 2013.

C. FACTUAL BACKGROUND

7. In or around early 2012, AirTouch developed a new product, the "U250 SmartLinx", designed for sale to Mexico's largest provider of landline telephone services (the "Mexican Entity").

8. On July 30, 2012, AirTouch contacted a Florida provider of logistics and fulfillment services (the "Florida Entity") about the possibility of warehousing AirTouch's U250

SmartLinx product for possible sale to the Mexican Entity. AirTouch had never done business with the Florida Entity prior to July 30, 2012.

9. During contract negotiations related to this potential warehousing arrangement, the Florida Entity's CEO told Kanakubo that the Florida Entity was not buying any product from AirTouch, but rather would only warehouse the U250 SmartLinx inventory for eventual delivery to the Mexican Entity or other customers of AirTouch. AirTouch's salesperson relayed the same information to Kaiser.

10. On July 30, 2012, Kaiser sent Kanakubo a Fulfillment and Logistics Agreement between AirTouch and the Florida Entity (the "Agreement"), asking him to immediately review and sign it, which Kanakubo did. The Agreement included, among other terms, the following provisions:

- a) "Section 3 (Orders and Acceptance): [The Florida Entity]'s purchase orders are subject to purchase orders by [the Mexican Entity] and/or any other customer that may be assigned from time to time by AirTouch. In the event [the Mexican Entity] or any of the customers does not fulfill the purchase orders and/or cancels the orders, [the Florida Entity] shall have the right to return these products to AirTouch and obtain a full credit equal to the original purchase amount with no offsets or deductions or any kind.";
- b) "Section 5 (Resale to [the Mexican Entity] and/or Assigned Customers by AirTouch): [The Florida Entity] shall store the merchandise until shipment of the Products and shall invoice AirTouch for storage of the products, in/out control, invoicing, stock reconciliation, at 1.5% of the invoice value for the first 30 days and an additional 1% for each additional 30 days."; and
- c) "Section 6 (Payment): [The Florida Entity] shall pay for Products in 90 days in accordance with the payment terms invoiced by AirTouch. However, [the Florida Entity] shall not be obligated to pay AirTouch until the Products have been received by [the Mexican Entity] and [the Florida Entity] has received full payment therefor, at which time then [the Florida Entity] shall pay AirTouch for the Products within 10 days thereafter."

11. The same day, the Florida Entity issued a \$1.74 million "purchase order" for 20,000 U250 SmartLinx (the "Purchase Order"). The Purchase Order stated a payment term of "Net 90" but also stated that its payment terms were "according to term sheet." The Agreement was the "term sheet." Kaiser received emails where representatives of the Florida Entity described the Purchase Order as "conditional" upon AirTouch's execution of the Agreement. Kanakubo was also made aware that the Florida Entity would not issue the Purchase Order unless AirTouch first executed the Agreement.

12. On July 31, 2012, the Florida Entity sent Kaiser the counter-signed Agreement and the Purchase Order in a single email. Before forwarding this email to AirTouch's controller, he deleted the Agreement as an attachment, and forwarded only the Purchase Order.

13. AirTouch shipped approximately \$1.24 million of inventory to the Florida Entity during the third quarter of 2012, pursuant to the Agreement and the Purchase Order. AirTouch recognized revenue on all \$1.24 million of inventory shipped to the Florida Entity during the quarter.

14. In October 2012, in connection with AirTouch's quarterly review, AirTouch's controller provided its outside independent accountant with a copy of the Purchase Order, but not the Agreement. The outside independent accountant did not receive the Agreement since Kaiser had never provided AirTouch's controller with the Agreement.

15. When discussing the purported receivable AirTouch booked from the Florida Entity at board meetings, Kanakubo and Kaiser did not inform AirTouch's outside directors, including the chairman of the audit committee, that shipments to the Florida Entity were controlled by the Agreement.

16. AirTouch did not receive any payment from the Florida Entity during the third quarter of 2012, and likewise received no commitment from the Mexican Entity that it would buy product shipped to the Florida Entity, or otherwise.

1. AirTouch, Kanakubo and Kaiser Made False and Misleading Statements and Engaged in a Scheme to Defraud and Deceptive Conduct Concerning Revenue Recognition in AirTouch's Form 10-Q for the Third Quarter 2012

17. On November 14, 2012, AirTouch filed its Form 10-Q for the third quarter of 2012, reporting net revenues of \$1,031,747. Without the revenue recognized on the inventory shipped to the Florida Entity, AirTouch would not have had any positive revenue for the quarter.

18. Under Generally Accepted Accounting Principles ("GAAP"), revenue cannot be recognized unless it is "realized or realizable" and "earned."

19. AirTouch's recognition of revenues for the inventory shipped to the Florida Entity did not comply with GAAP. Because AirTouch did not sell any product to the Florida Entity—the Purchase Order and the Agreement merely documented, for tracking purposes, the transfer of AirTouch inventory to the Florida Entity in contemplation of future sales—the revenue associated with shipments to the Florida Entity was not realized, realizable or earned.

20. AirTouch's revenue recognition policy, which was disclosed in the 10-Q and was consistent with the requirements of Generally Accepted Accounting Principles, permitted the recognition of revenue only where: "(1) persuasive evidence of an arrangement exists in the form of an accepted purchase order or equivalent documentation; (2) delivery has occurred, based on shipping terms, or services have been provided; (3) the company's price to the buyer is fixed or determinable, as documented on the accepted purchase order or similar documentation; and (4) collectability is reasonably assured."

21. Given the terms of the Purchase Order and the Agreement, AirTouch had no reasonable assurance of collectability from the Florida Entity because AirTouch did not even have a valid receivable to collect from the Florida Entity.

22. Kanakubo and Kaiser signed certifications intended to be made pursuant to the Sarbanes-Oxley Act of 2002, stating that the Form 10-Q fairly presented AirTouch's financial condition and results.

23. Kanakubo and Kaiser knew, or were reckless in not knowing, that AirTouch's Form 10-Q contained materially false or misleading statements concerning reported net revenues and compliance with GAAP or AirTouch's revenue recognition policy.

24. The false and misleading statements in AirTouch's Form 10-Q occurred in connection with the purchase or sale of securities.

25. The false and misleading statements in AirTouch's Form 10-Q were material. These statements would have been viewed by a reasonable investor as significantly altering the total mix of available information, given that AirTouch would not have had any positive revenues for the quarter if it did not recognize the revenue from the Florida Entity. The Form 10-Q also reflected AirTouch's largest revenues ever reported for a quarter.

26. Kanakubo and Kaiser each knew about the Agreement but concealed it from others involved in AirTouch's financial reporting process, including the controller, the chairman of the audit committee, and the company's outside independent accountant. These acts of concealment, along with other deceptive conduct, contributed to a revenue recognition scheme and operated as a fraud.

27. Because of Kanakubo's and Kaiser's positions as AirTouch's senior management, their scienter is attributable to AirTouch.

28. At all relevant times, Kanakubo and Kaiser were the company's principal officers; they were the members of management in charge of AirTouch's day-to-day management, policies, and operations; and they were responsible for preparing and signing AirTouch's SEC filings.

2. Kanakubo and Kaiser Made False and Misleading Statements and Omissions to an Investor and Engaged in a Scheme to Defraud and Deceptive Conduct Concerning Revenues from the Florida Entity

29. In or around 2012, Kanakubo and Kaiser solicited a short term bridge loan from an existing AirTouch investor ("Investor A"), in exchange for a promissory note and a warrant to purchase 100,000 shares of AirTouch common stock. Investor A recommended the loan and warrant acquisition opportunity to a related entity, for which he served as the authorized agent during the due diligence process.

30. On October 3, 2012, Kanakubo falsely told Investor A by email that the inventory to be shipped by AirTouch to the Florida Entity—which he mischaracterized as an "authorized fulfillment house" for the Mexican Entity—pertained to an existing purchase order from the Mexican Entity.

31. Around the same time, Kaiser provided Investor A's representatives with the Purchase Order, but did not provide them with or disclose the existence of the Agreement.

32. On October 17, 2012, AirTouch received the loan of \$2 million from Investor A in exchange for a warrant to purchase its common stock.

33. Two days later, on October 19, 2012, Kanakubo approved a \$15,000 bonus payment to Kaiser for his work on raising capital. The same day, Kanakubo authorized a \$15,000 payment to himself in connection with unused vacation time.

34. Kanakubo and Kaiser knew, or were reckless in not knowing, that their statements to Investor A concerning revenues from the Florida Entity were materially false and misleading.

35. Kanakubo and Kaiser also failed to act with reasonable care because: (1) they did not ensure that Investor A was provided with all material information necessary to make their statements to him concerning the inventory shipped to the Florida Entity not misleading; and (2) they provided Investor A's representatives with the Purchase Order but not the Agreement.

36. The false and misleading statements and omissions to Investor A occurred in the offer or sale of, and in connection with the purchase or sale of, securities.

37. Kanakubo's and Kaiser's false and misleading statements to Investor A, and their failure to disclose the terms of the Agreement, were material. Kanakubo's and Kaiser's statements to Investor A, and the terms of the Agreement, would have been viewed by a reasonable investor as significantly altering the total mix of available information because, among other reasons, AirTouch had not sold any of the inventory warehoused with the Florida Entity to the Mexican Entity, and thus had no basis to represent that it expected to collect revenue from the Florida Entity.

38. Kanakubo and Kaiser lured Investor A over several months into loaning AirTouch \$2 million based on a distorted view of AirTouch's finances and relationships with third parties, including the Mexican Entity and the Florida Entity. They led Investor A to believe that AirTouch would receive a substantial financial commitment from the Mexican Entity, which would then provide AirTouch with sufficient cash flow for AirTouch to service and repay the loan. These inducements by Kanakubo and Kaiser, along with other deceptive conduct, contributed to an offering fraud scheme and a fraudulent transaction.

39. Because of Kanakubo's and Kaiser's positions as AirTouch's senior management, their scienter and their negligence are attributable to AirTouch.

40. At all relevant times, Kanakubo and Kaiser were the company's principal officers; they were the members of management in charge of AirTouch's day-to-day management, policies, and operations; and they were responsible for negotiating with Investor A, providing Investor A with due diligence materials, and for preparing and signing AirTouch's SEC filings.

3. AirTouch Announces It Will Restate Revenues

41. In January 2013, AirTouch's board of directors commenced an internal investigation concerning the net revenues reported in the Form 10-Q for the third quarter of 2012.

42. At this time, Kaiser provided the chairman of the audit committee with the Purchase Order, but withheld the Agreement.

43. AirTouch's board of directors and its outside auditor subsequently received the Agreement, and determined to restate reported revenues for the third quarter of 2012.

44. AirTouch filed a Form 8-K on February 7, 2013, announcing errors in revenue recognition and the intention to file an amended Form 10-Q. No amended Form 10-Q has been filed.

E. VIOLATIONS

45. As a result of the conduct described above, Respondents AirTouch and Kanakubo violated, and Kaiser willfully violated, Sections 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

46. Respondents Kanakubo and Kaiser are jointly and severally liable under Section 8A(a) of the Securities Act for causing AirTouch's violations of Section 17(a) of the Securities Act and under Section 21C(a) of the Exchange Act for causing AirTouch's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and in the case of Kaiser, for willfully aiding and abetting AirTouch's violations of the Securities Act and the Exchange Act.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 17(a) of the Securities Act and Sections 10(b) of the Exchange Act and Rule 10b-5 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, in the public interest, and Section 21B(a) of the Exchange Act; whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act; and whether other appropriate relief should be granted, including a prohibition from service as an officer or director of any issuer pursuant to Section 8A(f) of the Securities Act and Section 21C(f) of the Exchange Act; and

C. Whether, pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, it is appropriate to censure or deny Kaiser the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fails to appear at a hearing after being duly notified, Respondents may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

*Chair White
Commissioner Gallagher
Not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72906 / August 22, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16035

In the Matter of

DONNA JESSEE TUCKER,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Donna Jessee Tucker ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2. and III.4. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

60 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Donna Jessee Tucker was a registered representative associated with the Roanoke, Virginia branch office of UBS Financial Services Inc., a registered broker-dealer, from November 2007 to April 2013. Tucker, 58 years old, is a resident of Roanoke, Virginia.

2. On August 1, 2014, a final judgment ("Final Judgment") was entered by consent against Tucker, permanently enjoining her from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled *Securities and Exchange Commission v. Donna Jessee Tucker*, Civil Action No. 7:14-cv-00398, in the United States District Court for the Western District of Virginia.

3. The Commission's complaint alleged that, among other things, from in or around January 2008 to in or around April 2013, Tucker misappropriated \$730,289 from four customers using an elaborate scheme involving, among other things, unauthorized sales of securities in customer accounts, forged signatures on customer checks, and forged loan applications. The complaint further alleged that Tucker concealed her theft by providing customers with fabricated account statements and fraudulent verbal assurances concerning the value of their investment accounts.

4. On July 31, 2014, Tucker pled guilty to one count of wire fraud, in violation of 18 U.S.C. §1343, and one count of tax evasion, in violation of 26 U.S.C. §7201, before the United States District Court for the Western District of Virginia, in *United States v. Donna Jessee Tucker*, Criminal Information No. 7:14-cr-00043.

5. The counts of the criminal information to which Tucker pled guilty are based on the same facts in the Commission's action, and alleged, *inter alia*, that Tucker devised a scheme to defraud customers and to obtain money and property by means of false and fraudulent pretenses, representations and promises, and that she attempted to evade and defeat part of the income tax due and owing as a result of the money she stole from customers.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Tucker's Offer.

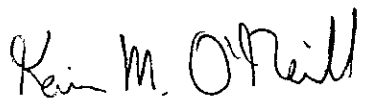
Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Tucker be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Peterson
Assistant Secretary


By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72905 / August 22, 2014

INVESTMENT ADVISERS ACT OF 1940

Release No. 3903 / August 22, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16034

In the Matter of

STEPHEN WALSH,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Stephen Walsh ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

61 of 82

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Walsh, age 70, resides in Port Washington, New York. From at least 1996 to February 2009, he was the co-general partner, Chief Executive Officer and senior registered options principal of WG Trading Company, Limited Partnership, a registered broker-dealer ("WGTC"). Walsh was also an owner of Westridge Capital Management, Inc., a registered investment adviser. During his association with WGTC, Walsh held Series 3, 4 and 40 licenses.

2. On July 8, 2014, a judgment was entered by consent against Walsh, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. WG Trading Investors, L.P., et al., Civil Action Number 09 CV 1750 (GBD), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that, since at least 1996, Walsh solicited investors by promising to invest their money in an enhanced equity index strategy. However, according to the complaint, instead of investing the money as promised, Walsh misappropriated investor funds for his own personal use.

4. On April 25, 2014, Walsh pled guilty to one count of securities fraud in violation of Title 15, United States Code, Sections 78j(b) and 78ff and Title 17, Code of Federal Regulations, Section 240.10b-5 before the United States District Court for the Southern District of New York, in United States v. Walsh, 09-CR-722 (MGC).

5. The count of the complaint to which Walsh pled guilty alleged, inter alia, that Walsh defrauded investors by making and causing to be made false representations to investors regarding their investments, omitting to disclose material facts to investors regarding his use and misappropriation of investor funds, and enriching himself at investors' expense, and that he did so by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Walsh's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Walsh be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating

organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72910 / August 25, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16036

In the Matter of

**China Clean Energy Acquisition Corp.,
China Education Acquisition Corp.,
China Food & Beverage Acquisition Corp.,
China High Technology Acquisition
Corp.,
China Manufacturing Acquisition III Corp.,
DRC Ventures, Inc., and
Elite Talent Consulting Corp. (f/k/a China
Transportation Acquisition Corp.),**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents China Clean Energy Acquisition Corp., China Education Acquisition Corp., China Food & Beverage Acquisition Corp., China High Technology Acquisition Corp., China Manufacturing Acquisition III Corp., DRC Ventures, Inc., and Elite Talent Consulting Corp. (f/k/a China Transportation Acquisition Corp.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. China Clean Energy Acquisition Corp. (CIK No. 1486788) is a void Delaware corporation located in New York, New York with a class of securities registered with the

62 of 82

Commission pursuant to Exchange Act Section 12(g). China Clean Energy Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended May 31, 2011, which reported a net loss of \$27,861 for the prior twelve months.

2. China Education Acquisition Corp. (CIK No. 1478913) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Education Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2011, which reported a net loss of \$48,242 from the company's August 14, 2009 inception to February 28, 2011.

3. China Food & Beverage Acquisition Corp. (CIK No. 1476763) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Food & Beverage Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2011, which reported a net loss of \$44,959 from the company's August 14, 2009 inception to March 31, 2011.

4. China High Technology Acquisition Corp. (CIK No. 1478914) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China High Technology Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2011, which reported a net loss of \$48,242 from the company's August 14, 2009 inception to February 28, 2011.

5. China Manufacturing Acquisition III Corp. (CIK No. 1486786) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Manufacturing Acquisition III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2011, which reported a net loss of \$31,880 from the company's August 14, 2009 inception to February 28, 2011. Moreover, the company has never filed a Form 10-K since it was registered on July 29, 2010.

6. DRC Ventures, Inc. (CIK No. 1434109) is a defaulted Nevada corporation located in South Hempstead, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DRC Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$39,730 from the company's April 15, 2008 inception to March 31, 2012.

7. Elite Talent Consulting Corp. (f/k/a China Transportation Acquisition Corp.) (CIK No. 1486787) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section

12(g). Elite Talent Consulting is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended May 31, 2011, which reported a net loss of \$27,658 for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Steere
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72922 / August 26, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3905 / August 26, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16038

In the Matter of

BRIAN SCOTT ZWERNER,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Brian Scott Zwerner ("Zwerner" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

63 of 82

1. From approximately July 1998 until approximately October 2002, Zwerner was employed as a dual officer of Banc of America Securities LLC ("BAS") and Bank of America, N.A. ("BANA") (collectively referred to as "BoFA"). BAS, now known as Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger, was a Delaware limited liability corporation with its principal place of business in New York, New York, and was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and as an investment adviser pursuant to Section 203(c) of the Advisers Act.¹ BANA is a federally-chartered commercial bank with its principal place of business in Charlotte, North Carolina. During the relevant time period, Zwerner worked in BANA's Chicago, Illinois office and was the Manager of BoFA's Municipal Derivatives Trading Desk, where his duties included calculating profitability and hedging interest rate risk for investment agreements and other municipal finance contracts sold by members of BoFA's Municipal Reinvestment and Risk Management Group. Zwerner, age 41, is a resident of Atlanta, Georgia.

2. On March 30, 2011, Zwerner pled guilty to one count of conspiracy to make false entries in bank records related to marketing profits for investment agreements and other municipal finance contracts in violation of Title 18, United States Code, Section 371, before the United States District Court for the Southern District of New York, in United States v. Brian Scott Zwerner, Criminal No. 1:11-CR-293-VM.

3. The information to which Zwerner pled guilty charged, among other things, that from at least as early as January 1999 until at least May 2002, Zwerner and others unlawfully, willfully, and knowingly did combine, conspire, confederate, and agree together and with each other to commit offenses against the United States of America, namely, to violate Title 18, United States Code, Section 1005 in violation of Title 18, United States Code, Section 371. It was a part and an object of the conspiracy that Zwerner and others, being officers, directors, agents or employees of a certain financial institution that is a national banking association, chartered and examined by the Comptroller of the Currency and whose deposits are insured by the Federal Deposit Insurance Corporation, would and did cause to be made, false entries in the books, reports, and statements of such bank, company, branch, agency, or organization for the purpose of deceiving and with the intent to deceive officers of such bank, while knowing that the entry or entries were false, in violation of Title 18, United States Code, Section 1005. For the purposes of effectuating the aforesaid conspiracy, Zwerner and others did those things which they conspired to do, including, among other things: (a) agreeing to misstate marketing profits on trade tickets for certain investment agreements or other municipal finance contracts; (b) understating marketing profits on trade tickets for certain investment agreements or other municipal finance contracts so that money could be held back and accumulated in an off-the-books account known as the "kitty"; (c) understating marketing profits on trade tickets for certain investment agreements or other municipal finance contracts so that money could be held back and accumulated in the kitty in order to pay kickbacks, disguised as fees to compensate brokers for purportedly brokering financial transactions between the bank and other entities. In reality, the

¹ On November 1, 2010, BAS was merged into Merrill Lynch, Pierce, Fenner & Smith Incorporated, an indirect wholly-owned subsidiary of Bank of America Corporation, which is registered with the Commission as a broker-dealer.

bank paid these kickbacks to brokers for controlling and manipulating the competitive bidding process for investment agreements and other municipal finance contracts to ensure that the bank won certain of the bids; (d) overstating marketing profits on trade tickets for investment agreements and other municipal finance contracts to make those agreements and contracts appear to the bank's officers to be more profitable than they actually were; (e) allowing misstated marketing profits to be incorporated into a computerized sales tracking and reporting database, known as STARS; and (f) deceiving certain of the bank's officers as to the true results of the municipal derivatives marketing desk. In connection with his plea agreement, Zwerner admitted that he conspired to make false entries in bank records.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Zwerner's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Zwerner be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72921 / August 26, 2014

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3577 / August 26, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-12817

In the Matter of Paul R. Venesky, CPA	:	ORDER GRANTING APPLICATION FOR REINSTATEMENT TO APPEAR AND PRACTICE BEFORE THE COMMISSION AS AN ACCOUNTANT RESPONSIBLE FOR THE PREPARATION OR REVIEW OF FINANCIAL STATEMENTS REQUIRED TO BE FILED WITH THE COMMISSION
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On September 20, 2007, Paul R. Venesky, CPA ("Venesky") was suspended from appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against Venesky pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹ This order is issued in response to Venesky's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission found that Venesky had been permanently enjoined by a United States District Court from future violations of Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder. In its complaint in the injunctive action, the Commission alleged, among other things, that Venesky, in his role as the controller of OMG Americas ("OMGA"), aided and abetted fraudulent accounting practices in September 2001 and prior.² This conduct resulted in OM Group, Inc. ("OM") filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2001 and, in part, the fiscal year ended December 31, 2002. According to the complaint, Venesky recorded numerous erroneous and unsupported accounting entries at the

¹ See Accounting and Auditing Enforcement Release No. 2722 dated September 20, 2007. Venesky was permitted, pursuant to the order, to apply for reinstatement after three years upon making certain showings.

² OMG Americas was a wholly owned subsidiary of OM.

64 of 82

direction of OM's former Chief Financial Officer and former Controller to OMGA's books and records, which were consolidated into OM's financial statements. These accounting practices allegedly included, among other things, recording inaccurate inventory estimates, and recording erroneous journal entries related to certain litigation involving OMGA. In addition, the complaint alleges that Venesky, in part, failed to provide sufficient information to OM's independent auditor about the accounting entries and estimates.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Venesky attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Venesky is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Venesky's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."³ This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Venesky, it appears that he has complied with the terms of the September 20, 2007 order suspending him from appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Venesky, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Paul R. Venesky, CPA is hereby reinstated to appear and practice before the Commission as an

³ Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.


Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Stern
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940

Release No. 3904 / August 26, 2014

INVESTMENT COMPANY ACT OF 1940

Release No. 31223 / August 26, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16037

In the Matter of

EDGAR R. PAGE and
PAGEONE FINANCIAL
INC.,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTIONS 203(e), 203(f) AND
203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940 AND
SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Edgar R. Page ("E. Page") and PageOne Financial, Inc. ("PageOne" and, together with E. Page, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. PageOne, a registered investment adviser, and E. Page, its sole owner and principal, hid serious conflicts of interest from their advisory clients in connection with recommending investments in three private investment funds (the "Private Funds").

2. Specifically, from early 2009 through approximately September 2011, Respondents knowingly or recklessly failed to tell their clients that:

65 of 82

- a. One of the Private Funds' managers (the "Fund Manager") was in the process of acquiring at least 49% of PageOne for approximately \$2.7 million;
- b. As part of that acquisition, E. Page had agreed to raise millions of dollars for the Private Funds from his advisory clients; and
- c. The Fund Manager was paying for the acquisition by making a series of installment payments over time, the timing and amounts of which were, at least partially, tied to Respondents' ability to direct client money into the Private Funds.

3. Indeed, the disclosures that Respondents did make in PageOne's Forms ADV materially misrepresented both the nature and amounts of the Fund Manager's payments to E. Page. For example—from approximately July 2009 to September 2010—PageOne's ADV stated that it received on an "annual basis, a referral fee" from the Fund Manager of "between 7.0% and 0.75% of the amount invested by" Respondents' clients in the Private Funds. However, as both Respondents knew or recklessly disregarded, (a) the Fund Manager's payments were not referral fees, but rather installments on the acquisition of PageOne; and (b) during that same period, those payments totaled more than 20% of the PageOne clients' investment in the Private Funds. As set out below, Respondents' other disclosures concerning their interests in the Private Funds and the Fund Manager were similarly misleading.

4. As a result of Respondents' fraud, their clients were unaware of the nature and extent of Respondents' conflicts of interest in recommending the Private Funds. Not least of those conflicts was the fact that the Fund Manager's ability to finalize the acquisition—and, thus, complete its payments to E. Page—was, at least partially dependent on the Respondents' continuing to raise money from PageOne clients for investment into the Private Funds.

5. From March 2009 through September 2011, Respondents' clients invested approximately \$13 million in the Private Funds at Respondents' recommendation. During roughly the same period, the Fund Manager paid Respondents (directly or indirectly) over \$2.7 million in acquisition payments.

B. RESPONDENTS

6. **E. Page**, age 62, lives in Gansevoort, New York. E. Page owns more than 95% of PageOne and is the company's Chairman, Chief Executive Officer, Chief Operating Officer, Chief Compliance Officer, Lead Portfolio Manager, and Chairman of its Investment Committee. From 1981 to 2009, E. Page was a registered representative of a number of registered broker dealers. In addition, as PageOne's Chief Compliance Officer, E. Page was responsible for authorizing any changes to PageOne's client disclosures, including its Forms ADV. Indeed, PageOne directed all questions concerning its Forms ADV to E. Page.

7. **PageOne** is a New York corporation headquartered in Malta, New York. PageOne has been registered with the Commission as an investment adviser since December 31, 1986. PageOne reported assets under management of about \$215 million on its Form ADV of March 31, 2014.

C. **OTHER RELEVANT INDIVIDUALS AND ENTITIES**

8. **The Fund Manager** is in the business of real estate management, development, and finance.

9. **The Private Funds** are private investment funds, not registered with the Commission. Their assets consist primarily of investments in real estate.

D. **FACTS**

The Acquisition Agreement

10. Sometime in late 2008, E. Page agreed that the Fund Manager would acquire PageOne. The parties further agreed that:

- a. The Fund Manager would pay the acquisition price of approximately \$3 million in installments over time; and
- b. The acquisition would not close—and the Fund Manager would not make the final payments of the purchase price—until E. Page raised approximately \$20 million for the Private Funds.

11. Sometime before April 2010, the Fund Manager and E. Page revised the acquisition terms to have the Fund Manager acquire 49% of PageOne for approximately \$2.4 million, which was later increased by agreement to approximately \$3 million.

12. Beginning in early 2009, Respondents began recommending that their clients invest in the Private Funds. From March 2009 through September 2011, Respondents' clients invested approximately \$13.2 million in the Private Funds as Respondents knew or recklessly disregarded. Respondents (a) could view their client's accounts; and (b) executed at least certain of the transfers of client funds from their existing investments into the Private Funds.

13. Over roughly the same time, the Fund Manager made installment payments on the acquisition of approximately \$2.7 million, an amount equal to roughly 20% of PageOne clients' investments in the Private Funds. The Fund Manager made these payments directly to E. Page, or to PageOne and other entities and persons, at E. Page's direction.

14. The size and timing of the Fund Manager's payments was determined, at least partially, by when PageOne clients made investments into the Private Funds. This reflected both (a) E. Page's explicit agreement to raise money for the Private Funds as part of the acquisition; and (b) the fact that the Fund Manager had limited liquidity. In other

words, the Fund Manager needed to receive investments from PageOne clients to free up cash to make the periodic acquisition payments.

15. Moreover, Respondents knew (or recklessly disregarded) that the timing of the Fund Manager's acquisition payments—which often followed very closely in time behind PageOne clients' investments in the Private Funds—was linked to those investments. First, Respondents had explicitly agreed to raise money for the Private Funds as a term of the acquisition. Thus, on at least one occasion, E. Page emailed the Fund Manager's founder and Chairman (the "Chairman") to notify him that a PageOne client had invested in the Private Funds and to ask for an acquisition payment. Moreover, E. Page understood that the Chairman and the Fund Manager did not have sufficient liquidity of their own to complete the acquisition of PageOne. Indeed, E. Page understood that the Chairman was, at the time, selling certain personal assets to keep the Fund Manager's business going.

The Promissory Notes

16. The acquisition payments were memorialized as promissory notes from E. Page to the Fund Manager. E. Page understood, from the Chairman, that—in the event that the acquisition was consummated—the Fund Manager would cancel the notes. However, he likewise understood that until the acquisition closed and the Fund Manager cancelled the notes, E. Page was personally liable for the notes. Indeed, E. Page expressed just this concern to the Chairman, writing in an email in January 2010 that, as a result of the acquisition not closing, "I have a large loan 'liability' [sic] and no assets."

Respondents' Materially False and Misleading Statements and Omissions Concerning their Relationship to the Fund Manager and the Private Funds

17. Respondents knowingly or recklessly failed to disclose accurately the acquisition agreement as well as the true nature and amounts of the Fund Manager's payments to Respondents. E. Page refused to do so because, as he testified, "It's too dangerous. It would cause thousands of clients to get extremely nervous if I was selling my firm." In other words, E. Page was concerned that the true nature of his interest in the Fund Manager—and, in turn, in the Private Funds he was recommending—would be important information to investors.

18. Initially, Respondents knowingly or recklessly omitted to make any disclosure at all to their clients. Thus, from March through July 2009, Respondents remained entirely silent concerning their relationship to the Fund Manager and the Private Funds. During this time (a) Respondents' clients invested \$4.25 million in the Private Funds; and (b) the Fund Manager paid Respondents \$300,000, equivalent to 7% of the total invested.

19. Thereafter, E. Page—who was PageOne's Chief Compliance Officer, Chairman and CEO, as well as controlling person, at all relevant times—knowingly or recklessly had PageOne make a series of false and misleading disclosures concerning the Fund Manager's acquisition in its Forms ADV.

i. PageOne's False and Misleading Forms ADV: July 31, 2009 to September 14, 2010

20. On July 31, 2009, PageOne revised its Form ADV, Part II to include in the section relating to advisory services and fees disclosure concerning the Fund Manager and the Private Funds. That Form ADV stated that Respondents may recommend investments in the Private Funds, calling them "unaffiliated private funds." This latter statement was misleading as it suggested no relationship between Respondents and the Private Funds. By this point in time, however, the Fund Manager had agreed in principal to acquire at least 49% of PageOne and had made a \$300,000 down payment on that acquisition.

21. That section of PageOne's Form ADV, Part II also purported to describe the financial relationship between PageOne and the Private Funds:

Fee Schedule: PageOne Financial does not directly charge the client a fee for this service. PageOne Financial is compensated by a referral fee paid by the [Fund] Manager of the Private Fund(s) in which its clients invest. The management and other fees the client pays to the Private Funds are not increased as a result of Registrant's referral of clients to the Private Funds. PageOne Financial will typically receive, on an annual basis, a referral fee of between 7.0% and 0.75% of the amount invested by the client in the applicable Private Fund(s).

22. This disclosure was materially false and misleading. First, the Fund Manager's payments to Respondents were simply not fees for referring investments to the Private Funds—rather they were down payments on the acquisition of at least 49% of PageOne. Because of the false disclosure, investors did not know that: (a) Respondents had agreed to raise millions of dollars for the Private Funds as a condition to closing the acquisition; (b) as opposed to a "referral fee," Respondents had an expectation of future payments from the Fund Manager in the form of the full acquisition price, future payments that would only be made if the Fund Manager could afford to acquire PageOne and Respondents were able to raise the promised funds; and (c) if the acquisition did not close, E. Page was personally liable for the promissory notes.

23. Respondents, thus, had an undisclosed interest in ensuring the ongoing success of the Private Funds and the Fund Manager—i.e., to ensure that Respondents received the entire acquisition price. This interest represented, at least, a potential conflict with the purported objectivity of Respondents' investment advice to their clients.

24. Second, it was not true that the Fund Manager's payments to Respondents were limited to "between 7.0% and 0.75% of the amount invested" on an annual basis in the Private Funds. Indeed, in the approximately one year from July 31, 2009 to September 14, 2010—when PageOne again changed its disclosure concerning the Fund Manager (see below)—the Fund Manager paid Respondents \$1,312,755, an amount equivalent to 20% of the \$6,559,400 that Respondents' clients invested into the Private Funds during that time.

25. Respondents knew or recklessly disregarded the false and misleading statements contained in the Form ADV, Part II. E. Page told his Assistant Compliance Officer that he did not want to disclose the true nature of the arrangement with the Fund Manager. Moreover, as PageOne's Chief Compliance Officer, Chairman and CEO, E. Page was ultimately responsible for PageOne's disclosures, including its Forms ADV. Indeed, he reviewed and approved the July 31, 2009 Form ADV, Part II.

ii. PageOne's False and Misleading Forms ADV: September 14, 2010 to March 1, 2011

26. On September 14, 2010, PageOne again amended the disclosure in its Form ADV, Part II concerning the Fund Manager and the Private Funds. And again, Respondents knew or recklessly disregarded that the new disclosure was materially false and misleading.

27. The September 14, 2010 Form ADV, Part II section concerning advisory services and fees was amended to remove the descriptions of the purported "referral fee" discussed above, as well as the amounts of that fee. In its place, the revised Form ADV stated that PageOne would charge its clients a 1% annual management fee on money invested in the Private Funds. The September 14, 2010 ADV, Part II, in the sections concerning "Other Business Activities" and "Participation or Interest in Client Transactions," went on to state that:

Edgar R. Page . . . is also employed as a consultant to the [the Fund Manager]. [The Fund Manager] is a real estate investment and development firm. Mr. Page is compensated for the consulting services he provides to [the Fund Manager]. As disclosed above, PageOne Financial recommends private funds that are managed by [the Fund Manager] to PageOne Financial's advisory clients for which PageOne Financial receives an advisory fee. Advisory clients are under no obligation to participate in such investments.

28. Moreover, as had been true since early 2009, the Fund Manager continued to make installment payments on its acquisition of PageOne. Between September 14, 2010 and March 1, 2011 (when PageOne again changed its ADV disclosure), the Fund Manager paid Respondents \$468,500, equivalent to about 71% of the \$652,770 that Respondents' clients invested into the Private Funds during that time.

29. In addition—as with the July 31, 2009 Form ADV—the amended Form ADV continued to state that "[a]ll private investment funds recommended by [PageOne] are managed by unaffiliated investment advisors." This statement was misleading. Despite its suggestion that the Private Funds were entirely unaffiliated with PageOne, by September 14, 2010, the Fund Manager had paid E. Page \$1.6 million, or more than 50% of the agreed-upon \$3 million acquisition price.

30. As with the prior false statements and omissions, Respondents knew or recklessly disregarded that the September 14, 2010 Form ADV, Part II was false and misleading.

- a. As E. Page knew, he was never a consultant to the Fund Manager, provided no consulting services, and, thus, was never compensated for any such services;
 - b. E. Page understood the true terms of the acquisition; and
 - c. E. Page authorized the amendments and was, thus, aware of their wording.
- iii. PageOne's False and Misleading Forms ADV: March 1, 2011 to September 29, 2011

31. On March 1, 2011, PageOne again amended its Form ADV, Part 2A, this time deleting all references to the Fund Manager and the Private Funds. Despite the deletions, Respondents' undisclosed conflict of interest did not disappear. Between March 1, 2011 and September 29, 2011, PageOne clients invested an additional \$1,738,000 in the Private Funds. At the same time, the Fund Manager made installment payments to E. Page during this period of \$700,000, equivalent to 40% of PageOne clients' investment in the Private Funds during that time.

32. Respondents knew or were reckless in not knowing that the March 1, 2011 Form ADV, Part 2A omitted to disclose the acquisition agreement. E. Page was the Chief Compliance Officer, Chairman and CEO at the time and, as such, it was his responsibility to approve any changes to the Form ADV.

33. In addition to the above false and misleading statements and omissions, Respondents also intentionally or recklessly omitted to tell their clients about the promissory notes at all relevant times.

34. PageOne published its Forms ADV on its website and delivered them to prospective clients during the relevant time period.

35. In addition to the above—by failing to tell their clients about the true nature of their relationship to the Fund Manager and the Private Funds and by preparing and disseminating Forms ADV that falsely described those relationships—Respondents failed to act as a reasonably careful person would in similar circumstances.

The Fund Manager's Acquisition Collapses

36. Over the course of 2010 and 2011, E. Page became increasingly concerned that the acquisition would not close. He understood that he had not been able to raise the \$20 million, a condition precedent for the acquisition. And, he knew or recklessly disregarded that the Fund Manager had not been able to otherwise raise sufficient funds to pay the balance on the acquisition price. In both 2010 and 2011, the Chairman made

increasingly urgent appeals to E. Page to assist the Fund Manager in fund-raising, for example, telling him of his "need" to raise money and saying that he "[d]esperately need[ed]" E. Page's help in doing so.

37. Respondents' clients made their last investments in the Private Funds in September 2011, shortly after the Fund Manager made its last payment to E. Page.

38. Despite paying approximately \$2.7 million to Respondents, the Fund Manager never consummated its acquisition of 49% of PageOne.

39. In April 2013, the Fund Manager wrote to E. Page seeking repayment of the promissory notes of \$2,751,345 in principal and \$933,486.32 in interest on the grounds that the acquisition had not closed.

E. VIOLATIONS

40. As a result of the conduct described above, Respondents willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

41. As a result of the conduct describe above, Respondents willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

42. As a result of the conduct described above, E. Page willfully aided and abetted and caused PageOne's violations of:

- a. Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser; and
- b. Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

D. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1), 206(2), and 207 of the Advisers Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 203 of the Advisers Act, and Section 9 of the Investment Company Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72927 / August 27, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16040

In the Matter of

Xinde Technology Company,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT ¹

1. Xinde Technology Company ("WTFS") (CIK No. 1401306) is a revoked Nevada corporation located in Weifang, Shandong Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WTFS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012. As of August 20, 2014, the common stock of WTFS was quoted on OTC Link operated by OTC Markets Group, Inc. (formerly "Pink Sheets"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic

¹ The short form of the issuer's name is also its ticker symbol.

66 of 82

reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 27, 2014

In the Matter of

Xinde Technology Company,

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Xinde Technology Company because it has not filed any periodic reports since the period ended March 31, 2012.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on August 27, 2014, through 11:59 p.m. EDT on September 10, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

67 of 82

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 27, 2014

In the Matter of

Clavis Technologies International Co., Ltd.,

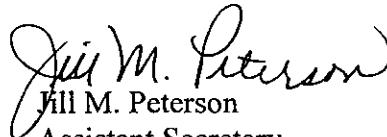
File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Clavis Technologies International Co., Ltd. because it has not filed any periodic reports since the period ended September 30, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on August 27, 2014, through 11:59 p.m. EDT on September 10, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

68 of 82

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72931 / August 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16042

In the Matter of

Clavis Technologies International Co., Ltd.,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF
HEARING PURSUANT TO SECTION 12(j)
OF THE SECURITIES EXCHANGE ACT OF
1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT ¹

1. Clavis Technologies International Co., Ltd. ("CTLH") (CIK No. 1482550) is a Nevada corporation located in Seoul, Korea with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CTLH is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011, which reported a net loss of \$270,857 for the prior nine months. As of August 20, 2014, the common stock of CTLH was quoted on OTC Link operated by OTC Markets Group, Inc. (formerly "Pink Sheets"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic

¹ The short form of the issuer's name is also its ticker symbol.

69 of 82

reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

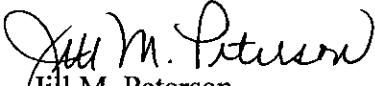
If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72929 / August 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16041

In the Matter of

Gold Horse International, Inc.,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT ¹

1. Gold Horse International, Inc. ("GHII") (CIK No. 1111284) is a dissolved Florida corporation located in Hohhot, Inner Mongolia, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GHII is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012. As of August 20, 2014, the common stock of GHII was quoted on OTC Link operated by OTC Markets Group, Inc. (formerly "Pink Sheets"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic

¹ The short form of the issuer's name is also its ticker symbol.

reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 27, 2014

In the Matter of

Gold Horse International, Inc.,

File No. 500-1

ORDER OF SUSPENSION OF
TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Gold Horse International, Inc. because it has not filed any periodic reports since the period ended March 31, 2012.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on August 27, 2014, through 11:59 p.m. EDT on September 10, 2014.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

71 of 82

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 232, 240, 249, and 249b

Release No. 34-72936; File No. S7-18-11

RIN 3235-AL15

Nationally Recognized Statistical Rating Organizations

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and to enhance oversight, the Securities and Exchange Commission ("Commission") is: adopting amendments to existing rules and new rules that apply to credit rating agencies registered with the Commission as nationally recognized statistical rating organizations ("NRSROs"); adopting a new rule and form that apply to providers of third-party due diligence services for asset-backed securities; and adopting amendments to existing rules and a new rule that implement a requirement added by the Dodd-Frank Act that issuers and underwriters of asset-backed securities make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. The Commission also is adopting certain technical amendments to existing rules.

DATES: The amendments to existing rules are effective [insert date that is 60 days after this release is published in the Federal Register]; except that the amendments to § 240.17g-3(a)(7) and (b)(2) and Form NRSRO are effective on January 1, 2015; and the amendments to § 240.17g-2(a)(9), (b)(13), (b)(14), and (b)(15), § 240.17g-5(a)(3)(iii)(E), (c)(6), (c)(7), and (c)(8), § 240.17g-7(a) and (b), and Form ABS-15G are effective [insert date that is nine months after this release is published in the Federal Register]. New rules § 240.15Ga-2, § 240.17g-8, §

*Commissioner Gallagher
Commissioner Prower
Disapproved*

240.17g-9, § 240.17g-10, and Form ABS Due Diligence-15E are effective [insert date that is nine months after this release is published in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Randall W. Roy, Assistant Director, at (202) 551-5522; Raymond A. Lombardo, Branch Chief, at (202) 551-5755; Rose Russo Wells, Senior Counsel, at (202) 551-5527; Division of Trading and Markets; Harriet Orol, Branch Chief, at (212) 336-0554; Kevin Vasel, Attorney, at (212) 336-0981; Office of Credit Ratings; or, with respect to the rules for issuers and underwriters of asset-backed securities, Michelle M. Stasny, Special Counsel in the Office of Structured Finance, at (202) 551-3674; Division of Corporation Finance; Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission, with respect to NRSROs, is adopting amendments to rules 17 CFR 232.101 (“Rule 101 of Regulation S-T”), 17 CFR 240.17g-1 (“Rule 17g-1”), 17 CFR 240.17g-2 (“Rule 17g-2”), 17 CFR 240.17g-3 (“Rule 17g-3”), 17 CFR 240.17g-5 (“Rule 17g-5”), 17 CFR 240.17g-6 (“Rule 17g-6”), 17 CFR 240.17g-7 (“Rule 17g-7”), and 17 CFR 249b.300 (“Form NRSRO”); and is adopting new rules 17 CFR 240.17g-8 (“Rule 17g-8”) and 17 CFR 240.17g-9 (“Rule 17g-9”).

In addition, the Commission, with respect to providers of third-party due diligence services for asset-backed securities, is adopting new rules 17 CFR 240.17g-10 (“Rule 17g-10”) and 17 CFR 249b.500 (“Form ABS Due Diligence-15E”).

Finally, the Commission, with respect to issuers and underwriters of asset-backed securities, is adopting amendments to 17 CFR 249.1400 (“Form ABS-15G”) and is adopting new rule 17 CFR 240.15Ga-2 (“Rule 15Ga-2”).

TABLE OF CONTENTS

I. INTRODUCTION.....	5
A. BACKGROUND	5
B. ECONOMIC ANALYSIS.....	9
1. Guiding Principles.....	9
2. Baseline.....	18
a. NRSROs.....	19
b. Asset-Backed Security Issuers, Underwriters, and Third-Party Due Diligence Providers.....	28

c.	Industry Practices.....	34
3.	Broad Economic Considerations.....	35
a.	Amendments and Rules Enhancing NRSRO Governance and Integrity of Credit Ratings.....	39
b.	Amendments and Rules Enhancing Disclosure and Transparency of Credit Ratings.....	48
II.	FINAL RULES AND RULE AMENDMENTS.....	55
A.	INTERNAL CONTROL STRUCTURE.....	55
1.	Prescribing Factors.....	57
2.	Amendment to Rule 17g-2.....	66
3.	Amendments to Rule 17g-3.....	71
4.	Economic Analysis.....	86
B.	SALES AND MARKETING CONFLICT OF INTEREST.....	94
1.	New Prohibited Conflict.....	95
2.	Exemption for "Small" NRSROs.....	109
3.	Suspending or Revoking a Registration.....	115
4.	Economic Analysis.....	124
C.	"LOOK-BACK" REVIEW.....	130
1.	Paragraph (c) of New Rule 17g-8.....	131
2.	Amendment to Rule 17g-2.....	151
3.	Economic Analysis.....	152
D.	FINES AND OTHER PENALTIES.....	163
1.	Final Rule.....	163
2.	Economic Analysis.....	166
E.	DISCLOSURE OF INFORMATION ABOUT THE PERFORMANCE OF CREDIT RATINGS.....	167
1.	Amendments to Instructions for Exhibit 1 to Form NRSRO.....	168
a.	Proposal.....	168
b.	Final Rule.....	176
2.	Amendments to Rule 17g-1.....	203
3.	Amendments to Rule 17g-2 and Rule 17g-7.....	206
a.	Proposal.....	206
b.	Final Rule.....	211
4.	Economic Analysis.....	232
F.	CREDIT RATING METHODOLOGIES.....	258
1.	Paragraph (a) of New Rule 17g-8.....	259
2.	Amendment to Rule 17g-2.....	281
3.	Economic Analysis.....	282
G.	FORM AND CERTIFICATIONS TO ACCOMPANY CREDIT RATINGS.....	290
1.	Paragraph (a) of Rule 17g-7 – Prefatory Text.....	291
2.	Paragraph (a)(1)(i) of Rule 17g-7 – Format of the Form.....	303
3.	Paragraph (a)(1)(ii) of Rule 17g-7 – Content of the Form.....	308
4.	Paragraph (a)(1)(iii) of Rule 17g-7 – Attestation.....	343
5.	Paragraph (a)(2) of Rule 17g-7 – Third-Party Due Diligence Certification.....	347
6.	Economic Analysis.....	351
H.	THIRD-PARTY DUE DILIGENCE FOR ASSET-BACKED SECURITIES.....	360
1.	New Rule 15Ga-2 and Amendments to Form ABS-15G.....	361
2.	New Rule 17g-10.....	383
3.	New Form ABS Due Diligence-15E.....	402
4.	Economic Analysis.....	416
I.	STANDARDS OF TRAINING, EXPERIENCE, AND COMPETENCE.....	430
1.	New Rule 17g-9.....	431
2.	Amendment to Rule 17g-2.....	447
3.	Economic Analysis.....	449
J.	UNIVERSAL RATING SYMBOLS.....	453
1.	Paragraph (b) of New Rule 17g-8.....	455
2.	Amendment to Rule 17g-2.....	465
3.	Economic Analysis.....	466
K.	ANNUAL REPORT OF DESIGNATED COMPLIANCE OFFICER.....	471

1.	Amendment to Rule 17g-3	473
2.	Economic Analysis	475
L.	ELECTRONIC SUBMISSION OF FORM NRSRO AND THE RULE 17g-3 ANNUAL REPORTS	476
1.	Amendments to Rule 17g-1, Form NRSRO, Rule 17g-3, and Regulation S-T	476
2.	Economic Analysis	485
M.	OTHER AMENDMENTS	491
1.	Changing "Furnish" to "File"	492
2.	Amended Definition of NRSRO	495
3.	Definition of Asset-Backed Security	496
4.	Other Amendments to Form NRSRO	498
a.	Clarification with Respect to Items 6 and 7	498
b.	Clarification with Respect to Exhibit 8	503
c.	Clarification with Respect to Exhibits 10 through 13	503
5.	Economic Analysis	504
III.	EFFECTIVE DATES	506
A.	AMENDMENTS EFFECTIVE SIXTY DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER	507
B.	AMENDMENTS EFFECTIVE ON JANUARY 1, 2015	509
C.	AMENDMENTS AND NEW RULES EFFECTIVE NINE MONTHS AFTER PUBLICATION IN THE FEDERAL REGISTER	511
IV.	PAPERWORK REDUCTION ACT	518
A.	SUMMARY OF THE COLLECTION OF INFORMATION REQUIREMENTS	520
1.	Amendments to Rule 17g-1	520
2.	Amendments to Instructions for Exhibit 1 to Form NRSRO	521
3.	Amendments to Rule 17g-2	521
4.	Amendments to Rule 17g-3	522
5.	Amendments to Rule 17g-5	524
6.	Amendments to Rule 17g-7	525
7.	New Rule 17g-8	526
8.	New Rule 17g-9	528
9.	New Rule 17g-10 and New Form ABS Due Diligence-15E	528
10.	New Rule 15Ga-2 and Amendments to Form ABS-15G	530
11.	Amendments to Regulation S-T	531
12.	Form ID	531
B.	USE OF INFORMATION	532
1.	Amendments to Rule 17g-1	532
2.	Amendments to Instructions for Exhibit 1 to Form NRSRO	532
3.	Amendments to Rule 17g-2	533
4.	Amendments to Rule 17g-3	534
5.	Amendments to Rule 17g-5	535
6.	Amendments to Rule 17g-7	536
7.	New Rule 17g-8	538
8.	New Rule 17g-9	540
9.	New Rule 17g-10 and New Form ABS Due Diligence-15E	541
10.	New Rule 15Ga-2 and Amendments to Form ABS-15G	541
11.	Amendments to Regulation S-T	541
12.	Form ID	542
C.	RESPONDENTS	542
D.	TOTAL INITIAL AND ANNUAL RECORDKEEPING AND REPORTING BURDENS	544
1.	Amendments to Rule 17g-1	548
2.	Amendments to Form NRSRO Instructions	553
3.	Amendments to Rule 17g-2	557
4.	Amendments to Rule 17g-3	561
5.	Amendments to Rule 17g-5	565
6.	Amendments to Rule 17g-7	568
7.	New Rule 17g-8	579
8.	New Rule 17g-9	582

9.	New Rule 17g-10 and New Form ABS Due Diligence-15E	587
10.	New Rule 15Ga-2 and Amendments to Form ABS-15G	590
11.	Amendments to Regulation S-T	595
12.	Form ID	596
13.	Total Paperwork Burdens	596
E.	COLLECTION OF INFORMATION IS MANDATORY	597
F.	CONFIDENTIALITY	597
G.	RETENTION PERIOD OF RECORDKEEPING REQUIREMENTS	601
V.	IMPLEMENTATION AND ANNUAL COMPLIANCE CONSIDERATIONS	601
A.	INTERNAL CONTROL STRUCTURE	601
B.	CONFLICTS OF INTEREST RELATING TO SALES AND MARKETING	603
C.	"LOOK-BACK" REVIEW	604
D.	FINES AND OTHER PENALTIES	605
E.	ENHANCEMENTS TO DISCLOSURES OF PERFORMANCE STATISTICS	605
F.	ENHANCEMENTS TO RATING HISTORIES DISCLOSURES	607
G.	CREDIT RATING METHODOLOGIES	607
H.	FORM AND CERTIFICATION TO ACCOMPANY CREDIT RATINGS	609
I.	NEW RULE 15Ga-2 AND AMENDMENTS TO FORM ABS-15G	610
J.	NEW RULE 17g-10 AND NEW FORM ABS DUE DILIGENCE-15E	610
K.	STANDARDS OF TRAINING, EXPERIENCE, AND COMPETENCE	612
L.	UNIVERSAL RATING SYMBOLS	613
M.	ELECTRONIC SUBMISSION OF FORM NRSRO AND THE RULE 17G-3 ANNUAL REPORTS	614
VI.	FINAL REGULATORY FLEXIBILITY ANALYSIS	615
A.	NEED FOR AND OBJECTIVES OF THE AMENDMENTS AND NEW RULES	615
B.	SIGNIFICANT ISSUES RAISED BY PUBLIC COMMENTS	616
C.	SMALL ENTITIES SUBJECT TO THE RULES	628
1.	NRSROs and Providers of Third-Party Due Diligence Services	628
2.	Issuers	629
D.	REPORTING, RECORDKEEPING, AND OTHER COMPLIANCE REQUIREMENTS	630
E.	AGENCY ACTION TO MINIMIZE EFFECT ON SMALL ENTITIES	641
VII.	STATUTORY AUTHORITY	645

I. INTRODUCTION

A. BACKGROUND

The Dodd-Frank Act,¹ through Title IX, Subtitle C, "Improvements to the Regulation of Credit Rating Agencies," among other things, establishes new self-executing requirements applicable to NRSROs and requires that the Commission adopt rules applicable to NRSROs in a number of areas.² It also requires certain studies relating to NRSROs.³ The NRSRO provisions

¹ Pub. L. No. 111-203, 124 Stat. 1376, H.R. 4173 (July 21, 2010).

² See Pub. L. No. 111-203, 931 through 939H. In addition, Title IX, Subtitle D, "Improvements to the Asset-Backed Securitization Process," contains section 943, which provides that the Commission shall adopt rules, within 180 days, requiring an NRSRO to include in any report accompanying a credit rating of an asset-backed security a description of the representations, warranties, and enforcement mechanisms available to investors and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities. See Pub. L. No. 111-203, 943. On January 20, 2011, the Commission adopted Rule 17g-7 to implement section 943. See Disclosure for Asset-Backed Securities

in the Dodd-Frank Act augment the Credit Rating Agency Reform Act of 2006 (the “Rating Agency Act of 2006”), which established a registration and oversight program for NRSROs through self-executing provisions added to the Exchange Act and implementing rules adopted by the Commission under the Exchange Act, as amended by the Rating Agency Act of 2006.⁴ Title

Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Securities Act of 1933 (“Securities Act”) Release No. 9175 (Jan. 20, 2011), 76 FR 4489 (Jan. 26, 2011). Prior to enactment of the Dodd-Frank Act and the adoption of Rule 17g-7, the Commission proposed a different rule to be codified at 17 CFR 240.17g-7. See Proposed Rules for Nationally Recognized Statistical Rating Organizations, Securities Exchange Act of 1934 (“Exchange Act”) Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008). This proposed rule would have required an NRSRO to publish a report containing certain information with the publication of a credit rating for a structured finance product or, as an alternative, use ratings symbols for structured finance products that differentiate them from the credit ratings for other types of debt securities. See id. In November 2009, the Commission announced it was deferring consideration of action on that proposal and separately proposed a different rule to be codified at 17 CFR 240.17g-7 that would have required an NRSRO to annually disclose certain information. See Proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61051 (Nov. 23, 2009), 74 FR 63866 (Dec. 4, 2009). As discussed above, a different rule from either of these proposals ultimately was adopted and codified at 17 CFR 240.17g-7 in January 2011. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 4489.

³ See Pub. L. No. 111-203, 939(h), 939C, 939D, 939E, 939F. Pursuant to section 939(h) of the Dodd-Frank Act, the Commission submitted a staff report to Congress on standardizing credit rating terminology. See Report to Congress Credit Rating Standardization Study As Required by Section 939(h) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Sept. 2012), available at http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf (“2012 Staff Report on Credit Rating Standardization”). Pursuant to section 939F of the Dodd-Frank Act, the Commission submitted a staff report to Congress on the feasibility of establishing a system for assigning NRSROs to determine credit ratings for structured finance products. See Report to Congress on Assigned Credit Ratings As Required by Section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dec. 2012), available at <http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf> (“2012 Staff Report on Assigned Credit Ratings”). Pursuant to section 939C of the Dodd-Frank Act, the Commission submitted a staff report to Congress on the independence of credit rating agencies. See Report to Congress on Credit Rating Agency Independence Study As Required by Section 939C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Nov. 2013), available at <http://www.sec.gov/news/studies/2013/credit-rating-agency-independence-study-2013.pdf> (“2013 Staff Report on Credit Rating Agency Independence”).

⁴ See Pub. L. No. 109-291 (2006). The Rating Agency Act of 2006, among other things, amended section 3 of the Exchange Act to add definitions, added section 15E to the Exchange Act to establish self-executing requirements for NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs, amended section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over NRSROs, and amended section 21B(a) of the Exchange Act to provide the Commission with the authority to assess penalties “against any person” in administrative proceedings instituted under section 15E of the Exchange Act. See Pub. L. No. 109-291, 3 and 4; 15 U.S.C. 78c; 15 U.S.C. 78o-7; 15 U.S.C. 78q; 15 U.S.C. 78u-2. The Commission adopted rules to implement a registration and oversight program for NRSROs in June 2007. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007). The implementing rules were Form NRSRO, Rule 17g-1, Rule 17g-2, Rule 17g-3, Rule 17g-4, Rule 17g-5, and Rule 17g-6. The Commission has twice

IX, Subtitle C of the Dodd-Frank Act also provides that the Commission shall prescribe the format of a certification that providers of third-party due diligence services must provide to each NRSRO producing a credit rating for an asset-backed security to which the due diligence services relate.⁵ Finally, Title IX, Subtitle C of the Dodd-Frank Act establishes a new requirement for issuers and underwriters of asset-backed securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.⁶

On May 18, 2011, the Commission proposed for comment amendments to existing rules and new rules in accordance with Title IX, Subtitle C of the Dodd-Frank Act and to enhance oversight of NRSROs.⁷ The Commission received a number of comment letters in response to the proposals.⁸ The comments on specific proposals are summarized below in the corresponding

adopted amendments to some of these rules. See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (Feb. 2, 2009), 74 FR 6456 (Feb. 9, 2009); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009).

⁵ See Pub. L. No. 111-203, 932(a)(8) (adding new paragraph (s)(4)(C) to section 15E of the Exchange Act); 15 U.S.C. 78o-7(s)(4)(C)).

⁶ See Pub. L. No. 111-203, 932(a)(8) (adding new paragraph (s)(4)(A) to section 15E of the Exchange Act); 15 U.S.C. 78o-7(s)(4)(A).

⁷ See Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 64514 (May 18, 2011), 76 FR 33420 (June 8, 2011). The Commission also proposed technical amendments to its existing NRSRO rules. Id.

⁸ See letter from Jeffrey W. Rubin, Chair, Business Law Section, American Bar Association, dated Aug. 19, 2011 ("ABA Letter"); letter from Bruce E. Stern, Chairman, Association of Financial Guaranty Insurers, dated Aug. 8, 2011 ("AFGI Letter"); letter from Gerald W. McEntee, President, American Federation of State, County and Municipal Employees, dated Aug. 5, 2011 ("AFSCME Letter"); letter from Marcus Stanley, Policy Director, Americans for Financial Reform, dated Apr. 1, 2014 ("AFR II Letter"); letter from Daryl Schubert, Chair, Auditing Standards Board, American Institute of Certified Public Accountants, dated Aug. 10, 2011 ("AICPA Letter"); letter from Larry G. Mayewski, Executive Vice President, A.M. Best, dated Aug. 8, 2011 ("A.M. Best Letter"); letter from the Honorable Robert E. Andrews, U.S. Congress, House of Representatives, dated Mar. 3, 2012 ("Andrews Letter"); letter from Tom Deutsch, Executive Director, American Securitization Forum, dated Aug. 8, 2011 ("ASF Letter"); letter from Chris Barnard dated June 30, 2011 ("Barnard Letter"); letter from Joel Barton dated Aug. 8, 2011 ("Barton Letter"); letter from Marie Benson dated June 16, 2011 ("Benson Letter"); letter from Dennis M. Kelleher, President & CEO, and Stephen W. Hall, Securities Specialist, Better Markets, Inc., dated Aug. 8, 2011 ("Better Markets Letter"); letter from Zenia Brown dated May 21, 2011 ("Brown Letter"); letter from John J. Cadigan, General Partner, CECO LLC, dated June 15, 2011 ("Cadigan Letter"); letter from Nancy

Campbell dated Sept. 29, 2011 ("Campbell Letter"); letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, and Marcus Stanley, Policy Director, Americans for Financial Reform, dated Aug. 8, 2011 ("CFA/AFR Letter"); letter from Micah Hauptman, Financial Services Counsel, and Barbara Roper, Director of Investor Protection, Consumer Federation of America, dated Mar. 3, 2014 ("CFA II Letter"); letter from Robert M. Chandler dated June 8, 2011 ("Chandler Letter"); letter from Laurel Leitner, Senior Analyst, Council of Institutional Investors, dated Aug. 8, 2011 ("CII Letter"); letter from Susan R. Clark dated June 17, 2011 ("Clark Letter"); letter from Steven Cohen, Senior Vice President and General Counsel, Clayton Holdings LLC, dated Aug. 8, 2011 ("Clayton Letter"); letter from Gregory W. Smith, Chief Operating Officer, General Counsel, Colorado Public Employees Retirement Association, dated Aug. 8, 2011 ("COPERA Letter"); letter from Dave Cowen dated May 23, 2011 ("Cowen Letter"); letter from Stephen M. Renna, Chief Executive Officer, CRE Finance Council, dated Aug. 8, 2011 ("CRE Letter"); letter from Gary D. Cristofani dated July 28, 2011 ("Cristofani Letter"); letter from William Michael Cunningham, Creative Investment Research, Inc., dated May 23, 2005 ("Cunningham I Letter"); letter from William Michael Cunningham, Creative Investment Research, Inc., dated July 4, 2011 ("Cunningham II Letter"); letter from Bonnie Davis dated June 16, 2011 ("Davis Letter"); letter from Theresa Day dated June 16, 2011 ("Day Letter"); letter from Daniel Curry, President, and Mary Keogh, Managing Director, Regulatory Affairs, DBRS, Inc., dated Aug. 8, 2011 ("DBRS Letter"); letter from Daniel Curry, Chief Executive Officer, and Mary Keogh, Managing Director, Global Regulatory Affairs, DBRS, Inc., dated Dec. 5, 2013 ("DBRS II Letter"); letter from Deloitte & Touche LLP dated Aug. 8, 2011 ("Deloitte Letter"); letter from Sean Egan, Egan-Jones Ratings Company, dated Aug. 5, 2011 ("EJR Letter"); letter from Roberta Y. Ely dated June 17, 2011 ("Ely Letter"); letter from Ernst & Young LLP dated Aug. 8, 2011 ("Ernst & Young Letter"); letter from Anne S. McCulloch, Senior Vice President and Deputy General Counsel, Federal National Mortgage Association, dated Aug. 8, 2011 ("Fannie Mae Letter"); letter from Charles D. Brown, General Counsel, Fitch, Inc., dated Aug. 5, 2011 ("Fitch Letter"); letter from Marianne Freebury dated June 16, 2011 ("Freebury Letter"); letter from Richard M. Whiting, Executive Director and General Counsel, The Financial Services Roundtable, dated Aug. 8, 2011 ("FSR Letter"); letter from Myrna D. Gardner dated June 14, 2011 ("Gardner Letter"); letter from Corrine M. Garza dated June 14, 2011 ("Garza Letter"); letter from David Gaus dated Nov. 1, 2012 ("Gaus Letter"); letter from William J. Harrington, dated Aug. 8, 2011 ("Harrington Letter"); letter from William J. Harrington dated May 29, 2014 ("Harrington II Letter"); letter from Karrie McMillan, General Counsel, Investment Company Institute, dated Aug. 8, 2011 ("ICI Letter"); letter from KPMG LLP dated Aug. 8, 2011 ("KPMG Letter"); letter from Markus Krebsz dated Nov. 4, 2010 ("Krebsz Letter"); letter from Jules B. Kroll, Chairman and CEO, Kroll Bond Rating Agency, Inc., dated Aug. 8, 2011 ("Kroll Letter"); letter from Jules B. Kroll, Chairman and CEO, Kroll Bond Rating Agency, Inc., dated August 19, 2014 ("Kroll II Letter"); letter from Francis Lambert dated Aug. 8, 2011 ("Lambert Letter"); letter from Kashif Latif dated May 19, 2011 ("Latif Letter"); letter from the Honorable Carl Levin, U.S. Senate, Permanent Subcommittee on Investigations, dated Aug. 8, 2011 ("Levin Letter"); letter from Dee Longenbaugh dated June 15, 2011 ("Longenbaugh Letter"); letter from Ray Lynch dated June 17, 2011 ("Lynch Letter"); letter from Craig R. Mills, CraigRMills LLC, dated Aug. 19, 2011 ("Mills Letter"); letter from Michel Madelain, President and Chief Operating Officer, Moody's Investors Service, dated Aug. 8, 2011 ("Moody's Letter"); letter from Robert Dobilas, President, Morningstar Credit Ratings, LLC, dated Aug. 8, 2011 ("Morningstar Letter"); letter from Kevin Overholt dated June 14, 2011 ("Overholt Letter"); letter from Maneesh Pangasa dated July 29, 2011 ("Pangasa Letter"); letter from PricewaterhouseCoopers, LLP, dated Aug. 8, 2011 ("PWC Letter"); letter from William E. Reno dated June 16, 2011 ("Reno Letter"); letter from LaVonne L. Rhyneer dated June 17, 2011 ("Rhyneer Letter"); letter from Andrew M. Siff, Esquire, Siff & Associates, PLLC, dated June 13, 2011 ("Siff Letter"); letter from Deven Sharma, President, Standard and Poor's Ratings Services, dated Aug. 8, 2011 ("S&P Letter"); letter from Anne Rutledge, President, TradeMetrics Corporation, dated Aug. 8, 2011 ("TradeMetrics Letter"). Copies of these letters are available on the Commission's website at: <http://www.sec.gov/comments/s7-18-11/s71811.shtml>. In addition, in connection with the Commission's solicitation of comments on the Commission's request pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.) for approval of the extension of the previously approved collection of information provided for in Rule 17a-7, several commenters submitted letters that are relevant to this rulemaking. See letter from Daniel Curry, President, and Mary Keogh, Managing Director, Regulatory Affairs, DBRS, Inc., dated Apr. 14, 2014 ("DBRS PRA Letter"); letter from Angela Y. Liang, Assistant General Counsel, Kroll Bond Rating Agency, Inc., dated

sections of this release discussing the proposals and the amendments and new rules being adopted today.

B. ECONOMIC ANALYSIS

The Commission has performed an economic analysis in connection with today's adoption of the amendments and new rules discussed in section II. of this release. The economic analysis is reflected in this section I.B. of the release as well as throughout the rest of the release.⁹

1. Guiding Principles

Title IX, Subtitle C of the Dodd-Frank Act mandates that the Commission prescribe rules to improve regulation of NRSROs.¹⁰ Section 931 of the Dodd-Frank Act, "Findings," introduces Title IX, Subtitle C of the Dodd-Frank Act and provides context to what motivated Congress to enact these provisions with respect to NRSROs.¹¹ In particular, Congress found:

- Because of the systemic importance of credit ratings and the reliance placed on credit ratings by individual and institutional investors and financial regulators, the activities and performances of credit rating agencies, including NRSROs, are matters of national public interest, as credit rating agencies are central to capital formation, investor confidence, and the efficient performance of the U.S. economy.¹²
- Credit rating agencies, including NRSROs, play a critical "gatekeeper" role in the debt market that is functionally similar to that of securities analysts, who evaluate the quality of securities in the equity market, and auditors, who review the financial statements of firms. Such role justifies a similar level of public oversight and accountability.¹³

Apr. 17, 2014 ("Kroll PRA Letter"); and letter from Michael Kanef, Chief Regulatory and Compliance Officer, Moody's Investors Service, dated Apr. 28, 2014 ("Moody's PRA Letter").

⁹ The discussion of the amendments and new rules in section II of this release is organized into sections that in large part are based on the distinct rulemaking mandates in Title IX, Subtitle C of the Dodd-Frank Act. See sections II.A. through II.M. of this release. Each section includes an economic analysis that focuses specifically on the amendments or rules being discussed in the section.

¹⁰ See Pub. L. No. 111-203, 931 through 939H, entitled "Improvements to the Regulation of Credit Rating Agencies."

¹¹ See Pub. L. No. 111-203, 931.

¹² See Pub. L. No. 111-203, 931(1).

¹³ See Pub. L. No. 111-203, 931(2).

- Because credit rating agencies perform evaluative and analytical services on behalf of clients, much as other financial “gatekeepers” do, the activities of credit rating agencies are fundamentally commercial in character and should be subject to the same standards of liability and oversight as apply to auditors, securities analysts, and investment bankers.¹⁴
- In certain activities, particularly in advising arrangers of structured financial products on potential ratings of such products, credit rating agencies face conflicts of interest that need to be carefully monitored and that therefore should be addressed explicitly in legislation in order to give clearer authority to the Commission.¹⁵
- In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies.¹⁶

The amendments and new rules being adopted today to implement sections 932, 936, and 938 of the Dodd-Frank Act are designed to address these findings of Congress. For example, they are intended to increase the integrity and transparency of credit ratings and promote public oversight and accountability of NRSROs as “gatekeepers” for the primary benefit of the users of credit ratings.¹⁷ The amendments and new rules also prescribe new disclosure requirements relating to structured finance products and, in particular, asset-backed securities.¹⁸ These requirements are designed to address concerns about the role of NRSROs in the financial crisis

¹⁴ See Pub. L. No. 111-203, 931(3).

¹⁵ See Pub. L. No. 111-203, 931(4).

¹⁶ See Pub. L. No. 111-203, 931(5).

¹⁷ See John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, Turmoil in the U.S. credit markets: the role of the credit rating agencies (Apr. 22, 2008) (testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs), p. 1, available at http://www.banking.senate.gov/public/_files/OpgStmntCoffeeSenateTestimonyTurmoilintheUSCreditMarkets.pdf (“Coffee Testimony I”).

¹⁸ The term structured finance product as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This broad category of financial instrument includes an asset-backed security as defined in section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)) and other types of structured debt instruments, including synthetic and hybrid collateralized debt obligations (“CDOs”). The term Exchange Act-ABS as used throughout this release refers more narrowly to an asset-backed security as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

of 2007–2009¹⁹ in terms of how they rated certain types of structured finance products and, in particular, the inherent conflicts of interest in rating these products.²⁰

In the market for structured finance products, the pool of assets underlying or referenced by the product is often comprised of hundreds of thousands of loans, each requiring time and expense to evaluate. In these markets, the separation between the borrower and the ultimate provider of credit can introduce significant information asymmetries between the parties involved in the securitization process that creates a structured finance product²¹ and investors in the product, who may have less information on the credit quality and other relevant characteristics of the asset pool.²² Further, disclosures to investors regarding the asset pool may not be sufficiently detailed to allow investors to adequately evaluate the quality of the collateral backing the securities and, thereby, assess the credit risk of the securities. Consequently, the market for structured finance products has evolved as a “rated” market in which the credit risk of the products is assessed by credit rating agencies²³ and the valuations of the products depend

¹⁹ Throughout this Release, unless indicated otherwise, when the Commission uses the term “financial crisis” it is referring to the financial crisis that took place between 2007 and 2009.

²⁰ See Pub. L. No. 111-203, 931 (setting forth, among other things, Congress’ findings with respect to the role played by credit ratings agencies, the services provided by credit ratings agencies, certain conflicts of interests facing credit rating agencies, and inaccuracies in ratings on structured finance products).

²¹ Asset-backed securitization – the process used to create asset-backed securities – is a financing technique in which financial assets are pooled and converted into instruments that may be offered and sold in the capital markets. In a basic securitization structure, an entity – often a financial institution – originates or otherwise acquires a pool of financial assets, such as mortgage loans, either directly or through an affiliate. It then sells the financial assets, again either directly or through an affiliate, for the purpose of depositing them into a specially created investment vehicle that issues securities “backed” by those financial assets. Payment on the asset-backed securities depends primarily on the cash flows generated by the assets in the underlying pool (and possibly other rights designed to assure timely payment, generally known as “credit enhancements”). See Asset-Backed Securities, Securities Act Release No. 8518 (Dec. 22, 2004), 70 FR 1506 (Jan. 7, 2005).

²² See Adam B. Ashcraft and Til Schuermann, Understanding the Securitization of Subprime Mortgage Credit, Staff Report, Federal Reserve Bank of New York, Working Paper No. 318 (2008). The authors identify seven information frictions that can cause moral hazard and adverse selection problems in a subprime mortgage securitization transaction.

²³ See Joshua Coval, Jakub Jurek, and Erik Stafford, The Economics of Structured Finance, 23(1) J. Econ. Perspectives 3-26 (2009).

significantly on credit ratings.²⁴ To curb their informational disadvantage, certain investors in structured finance products may use credit ratings to inform their investment decisions.²⁵

Given that investors may not know the quality of the assets underlying structured finance products, certain originators of these assets may attempt to adversely transfer risks of poor origination decisions to investors by creating complex and opaque structured finance products.²⁶ This risk is especially pronounced when the originator, sponsor, depositor, or underwriter receives compensation before investors learn about the quality of the assets.²⁷ Because

²⁴ See Adam Ashcraft, Paul Goldsmith-Pinkham, Peter Hull, and James Vickery, Credit Ratings and Security Prices in the Subprime MBS Market, 101(3), Amer. Econ. Rev. 115-119 (2011).

²⁵ See Frank Partnoy, Overdependence on Credit Ratings Was a Primary Cause of the Crisis, in The Panic of 2008: Causes, Consequences, and Implications for Reform (Edward Elgar Press 2010, Lawrence Mitchell and Arthur Wilmarth, eds.). References to credit ratings in federal regulations also may have contributed to investor reliance on credit ratings. Section 939A of the Dodd-Frank Act requires each federal agency, including the Commission, to review any regulation issued by such agency that requires the use of an assessment of the creditworthiness of a security or money market instruments and any references to or requirements in such regulations regarding credit ratings. See Pub. L. No. 111-203, 939A. The section further provides that each such agency shall “modify any such regulations identified by the review...to remove any reference to or requirement of reliance on credit ratings, and to substitute in such regulations such standard of creditworthiness as each respective agency shall determine as appropriate for such regulations.” Id.

²⁶ See Chris Downing, Dwight Jaffee, and Nancy Wallace, Is the Market for Mortgage-Backed Securities a Market for Lemons?, 22(7) REV. FIN. STUD. 2457-2494 (2009). The authors argue that the quality of the assets sold to investors through securitization is lower than the quality of similar assets that are not sold to investors. They find empirical support for this proposition using a comprehensive dataset of sales of mortgage-backed securities (Freddie Mac Participation Certificates) to special-purpose vehicles over the period 1991 through 2002.

²⁷ Several parties may be involved in the securitization process that creates an asset-backed security, including an originator, sponsor, depositor, issuing entity, underwriter, and arranger. See generally Asset-Backed Securities, 70 FR at 1508. The originator is the entity that creates a financial asset (for example, mortgage loan, auto loan, or credit card receivable) that collateralizes an asset-backed security through an extension of credit or otherwise and that sells the asset to be included in an asset-backed security. The sponsor is the entity that organizes and initiates the asset-backed securities transaction by transferring the financial assets underlying an asset-backed security directly or indirectly to the issuing entity. The depositor is an entity that receives or purchases the financial assets from the sponsor and transfers them to the issuing entity (in some cases the sponsor transfers the financial assets directly to the issuing entity, thereby by-passing the use of a separate depositor). The issuing entity is the trust or other vehicle created at the direction of the sponsor or depositor that owns or holds the financial assets and in whose name the asset-backed securities are issued. The underwriter is the entity that underwrites the offering of asset-backed securities and sells them to investors. The arranger is an entity that organizes and arranges a securitization transaction, but does not sell or transfer the assets to the issuing entity. It also structures the transaction and may act as an underwriter for the deal. In jurisdictions where an arranger is used, the arranger’s role is similar to that of a sponsor in other jurisdictions. In some cases, a single entity may perform more than one function (for example, a financial institution may act as an originator and sponsor).

origination fees are based on transaction volume and risks are transferred to investors, an originator may have the economic incentive to produce as many assets (for example, mortgage loans) as possible without adequately screening their credit quality.²⁸

The rating process for structured finance products differs from the rating process for corporate bonds, whose ratings are largely based on publicly available data such as audited financial statements. The data used in rating structured finance products is primarily provided by the sponsor, depositor, or underwriter.²⁹ Unlike credit ratings for corporate bonds, credit ratings of structured finance products are “highly sensitive to the assumptions of 1) default probability and recovery value, 2) correlation of defaults, and 3) the relation between payoffs and the

The issuer of a structured finance product as used in this release can mean, depending on the context, the issuing entity or the person that organizes and initiates the offering of the structured finance product (for example, the sponsor or depositor). Generally, when this release discusses an issuer taking a specific action in the context of an offering of a structured finance product (for example, making a disclosure), the person that organizes and initiates the offering would be the person taking the action (as opposed to the issuing entity). Further, in the context of the discussion of Rules 17g-10 and 15Ga-2, the term issuer (which is defined in Rule 17g-10) includes a sponsor or depositor.

²⁸ See Amiyatosh Purnanandam, Originate-to-Distribute Model and the Subprime Mortgage Crisis, 24(6) REV. FIN. STUD. 1881-1915 (2011). The author argues that, during the financial crisis, banks with high involvement in the originate-to-distribute market originated excessively poor-quality mortgages, consistent with the view that the originating banks did not expend resources to adequately screen the credit quality of their borrowers.

²⁹ See Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (July 2008), available at <http://www.sec.gov/news/studies/2008/craexamination070808.pdf> (“2008 Staff Inspection Report”), pp. 7-10. The report describes the rating process for a residential mortgage-backed security (“RMBS”) and CDO at the three examined credit rating agencies (Standard & Poor’s Ratings Services, Moody’s Investor’s Services, Inc., and Fitch, Inc.). For example, with respect to a involving subprime loans, the arranger of the RMBS typically initiates the rating process by sending the credit rating agency data on each of the subprime loans to be held by the trust (for example, principal amount, geographic location of the property, credit history and FICO score of the borrower, ratio of the loan amount to the value of the property, and type of loan), the proposed capital structure of the trust and the proposed levels of credit enhancement for each tranche issued by the trust. *Id.* at 7. Upon receipt of the information, the credit rating agency assigns a lead analyst who is responsible for analyzing the loan pool, the proposed capital structure, and the proposed credit enhancement levels and, ultimately, for formulating a rating recommendation to a rating committee composed of analysts and/or senior-level analytic personnel. *Id.* at 7. The rating committee votes on the credit ratings for each tranche and usually communicates its decision to the issuer. *Id.* at 9. In most cases, the issuer can appeal a rating decision, although the appeal is not always granted (and, if granted, may not necessarily result in any change in the rating decision). Typically, the credit rating agency is paid for determining the credit rating only if the credit rating is issued.

economic states that investors care about most.”³⁰ The rating process for these products may happen in the reverse of how a more traditional product is rated because the sponsor, depositor, arranger, or underwriter often decides before the structure is finalized what credit rating it would like for each tranche of securities to be issued, within the limits of what is possible, and structures the product accordingly (for example, with regard to selecting the underlying assets and establishing the credit enhancements applicable to the different tranches of securities). Concerns have been raised that the inherently iterative nature of the process between the credit rating agency and the sponsor, depositor, arranger, or underwriter may give rise to potential conflicts of interest³¹ and that credit rating agencies marketing advisory and consulting services to their clients during this process may accentuate the conflict.³²

Just prior to the financial crisis, the size of the structured finance market was considerable. New issuances of RMBS, for example, peaked in 2006 for a total of \$801.7 billion.³³ Low interest rates drove investor demand for products that had high yields but also

³⁰ See Coval, Jurek, and Stafford, The Economics of Structured Finance, p. 23. The authors argue that, “unlike corporate bonds, whose fortunes are primarily driven by firm-specific considerations, the performance of securities created by tranching large asset pools is strongly affected by the performance of the economy as a whole.” Id. at 23.

³¹ See International Organization of Securities Commissions (“IOSCO”), The Role of Credit Rating Agencies in Structured Finance Markets (May 2008), p. 5 (“Some critics have argued that the inherently iterative nature of this process may give rise to potential conflicts of interest.”).

³² See Coffee Testimony I, p. 3, (“Today, the rating agency receives one fee to consult with a client, explain its model, and indicate the likely outcome of the rating process; then, it receives a second fee to actually deliver the rating (if the client wishes to go forward once it has learned the likely outcome)”). Rule 17g-6 prohibits, among other things, an NRSRO from conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO. See 17 CFR 240.17g-6(a)(1).

³³ The total amount of new issuances is calculated by staff in the Commission’s Division of Economics and Risk Analysis (“DERA”) using Asset-Backed Alert and Commercial Mortgage Alert databases. The amounts include only non-agency RMBS sold in the United States through Commission-registered offerings, Rule 144A offerings, or traditional private offerings.

were highly rated by the credit rating agencies.³⁴ Mortgage originators largely exhausted the supply of traditional quality mortgages and, to keep up with investor demand for RMBS, subprime lending became increasingly popular. As the number of delinquencies on subprime mortgages suddenly soared in late 2007, RMBS lost a considerable amount of value,³⁵ and investors began to question the accuracy of credit ratings assigned to RMBS and CDOs linked to RMBS.³⁶ Certain academic studies argue that, as the structured finance market boomed between 2004 and 2007, NRSROs might have had an incentive to generate revenue by relaxing rating standards,³⁷ inflating credit ratings,³⁸ facilitating the sale of asset-backed securities by a small number of large issuers,³⁹ and reducing due diligence in the presence of investors that solely rely

³⁴ See Testimony of John B. Taylor, the Mary and Robert Raymond Professor of Economics at Stanford University and George P. Shultz Senior Fellow in Economics at Stanford's Hoover Institution, before the Subcommittee on Monetary Policy and Trade Committee on Financial Services, U.S. House of Representatives (Mar. 5, 2013), available at <http://financialservices.house.gov/uploadedfiles/hhrg-113-ba19-wstate-jtaylor-20130305.pdf>.

³⁵ See Board of Governors of the Federal Reserve System ("Federal Reserve"), Report to the Congress on Risk Retention (Oct. 2010), pp. 50–51 (discussing the drop in the triple-A and triple-B ABX.HE 2006-2 index (–70% by the end of 2008 for triple-A rated and –95% for triple-B rated subprime RMBS issued in 2006)).

³⁶ See IOSCO, The Role of Credit Rating Agencies in Structured Finance Markets, p. 2.

³⁷ See John M. Griffin and Dragon Yongjun Tang, Did Subjectivity Play a Role in CDO Credit Ratings?, 67(4) J. FIN. 1293-1328 (2012). The authors analyze a sample of 916 CDOs and find that a large credit rating agency frequently made positive adjustments outside its main model that resulted in increasingly larger AAA tranche sizes. These adjustments are difficult to explain by likely determinants, such as manager experience or credit enhancements, but exhibit a clear pattern: CDOs with smaller model-implied AAA sizes receive larger adjustments and CDOs with larger adjustments experience more severe subsequent downgrading.

³⁸ See Vasiliki Skreta and Laura Veldkamp, Ratings Shopping and Asset Complexity: A Theory of Ratings Inflation, 56 J. MONETARY ECON. 678-695 (2009); Efraim Benmelech and Jennifer Dlugosz, The Credit Rating Crisis, NBER Working Paper No. 15045 (2009); Bo Becker and Todd Milbourn, How Did Increased Competition Affect Credit Ratings?, 101 J. FIN. ECON. 493-514 (2011); Andrew Cohen and Mark D. Manuszak, Ratings Competition in the CMBS Market, 45(1) J. MONEY, CREDIT AND BANKING 93-119 (2013).

³⁹ See Jie He, Jun Qian, and Philip E. Strahan, Credit Ratings and the Evolution of the Mortgage-Backed Securities Market, 101(3) AMER. ECON. REV., 131-135 (2011). The authors find that in 2006 the mortgage-backed securities ("MBS") market was highly concentrated among large issuers, with the top five accounting for 39% of all newly issued securities; between 2004 and 2006, a larger fraction of MBS sold by large issuers received triple-A ratings than MBS sold by small issuers; and tranches sold by large issuers then experienced larger price drops than those sold by smaller issuers when the "housing bubble" began to unravel.

on credit ratings.⁴⁰ The concerns about the accuracy of credit ratings fueled an emergent reluctance to invest in these products.⁴¹ The new issuances of RMBS totaled \$715.3 billion in 2007 and plunged to \$34.5 billion in 2008.

In August 2007, the Commission staff initiated examinations of the three largest credit rating agencies to review their role in the turmoil in the subprime mortgage-related securities markets.⁴² Among other things, these examinations revealed that the credit rating agencies struggled to adjust the number of staff and resources employed in the rating process to the increasing volume and complexity of RMBS and CDOs.⁴³ Certain significant aspects of the rating process and methodologies used to rate RMBS and CDOs were not documented or disclosed.⁴⁴ The credit rating agencies examined did not have specific written procedures for rating RMBS and CDOs.⁴⁵ Also, the credit rating agencies did not appear to have specific written policies and procedures to identify or address errors in their models or methodologies.⁴⁶

⁴⁰ See Patrick Bolton, Xavier Freixas, and Joel Shapiro, The Credit Ratings Game, 67(1) J. OF FINANCE 85-111 (2012), available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2011.01708.x/full>. The authors develop a model of competition among credit rating agencies that includes two types of investors with different incentives to perform due diligence: sophisticated and “trusting” investors. Trusting investors take credit ratings at face value because their compensation depends only marginally on the ex-post returns of the assets they manage. In the authors’ view, regulation that forces money managers to only purchase investments with good credit ratings could also provide incentives to be trusting. The authors find that competition can reduce efficiency, as it facilitates rating shopping. Moreover, credit ratings are more likely to be inflated during booms and when investors are more trusting.

⁴¹ See Coval, Jurek, and Stafford, The Economics of Structured Finance.

⁴² See 2008 Staff Inspection Report.

⁴³ See 2008 Staff Inspection Report, p. 10-13.

⁴⁴ See 2008 Staff Inspection Report, p. 13.

⁴⁵ See 2008 Staff Inspection Report, p. 16 (“One rating agency maintained comprehensive written procedures for rating structured finance securities, but these procedures were not specifically tailored to rating RMBS and CDOs. The written procedures for the two other rating agencies were not comprehensive and did not address all significant aspects of the RMBS and/or CDO ratings process. For example, written materials set forth guidelines for the structured finance ratings committee process (including its composition, the roles of the lead analyst and chair, the contents of the committee memo and the voting process) but did not describe the ratings process and the analyst’s responsibilities prior to the time a proposed rating is presented to a ratings committee.”).

⁴⁶ See 2008 Staff Inspection Report, p. 17.

In certain instances, Commission staff believed that adjustments to models were made without appropriately documenting a rationale for deviations from the model.⁴⁷ Processes for performing surveillance and monitoring of outstanding credit ratings on an ongoing basis appeared to be less robust than the processes for determining initial credit ratings.⁴⁸ Moreover, in the Commission staff's view, sufficient steps were not taken to prevent considerations of fees, market share, or other business interests from influencing credit ratings or rating criteria.⁴⁹ Finally, the examined credit rating agencies appeared to solely rely on the information provided by RMBS sponsors.⁵⁰ In particular, they did not appear to verify the integrity and accuracy of such information as, in their view, due diligence duties belonged to other parties and they did not appear to seek representations from sponsors that due diligence was performed.⁵¹

Following the financial crisis, the Dodd-Frank Act mandated regulatory actions intended to enhance regulation, accountability, and transparency of NRSROs.⁵² Generally, the majority of the rulemaking mandated by the Dodd-Frank Act addresses all classes of credit ratings, rather than credit ratings for only structured finance products.⁵³ In implementing the mandate, the amendments and new rules being adopted today are designed to further enhance the governance

⁴⁷ Id. at 19.

⁴⁸ Id. at 21.

⁴⁹ Id. at 24.

⁵⁰ Id. at 18.

⁵¹ Id. at 18.

⁵² See Pub. L. No. 111-203, 932, entitled "Enhanced Regulation, Accountability, and Transparency of Nationally Recognized Statistical Rating Organizations."

⁵³ One commenter suggested that the proposed rules are overly broad in their application and "fail to sufficiently account for the differences between corporate ratings (such as financial strength ratings of insurance companies) and ratings of the structured and asset-backed financial products that contributed to the recent economic crisis." See A.M. Best Letter. The Commission notes that the amendments and new rules being adopted today reflect the statutory mandate that generally, with one exception, was not limited to certain classes of credit ratings. In particular, sections 932, 936 and 938 of the Dodd-Frank Act generally do not focus exclusively on activities relating to rating structured finance products, with the exception of section 932(s)(4) (which focuses on third-party due diligence services with respect to asset-backed securities).

of NRSROs in their role as “gatekeepers”⁵⁴ and increase the transparency of the credit rating process as a whole. Further, as discussed in section II. of this release, the amendments and new rules being adopted today include new requirements designed to enhance transparency with respect to structured finance products, including requirements for NRSROs to disclose information about the performance and history of credit ratings for subclasses of structured finance products and requirements for NRSROs, issuers, underwriters, and providers of third-party due diligence services to disclose information about due diligence services performed with respect to asset-backed securities.⁵⁵

2. Baseline

The amendments and new rules being adopted today primarily affect NRSROs, issuers, and underwriters of asset-backed securities, and providers of third-party due diligence services for asset-backed securities. To the extent that the new requirements change the business practices of the primarily affected parties, such changes may also affect clients of NRSROs (that is, obligors who pay NRSROs to obtain entity credit ratings, issuers who pay NRSROs to obtain credit ratings for their issued securities, subscribers who pay NRSROs to access credit ratings and research, and persons who pay NRSROs for other services), credit raters or credit rating agencies other than NRSROs, parties involved in asset-backed securities markets (other than issuers, underwriters, third-party due diligence providers, and NRSROs), and users of credit ratings in general.

The baseline against which economic costs and benefits, as well the impact of the

⁵⁴ See John C. Coffee, Jr., Gatekeepers: The Professions and Corporate Governance, Oxford University Press (2006).

⁵⁵ See sections II.E.1. and II.E.2. of this release (discussing requirements for NRSROs to disclose performance statistics and rating history information for subclasses of structured finance products); sections II.G. and II.H. of this release (discussing requirements to disclose information about third-party due diligence services provided for asset-backed securities).

amendments and new rules being adopted today on efficiency, competition, and capital formation, are measured is the situation in existence today, prior to the adoption of the amendments and rules. The baseline includes an estimate of the number of entities that will likely be directly affected by the amendments and rules and a description of the relevant features of the regulatory and economic environment in which the affected entities operate. The discussion below identifies the main features of the regulatory and economic baseline, which will be further developed in section II of this release discussing the amendments and rules, including in the focused economic analyses that follow the discussions of the amendments and rules.

a. NRSROs

As discussed above, the Rating Agency Act of 2006, among other things, amended section 3 of the Exchange Act to add definitions, added section 15E to the Exchange Act to establish self-executing requirements for NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs, amended section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over NRSROs, and amended section 21B(a) of the Exchange Act to provide the Commission with the authority to assess penalties “against any person” in administrative proceedings instituted under section 15E of the Exchange Act.⁵⁶

To implement the Rating Agency Act of 2006, the Commission adopted Rules 17g-1 through 17g-6 and Form NRSRO.⁵⁷ Section 943 of the Dodd-Frank Act mandates that the Commission adopt rules requiring an NRSRO to include in any report accompanying a credit rating of an asset-backed security a description of the representations, warranties, and

⁵⁶ See Pub. L. No. 109-291, 3, 4; 15 U.S.C. 78c; 15 U.S.C. 78o-7; 15 U.S.C. 78q; 15 U.S.C. 78u-2.

⁵⁷ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR 33564.

enforcement mechanisms available to investors and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities.⁵⁸ In January 2011, the Commission adopted Rule 17g-7 to implement section 943.⁵⁹ The Exchange Act, Rules 17g-1 through 17g-7, and Form NRSRO represent the baseline for the amendments and new rules being adopted today in terms of requirements applicable to NRSROs.

Pursuant to section 6 of the Rating Agency Act of 2006, the Commission is required to submit an annual report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that includes the views of the Commission on the state of competition, transparency, and conflicts of interest among NRSROs.⁶⁰ In addition, section 15E(b) of the Exchange Act provides that not later than ninety days after the end of each calendar year, each NRSRO shall file with the Commission an amendment to its registration application, in such form as the Commission, by rule, may prescribe: (1) certifying that the information and documents in the application for registration continue to be accurate; (2) listing any material change that occurred to such information or documents during the previous calendar year; and (3) amending its credit ratings performance statistics.⁶¹ Rule 17g-1 requires these filings (“annual certifications”) to be made on Form NRSRO.⁶² Further, each NRSRO is required to furnish the Commission with annual reports containing audited financial statements and information about revenues and other matters.⁶³ The

⁵⁸ See Pub. L. No. 111-203, 943.

⁵⁹ See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 4489.

⁶⁰ See Pub. L. No. 109-291, 6. The Commission staff annual reports are available at <http://www.sec.gov/ocr>.

⁶¹ See 15 U.S.C. 78o-7(b).

⁶² See paragraph (f) of Rule 17g-1. See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33567, 33569-33582.

⁶³ See 17 CFR 240.17g-3.

Commission's annual reports submitted to Congress and the NRSROs' annual certifications and annual reports are an integral part of establishing the baseline for the amendments and new rules being adopted today, as discussed below.

As of today, there are ten credit rating agencies registered with the Commission as NRSROs.⁶⁴ Based on the annual reports the NRSROs furnish with the Commission, in their 2013 fiscal years, the ten NRSROs had \$5.4 billion of total revenue – an approximate 6% increase over their 2012 fiscal years. In addition, based on their annual certifications, the NRSROs employed a total of 4,218 credit analysts at the end of the 2013 calendar year. Table 1 shows the number of credit analysts employed by each NRSRO at the end of the 2013 calendar year and, of the total number of credit analysts employed by the NRSROs, the percent of credit analysts at S&P, Moody's, and Fitch (90%) and the remaining seven NRSROs (10%).

⁶⁴ The ten NRSROs are: A.M. Best Company, Inc. ("A.M. Best"); DBRS, Inc. ("DBRS"); Egan-Jones Ratings Company ("EJR"); Fitch, Inc. ("Fitch"); HR Ratings de Mexico, S.A. de C.V. ("HR Ratings"); Japan Credit Rating Agency, Ltd. ("JCR"); Kroll Bond Rating Agency, Inc. ("Kroll"); Moody's Investor's Services, Inc. ("Moody's"); Morningstar Credit Ratings, LLC ("Morningstar"); and Standard & Poor's Ratings Services ("S&P"). See Commission staff, Annual Report on Nationally Recognized Statistical Rating Organizations (Dec. 2013), p. 6, available at <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf>. ("2013 Annual Staff Report on NRSROs").

Table 1 – Credit analysts employed by NRSROs (as of [–])

NRSROs	Total Credit Analysts
S&P, Moody's, & Fitch	90%
Other NRSROs	10%
A.M. Best	123
DBRS	98
EJR	7
Fitch	1,102
HR Ratings	34
JCR	57
Kroll	58
Moody's	1,244
Morningstar	30
S&P	1,465
Total	4,218

Note: The total number of credit analysts, including credit analyst supervisors, is provided by each NRSRO in Exhibit 8 to Form NRSRO, which is available on each NRSRO's website.

Among other things, the operations of the ten NRSROs differ in terms of business model, classes of credit ratings for which they are registered, history of issuing credit ratings, size, and market share. Of the ten NRSROs, seven operate primarily under the issuer-pay model,⁶⁵ in which an obligor pays the NRSRO to rate it as an entity or an issuer pays the NRSRO to rate the securities it issues.⁶⁶ One NRSRO operates exclusively under the subscriber-pay model,⁶⁷ in

⁶⁵ The seven NRSROs are A.M. Best, DBRS, Fitch, HR Ratings, JCR, Moody's, and S&P. See 2013 Annual Staff Report on NRSROs, p. 6.

⁶⁶ The issuer-pay model often raises concerns of potential conflicts of interest because the collection of fees from rated entities and issuers of rated securities, as a principal source of revenue, may provide an NRSRO with an economic incentive to issue inflated ratings as a way to promote business with its clients. Several academic studies try to answer theoretically and empirically the question of whether reputational concerns of a credit rating agency effectively neutralize potential conflicts of interest in the issuer-pay model. The conclusions of these studies are neither unanimous nor definite. For example, recently, Kashyap and Kovrijnykh (2013) found that, under the issuer-pay model, a credit rating is less accurate than under the subscriber-pay model. However, the authors found that subscribers tend to ask for a credit rating inefficiently (that is, when the expected quality of the rated entity or security is sufficiently high) and that the subscriber-pay model suffers from a potential free-riding problem. Cole and Cooley (2014) argue that much of the regulatory concerns with the conflict created by issuers paying for ratings are a distraction. The authors argue that in equilibrium, reputation ensures that credit ratings have value and reflect sound assessments of creditworthiness. Regulatory reliance on credit ratings and the importance of risk-weighted capital in prudential regulation more likely contributed to distorted credit ratings than the matter of who pays for them. See Anil Kashyap and Natalia Kovrijnykh, Who Should Pay for Credit Ratings and How?, NBER working paper No. 18923 (Mar. 2013); Harold Cole and Thomas F. Cooley, Rating Agencies, NBER working paper No. 19972 (Mar. 2014).

which subscribers pay a fee to access the credit ratings issued by the NRSRO.⁶⁸ Two NRSROs previously operated primarily under the subscriber-pay model but for several years have been issuing an increasing number of credit ratings paid for by the obligor being rated or the issuer of the securities that are rated.⁶⁹

The ten NRSROs also differ by the scope of their business and, in particular, by whether their operations include products and services other than credit ratings,⁷⁰ which can be provided through business lines, segments, groups, or divisions within the NRSROs or through affiliated companies or other businesses not within the NRSRO.⁷¹ For credit ratings, there are five classes

⁶⁷ The one NRSRO is EJR. See 2013 Annual Staff Report on NRSROs, p. 6.

⁶⁸ See 2013 Annual Staff Report on NRSROs, p. 23. The subscriber-pay model also is subject to potential conflicts of interest. See id. at p. 23. For example, the NRSRO may be aware that an influential subscriber holds a securities position (long or short) that could be advantaged if a credit rating upgrade or downgrade causes the market value of the security to increase or decrease; or that the subscriber invests in newly issued bonds and would obtain higher yields if the bonds were to have lower credit ratings. Another example of a conflict in the subscriber-pay model is that the NRSRO may be aware that a subscriber wishes to acquire a particular security but is prevented from doing so because the credit rating of the security is lower than internal investment guidelines or an applicable contract permit.

⁶⁹ The two NRSROs are Kroll and Morningstar. See 2013 Annual Staff Report on NRSROs, p. 7.

⁷⁰ Ancillary services often raise concerns of potential conflicts of interest because, for example, an NRSRO might issue a more favorable credit rating to an issuer in exchange for purchasing ancillary services, or an issuer that purchases a large amount of ancillary services might pressure the NRSRO to issue a more favorable credit rating for the issuer. See 2013 Staff Report on Credit Rating Agency Independence, pp. 21-24. Another concern with respect to ancillary services is that they might have involved an NRSRO making recommendations on the structure of a security to be rated. Id. at 22-23. Paragraph (c)(5) of Rule 17g-5 prohibits an NRSRO from issuing or maintaining a credit rating with respect to an obligor or security where the NRSRO or a person associated with the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. See 17 CFR 240.17g-5(c)(5). In addition, Rule 17g-6 prohibits, among other things, an NRSRO from: (1) conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO; (2) issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO; and (3) modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the NRSRO's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO. See 17 CFR 240.17g-6.

⁷¹ See 2013 Staff Report on Credit Rating Agency Independence, p. 19.

of credit ratings for which a credit rating agency can be registered as an NRSRO: (1) financial institutions, brokers, or dealers; (2) insurance companies; (3) corporate issuers; (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, “as in effect on the date of enactment of this paragraph”); and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.⁷²

Eight of the NRSROs are registered in multiple classes, while two NRSROs are registered in one class.⁷³ Table 2 shows the approximate number of outstanding credit ratings as reported by each NRSRO in its annual certification for the 2013 calendar year end, in each of the five categories for which the NRSRO is registered.

Table 2 – Approximate number of NRSRO credit ratings outstanding by class of credit rating (as of [December 31, 2013])

NRSROs	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total Ratings
S&P, Moody's, & Fitch	84%	74%	92%	90%	99%	97%
Other NRSROs	16%	26%	8%	10%	1%	3%
A.M. Best	N/R	4,492	1,653	56	N/R	6,201
DBRS	13,624	150	3,790	10,706	16,038	44,308
EJR	104	46	877	N/R	N/R	1,027
Fitch	49,821	3,222	15,299	53,612	204,303	326,257
HR Ratings	N/R	N/R	N/R	N/R	189	189
JCR	150	27	463	N/R	56	696
Kroll	15,982	44	2,749	1,401	25	20,201
Moody's	53,383	3,418	40,008	76,464	728,627	901,900
Morningstar	N/R	N/R	N/R	11,567	N/R	11,567
S&P	59,000	7,200	49,700	90,000	918,800	1,124,700
Total	192,064	18,599	114,539	243,806	1,868,038	2,437,046

Note: The approximate number of NRSRO credit ratings outstanding as of December 31, 2013 is provided by each NRSRO in its annual certification, which is available on each NRSRO's website. “N/R” indicates that an NRSRO is not registered for that class of credit rating.

As shown in Table 2, S&P has the greatest number of outstanding credit ratings in each of the five classes. S&P, Moody's, and Fitch are the top three producers of credit ratings in

⁷² See 15 U.S.C. 78c(a)(62) (defining the term nationally recognized statistical rating organization).

⁷³ See 2013 Annual Staff Report on NRSROs, p. 8.

every class of credit ratings except for insurance companies (in this class, A.M. Best has the second highest number of outstanding credit ratings after S&P). Overall, S&P accounts for about 46% of the total NRSRO credit ratings outstanding, followed by Moody's (37%) and Fitch (13%), implying that two NRSROs (S&P and Moody's) account for 83% of all credit ratings outstanding and three NRSROs (S&P, Moody's, and Fitch) account for approximately 97%. Also, as discussed above, Table 1 shows that these three NRSROs employ 90% of the total number of NRSRO credit analysts. Comparing the number of credit ratings outstanding for established NRSROs and newly registered NRSROs may not provide a complete picture of competition in the industry. The incumbent NRSROs (particularly S&P, Moody's, and Fitch) have a longer history of issuing credit ratings, and their credit ratings include those for debt obligations and obligors that were rated long before the establishment of the newer entrants.⁷⁴

Recent trends in the industry structure are shown in Table 3, which reports the inverse of the Herfindahl-Hirschman Index (HHI) as a measure of industry concentration by rating class.⁷⁵ The HHI inverse is calculated from 2007 to 2013 for credit ratings outstanding as reported by the NRSROs in each rating class. Table 3 shows that the NRSRO industry concentration for all rating classes has moderately increased as suggested by the decrease in the HHI inverse since 2010. Despite a monotonic increase in competition in the rating class of asset-backed securities, the NRSRO industry remains concentrated, with the three largest NRSROs accounting for approximately 95% of the NRSROs' 2013 fiscal year total revenue, based on the annual reports the NRSROs furnish to the Commission.

⁷⁴ See 2013 Annual Staff Report on NRSROs, p. 12.

⁷⁵ The inverse of HHI can be interpreted as the number of equally-sized firms necessary to replicate the degree of concentration in a particular industry.

Table 3 – Inverse of Herfindahl-Hirschman index by class of credit rating

Year	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-backed Securities	Government Securities	Total Ratings
2007	3.37	4.02	3.27	2.71	2.35	2.65
2008	3.72	4.05	3.79	2.82	2.83	2.99
2009	3.85	3.84	3.18	3.18	2.65	2.86
2010	3.99	3.37	3.17	3.20	2.69	2.88
2011	4.16	3.76	3.02	3.38	2.47	2.74
2012	4.04	3.72	3.00	3.44	2.50	2.75
2013	3.99	3.68	3.03	3.48	2.46	2.72

Note: The inverse of HHI is determined using the approximate numbers of NRSRO credit ratings outstanding reported in the Commission staff annual reports on NRSROs published in June 2008, September 2009, January 2011, March 2012, December 2012, and December 2013. For the 2013 calendar year end, the inverse of HHI is calculated using the number of outstanding credit ratings reported by NRSROs in their annual certifications.

In particular, for the asset-backed security class – which includes, among other things, RMBS, commercial mortgage backed securities (“CMBS”), and consumer finance and other asset-backed securities – Table 4 below shows the number of credit ratings outstanding from 2007 to 2013. The total number of outstanding credit ratings has significantly decreased (by 38%) since 2007, mostly due to pay-downs of existing asset-backed securities that have not been replaced by newly issued asset-backed securities that are rated by NRSROs.⁷⁶ While the three largest NRSROs accounted for 97% of the outstanding credit ratings for asset-backed securities in 2007, this number decreased to 90% in 2013.

⁷⁶

See 2013 Annual Staff Report on NRSROs, p. 12.

Table 4 – Approximate number of credit ratings outstanding in the asset-backed security class

NRSROs	2007	2008	2009	2010	2011	2012	2013
S&P, Moody's, & Fitch	97%	96%	94%	94%	91%	91%	90%
Other NRSROs	3%	4%	6%	6%	9%	9%	10%
A.M. Best	54	54	54	54	56	55	56
DBRS	840	7,470	8,430	10,091	9,889	10,054	10,706
EJR	–	14	14	13	13	N/R	N/R
Fitch	72,278	77,480	69,515	64,535	58,315	56,311	53,612
HR Ratings	–	–	–	–	–	N/R	N/R
JCR	68	71	64	N/R	N/R	N/R	N/R
Kroll	246	0	0	0	40	352	1,401
Moody's	110,000	109,261	106,337	101,546	93,913	82,357	76,464
Morningstar	10,235	9,200	8,856	8,322	16,070	13,935	11,567
R&I	214	210	186	N/R	–	–	–
S&P	197,700	198,200	124,600	117,900	108,400	97,500	90,000
Total	391,635	401,960	318,056	302,461	286,696	260,564	243,806

Note: "N/R" indicates that an NRSRO is not registered for the asset-backed security class of credit ratings and "–" indicates that the credit rating agency was not registered as an NRSRO for the applicable year. Kroll acquired LACE Financial Corp. in August 2010. Morningstar, formerly known as Realpoint LLC, changed its name in 2011. Rating and Investment Information, Inc. ("R&I") withdrew its registration as an NRSRO with the Commission in October 2011. HR Ratings became registered as an NRSRO in 2012. Statistics come from the Commission staff annual reports on NRSROs published in June 2008, September 2009, January 2011, March 2012, December 2012, and December 2013. For calendar year 2013, the statistics come from the annual certifications of the NRSROs.

In 2013, some of the relatively newer or smaller NRSROs increased their market shares in terms of rating asset-backed securities. Table 5 reports full-year credit rating agency information for 2013, compared to 2007, the year immediately prior to the financial crisis. As the total issuances of asset-backed securities decreased considerably from 2007 to 2013, DBRS has maintained its market share in rating new issuances and has become the most active participant in rating RMBS, while S&P, Moody's and Fitch have lost market shares. DBRS, Kroll, and Morningstar have gained market shares in rating CMBS after the financial crisis and have rated a significant number of newly issued CMBS in 2013. Finally, in the market for rating consumer finance and other asset-backed securities, which has the largest number of issuances, DBRS and Kroll have increased their market shares, although S&P, Moody's and Fitch continue to play a significant role.

Table 5 – Market shares of credit rating agencies for RMBS, CMBS, and consumer finance and other asset-backed securities, 2013 and 2007

Rank	NRSROs	2013 Issuance (\$ mil.)	No. of Offerings	Market Share (%)	2007 Issuance (\$ mil.)	No. of Offerings	Market Share (%)	2007- 2013 Change (%)
Residential mortgage-backed securities								
1	DBRS	\$12,501.90	50	61.4	\$12,817.60	20	2.9	-2.5
2	Fitch	9,969.60	23	48.9	253,721.10	318	58.2	-96.1
3	S&P	9,597.50	23	47.1	409,532.40	534	94.0	-97.7
4	Kroll	7,908.70	17	38.8	N/A	N/A	N/A	N/A
5	Moody's	3,796.00	9	18.6	324,923.50	421	74.6	-98.8
	Total	\$20,372.00	68	100.0	\$435,815.60	575	100.0	-95.3
Commercial mortgage-backed securities								
1	Moody's	\$62,802.60	67	72.9	\$171,787.00	61	74.6	-63.4
2	Fitch	50,447.70	56	58.6	159,687.30	60	69.4	-68.4
3	Kroll	45,140.10	55	52.4	N/A	N/A	N/A	N/A
4	S&P	34,255.20	49	39.8	202,381.00	71	87.9	-83.1
5	DBRS	18,574.90	26	21.6	13,295.30	6	5.8	39.7
6	Morningstar	17,089.00	27	19.8	N/A	N/A	N/A	N/A
	Total	\$86,135.80	122	100.0	\$230,195.80	86	100.0	-62.6
Consumer finance and other asset-backed securities								
1	S&P	\$134,860.60	244	69.3	\$576,417.90	884	96.7	-76.6
2	Moody's	114,569.90	155	58.9	563,982.90	735	94.6	-79.7
3	Fitch	113,213.80	156	58.2	342,140.10	418	57.4	-66.9
4	DBRS	16,530.60	51	8.5	43,102.70	73	7.2	-61.6
5	Kroll	3,983.10	16	2.0	N/A	N/A	N/A	N/A
	Total	\$194,600.70	341	100.0	\$596,016.20	981	100.0	-67.3

Note: A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. Market shares of individual NRSROs do not add up to 100% since more than one NRSRO may rate a particular offering. "N/A" indicates that statistics are not available for 2007. CMBS data relates to U.S. CMBS, including U.S. conduit/fusion and U.S. single borrower. Data comes from Asset-Backed Alert and Commercial Mortgage Alert websites, publicly available at <http://www.abalert.com/ranks.php> and <http://www.cmalert.com/ranks.php>.

b. Asset-Backed Security Issuers, Underwriters, and Third-Party Due Diligence Providers

The asset-backed security market that existed in the United States as of the end of 2013 differed significantly from the market prior to the crisis. In 2004, issuing entities of non-agency asset-backed securities held \$2.6 trillion in assets, which grew to \$4.5 trillion in 2007 and declined to \$1.6 trillion in 2013.⁷⁷ Table 6 presents issuance amounts, number of offerings, and number of unique issuers for non-agency asset-backed securities, categorized by type of

⁷⁷ This information is derived from data compiled by the Federal Reserve and published in quarterly Z.1 releases, which are available at <http://www.federalreserve.gov/releases/Z1/default.htm>. Statistics include private mortgage pools, consumer credit, business loans, student loans, consumer leases, and trade credit securitization.

offering.⁷⁸ While new issuances of registered asset-backed securities represented the majority of offerings and totaled \$1.0 trillion in 2004, they drastically dropped to \$140.7 billion in 2008. In 2013, the asset-backed security market totaled \$393.6 billion, of which \$174.1 billion is the new issuance amount of registered asset-backed securities.

Table 6 – Issuance amount, number of offerings, and number of unique issuers for non-agency asset-backed securities

Year	Issuance Amount (\$ bln)				Number of Offerings				Number of Unique Issuers			
	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total	Regist'd	144A	Private	Total
2002	617.13	122.07	2.00	741.20	1,074	491	31	1,596	143	226	17	327
2003	790.47	149.20	0.17	939.85	1,271	589	3	1,863	139	223	3	309
2004	1,024.16	186.53	0.85	1,211.53	1,370	670	2	2,042	131	218	2	298
2005	1,450.33	322.64	3.70	1,776.68	1,594	907	3	2,504	134	300	2	376
2006	1,446.07	623.38	0.50	2,069.95	1,508	1,551	1	3,060	116	406	1	460
2007	1,048.81	518.59	0.55	1,567.95	1,088	1,102	1	2,191	111	342	1	396
2008	140.70	130.80	0.00	271.49	163	240	0	403	51	96	0	128
2009	85.45	120.14	0.00	205.58	80	266	0	346	30	81	0	97
2010	51.01	163.30	14.01	228.32	65	401	4	470	29	145	1	160
2011	74.94	139.06	13.58	227.59	86	291	15	392	39	163	6	179
2012	157.15	186.53	0.00	343.68	157	465	0	622	51	242	0	270
2013	174.06	219.47	0.08	393.61	182	532	1	715	61	294	1	336

Note: Statistics are calculated by DERA using the Asset-Backed Alert and Commercial Mortgage Alert databases. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. The offerings are categorized by offering year and offering type (Commission registered, Rule 144A, or traditional private offerings). Non-agency asset-backed securities include RMBS, CMBS, and other asset-backed securities. Non-agency RMBS include residential, Alt-A, subprime RMBS, high loan-to-value ("no-equity") loans, and non-U.S. residential loans. Auto loan asset-backed securities include asset-backed securities backed by auto loans and auto leases, both prime and subprime, motorcycle loans, recreational vehicle loans, and truck loans. The first set of columns show the total issuance amounts in billions of dollars. The second set of columns show the total number of asset-backed security offerings. The third set of columns show the number of unique issuers of asset-backed securities in each category. The number in the column "Total" may not be the sum of numbers in the columns "Regist'd", "144A" and "Private" because some issuers may initiate offerings in several categories. Only non-agency asset-backed security offerings sold in the United States and issuers of such offerings are counted.

Issuers of asset-backed securities often include banks, mortgage companies, finance companies, investment banks, and other entities that originate or acquire and package financial assets for resale as asset-backed securities.⁷⁹ As reported in Table 6, in 2004 there were 298 unique issuers, while in 2013 there were 336 unique issuers, mostly involved in Rule 144A

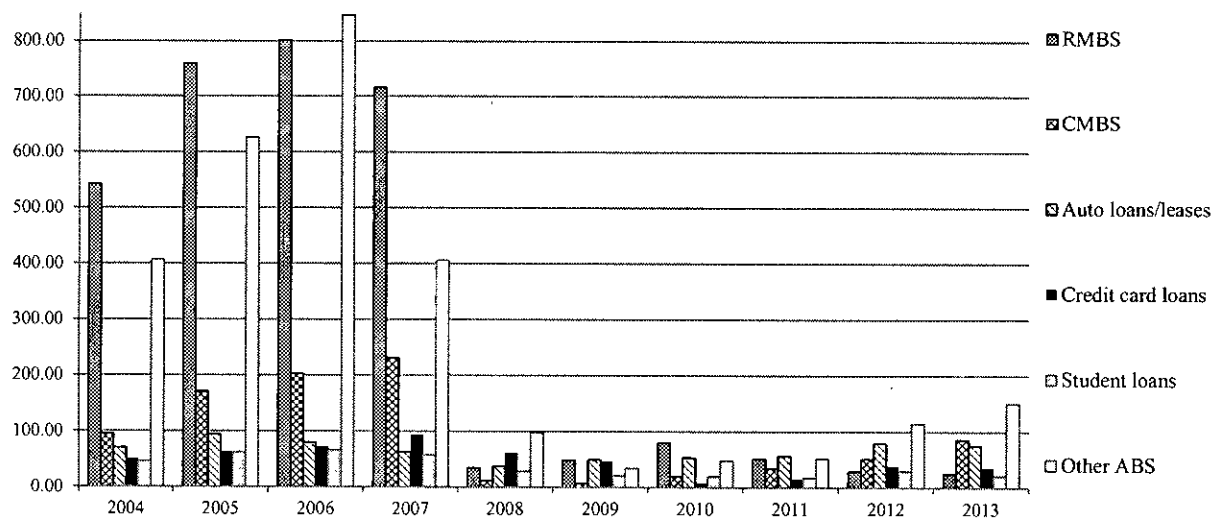
⁷⁸ In this section of the release, the issuer of the asset-back security means the person that primarily organizes and initiates the offering of the asset-backed security, often referred to as the sponsor.

⁷⁹ See Asset-Backed Securities, Securities Act No. 8518 (Dec. 22, 2004), 70 FR 1506 (Jan. 7, 2005).

offerings.⁸⁰ The ten most active issuers were responsible for about 30% of the total issuance amounts at the end of 2013.⁸¹

As noted in Figure 1 below, an analysis of the segments of the asset-backed security market shows that all segments experienced significant downturns during the crisis but only a few of them have experienced a recovery in the aftermath. Figure 1 focuses on non-agency asset-backed security offerings and reports the issuance volume by main asset classes (RMBS, CMBS, auto loans/leases, credit card loans, student loans, and other asset-backed securities).

Figure 1 - Issuance volume (in billions of dollars) of asset-backed security offerings by main asset classes, 2004-2013



Note: The offerings are categorized by offering year and underlying asset type. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. Non-agency RMBS include residential, Alt-A, and subprime RMBS, and asset-backed securities backed by home equity loans and lines of credit. Only non-agency RMBS offerings sold in the United States are counted. Auto loan asset-backed securities include asset-backed securities backed by auto loans, both prime and subprime, motorcycle loans, truck loans, and recreational vehicle loans. Data is compiled from Asset-Backed Alert and Commercial Mortgage Alert databases.

As shown in Figure 1, new issuances of non-agency RMBS in 2004 totaled \$542 billion, with registered offerings representing the majority of non-agency RMBS issued before the crisis.

⁸⁰ The number of issuers varies across segments of the asset-backed security market. For example, as of December of 2013 there were twenty-two and eighty-three issuers involved in RMBS and CMBS offerings, respectively.

⁸¹ The market share attributed to the issuer of an asset-backed security is calculated by DERA staff using the Asset-Backed Alert and Commercial Mortgage Alert databases.

Non-agency RMBS issuance – which totaled \$715 billion in 2007 – dropped drastically to \$35 billion in 2008. As of the end of 2013, the non-agency RMBS market remains weak and consists almost exclusively of unregistered RMBS offerings. In particular, new issuances of non-agency RMBS totaled \$25 billion in 2013, which represents about 5% of the issuance level in 2004. CMBS experienced a similar drop in issuance levels, though it has rebounded to a level that is closer to the 2004 issuance level than RMBS. In particular, CMBS issuance rose from \$96 billion in 2004 to \$231 billion in 2007. It then dropped to \$12 billion in 2008. It was \$86 billion in 2013, which is about 90% of the issuance level in 2004. The consumer finance asset-backed security market also declined drastically in terms of number of offerings and issuance volume after the financial crisis. For example, \$70 billion of securities backed by auto loans and leases were issued in 2004, but issuance decreased to \$38 billion in 2008. The issuances of consumer finance asset-backed securities, especially those securities backed by auto loans and leases, and other asset-backed securities have steadily increased since 2008 to reach pre-crisis levels of about \$75 billion in 2013.

Among the asset-backed security segments, the non-agency RMBS segment has experienced a significant decline in the number of issuers with twenty-two issuers arranging non-agency RMBS (and only one issuer arranging non-agency registered RMBS) as of the end of 2013, compared to fifty-eight issuers in 2004. In the RMBS market, issuers arranging non-agency RMBS encounter competitive pressure from government-sponsored enterprises that arrange RMBS that are guaranteed⁸² and exempt from registration and reporting requirements.⁸³

⁸² See N. Eric Weiss, GSEs and the Government's Role in Housing Finance: Issues for the 113th Congress, Congressional Research Service Report for Congress (2013).

⁸³ Mortgage-backed securities issued by government-sponsored enterprises and the Government National Mortgage Association have been and continue to be exempt from registration under the Securities Act and most provisions of the federal securities laws. For example, the mortgage-backed securities issued by the Government National Mortgage Association are exempt securities under section 3(a)(2) of the Securities

As non-agency RMBS issuance has declined, issuance of agency RMBS has increased.

Issuances of RMBS arranged by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association were \$1.4 trillion in 2004 and grew to \$1.9 trillion in 2013.⁸⁴

Table 7 shows the number of unique underwriters of non-agency asset-backed securities. As of the end of 2013, it is a highly concentrated industry with ninety underwriters (if international securitizations are included in the data) and fifty underwriters (if international securitizations are excluded), with the top ten underwriters by volume underwriting about 70% of the securitizations.⁸⁵

Table 7 – Number of unique asset-backed security underwriters

Year	Regist'd	144A	Private	Total Excluding Internat'l	Internat'l	Total Including Internat'l
2002	22	40	15	47	86	107
2003	29	41	3	47	87	109
2004	29	46	2	56	99	123
2005	29	45	3	50	101	118
2006	28	57	1	59	114	137
2007	27	59	1	61	109	132
2008	19	42	0	44	95	113
2009	14	26	0	28	58	72
2010	15	45	1	46	76	90
2011	18	44	5	45	62	79
2012	20	46	0	48	63	81
2013	22	47	0	50	72	90

Note: Statistics are calculated by DERA staff using the Asset-Backed Alert and Commercial Mortgage Alert databases. A single offering of asset-backed securities may consist of multiple tranches of securities. An NRSRO may rate one or multiple tranches of the securities issued in the offering. The number of unique underwriters of asset-backed securities is divided into categories by type of offering (registered, 144A, private, or international). The total number in the last column may not be the sum of numbers in the columns labeled "Public", "144A", "Private," and "Internat'l" because some underwriters may market offerings in several categories. Only non-agency asset-backed security offerings and underwriters of such deals are counted.

Act (15 U.S.C. 77c(a)(2)) and section 3(a)(12) of the Exchange Act (15 U.S.C. 78c(a)(12)). The chartering legislation for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation contain exemptions with respect to the mortgage-backed securities issued by these entities. See 12 U.S.C. 1723c; 12 U.S.C. 1455g.

⁸⁴ See Securities Industry Financial Market Association ("SIFMA"), US Mortgage-Related Issuance and Outstanding Data from 1996 to May 2014 (issuance), 2002 to 2014 Q1 (outstanding) (June 3, 2014 update).

⁸⁵ The market share attributed to an asset-backed security underwriter is calculated by DERA staff using Asset-Backed Alert and Commercial Mortgage Alert databases.

Finally, providers of third-party due diligence services with respect to asset-backed securities are significantly affected by the amendments and new rules being adopted today. The Commission has little information about these firms and the characteristics of the industry. The Commission estimates that there are approximately fifteen providers of third-party due diligence services.⁸⁶ Because there are very few publicly traded firms specializing in due diligence, little is known about these service providers in terms of loan review volume, market share, and revenue.⁸⁷

Asset-backed security issuers and underwriters may use third-party due diligence services to identify issues with loans, to negotiate better prices on pools of loans they are considering for purchase, and to negotiate expanded representations and warranties in purchase and sale agreements from sellers.⁸⁸ The reviews of third-party due diligence providers are performed on an adverse or random sample of loans consistent with the guidelines of clients. Compensation is likely not contingent on due diligence findings or the ultimate performance of the loans reviewed. Instead, third-party due diligence providers may be paid a standard service fee for each loan reviewed.⁸⁹

⁸⁶ This number comes from combining the names of third-party due diligence firms cited by Vicki Beal, Senior Vice President of Clayton Holdings, in her testimony before the Financial Crisis Inquiry Commission, and the names of third-party due diligence firms that S&P reviews as a part of its U.S. RMBS rating process. See Testimony of Vicki Beal, Senior Vice President of Clayton Holdings before the Financial Crisis Inquiry Commission, (Sept. 23, 2010), available at http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Beal.pdf ("Clayton Testimony"). S&P's updated list of third-party due diligence firms reviewed for U.S. RMBS is available at https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1246530&SctArtId=208825&from=CM&ns_l_code=LIME. The Commission does not know whether the estimate of fifteen providers of third-party due diligence services captures all of the primary participants in this business but believes that, based on available information, this is a reasonable estimate for purposes of this economic analysis.

⁸⁷ See Clayton Testimony, p. 1 (describing the market for due diligence services as "highly fragmented, highly competitive and rapidly changing").

⁸⁸ See id. at 2.

⁸⁹ See id. at 3.

c. Industry Practices

The Commission staff conducts annual examinations of each NRSRO and publishes a report summarizing the essential findings of the examinations, as required by section 15E(p)(3) of the Exchange Act.⁹⁰ The staff's 2013 report noted improvements, relative to prior examinations, among the NRSROs in five general areas that are related to the amendments and new rules being adopted today: enhanced documentation, disclosure, and board of director oversight of criteria and methodologies; investment in software or computer systems for electronic recordkeeping and monitoring employee securities trading; increased prominence of the role of the designated compliance officer within NRSROs; implementation or enhancement of internal controls over the rating process (for example, use of audits and other testing to verify compliance with federal securities laws, and employee training on compliance matters); and adherence to internal policies and procedures.⁹¹ The report also discussed certain weaknesses or concerns in a number of review areas: adherence to policies, procedures, and methodologies;⁹² management of conflicts of interest;⁹³ implementation of ethics policies;⁹⁴ internal supervisory controls;⁹⁵ governance;⁹⁶ the activities of the designated compliance officer;⁹⁷ the processing of

⁹⁰ Section 923(a)(8) of the Dodd-Frank Act struck the existing text in paragraph (p) of section 15E of the Exchange Act, which related to the date of applicability of the Rating Agency Act of 2006, and added new text. See Pub. L. No. 111-203, 932(a)(8). Section 15E(p)(3) of the Exchange Act requires, among other things, the Commission staff to conduct an examination of each NRSRO at least annually. See 15 U.S.C. 78o-7(p)(3). Annual inspection reports for 2011, 2012, and 2013 are available at <http://www.sec.gov/divisions/marketreg/ratingagency.htm>.

⁹¹ See Commission staff, 2013 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization (Dec. 2013) ("2013 Annual Staff Inspection Report"), pp. 7-9.

⁹² See 2013 Annual Staff Inspection Report, pp. 9-11.

⁹³ Id. at 11-13.

⁹⁴ Id. at 13-14.

⁹⁵ Id. at 14-19.

⁹⁶ Id. at 19-20.

⁹⁷ Id. at 20-21.

complaints;⁹⁸ and the policies governing post-employment activities of former staff of the NRSRO.⁹⁹ These essential findings were related to several areas of NRSRO operations and were not limited to activities relating to rating asset-backed securities.

3. Broad Economic Considerations

In this section, the Commission describes the primary economic impacts that may derive from the amendments and new rules being adopted today, relative to the baseline discussed above. A detailed analysis of the particular economic effects – including the costs and benefits and the impact on efficiency, competition, and capital formation – that may result from the amendments and rules is presented in the focused economic analyses in section II of this release.¹⁰⁰

Section 3(f) of the Exchange Act requires the Commission, when engaging in rulemaking that requires the Commission to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.¹⁰¹ Further, section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.¹⁰² The Commission's analysis of the economic effects, including the likely costs and benefits and the likely impact on efficiency, competition, and capital formation of the

⁹⁸ Id. at 21-22.

⁹⁹ Id. at 22-23.

¹⁰⁰ See sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

¹⁰¹ See 15 U.S.C. 78c(f).

¹⁰² See 15 U.S.C. 78w(a)(2); see also Current Guidance on Economic Analysis in SEC Rulemakings (available at: http://insider.sec.gov/divisions/offices/hqo/dera/rsfi-guidance-econ_analysis-rulemaking.pdf)

amendments and new rules, include those attributable to the rulemaking that the Commission is mandated to undertake in accordance with the Dodd-Frank Act and those attributable to the exercise of the Commission's discretionary authority.

In the proposing release, the Commission solicited comments on all aspects of the costs and benefits associated with the proposed rules. In addition to comments on the economic effects of specific provisions, which will be discussed in section II of this release, the Commission received comments on the overall economic effects of the proposed amendments and new rules. Generally, commenters expressed concerns that the potential cumulative burden and costs associated with the proposed amendments and new rules could be so onerous that they would have negative effects on competition by imposing an excessive burden on smaller NRSROs and raising barriers to entry for credit rating agencies that seek to register as NRSROs.¹⁰³ In particular, one commenter suggested that "fostering competition among rating agencies was a primary goal of both the Rating Agency Act of 2006 and the Dodd-Frank Act" but that "the proposed rules will be so costly to implement that additional credit rating agencies are unlikely to register as NRSROs and the existing pool of registrants may contract."¹⁰⁴

As discussed in section II of this release, the Commission has considered these comments and has modified the amendments and new rules being adopted today from the proposals in a number of ways that are designed to reduce the cumulative burden and costs associated with complying with the new requirements. Nonetheless, the Commission recognizes – as reflected in the economic analysis – that the amendments and rules establish a substantial package of new

¹⁰³ See A.M. Best Letter; DBRS Letter; EJR Letter; Kroll Letter; Morningstar Letter; S&P Letter; TradeMetrics Letter.

¹⁰⁴ See DBRS Letter. This commenter also stated that a "contradiction lies in the fact that, while directing the Commission to impose costly and onerous new obligations on rating agencies who choose to register as NRSROs, the Dodd-Frank Act also directs the Commission to remove all references to credit ratings from the federal securities regulations." See DBRS Letter. See also Pub. L. No. 111-203, 939A.

requirements applicable to NRSROs and that complying with these requirements will entail significant costs to NRSROs.¹⁰⁵ The amendments and rules also impose burdens on issuers and underwriters of asset-backed securities and providers of third-party due diligence services with respect to asset-backed securities. As discussed throughout the economic analysis, the Commission believes that the new requirements should result in substantial benefits and should not impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

In particular, the amendments and new rules being adopted today are designed to implement Title IX, Subtitle C of the Dodd-Frank Act, which, in turn, was designed to address the causes of certain market failures (that is, the principal-agent problem,¹⁰⁶ including conflicts of interest, and asymmetric information) that may impair the integrity and transparency of NRSRO credit ratings and the procedures and methodologies NRSROs use to determine credit ratings. Some of the amendments and new rules are primarily designed to enhance the integrity of how NRSROs determine credit ratings by improving internal governance of NRSROs, managing potential principal-agent problems and conflicts of interest in the credit rating process, and promoting adherence to the procedures and methodologies for determining credit ratings and compliance with laws and regulations.¹⁰⁷ For example, provisions in the amendments and new

¹⁰⁵ Some NRSROs may be subject to rules in foreign jurisdictions under which certain of their policies and procedures or other practices are affected by requirements of these foreign jurisdictions that may be similar to some of the requirements imposed by the amendments and new rules. While the requirements of foreign jurisdictions are not analyzed here in detail, they may impact the incremental costs and benefits of the amendments and new rules.

¹⁰⁶ A principal-agent problem occurs when one person (the "agent") is able to act in the person's own best interest rather than in the interest of another person (the "principal"). The problem arises when the parties have different interests and the agent has more information than the principal so that the principal cannot ensure that the agent is always acting in the principal's best interests, especially where activities that are useful to the principal are costly to the agent and where monitoring of the agent's activities is costly to the principal. For example, a principal-agent problem may arise if an NRSRO produces credit ratings that, as a result of conflicts of interest, are not informative to the users of credit ratings.

¹⁰⁷ These requirements are discussed below in sections II.A., II.B., II.C., II.D., II.F., II.I., II.J., and II.K. of this

rules require an NRSRO, among other things, to: (1) assess and report on the effectiveness of internal controls; (2) address conflicts of interest relating to sales and marketing activities and employment of former analysts; (3) have policies and procedures relating to their procedures and methodologies for determining credit ratings; (4) have standards of training, experience and competence for their credit analysts; and (5) have policies and procedures to promote the consistent use of credit rating symbols.¹⁰⁸

Other provisions in the amendments and new rules being adopted today are designed mainly to enhance the transparency of NRSRO credit ratings by increasing disclosure and reducing information asymmetries that may adversely affect users of credit ratings. This should facilitate external scrutiny of NRSRO activities. More specifically, provisions in the amendments and new rules require an NRSRO, among other things, to disclose: (1) standardized performance statistics; (2) increased information about credit rating histories; (3) information about material changes and significant errors in the procedures and methodologies used to determine credit ratings; and (4) information about a specific rating action.¹⁰⁹ The main objective of these requirements is to improve the information provided to users of credit ratings, including investors. The enhanced disclosure may reduce information asymmetries between the NRSRO and the users of its credit ratings, enabling the users to make more informed investment and credit related decisions and allowing them to compare the performance of credit ratings by different NRSROs. Additionally, there are requirements in the amendments and new rules that are designed to reduce information asymmetries among issuers and underwriters of asset-backed securities, NRSROs rating asset-backed securities, and the users of credit ratings for asset-

release.

¹⁰⁸ These requirements are discussed below in sections II.A., II.B., II.C., II.F., II.I., and II.J. of this release.

¹⁰⁹ These requirements are discussed below in sections II.E., II.F., II.G., and II.L. of this release.

backed securities.¹¹⁰ These requirements may benefit NRSROs and users of credit ratings, including investors in these securities.

a. Amendments and Rules Enhancing NRSRO Governance and Integrity of Credit Ratings

The requirements in the amendments and new rules being adopted today that are primarily designed to enhance an NRSRO's internal governance should have economic benefits, relative to the existing baseline, in terms of promoting the integrity of how NRSROs determine and monitor credit ratings. In particular, there are new requirements applicable to NRSROs that assign responsibilities to an NRSRO's management and board of directors, which should promote accountability and facilitate internal oversight over the processes governing the determination of credit ratings and the implementation of the procedures and methodologies an NRSRO uses to determine credit ratings. For example, an NRSRO is required to file an annual report containing an assessment by management of the effectiveness during the fiscal year of the internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.¹¹¹ Similarly, an NRSRO is required to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.¹¹² The board's oversight may prevent situations in which an NRSRO seeks to implement a procedure or methodology to determine credit ratings that is designed to inappropriately issue favorable credit ratings for

¹¹⁰ These requirements are discussed below in sections II.E., II.G., and II.H of this release.

¹¹¹ This requirement is discussed below in section II.A.3. of this release.

¹¹² This requirement is discussed below in section II.F.1. of this release.

existing and prospective clients in order to retain or gain market share.¹¹³

There are new requirements applicable to NRSROs pursuant to which they must avoid certain conflicts of interest and have policies and procedures to take certain actions to address credit ratings that are influenced by a conflict of interest.¹¹⁴ These requirements may facilitate the alignment of incentives at both the NRSRO and individual NRSRO employee level to ultimately promote the production of unbiased credit ratings. At the NRSRO level, for example, sales and marketing considerations may influence the NRSRO's production of credit ratings. Consequently, there is a new requirement that prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.¹¹⁵ This absolute prohibition should result in internal policies, procedures, and organizational solutions that isolate the analytical function from sales and marketing considerations within the NRSRO. To the extent that the absolute prohibition prevents credit analysts that participate in the determination of credit ratings from being influenced by sales and marketing considerations, this should curb potential conflicts of interest related to "rating catering" practices that have been suggested by anecdotal evidence¹¹⁶ and academic literature.¹¹⁷ Isolating the production of credit ratings and

¹¹³ See Griffin and Tang, Did Subjectivity Play a Role in CDO Credit Ratings?.

¹¹⁴ These requirements are discussed below in sections II.B. and II.C. of this release.

¹¹⁵ This requirement is discussed below in section II.B.1. of this release.

¹¹⁶ See Coffee Testimony I, pp. 2-3.

¹¹⁷ See John M. Griffin, Jordan Nickerson, Dragon Yongjun Tang, Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Credit Ratings, REV. FIN. ST. 2270-2310 (2013). The authors draw a distinction between rating shopping and rating catering. "Rating shopping"

the development of procedures and methodologies for determining credit ratings from sales and marketing considerations should promote the integrity and quality of credit ratings to the benefit of their users.

At the individual level, an analyst's incentives may be distorted by the prospect of future employment at an issuer or underwriter, which could influence the analyst in determining a credit rating for that issuer or underwriter. Consequently, there is a new requirement that an NRSRO must have policies and procedures that address instances in which this conflict of interest influenced a credit rating that are reasonably designed to ensure that the NRSRO promptly determines whether the current credit rating must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings and to promptly publish a revised credit rating, an affirmation of the credit rating, or potentially place the credit rating on watch or review and in each case include certain disclosures about the existence of the conflict.¹¹⁸ This provision is designed to require the NRSRO to promptly address a conflicted credit rating, and it will likely limit the potential risk that users of credit ratings may make investment decisions using biased or inaccurate information. The disclosures also should provide information to investors and other users of credit ratings that they can use to scrutinize an NRSRO, thereby promoting accountability to the market for failing to appropriately manage this conflict of

refers to a situation in which issuers solicit ratings from multiple credit rating agencies and then hire the credit rating agencies that will issue the most favorable credit ratings (Skreta and Veldkamp, 2009). Even though rating agencies adhere to their rating procedures and methodologies and issue unbiased ratings, credit rating inflation is a natural consequence of the rating shopping process and is not driven by the rating agencies. "Rating catering" refers to a situation in which issuers solicit credit ratings from multiple credit rating agencies and the credit rating agencies may not strictly adhere to their procedures and methodologies for determining credit ratings in order to issue more favorable credit ratings. The authors argue that under pressure from investment banks, the credit rating agency with a more stringent procedure or methodology for determining credit ratings stretches the procedure or methodology to match more lenient competitors (Bolton, Freixas, and Shapiro, 2012).

¹¹⁸

This requirement is discussed below in section II.C.1. of this release.

interest.

In terms of accountability, the Commission is finalizing a rule amendment pursuant to which an NRSRO could have its registration suspended or revoked for violating a rule governing conflicts of interest.¹¹⁹ In addition, the Commission is amending Form NRSRO to provide notice to an NRSRO or a credit rating agency applying for registration as an NRSRO that an NRSRO is subject to applicable fines, penalties, and other sanctions under the Exchange Act.¹²⁰ This may serve as a reminder to the NRSRO or applicant of the potential consequences of failing to comply with federal laws and regulations. Taken together, these accountability measures may have incremental effects on the integrity of an NRSRO's activities and credit ratings by promoting compliance with the Commission's rules.

There are new requirements applicable to NRSROs pursuant to which they must establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that: (1) the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are developed and modified in accordance with the policies and procedures of the NRSRO; and (2) material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, that the NRSRO uses to determine credit ratings are applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply and, to the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the

¹¹⁹ This requirement is discussed below in section II.B.3. of this release.

¹²⁰ This requirement is discussed below in section II.D.1. of this release.

type of obligor, security, or money market instrument being rated.¹²¹ To the extent that these policies and procedures are effectively implemented and enforced, their application may enhance the integrity of how NRSROs determine credit ratings.

There are new requirements applicable to NRSROs pursuant to which they must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals they employ to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered. At a minimum, these standards must include: (1) a requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings; and (2) a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating.¹²² These requirements may increase the level of competence and experience of the credit analysts employed by the NRSRO to participate in the production of credit ratings with possible positive effects on the integrity and quality of credit ratings.¹²³

There are new requirements applicable to NRSROs pursuant to which they must have reasonably designed policies and procedures relating to: (1) assessing the probability that an

¹²¹ This requirement is discussed below in section II.F.1. of this release.

¹²² See section II.I.1. of this release (providing a more detailed discussion of the requirements of this paragraph).

¹²³ See Cesare Fracassi, Stefan Petry, and Geoffrey Tate, Are Credit Ratings Subjective? The Role of Credit Analysts in Determining Ratings (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2230915. The authors find that the identity of the credit analysts covering a firm significantly affects the firm's credit rating, comparing credit ratings for the same firm at the same time across credit rating agencies. Analyst effects account for 30% of the variation within credit ratings. In addition, the quality of credit ratings varies with observable analyst characteristics.

issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or money market instrument; (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO; and (3) applying any symbol, number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.¹²⁴ Compliance with these policies and procedures may increase the likelihood that NRSROs apply rating symbols, numbers, or scores consistently across classes of credit ratings to the benefit of the users of credit ratings and obligors and issuers that are subject to credit ratings.

Finally, there are new requirements applicable to NRSROs pursuant to which they must retain records of certain internal controls, policies, procedures and standards they are required to document.¹²⁵ These record retention requirements should facilitate Commission oversight of NRSROs to the benefit of users of credit ratings. Similarly, the Exchange Act requires an annual report of the NRSRO's designated compliance officer to be filed on a confidential basis with the Commission.¹²⁶ The new requirement should facilitate Commission oversight as well.

There will be costs associated with the amendments and new rules being adopted today related to governance of NRSROs.¹²⁷ These costs will be primarily incurred by NRSROs.¹²⁸

Initial and ongoing direct costs, including compliance costs, may vary among the NRSROs

¹²⁴ These requirements are discussed below in section II.J. of this release.

¹²⁵ These requirements are discussed below in sections II.A.2., II.C.2., II.F.2., II.I.2., and II.J.2. of this release.

¹²⁶ This requirement is discussed below in section II.K. of this release.

¹²⁷ A detailed analysis of the economic costs, including compliance costs that can potentially result from each amendment and/or rule is presented in the focused economic analyses in section II of this release. See sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

¹²⁸ NRSROs may be able to pass some of the incremental costs to their clients.

depending on the size and complexity of their business activities (for example, number of credit ratings outstanding, number of analysts, or number of classes of credit ratings). Among other costs, NRSROs also may incur training costs in order to make their personnel aware of the changes in internal controls, policies, and procedures required by the amendments and new rules. These costs are difficult to quantify because they depend significantly on how the required changes differ from the internal policies and procedures currently in place within each NRSRO. In addition, they depend on factors such as the NRSRO's size and business complexity. For example, an NRSRO may need to train its credit analysts and sales and marketing staff in the updated policies and procedures related to the sales and marketing conflict requirements. Among other factors, this cost will likely vary significantly with the degree of the existing separation between the functions of analytical staff and sales and marketing personnel.¹²⁹

Keeping all other factors constant, the costs associated with establishing, maintaining, enforcing, and documenting internal policies and procedures may be higher for structured finance products because the inherent conflict of interest that credit rating agencies face in rating these products is more acute than it is with respect to rating other types of securities.¹³⁰ In addition, keeping all other factors constant, NRSROs operating under a business model that combines the issuer-pay and subscriber-pay models may face greater direct costs, given that the two models may entail different internal policies and procedures to prevent different sources of potential conflicts of interest. A component of these costs may also be fixed, which may have a disproportionate impact on smaller NRSROs that may find it more difficult to bear the costs. If

¹²⁹ This requirement is discussed below in section II.B.4. of this release.

¹³⁰ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63844. ("In the case of structured finance products, the Commission believes this 'issuer/underwriter-pay' conflict is particularly acute because certain arrangers of structured finance products repeatedly bring ratings business to the NRSROs. As sources of frequent, repeated deal-based revenue, some arrangers have the potential to exert greater undue influence on an NRSRO than, for example, a corporate issuer that may bring far less ratings business to the NRSRO.") (footnotes omitted).

NRSROs are not able to readily pass the overall additional costs to clients, there may be adverse effects, particularly on smaller NRSROs.

As a result of the amendments and new rules being adopted today, the number of credit rating agencies registered with the Commission as NRSROs may decline if current registrants believe that the cost of being registered and being subject to these new requirements outweighs the benefit of registration. The barriers to entry for credit rating agencies to register as NRSROs may rise, discouraging credit rating agencies from registering as NRSROs. Further, historically, successful new entrants have established themselves by first specializing in a particular industry, creating a track record in a particular rating class, and building the necessary reputational capital to achieve marketplace acceptance of their credit ratings.¹³¹ Compliance costs may reduce the incentive for an NRSRO to expand its rating business into new classes of credit ratings, with adverse effects on competition in certain market segments. Also, if compliance costs significantly erode profit margins for NRSROs, the barriers to exit from being registered as an NRSRO in certain or all classes of credit ratings may lower. The risk for deregistration may likely be higher for smaller NRSROs. As mentioned earlier, these costs also should depend on the complexity of operations within the NRSRO. Further, given that the conflict of interest in rating structured finance products is more acute, the competitive effects could be greater within the markets for rating these products. These potential consequences could reduce competition among NRSROs.

An amendment being adopted today provides a mechanism for a small NRSRO to seek an exemption from the sales and marketing prohibition.¹³² The exemption based on size may

¹³¹ See Commission, Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets (Jan. 2003), p. 24.

¹³² This provision is discussed below in section II.B.3. of this release.

decrease the burden on small NRSROs. However, this amendment could create adverse effects on competition as exempted NRSROs may be able to draw business through rating catering. In particular, exempted NRSROs may be able to more readily produce conflicted and inflated ratings¹³³ or generate a greater stream of revenue from selling rating and ancillary services than non-exempted NRSROs. Reputation, which is an important disciplinary mechanism in this industry, may mitigate this risk to a certain extent.¹³⁴

A number of credit rating agencies located in the United States have not registered as NRSROs.¹³⁵ As U.S. regulatory agencies continue to remove references to NRSRO credit ratings from the regulations they administer, market participants subject to these regulations may choose to use unregistered credit rating agencies thereby diminishing the incentive to register as an NRSRO.¹³⁶ On the other hand, users of credit ratings may choose to use NRSROs over unregistered credit rating agencies because of the NRSRO registration and oversight program, which is being enhanced by the amendments and new rules being adopted today.

To the extent that these amendments and new rules improve the quality of credit-related information, they may have effects related to allocative efficiency and capital formation. As a result of these amendments and new rules, users of credit ratings could make more efficient investment decisions based on higher-quality information. Market efficiency also may improve

¹³³ See Griffin, Nickerson, and Tang, Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Credit Ratings.

¹³⁴ See Jerome Mathis, James McAndrews, and Jean-Charles Rochet, Rating the Raters: Are Reputation Concerns Powerful Enough to Discipline Rating Agencies?, J. OF MONETARY ECONOMICS 657-674 (July 2009).

¹³⁵ See, e.g., James H. Gellert, Chairman and CEO, Rapid Ratings International, Inc., Testimony Concerning: Oversight of the Credit Rating Agencies Post Dodd-Frank (July 27, 2011) (testimony before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Oversight and Investigations), available at http://www.rapidratings.com/images/custom/gellert_testimony_to_house_cfs_oversight_and_investigations_july_27_2011_final_w_bio.pdf.

¹³⁶ See Pub. L. No. 111-203, 939A.

if credit ratings become more informative and the additional information is reflected in asset prices. To the extent that the amendments and rules will be effective in enhancing the integrity and quality of NRSRO credit ratings, users of these credit ratings may benefit from an enhanced confidence in the quality of the creditworthiness assessments reflected in the credit ratings, which may have positive effects on the willingness of investors to participate in the securities markets and thereby enhance capital formation, as capital efficiently flows to more productive uses. The benefits in terms of efficiency and capital formation arising from the rules enhancing governance and the integrity of credit ratings are likely to be greater for asset-backed securities, where the inherent conflict of interest in the issuer-pay model is more acute, and, as a result of the amendments and new rules, investors may become less reluctant to invest in asset-backed securities.

b. Amendments and Rules Enhancing Disclosure and Transparency of Credit Ratings

The requirements in the amendments and new rules being adopted today that are primarily designed to enhance disclosure should have economic benefits, relative to the baseline that existed before the amendments and rules were adopted, in terms of promoting the transparency of credit ratings and NRSRO activities and, therefore, NRSRO accountability. This should benefit users of credit ratings, including investors. The amendments and rules also should enhance disclosure requirements with respect to asset-backed securities for the benefit of users of credit ratings, including investors in these securities.

The amendments significantly enhance the existing requirements for NRSROs to produce and disclose performance statistics to make the disclosures more comparable across NRSROs and easier for users of credit ratings and others to understand.¹³⁷ Similarly, the existing

¹³⁷ These amendments are discussed below in section II.E.1. of this release.

requirements for NRSROs to disclose rating histories are being enhanced to make the histories more complete in terms of the scope of credit ratings that must be included in the histories and more robust in terms of the information that must be disclosed with each rating action.¹³⁸ To the extent that the new disclosures facilitate the evaluation of the performance of an NRSRO's credit ratings and the comparison of rating performance across all NRSROs – including direct comparisons of the rating history of the same obligor or instrument across two or more NRSROs – the rules may benefit users of credit ratings, including investors. In particular, the enhanced disclosure may allow them to better assess the reliability of credit ratings from different NRSROs and, in the case of issuer-paid credit ratings or subscriber-paid credit ratings, make more informed decisions regarding whether to hire, or subscribe to the credit ratings of, a particular NRSRO.

There are new requirements applicable to NRSROs pursuant to which they must publish on their Internet websites: (1) material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings; and (2) notice of the existence of a significant error identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change to current credit ratings.¹³⁹ These requirements may benefit users of NRSRO credit ratings in terms of their ability to evaluate the procedures and methodologies used by an NRSRO to determine credit ratings. In this way, they also may promote the NRSROs' accountability to the market and the issuance of quality credit ratings.

There are new requirements applicable to NRSROs pursuant to which they must publish

¹³⁸ These amendments are discussed below in section II.E.3. of this release.

¹³⁹ These amendments are discussed below in section II.F.1. of this release.

two items when taking a rating action: (1) a form containing certain quantitative and qualitative information about the credit rating that is the result or subject of the rating action; and (2) any certification of a third-party due diligence provider relating to the credit rating.¹⁴⁰ The required disclosures may be used by investors and other users of credit ratings to better understand credit ratings issued by NRSROs. Specifically, the forms and certifications will provide incremental information about how a credit rating was produced (for example, disclosure about assumptions, limitations, information relied on, version of the procedure or methodology used, potential conflicts of interest) and the information content of the credit rating. The information disclosed in the form, including information about the limitations of the credit rating and information regarding due diligence, may discourage undue reliance on credit ratings by investors and other users of credit ratings in making investment and other credit-based decisions.

There is a new requirement applicable to issuers and underwriters of asset-backed securities pursuant to which they must disclose the findings and conclusions of any third-party due diligence report they obtain.¹⁴¹ The rule applies to both registered and unregistered offerings of asset-backed securities. Additionally, there is a new requirement applicable to providers of third-party due diligence services with respect to asset-backed securities pursuant to which they must provide a written certification to any NRSRO that is producing a credit rating with respect to the asset-backed security.¹⁴² The certification must disclose information about the due diligence performed, including a summary of the findings and conclusions of the third party, and identification of any relevant NRSRO due diligence criteria that the third party intended to meet in performing the due diligence.

¹⁴⁰ These amendments are discussed below in section II.G. of this release.

¹⁴¹ These amendments are discussed below in section II.H.1. of this release.

¹⁴² These amendments are discussed below in sections II.H.2. and II.H.3. of this release.

As discussed above, the amendments and new rules are intended to reduce asymmetric information in the asset-backed security market. NRSROs producing credit ratings for asset-backed securities may benefit from receiving the information in the certification. The certification also will be signed by an individual who is duly authorized by the third-party due diligence provider to make such a certification, promoting confidence in the accuracy of the information disclosed. Importantly, issuers and underwriters can no longer select what part of this information to provide to NRSROs, reducing the possibility of less favorable information being withheld from NRSROs and reducing the risk that the credit ratings will be based on imperfect or incomplete information (to the extent the NRSROs use information about due diligence in producing their credit ratings). Further, making this information available to all NRSROs (rather than just the NRSROs hired to rate the asset-backed security) could promote the issuance of more credit ratings for a given asset-backed security, including credit ratings that provide a more diverse range of views on the creditworthiness of the security. Users of credit ratings, including investors and other participants in the asset-backed securities markets, may benefit both directly and indirectly from the disclosures made by issuers, underwriters, and providers of third-party due diligence services. To the extent that findings and conclusions of all third-party due diligence reports were not previously disclosed to these persons, the amendments and new rules should enhance information available to the public.

Finally, there are new requirements pursuant to which NRSROs must use the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system to electronically submit Form NRSRO and required exhibits to the form to the Commission.¹⁴³ Having all information available in an electronic format in EDGAR will provide a centralized

¹⁴³

See section II.L. of this release (providing a more detailed discussion of the amendments).

location and should make the information and the history of that information more easily accessible, comparable, and searchable to users of credit ratings, including investors.

There will be costs associated with the amendments and new rules being adopted today that are related to enhanced disclosure and transparency.¹⁴⁴ These costs will be primarily incurred by NRSROs,¹⁴⁵ issuers and underwriters of asset-backed securities, and third-party due diligence providers. Initial and ongoing direct costs, including compliance costs, may vary among the affected parties depending on their size and the complexity of their business activities (for example, number of credit ratings outstanding, number of analysts, number of classes of credit ratings, number of years issuing credit ratings, and number of historical credit ratings). Keeping all other factors constant, NRSROs operating according to a subscriber-pay model may face greater losses in revenue from the sale of access to historical ratings data, as more of this data becomes publicly available, since they are likely to be more dependent on this source of revenue than NRSROs operating according to the issuer-pay model. A component of these costs may also be fixed, affecting more significantly smaller NRSROs that may find it more difficult to bear the costs. If NRSROs are not able to readily pass the overall additional costs to clients, there may be adverse effects, especially on smaller NRSROs.

Similar to the amendments and new rules relating to governance, the amendments and new rules relating to disclosure and transparency could reduce the number of credit rating agencies registered with the Commission as NRSROs to the extent that current registrants believe the cost of being registered and subject to these new requirements outweighs the benefit of registration. In addition, the barriers to entry for credit rating agencies to register as NRSROs

¹⁴⁴ A detailed analysis of the economic costs, including compliance costs that can potentially result from each rule is presented in the focused economic analyses in section II of this release. See sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release.

¹⁴⁵ NRSROs may be able to pass some of the incremental costs to their clients.

may rise, especially for smaller credit rating agencies. NRSROs may have a reduced incentive to register for a new class of credit ratings with adverse effects on competition in certain market segments. Barriers to exit from registration as an NRSRO may lower due to the possible erosion of profit margins, though an NRSRO's decision to deregister from certain or all classes of credit ratings may depend on whether users of credit ratings will favor NRSROs because of the NRSRO registration and oversight program, which is being enhanced by the amendments and new rules being adopted today. The risk for deregistration will likely be higher for smaller NRSROs, given the fixed component of some compliance costs and the greater difficulty to pass the increase in costs to their clients.

Also, the amendments and new rules may impact competition among third-party due diligence providers. Although the Commission knows little about the characteristics of the market for the services they provide, the certification requirement may increase the liability risk for these providers, particularly for those who do not already bear expert liability under Rule 193.¹⁴⁶ If third-party due diligence providers are not able to charge more for performing the asset review to account for the heightened risk of liability, some providers may exit the market or some entities that otherwise would have entered the market may decide against doing so.

The amendments and new rules also may have positive effects on competition, efficiency and capital formation. The enhanced standardization of the information content may facilitate comparing performance statistics and rating histories across NRSROs. Clients of NRSROs (for

¹⁴⁶ See 17 CFR 230.193; 17 CFR 229.1111. Under Rule 193 and Item 1111 of Regulation AB, an issuer of a registered asset-backed security is required to perform a review of the assets underlying the asset-backed security and disclose the nature of the review. In meeting this requirement, an issuer may engage a third party to perform the required review of the underlying assets. If the third party's findings and conclusions are to be attributed to it, the third-party must consent to being named in the issuer's registration statement as an "expert," thus subjecting the third party to so-called "expert liability" under the Securities Act. If third-party diligence providers are not subject to legal liability as experts, the issuer itself remains legally accountable for the accuracy of the disclosures it makes to investors.

example, issuers, subscribers, and others) may use the performance statistics to inform their hiring or subscribing decisions, increasingly promoting competition among NRSROs on the basis of the quality of their credit ratings and the procedures and methodologies used to determine credit ratings. To the extent that the adopted rules facilitate the external monitoring and comparative analysis of NRSROs, they may allow users of credit ratings to develop more refined views of NRSRO performance and thereby indirectly increase accountability and encourage integrity in the production of credit ratings. This, in turn, may facilitate the ability of NRSROs to establish and maintain reputations for issuing quality credit ratings to remain competitive. More comparable performance data may also help relatively smaller and newer NRSROs, including subscriber-paid NRSROs, to attract attention to their rating performance, enhancing their ability to develop a reputation for producing quality credit ratings. This may allow them to better compete with more established competitors. Also, the ability of non-hired NRSROs to obtain the information disclosed in the third-party due diligence certification may provide them with an advantage in producing informative unsolicited credit ratings, relative to unregistered credit rating agencies that cannot obtain this information.

The new disclosure requirements in the form and certifications that accompany a rating action may reduce information asymmetries about how a credit rating was determined by providing additional information about the rating process, such as assumptions, limitations, version of the procedures or methodologies used, and, in the case of an asset-backed security, a description of the findings and conclusions of a third-party due diligence provider, if such services were employed. To the extent that the required disclosure does not diminish the content and timeliness of the information conveyed with the rating actions, the enhanced information may increase the ability of users of credit ratings to accurately interpret the information,

potentially resulting in more efficient investment decisions and higher overall market efficiency to the benefit of those investors that use credit ratings. This, in turn, may increase investors' participation in the securities markets with positive effects on capital formation. Because of the higher degree of information asymmetry in the asset-backed security market, the benefits in efficiency and capital formation resulting from the enhanced disclosure and transparency of credit ratings are likely to be greater for these securities, with the result that investors may become more willing to participate in this market.

II. FINAL RULES AND RULE AMENDMENTS

As discussed in detail below, the Commission is adopting new rules and amendments to existing rules to implement Title IX, Subtitle C of the Dodd-Frank Act and to enhance the NRSRO registration and oversight program administered by the Commission. In designing rules to implement Title IX, Subtitle C of the Dodd-Frank Act, the Commission has taken into account section 15E(c)(2) of the Exchange Act.¹⁴⁷ This section provides, in pertinent part, that neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.¹⁴⁸ One way the Commission has sought to reconcile the rulemaking mandated by the Exchange Act, as amended by the Dodd-Frank Act, with the limitation in section 15E(c)(2) is to model rule text closely on statutory text.

A. INTERNAL CONTROL STRUCTURE

Section 932(a)(2)(B) of the Dodd-Frank Act added paragraph (3) to section 15E(c) of the Exchange Act.¹⁴⁹ Section 15E(c)(3)(A) requires an NRSRO to establish, maintain, enforce, and

¹⁴⁷ 15 U.S.C. 78o-7(c)(2).

¹⁴⁸ See 15 U.S.C. 78o-7(c)(2).

¹⁴⁹ See Pub. L. No. 111-203, 932(a)(2)(B); 15 U.S.C. 78o-7(c)(3)(A).

document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings (“internal control structure”), taking into consideration such factors as the Commission may prescribe, by rule.¹⁵⁰ While section 15E(c)(3)(A) provides that the Commission “may” prescribe factors an NRSRO would need to take into consideration when establishing, maintaining, enforcing, and documenting the internal control structure, the requirement that an NRSRO “establish, maintain, enforce, and document an effective internal control structure” is self-executing.¹⁵¹ Consequently, an NRSRO must adhere to this provision irrespective of whether the Commission prescribes factors pursuant to section 15E(c)(3)(A).

Section 15E(c)(3)(B) of the Exchange Act provides that the Commission “shall prescribe” rules requiring each NRSRO to submit an annual internal controls report to the Commission, which shall contain: (1) a description of the responsibility of the management of the NRSRO in establishing and maintaining an effective internal control structure; (2) an assessment of the effectiveness of the internal control structure; and (3) the attestation of the chief executive officer (“CEO”), or equivalent individual, of the NRSRO.¹⁵²

In the proposing release, the Commission: (1) deferred prescribing factors the NRSRO must take into consideration in establishing, maintaining, enforcing, and documenting an effective internal control structure; (2) proposed amending the NRSRO recordkeeping rule (Rule 17g-2) to require that the documentation of the internal control structure be subject to the rule’s record retention requirements; and (3) proposed amending the NRSRO annual reporting rule

¹⁵⁰ See 15 U.S.C. 78o-7(c)(3)(A).

¹⁵¹ See *id.*

¹⁵² See 15 U.S.C. 78o-7(c)(3)(B)(i) through (iii).

(Rule 17g-3) to require an NRSRO to file an unaudited annual internal controls report with the Commission.¹⁵³

1. Prescribing Factors

In the proposing release, the Commission stated that it was deferring prescribing factors an NRSRO must take into consideration when establishing, maintaining, enforcing, and documenting an effective internal control structure to provide the Commission with an opportunity – through the NRSRO examination process and the submission of annual reports by the NRSROs on the effectiveness of their internal control structures – to review how NRSROs have complied with the self-executing requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure.¹⁵⁴ However, the Commission sought comment on whether it would be appropriate as part of this rulemaking to prescribe factors and on potential factors the Commission could prescribe.¹⁵⁵ In particular, the Commission identified factors relating to: (1) the establishment of an internal control structure; (2) the maintenance of an internal control structure; and (3) the enforcement of an internal control structure.¹⁵⁶

In terms of establishing an internal control structure, the Commission requested comment on the following factors:

- Controls reasonably designed to ensure that a newly developed methodology or proposed update to an in-use methodology for determining credit ratings is subject to an appropriate review process (for example, by persons who are independent from the persons that developed the methodology or methodology update) and to management approval prior to the new or updated methodology being employed by the NRSRO to determine credit ratings;¹⁵⁷

¹⁵³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33421-33425.

¹⁵⁴ Id. at 33421-33423.

¹⁵⁵ Id.

¹⁵⁶ Id. at 33422-33423.

¹⁵⁷ Section 15E(t)(3)(A) of the Exchange Act contains a self-executing provision requiring that the board of

- Controls reasonably designed to ensure that a newly developed methodology or update to an in-use methodology for determining credit ratings is disclosed to the public for consultation prior to the new or updated methodology being employed by the NRSRO to determine credit ratings, that the NRSRO makes comments received as part of the consultation publicly available, and that the NRSRO considers the comments before implementing the methodology;
- Controls reasonably designed to ensure that in-use methodologies for determining credit ratings are periodically reviewed (for example, by persons who are independent from the persons who developed and/or use the methodology) in order to analyze whether the methodology should be updated;
- Controls reasonably designed to ensure that market participants have an opportunity to provide comment on whether in-use methodologies for determining credit ratings should be updated, that the NRSRO makes any such comments received publicly available, and that the NRSRO considers the comments;
- Controls reasonably designed to ensure that newly developed or updated quantitative models proposed to be incorporated into a credit rating methodology are evaluated and validated prior to being put into use;
- Controls reasonably designed to ensure that quantitative models incorporated into in-use credit rating methodologies are periodically reviewed and back-tested;
- Controls reasonably designed to ensure that an NRSRO engages in analysis before commencing the rating of a class of obligors, securities, or money market instruments the NRSRO has not previously rated to determine whether the NRSRO has sufficient competency, access to necessary information, and resources to rate the type of obligor, security, or money market instrument;
- Controls reasonably designed to ensure that an NRSRO engages in analysis before commencing the rating of an “exotic” or “bespoke” type of obligor, security, or money market instrument to review the feasibility of determining a credit rating;
- Controls reasonably designed to ensure that measures (for example, statistics) are used to evaluate the performance of credit ratings as part of the review of in-use methodologies for determining credit ratings to analyze whether the methodologies should be updated or the work of the analysts employing the methodologies should be reviewed;

directors of the NRSRO shall “oversee” the “establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.” See 15 U.S.C. 78o-7(t)(3)(A). At the same time, section 15E(r) of the Exchange Act requires the Commission to adopt rules “to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models” that are approved by the board of the NRSRO. See 15 U.S.C. 78o-7(r)(1)(A).

- Controls reasonably designed to ensure that, with respect to determining credit ratings, the work and conclusions of the lead credit analyst developing an initial credit rating or conducting surveillance on an existing credit rating is reviewed by other analysts, supervisors, or senior managers before a rating action is formally taken (for example, having the work reviewed through a rating committee process);
- Controls reasonably designed to ensure that a credit analyst documents the steps taken in developing an initial credit rating or conducting surveillance on an existing credit rating with sufficient detail to permit an after-the-fact review or internal audit of the rating file to analyze whether the analyst adhered to the NRSRO's procedures and methodologies for determining credit ratings; and
- Controls reasonably designed to ensure that the NRSRO conducts periodic reviews or internal audits of rating files to analyze whether analysts adhere to the NRSRO's procedures and methodologies for determining credit ratings.¹⁵⁸

In terms of maintaining an internal control structure, the Commission requested comment on the following factors:

- Controls reasonably designed to ensure that the NRSRO conducts periodic reviews of whether it has devoted sufficient resources to implement and operate the documented internal control structure as designed;
- Controls reasonably designed to ensure that the NRSRO conducts periodic reviews or ongoing monitoring to evaluate the effectiveness of the internal control structure and whether it should be updated; and
- Controls designed to ensure that any identified deficiencies in the internal control structure are assessed and addressed on a timely basis.¹⁵⁹

In terms of enforcing an internal control structure, the Commission requested comment on the following factors:

- Controls designed to ensure that additional training is provided or discipline taken with respect to employees who fail to adhere to requirements imposed by the internal control structure; and
- Controls designed to ensure that a process is in place for employees to report failures to adhere to the internal control structure.¹⁶⁰

¹⁵⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33422.

¹⁵⁹ Id.

¹⁶⁰ Id. at 33422-33423.

In terms of documenting the internal control structure, the Commission asked for comment on whether there should be a factor relating to the level of written detail about the internal control structure that should be documented.¹⁶¹

A number of commenters addressed whether the Commission should prescribe factors as part of this rulemaking and, if so, the type of factors the Commission should prescribe.¹⁶² NRSROs urged the Commission to defer rulemaking and stated that the Commission should not prescribe factors.¹⁶³ For example, one NRSRO stated that the Commission should defer rulemaking until it has the opportunity to determine through the examination process and its review of the NRSROs' annual reports the "best practices utilized" by NRSROs to comply with the self-executing requirement in section 15E(c)(3)(A) and that the Commission's "examination feedback regarding best practices related to internal controls will be an important element for the adequate design and monitoring of internal controls."¹⁶⁴ Another NRSRO stated that it "strongly agrees" with the Commission's proposal to defer rulemaking but that, if the Commission proceeds with rulemaking, it should "exercise caution" because attempting to create a "one-size fits all" rule in "such a short timeframe could result in the creation of an anti-competitive environment and the attendant unintended consequences."¹⁶⁵ A third NRSRO stated that

¹⁶¹ Id.

¹⁶² See AFSCME Letter; A.M. Best Letter; Better Markets Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter; DBRS Letter; Kroll Letter; Levin Letter; Morningstar Letter; S&P Letter; TradeMetrics Letter.

¹⁶³ See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter; S&P Letter.

¹⁶⁴ See Morningstar Letter.

¹⁶⁵ See A.M. Best Letter ("prescribing specific factors implies that all NRSROs are the same, which they are not. NRSROs vary in size, ownership, business plans, and management. 'Specific factors' would undoubtedly be designed to apply to the largest NRSROs – this scenario would create a disproportionate impact on smaller NRSROs, whose internal control structure would be best served by designing and implementing policies and procedures that apply the law to the specific characteristics of the NRSRO.").

“NRSROs should have the flexibility to implement whatever control structure suits their size and particular business operations.”¹⁶⁶

In contrast, several other commenters stated that the Commission should not defer rulemaking.¹⁶⁷ For example, one commenter stated that the Commission “already has significant information about the weak internal controls at the NRSROs and has already identified a number of factors critical to an effective internal control system” and that “[p]ostponing the issuance of any standards will result in the NRSROs developing different internal control structures, making oversight and the implementation of minimum standards more difficult, time consuming, and expensive down the line.”¹⁶⁸ Another commenter stated that the proposed approach “will be ineffective in reforming credit rating agency practices and will leave the Commission with little if any ability to hold ratings agencies accountable if they adopt weak and ineffective controls.”¹⁶⁹ These commenters and others recommended that the Commission prescribe factors,¹⁷⁰ and one of the commenters recommended that the Commission re-propose the rule to prescribe factors.¹⁷¹ One commenter discussed factors that the commenter believed should be included in “a set of mandatory minimum standards for an effective internal control system for credit ratings.”¹⁷² Another commenter stated that “the criteria on which the Commission seeks comment are precisely the sort of controls that ought to be in place if the system is operating effectively.”¹⁷³

¹⁶⁶ See DBRS Letter.

¹⁶⁷ See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; Levin Letter.

¹⁶⁸ See Levin Letter.

¹⁶⁹ See CFA/AFR Letter. See also CFA II Letter.

¹⁷⁰ See AFGI Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; Harrington Letter; Levin Letter; TradeMetrics Letter.

¹⁷¹ See CFA II Letter.

¹⁷² See Levin Letter.

¹⁷³ See CFA/AFR Letter.

A third commenter agreed that the rule should “incorporate all of these factors [as described in the proposing release].”¹⁷⁴ Two commenters pointed to the internal control framework developed by the Committee of Sponsoring Organizations of the Treadway Commission in 1992 as a model.¹⁷⁵ Two commenters stated that the rule should require that the documentation of the internal control structure include specific elements, such as how the board of directors conducted its oversight of the internal control structure.¹⁷⁶

The Commission believes it is critically important to investors and other users of credit ratings that, as required by section 15E(c)(3)(A) of the Exchange Act, NRSROs establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their policies, procedures, and methodologies for determining credit ratings.¹⁷⁷ The Commission agrees that the requirements established by the NRSROs to address the internal control structure should “provide the companies’ management the ability to effectively administer their internal compliance measures, and instill confidence in their investors and the public that the companies in fact are achieving the objectives of their internal control rules and, in so doing, promoting ratings that are high-quality, objective, independent, reliable, and free from influence by any conflicts of interest.”¹⁷⁸ This is one of the reasons that the Commission previously has expressed concerns about – and has taken action to

¹⁷⁴ See Better Markets Letter.

¹⁷⁵ See CFA/AFR Letter; AFSCME Letter.

¹⁷⁶ See AFSCME Letter (stating that the NRSRO should be required to document: the control environment; risk assessment; control activities; and information and communication within the NRSRO); CFA/AFR Letter (stating that the NRSRO should be required to document: the design of the system of internal controls; the evidence obtained and conclusions reached during testing of the effectiveness of the internal controls; material weaknesses identified and how they were remediated; how the board of directors conducted its oversight; significant matters that arose in the design, operation, or monitoring of internal controls and how they were resolved; and the basis for reports to the Commission on the effectiveness of the internal control structure).

¹⁷⁷ See 15 U.S.C. 78o-7(c)(3)(A).

¹⁷⁸ See CFA II Letter.

address – the integrity of policies, procedures, and methodologies for determining credit ratings used by certain NRSROs in light of the role these NRSROs played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages.¹⁷⁹

Moreover, the Commission staff conducts annual examinations of each NRSRO and publishes a report summarizing the essential findings of the examinations, as required by section 15E(p)(3) of the Exchange Act.¹⁸⁰ The annual report attributes the essential findings, as applicable, to the “smaller” NRSROs or “larger” NRSROs, and describes for the public the nature and extent of the deficiencies cited. The Commission staff, as part of the annual examination of each NRSRO, reviews whether the internal control structure of the NRSRO is effective as required by section 15E(c)(3)(A) of the Exchange Act.¹⁸¹

For example, in the annual report published in December 2013, the Commission staff noted that all NRSROs had “added or improved internal controls over the rating process” since the examinations began in 2010 and generally improved adherence to their rating policies and procedures, which “appear[ed] to be attributable, in part, to improvements in the internal control structure at NRSROs.”¹⁸² However, in several instances the staff found that an NRSRO did not follow its policies and procedures and the staff recommended that the NRSRO improve its internal controls to ensure compliance with the policies and procedures.¹⁸³ In particular, the

¹⁷⁹ See, e.g., Proposed Rules for Nationally Recognized Statistical Rating Organizations, 73 FR 36212; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63832; 2008 Staff Inspection Report.

¹⁸⁰ See 15 U.S.C. 78o-7(p)(3).

¹⁸¹ See 15 U.S.C. 78o-7(c)(3)(A). See also 15 U.S.C. 78o-7(p)(3)(B) (requiring the Commission to review, among other things, whether the NRSRO conducts business in accordance with the policies, procedures, and rating methodologies of the NRSRO, the internal supervisory controls of the NRSRO, and the governance of the NRSRO).

¹⁸² See 2013 Annual Staff Inspection Report, p. 8.

¹⁸³ See, e.g., 2013 Annual Staff Inspection Report, p. 10 (discussing Commission staff finding that an NRSRO did not consistently follow its policies and procedures for rating criteria development).

Commission staff cited section 15E(c)(3)(A) of the Exchange Act in its report and stated that many NRSROs relied on a testing or internal audit program as an internal supervisory control.¹⁸⁴ The staff then described certain weaknesses it found in those controls, and recommended that those NRSROs improve and better document their testing and audit programs.¹⁸⁵

Deficiencies in the internal control structure found by the examination staff are brought to the attention of the NRSRO, and the staff monitors whether and how those deficiencies are addressed. If warranted, the examination staff also can refer an NRSRO to the enforcement staff for potential violations of section 15E(c)(3)(A).

Given the importance of the NRSROs' internal control structures, the Commission believes that an NRSRO should be required to consider the factors identified in the proposing release when establishing, maintaining, enforcing, and documenting an effective internal control structure. The exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement. This should improve the overall effectiveness of the internal control structures of the NRSROs.

Consequently, the Commission is adding paragraph (d) to new Rule 17g-8 to provide that an NRSRO must consider certain factors when establishing, maintaining, enforcing, or documenting an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Act.¹⁸⁶ The factors identified in this paragraph are the same factors

¹⁸⁴ See 2013 Annual Staff Inspection Report, p. 18.

¹⁸⁵ See *id.*

¹⁸⁶ See paragraph (d) of Rule 17g-8.

the Commission identified in the proposing release.¹⁸⁷ Paragraph (d)(1) identifies the factors relating to establishing an effective internal control structure, paragraph (d)(2) identifies the factors relating to maintaining an effective internal control structure, and paragraph (d)(3) identifies the factors relating to enforcing an effective internal control structure.¹⁸⁸

In considering a given factor, an NRSRO should determine whether it would be appropriate for the firm's internal control structure. Moreover, paragraphs (d)(1), (d)(2), and (d)(3) contain a "catchall" provision that provides that the NRSRO must consider any other controls necessary to establish, maintain, or enforce an effective internal control structure taking into consideration the nature of the business of the NRSRO, including its size, activities, organizational structure, and business model. The Commission is including the catchall provisions because the factors identified in paragraph (d) of Rule 17g-8 may not be comprehensive or sufficient for the circumstances of a particular NRSRO. An NRSRO should not treat them as a checklist or "safe harbor" that allows the firm to conclude that it has established, maintained, enforced, and documented an effective internal control structure.

Paragraph (d)(4) of Rule 17g-8 addresses the documentation of the internal control structure.¹⁸⁹ In the proposing release, the Commission did not identify a factor relating to this provision of the statute.¹⁹⁰ Consequently, paragraph (d)(4) does not identify a specific factor.¹⁹¹ Instead, the paragraph provides – consistent with the catchall provisions in paragraphs (d)(1) through (d)(3) – that an NRSRO must take into consideration any controls necessary to document an effective internal control structure taking into consideration the nature of the

¹⁸⁷ See *id.* See also Nationally Recognized Statistical Rating Organizations, 76 FR at 33422-33423.

¹⁸⁸ See paragraphs (d)(1) through (3) of Rule 17g-8.

¹⁸⁹ See paragraph (d)(4) of Rule 17g-8.

¹⁹⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33421-33423.

¹⁹¹ See paragraph (d)(4) of Rule 17g-8.

business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.¹⁹²

Finally, in adopting the final rule, the Commission has taken into account comments from NRSROs that it should not prescribe factors or “exercise caution” in doing so because “NRSROs should have the flexibility to implement whatever control structure suits their size and particular business operations”¹⁹³ and attempting to create a “one-size fits all” rule in “could result in the creation of an anti-competitive environment and the attendant unintended consequences.”¹⁹⁴ In particular, the Commission notes that, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a specific factor be implemented. Consequently, while NRSROs must consider the factors identified by the Commission, they can tailor their internal control structures to their particular circumstances.

2. Amendment to Rule 17g-2

Section 15E(c)(3)(A) of the Exchange Act contains a self-executing provision that requires an NRSRO, among other things, to document its internal control structure.¹⁹⁵ However, the statute does not prescribe how an NRSRO must maintain this record. For example, the statute does not prescribe how long the record must be retained or the manner in which it must be maintained. Consequently, the Commission proposed adding paragraph (b)(12) to Rule 17g-2 to identify the internal control structure an NRSRO must document pursuant to 15E(c)(3)(A) of the

¹⁹²

Id.

¹⁹³

See DBRS Letter.

¹⁹⁴

See A.M. Best Letter (“prescribing specific factors implies that all NRSROs are the same, which they are not. NRSROs vary in size, ownership, business plans, and management. ‘Specific factors’ would undoubtedly be designed to apply to the largest NRSROs – this scenario would create a disproportionate impact on smaller NRSROs, whose internal control structure would be best served by designing and implementing policies and procedures that apply the law to the specific characteristics of the NRSRO.”).

¹⁹⁵

See 15 U.S.C. 78o-7(c)(3)(A).

Exchange Act as a record that must be retained.¹⁹⁶ As a result, the various retention and production requirements of paragraphs (c), (d), (e), and (f) of Rule 17g-2 would apply to the record documenting the internal control structure.¹⁹⁷

Two commenters expressed support for the proposal,¹⁹⁸ whereas three other commenters raised concerns which are discussed below.¹⁹⁹ The Commission is adding paragraph (b)(12) to Rule 17g-2 as proposed.²⁰⁰ Retention of the record will provide a means for the Commission to monitor the NRSROs' compliance with 15E(c)(3)(A) of the Exchange Act.

In addition, the Commission is amending paragraph (c) of Rule 17g-2. Prior to today's amendments, this paragraph provided that the records required to be retained under paragraphs (a) and (b) of Rule 17g-2 must be retained for three years after the date the record is made or received. The modification clarifies that the records documenting the internal control structure, the policies and procedures discussed in sections II.C., II.F., and II.J. of this release, and the standards discussed in section II.I. of this release must all be retained until three years after the record is replaced with an updated record (that is, when a control, policy, procedure, or standard documented in one of these records is replaced with a new control, policy, procedure, or standard).²⁰¹

¹⁹⁶ See proposed paragraph (b)(12) of Rule 17g-2; Nationally Recognized Statistical Rating Organizations, 76 FR at 33423, 33539.

¹⁹⁷ See 17 CFR 240.17g-2(c) through (f).

¹⁹⁸ See DBRS Letter; S&P Letter.

¹⁹⁹ See AFSCME Letter; A.M.Best Letter; Lambert Letter.

²⁰⁰ See paragraph (b)(12) of Rule 17g-2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

²⁰¹ See paragraph (c) of Rule 17g-2 (providing that the records required to be retained pursuant to paragraphs (a) and (b) of the rule must be retained for three years after the date the record is made or received, except that a record identified in paragraph (a)(9), (b)(12), (b)(13), (b)(14), or (b)(15) of the rule must be retained until three years after the date the record is replaced with an updated record).

The reason for this clarifying amendment is that the text of paragraph (c) of Rule 17g-2 prior to today's amendment was intended to address records that generally contain historical information. For example, the rule requires the retention of records reflecting entries to and balances in all general ledger accounts, records indicating the identity of any credit analyst(s) that participated in determining a credit rating, credit analysis reports, credit assessment reports, and private credit rating reports.²⁰² The intent of the three-year record retention requirement is to preserve these records documenting historical information for three years after the fact in order to allow Commission examiners the opportunity to review the past activities of the NRSRO as reflected in these records. It also provides the NRSRO with records that can be used in connection with internal or third-party audits and for tracking past activities.

The Commission intended the three-year record retention provision in paragraph (c) of Rule 17g-2 as applied to the documentation of the internal control structure, the policies and procedures, and the standards to also preserve historical information for three years after the fact to facilitate Commission examinations and NRSRO internal or third party audits of past activities. However, the record reflects current rather than historical information until there is an update of the internal control structure, policies and procedures, or standards documented in the record (that is, the record reflects the internal controls, policies and procedures, or standards, as applicable, that govern the NRSRO's conduct now and in the future). Consequently, because paragraph (c) of Rule 17g-2 – prior to today's amendments – required a record “to be retained for three years after the date the record is made or received,” this provision as applied to the documentation of the internal control structure, policies and procedures, and standards would be

²⁰²

See, e.g., 17 CFR 240.17g-2(a)(1), (a)(2)(i), and (b)(3).

ambiguous as to whether the record must be retained for three years after the information reflected in the record is no longer current.

For example, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to document its internal control structure.²⁰³ This means that at all times the NRSRO must document the internal control structure that is in effect and, consequently, if a given version of an internal control structure is in effect for more than three years, the NRSRO must continue to maintain the record documenting the internal control structure even though three years have elapsed since the record was made. The clarifying text being added to paragraph (c) of Rule 17g-2 addresses an ambiguity in the rule text. This ambiguity could be read to establish a three-year retention period that is largely meaningless and is inconsistent with the Commission's intent that these records be retained for three years after the information in the record is no longer current.²⁰⁴ Specifically, without the clarifying amendment, paragraph (c) of Rule 17g-2 could be read to provide that the three-year retention period begins to run at the time the internal control structure was first documented. Under this reading, the rule would be redundant because it would prescribe a retention period that is already addressed by the self-executing requirement in section 15E(c)(3)(A) of the Exchange Act (that an NRSRO must document its internal control structure). In other words, the statutory requirement to document the internal control structure acts as a retention requirement for as long as the current version of the internal control structure is in effect. Further, under this reading of the rule, if an internal control structure was in effect for three or more years, an NRSRO could discard the record documenting the previous internal control structure as soon as it is replaced with an updated record documenting the revised

²⁰³ See 15 U.S.C. 78o-7(c)(3)(A).

²⁰⁴ See paragraph (c) of Rule 17g-2 (providing that the records must be retained until three years after the date the record is replaced with an updated record).

internal control structure (as it would have retained the previous record of the internal control structure for three or more years). This could prevent the Commission from reviewing whether the NRSRO adhered to its previous internal control structure, as examinations generally review past activities. The appropriate and intended retention period is until three years after the internal control structure is updated. As a result, the documentation recording the current internal control structure and the documentation recording any prior versions of the internal control structure that were updated within three years will be available to Commission examiners. This will create an audit trail between prior versions of the internal control structure and the existing internal control structure. For these reasons, the Commission is amending paragraph (c) of Rule 17g-2 to make clear that the records documenting the internal control structure, the policies and procedures, and the standards must be retained until three years after the date the record is replaced with an updated record.²⁰⁵

One commenter stated that a three-year retention period is “insufficient,” since “the effects of a credit rating decision may not arise until after that retention period expires.”²⁰⁶ The Commission believes the three year retention period is sufficient. First, as noted above, an NRSRO must maintain a record documenting its existing internal control structure for as long as the internal control structure is in effect and for an additional three years after the record is replaced with an updated record documenting the internal control structure. Second, the Commission staff performs an annual examination of each NRSRO. Consequently, the record documenting an internal control structure that is no longer in effect will be available for several exam cycles.

²⁰⁵ See sections II.C.2., II.F.2., II.I.2., and II.J.2. (discussion the amendments to Rule 17g-2 to establish record retention requirements for the records documenting policies and procedures or standards).

²⁰⁶ See Lambert Letter. This commenter also suggested that the final amendments mandate record retention requirements of seven years, “similar to section 802 of the Sarbanes-Oxley Act.”

Another commenter suggested requiring that documentation be made available to the Commission “regardless of where the credit rating is produced.”²⁰⁷ The Commission notes that under the rules, regardless of where a credit rating is produced, an NRSRO must document its internal control structure and produce to Commission staff the records documenting both its current internal control structure and any prior versions of the internal control structure that are within the three-year retention period.²⁰⁸

A third commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, and argued that documenting policies and procedures “naturally coincide with the establishment of a properly functioning internal controls structure,” which the NRSRO should be allowed to establish on its own, and the commenter urged the Commission to exclude “extensive or overly-inclusive documentation requirements” should it adopt new paragraph (b)(12) of Rule 17g-2.²⁰⁹ In response, the Commission notes that section 15E(c)(3)(A) – not Rule 17g-2 – requires an NRSRO to document its internal control structure.²¹⁰ The amendment to Rule 17g-2 establishes retention requirements for this documentation.

3. Amendments to Rule 17g-3

Section 15E(c)(3)(B) of the Exchange Act provides that the Commission shall prescribe rules requiring an NRSRO to submit an annual internal controls report to the Commission, which must contain: (1) a description of the responsibility of management in establishing and

²⁰⁷ See AFSCME Letter.

²⁰⁸ See 15 U.S.C. 78o-7(c)(3)(A). See also paragraph (d) of Rule 17g-2, which requires, among other things, that an NRSRO maintain each record identified in paragraphs (a) and (b) in a manner that makes the original record or copy easily accessible to the principal office of the NRSRO. 17 CFR 240.17g-2(d).

²⁰⁹ See A.M. Best Letter.

²¹⁰ See 15 U.S.C. 78o-7(c)(3)(A).

maintaining an effective internal control structure; (2) an assessment of the effectiveness of the internal control structure; and (3) the attestation of the CEO or equivalent individual.²¹¹

The Commission proposed amending Rule 17g-3 to implement the rulemaking mandated by section 15E(c)(3)(B) of the Exchange Act.²¹² Rule 17g-3 requires an NRSRO to furnish annual reports to the Commission.²¹³ In particular, before today's amendments, paragraph (a) of Rule 17g-3 required an NRSRO to furnish five or, in some cases, six separate reports within ninety days after the end of the NRSRO's fiscal year and identified the reports that must be furnished.²¹⁴ The first report containing the NRSRO's financial statements must be audited; the remaining reports on revenues and other matters may be unaudited.²¹⁵ Before today's amendments, paragraph (b) of Rule 17g-3 provided that the NRSRO must attach to the reports a signed statement by a duly authorized person that the person has responsibility for the reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the information contained in the reports.²¹⁶

The proposed amendments would add paragraph (a)(7) to Rule 17g-3 to require an NRSRO to file an additional report – which would be unaudited – with its annual submission of

²¹¹ See 15 U.S.C. 78o-7(c)(3)(B)(i) through (iii).

²¹² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33423-33425; 15 U.S.C. 78o-7(c)(3)(B)(i) through (iii). In addition, as a technical amendment, the Commission proposed to amend the title of Rule 17g-3 to replace the words "financial reports" with the words "financial and other reports." Nationally Recognized Statistical Rating Organizations, 76 FR at 33424, n.25. The Commission stated that the report identified in paragraph (a)(6) of Rule 17g-3, the proposed internal control report that would be required under paragraph (a)(7), and the compliance report that would be required under paragraph (a)(8) (which is discussed below in section II.K. of this release) are not financial in nature. *Id.* The Commission also proposed adding the word "filed" in the title of Rule 17g-3 to conform to amendments the Dodd-Frank Act made to section 15E of the Exchange Act. See Pub. L. No. 111-203, 932(a).

²¹³ See 17 CFR 240.17g-3.

²¹⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33423.

²¹⁵ See *id.*

²¹⁶ See *id.*

reports pursuant to Rule 17g-3.²¹⁷ The proposed rule text describing the report that would need to be filed closely mirrored the statutory text.²¹⁸ In particular, proposed paragraph (a)(7) would have required that the internal controls report contain: (1) a description of the responsibility of management in establishing and maintaining an effective internal control structure; and (2) an assessment by management of the effectiveness of the internal control structure.²¹⁹

Section 15E(c)(3)(B)(iii) of the Exchange Act provides that the annual internal controls report must contain an attestation of the NRSRO's CEO or equivalent individual.²²⁰

Accordingly, the Commission proposed amending paragraph (b) of Rule 17g-3 to require that the NRSRO attach to the report a signed statement by the CEO or, if the firm does not have a CEO, an individual performing similar functions.²²¹

The Commission is adding paragraphs (a)(7) and (b)(2) to Rule 17g-3 with modifications from the proposal in response to comments.²²² As discussed below, the modifications to the text

²¹⁷ See paragraph (a)(7) of Rule 17g-3, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. As discussed below, while the report will not be audited, it will be reviewed by Commission examination staff.

²¹⁸ Compare paragraph (a)(7) of Rule 17g-3, as proposed, with 15 U.S.C. 78o-7(c)(3)(B)(i) through (ii).

²¹⁹ See paragraph (a)(7) of Rule 17g-3, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33539.

²²⁰ See 15 U.S.C. 78o-7(c)(3)(B)(iii).

²²¹ See paragraph (b) of Rule 17g-3, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. In particular, the Commission proposed re-organizing paragraph (b) of Rule 17g-3 into paragraphs (b)(1) and (b)(2). As proposed, paragraph (b)(1) would contain the current requirement that the NRSRO must attach to each of the annual reports required pursuant to paragraphs (a)(1) through (6) a signed statement by a duly authorized person associated with the NRSRO stating that the person has responsibility for the financial reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the information required to be contained in the reports. As proposed, paragraph (b)(2) of Rule 17g-3 would require that the NRSRO attach to the report filed pursuant to paragraph (a)(7) a signed statement by the CEO of the NRSRO or, if the NRSRO does not have a CEO, an individual performing similar functions, stating that the CEO or individual has responsibility for the report and, to the best knowledge of the CEO or other individual, the report fairly presents, in all material respects, a description of the responsibility of management in establishing and maintaining an effective internal control structure and an assessment of the effectiveness of the internal control structure.

²²² See paragraph (a)(7) of Rule 17g-3. The amendments to Rule 17g-3 also replace the phrase "financial reports" with the phrase "financial and other reports" and replace the phrase "to be furnished" with the phrase "to be filed or furnished." These amendments are being adopted as proposed.

of paragraph (a)(7) are designed to provide more guidance to NRSROs on the information that must be included in the report compared to the proposed rule text, which – as noted above – closely mirrored the statutory text.

Paragraph (a)(7) – as proposed and adopted – requires an NRSRO to include in the report a description of the responsibility of management in establishing and maintaining an effective internal control structure.²²³ This rule text largely mirrors the statutory text.²²⁴ A number of commenters addressed the level of management that should have primary responsibility for establishing and maintaining an effective internal control structure and for assessing its effectiveness.²²⁵ An NRSRO stated that the CEO (or equivalent) and other management, supervisory, and compliance personnel affiliated with the NRSRO should be responsible for designing the structure, and that the board of directors should oversee the structure.²²⁶ Two other commenters stated that the board of directors should oversee the structure.²²⁷ An NRSRO stated that the wording in the proposed rule was reasonable, but that the Commission should refrain from specifying which level of management should be responsible for establishing and maintaining the system and that this determination “is best left to each NRSRO based upon its business needs and organization.”²²⁸ Similarly, another NRSRO stated that management and board oversight of the internal control structure will vary greatly between each NRSRO and, therefore, such determinations should be left to each NRSRO.²²⁹ On the other hand, a commenter suggested that management should have no part in the establishment or maintenance

²²³ See paragraph (a)(7)(i)(A) of Rule 17g-3.

²²⁴ Compare paragraph (a)(7)(i)(A) of Rule 17g-3, with 15 U.S.C. 78o-7(c)(3)(B)(i).

²²⁵ See AFSCME Letter; CFA/AFR Letter; Harrington Letter; Kroll Letter; Morningstar Letter; S&P Letter.

²²⁶ See Morningstar Letter.

²²⁷ See AFSCME Letter; CFA/AFR Letter.

²²⁸ See S&P Letter.

²²⁹ See Kroll Letter.

of an internal control structure, and that a committee of analysts should assess the effectiveness of the NRSRO's internal control structure.²³⁰

In response to these comments, the Commission notes that section 15E(t)(3)(C) of the Exchange Act prescribes a self-executing requirement that the board of directors of the NRSRO shall "oversee" the "effectiveness of the internal control system with respect to the policies and procedures for determining credit ratings."²³¹ Moreover, as discussed above, the self-executing provision in section 15E(c)(3)(A) requires an NRSRO to establish, maintain, enforce, and document an effective internal control structure.²³² Further, section 15E(c)(3)(B) of the Exchange Act refers, in pertinent part, to "a description of the responsibility of the management of the [NRSRO] in establishing and maintaining an effective internal control structure."²³³ Moreover, this section of the statute also provides that the annual internal controls report – which must include an assessment of the effectiveness of the internal control structure – must contain an attestation of the NRSRO's CEO or equivalent individual.²³⁴ Consequently, a reasonable interpretation of these statutory provisions is that they allocate responsibility to the NRSRO's board to "oversee" the effectiveness of the internal control structure and responsibility to the NRSRO's management to establish, maintain, enforce, and document the internal control structure and to report annually on its effectiveness. This interpretation also is consistent with the Commission's understanding of how the responsibilities of a firm's board and management generally are allocated.

²³⁰ See Harrington Letter (suggesting the formation of a "Committee Assessment Function" that would be "devoted solely to evaluating the committee performance over the course of a year of all members regardless of title" and would "bypass management entirely and report directly to a board member tasked with sole responsibility for this function").

²³¹ See 15 U.S.C. 78o-7(t)(3)(A).

²³² See 15 U.S.C. 78o-7(c)(3)(A).

²³³ See 15 U.S.C. 78o-7(c)(3)(B)(i).

²³⁴ See 15 U.S.C. 78o-7(c)(3)(B)(ii) and (iii).

While it is the responsibility of management to establish, maintain, enforce, and document the internal control structure, in carrying out this responsibility management could, as a matter of good practice, consider the extent to which other persons within the NRSRO should be involved.²³⁵ For example, management could seek input from persons within the NRSRO that carry out the day-to-day functions related to governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. This could include input from persons responsible for determining credit ratings, developing rating methodologies, and reviewing and monitoring the NRSRO's compliance with its policies, procedures, and methodologies. In addition, establishing a mechanism for persons within the NRSRO to report, on a confidential basis if they choose, directly to the board of directors any material weaknesses in the NRSRO's internal control structure could be a useful check on management's annual assessment of the effectiveness of the internal control structure and could assist the board in its responsibility to oversee the effectiveness of the internal control structure. Finally, an NRSRO could consider developing procedures to identify and address internal conflicts of interest that potentially could prevent an independent, impartial, and unbiased assessment of the effectiveness of the internal control structure. This could promote more accurate reporting by the NRSRO on the internal control structure.

In addition to the description of the responsibility of management in establishing and maintaining an effective internal control structure, the proposal required that the internal controls report include "an assessment by management of the effectiveness of the internal control structure."²³⁶ As discussed in more detail below, several commenters stated that the Commission

²³⁵ See Harrington Letter; Morningstar Letter.

²³⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. This provision of the proposed amendment largely mirrored the statutory text. See 15 U.S.C. 78o-7(c)(3)(B)(ii).

should strengthen the reporting requirement in the rule relating to the assessment of the effectiveness of the internal control structure.²³⁷

The Commission is persuaded that the proposal should be modified to provide more clarity on the information that must be reported in the internal controls report. In particular, paragraph (a)(7) of Rule 17g-3, as adopted, requires that the internal controls report include (in addition to a description of the responsibility of management in establishing and maintaining an effective internal control structure): (1) a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and (2) a statement as to whether the internal control structure was effective as of the end of the fiscal year.²³⁸ Consequently, the final amendment provides more specificity as to the information that must be included in the internal controls report in terms of assessing the effectiveness of the NRSRO's internal control structure.²³⁹

Further, in response to comments that the rule should specify that the assessment covers the entire year, the Commission has made several modifications to the proposal.²⁴⁰ Specifically, the prefatory text of paragraph (a)(7)(i) of Rule 17g-3, as amended, provides that the internal

²³⁷ See AFSCME Letter; CFA/AFR Letter. These two commenters stated that the rule should require reporting on: (1) the period of time to which management's assessment relates, which should be the entire year; (2) the benchmark or framework used in assessing internal controls, as well as the definition of internal control used; (3) the statement that the board of directors is responsible for overseeing the system of internal controls; (4) if a material weakness was detected during the year, a description of that material weakness and whether it has been remediated (and how) as of the end of that year; and (5) non-compliance with applicable laws and regulations that have been identified, consistent with the Yellow Books standard of the General Accounting Office ("GAO").

²³⁸ See paragraph (a)(7)(i) of Rule 17g-3.

²³⁹ See paragraphs (a)(7)(i)(B) and (C) of Rule 17g-3. As discussed above, the proposal would have required the report to include an "assessment by management of the effectiveness of the internal control report." See Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. This more general description of what must be contained in the internal controls report is being moved to the prefatory text of paragraph (a)(7)(i) of Rule 17g-3.

²⁴⁰ See AFSCME Letter; CFA/AFR Letter.

controls report must contain an assessment by management of the effectiveness during the fiscal year of the internal control structure.²⁴¹ The amendment further requires that the report must include a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed.²⁴² Consequently, the reporting relating to material weaknesses must cover the entire fiscal year. The amendment also requires that the internal controls report contain a statement as to whether the internal control structure was effective as of the end of the fiscal year.²⁴³ Thus, this statement in the report relates to a point in time: the fiscal year end. However, the assessment of whether the internal control structure is effective as of the fiscal year end will depend on how the NRSRO addressed any material weaknesses identified during the fiscal year.²⁴⁴

Commenters also addressed how to assess the internal control structure. One commenter pointed to the internal control framework developed by the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission in 1992 as a model.²⁴⁵ Another commenter stated that the Commission should establish a framework against which the internal controls of an NRSRO can be measured that would identify the objectives of the controls, set forth mandatory minimum components, and specify how a material weakness would be

²⁴¹ See paragraph (a)(7)(i) of Rule 17g-3 (emphasis added).

²⁴² See paragraph (a)(7)(i)(B) of Rule 17g-3 (emphasis added). The Commission expects the description to include the nature and the duration of the material weakness.

²⁴³ See paragraph (a)(7)(i)(C) of Rule 17g-3 (emphasis added).

²⁴⁴ As discussed below, paragraph (a)(7)(ii) of Rule 17g-3 provides that management is not permitted to conclude that the internal control structure was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.

²⁴⁵ See CFA/AFR Letter (stating that the Commission should use the COSO framework as a basis for evaluating and inspecting the assessment of internal controls and the control structure on which management will report).

handled.²⁴⁶ Some commenters suggested that the Commission clarify how an NRSRO should assess whether its internal control structure is effective.²⁴⁷ One of these commenters suggested the Commission lay out a basic definition of internal control and the objectives the internal controls are designed to achieve but did not provide a suggested definition.²⁴⁸ An NRSRO suggested that the Commission clarify that “an ‘effective’ internal control structure is one that is ‘reasonably designed’ to achieve its purposes.”²⁴⁹ In contrast, another NRSRO stated that the proposed reporting requirement is “sufficiently explicit” and that “additional guidance is not needed.”²⁵⁰ This commenter added that each NRSRO operates in its own unique way and that prescribing more detailed rules “may not be appropriate for every NRSRO in every situation.”²⁵¹

The Commission agrees that providing more clarity as to when management of the NRSRO is not permitted to conclude that its internal control structure is effective would strengthen the requirement and provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure.²⁵² The Commission therefore is modifying the proposal to add a provision specifying when the NRSRO is not permitted to conclude that its internal control structure is effective.²⁵³ In particular, the final amendment provides that

²⁴⁶ See Levin Letter.

²⁴⁷ See CFA/AFR Letter; DBRS Letter.

²⁴⁸ See CFA/AFR Letter.

²⁴⁹ See DBRS Letter.

²⁵⁰ See S&P Letter.

²⁵¹ Id.

²⁵² See, e.g., CFA/AFR Letter; DBRS Letter. The Commission provided such guidance when it recently adopted a new reporting requirement for broker-dealers pursuant to which certain types of broker-dealers must file a compliance report that contains, among other statements, a statement as to whether the broker-dealer’s internal control over compliance with certain rules was effective. See Broker-Dealer Reports, Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910, 51916-51920 (Aug. 21, 2013). See also 17 CFR 240.17a-5(d)(3). The reporting requirement contains provisions prescribing when a broker-dealer is not permitted to conclude that its internal control over compliance with these rules was effective.

²⁵³ See paragraph (a)(7)(ii) of Rule 17g-3.

management of the NRSRO is not permitted to conclude that the internal control structure of the NRSRO was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.²⁵⁴

Commenters suggested several definitions of the term material weakness. For example, one commenter suggested that material weakness be defined as a “serious deficiency that would prevent or in fact did prevent the internal controls from achieving their objective.”²⁵⁵ Another commenter described a material weakness as “a serious deficiency in an internal control that would prevent it from achieving its objective.”²⁵⁶ Similarly, a third commenter stated that a definition of material weakness should be one “which clearly sets out what would be a serious deficiency in internal controls that would prevent the internal controls from achieving their objective.”²⁵⁷ An NRSRO requested that the Commission provide guidance as to what constitutes a material weakness and suggested that a material weakness be defined as a “deficiency, or combination of deficiencies, in internal controls where it is more likely than not that the integrity of the rating process will be compromised by the failure to follow the NRSRO’s policies, procedures, and methodologies.”²⁵⁸ This commenter also stated that it believed that one of the objectives of the internal control structure is to “provide reasonable assurance regarding the prevention or timely detection of actions that could have a material effect on the

²⁵⁴

Id.

²⁵⁵

See CFA/AFR Letter.

²⁵⁶

See Levin Letter.

²⁵⁷

See COPERA Letter.

²⁵⁸

See Morningstar Letter (also stating that, “[t]o the extent the CEO’s report requires a discussion of internal control deficiencies, this discussion should be limited to material deficiencies that prevent management from concluding its internal structure is effective, which is consistent with the Commission’s requirement for reports related to internal controls over financial reporting.”).

integrity of credit ratings.”²⁵⁹ On the other hand, another NRSRO stated that the Commission should allow NRSROs to define material weakness and other terms.²⁶⁰

The Commission is persuaded that including a description of a material weakness in paragraph (a)(7) of Rule 17g-3 will strengthen the reporting requirement and provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure. Consequently, the paragraph, as adopted, includes a description of when a material weakness exists.²⁶¹ This description is based, in part, on suggestions by commenters and on recent amendments to the broker-dealer reporting rule.²⁶² The description of material weakness in the rule incorporates the concept of a deficiency in the internal control structure of the NRSRO.²⁶³ Consequently, paragraph (a)(7) of Rule 17g-3 also includes a description of when a deficiency in the internal control structure exists.²⁶⁴ Under the requirements of the paragraph, the first step is to determine whether there are deficiencies in the internal control structure. If so, the second step is to determine whether a material weakness exists in light of the identified deficiencies.

The description in paragraph (a)(7) of Rule 17g-3 of when a deficiency exists is based on the control objectives set forth in section 15E(c)(3)(A) of the Exchange Act.²⁶⁵ This self-executing provision specifies that the internal control structure must effectively govern the implementation of and adherence to the NRSRO’s policies, procedures, and methodologies for determining credit ratings. In other words, the controls must be designed to achieve the

²⁵⁹ See Morningstar Letter.

²⁶⁰ See S&P Letter.

²⁶¹ See paragraph (a)(7)(iv) of Rule 17g-3.

²⁶² See Broker-Dealer Reports, 78 FR at 51916-51920; 17 CFR 240.17a-5(d)(3).

²⁶³ See paragraph (a)(7)(iv) of Rule 17g-3.

²⁶⁴ See paragraph (a)(7)(iii) of Rule 17g-3.

²⁶⁵ See 15 U.S.C. 78-o7(c)(3)(A) (requiring that the internal control structure govern the “implementation of and adherence to [the NRSRO’s] policies, procedures, and methodologies for determining credit ratings”).

following objectives: (1) that the NRSRO implements policies, procedures, and methodologies for determining credit ratings in accordance with its policies and procedures; and (2) that the NRSRO determines credit ratings in accordance with its policies, procedures, and methodologies for determining credit ratings. Given these control objectives, the paragraph provides that a deficiency in the internal control structure exists when the design or operation of a control does not allow management or employees of the NRSRO, in the normal course of performing their assigned functions, to prevent or detect a failure of the NRSRO to: (1) implement a policy, procedure, or methodology for determining credit ratings in accordance with its policies and procedures; or (2) adhere to an implemented policy, procedure, or methodology for determining credit ratings.²⁶⁶

The existence of a deficiency in the internal control structure, however, does not necessarily mean that a material weakness exists. Even a well-designed internal control structure cannot guarantee that a deficiency will never occur. Therefore, paragraph (a)(7) of Rule 17g-3 provides that a material weakness exists if a deficiency, or a combination of deficiencies, in the design or operation of the internal control structure creates a reasonable possibility that a failure identified in the description of deficiency (that is, a failure of the NRSRO to implement a policy, procedure, or methodology for determining credit ratings in accordance with its policies and procedures or to adhere to a policy, procedure, or methodology for determining credit ratings) that is material will not be prevented or detected on a timely basis.²⁶⁷

In the proposing release, the Commission asked whether the internal controls report should be made public.²⁶⁸ One commenter stated that the internal controls report should be made

²⁶⁶ See paragraph (a)(7)(iii) of Rule 17g-3.

²⁶⁷ See paragraph (a)(7)(iv) of Rule 17g-3.

²⁶⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33425.

publicly available.²⁶⁹ The commenter stated that making the report public would enable users of credit ratings “to evaluate the effectiveness of [the] rating agency’s internal control structure and consider what impact, if any, it may have on the quality of the credit ratings the NRSRO produces.”²⁷⁰ On the other hand, three commenters – all NRSROs – stated that the report should be kept confidential (as are the other reports submitted to the Commission under Rule 17g-3).²⁷¹ One NRSRO stated that publicizing the reports could make them less informative and more defensive in nature, limiting their effectiveness.²⁷² A second NRSRO stated that “[m]anagement reports to the board (including an annual report, which would also be filed with the Commission) are likely to be key elements of the board’s ability to oversee the effectiveness of the internal control structure” and “[s]ince board oversight will be promoted by open and free dialogue with management, the Commission should not impede such communication when imposing requirements that make some or all parts of such management reports publicly available.”²⁷³ A third NRSRO stated that the reports may contain proprietary or confidential information pertaining to the activities of the NRSRO.²⁷⁴

The Commission is adopting the amendment as proposed and, therefore, is not requiring that the internal controls report be made public. The final amendment is intended to assist the Commission in examining and monitoring the effectiveness of the internal control structures of

²⁶⁹ See CII Letter.

²⁷⁰ Id.

²⁷¹ See DBRS Letter; Kroll Letter; S&P Letter.

²⁷² See DBRS Letter (also arguing that nothing in the Dodd-Frank Act suggests the intent of Congress was to make the reports public and that there is no precedent under federal securities laws to force a private company to publicize information of this kind, and that users of credit ratings already have access to much information on NRSROs on which to make informed use of ratings, including how they formulate credit opinions and the historical performance of those opinions).

²⁷³ See Kroll Letter.

²⁷⁴ See S&P Letter.

NRSROs and how the structures evolve and improve over time.²⁷⁵ Making the reports public – as suggested by one commenter – could cause NRSROs to make them less detailed and candid.²⁷⁶ In appropriate cases, if an NRSRO fails to establish, maintain, enforce, and document an effective internal control structure, the Commission could institute enforcement proceedings, at which point the allegations related to the internal control structure would be a matter of public record.

One commenter suggested the report be subjected to a third-party audit attesting to the report's reliability.²⁷⁷ As stated above, the final amendment does not require that the internal controls report be made public. Consequently, the report is not a public document that will be relied upon by investors and other users of credit ratings. Rather, it is a non-public report that will be used by Commission examiners as part of their monitoring of NRSROs' compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure. The Commission has taken these factors into consideration in balancing the benefits of having the internal controls report audited by a third party and the costs of such a requirement. The Commission examines each of the ten NRSROs currently registered with the Commission annually. At this time, the Commission believes that the annual examinations by the Commission staff will provide a sufficient means for reviewing the accuracy of the internal controls reports filed by the NRSROs.

In order to implement section 15E(c)(3)(B)(iii) of the Exchange Act, the Commission is adopting the amendment to paragraph (b) of Rule 17g-3 with modifications to correspond to the

²⁷⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33513.

²⁷⁶ See DBRS Letter.

²⁷⁷ See Levin Letter.

modifications to paragraph (a)(7) discussed above.²⁷⁸ Specifically, as proposed, paragraph (b)(2) of Rule 17g-3 would require that the NRSRO attach to the internal controls report filed pursuant to paragraph (a)(7) a signed statement by the CEO of the NRSRO or, if the NRSRO does not have a CEO, an individual performing similar functions, stating, in pertinent part, that the report fairly presents, in all material respects, a description of the responsibility of management in establishing and maintaining an effective internal control structure and an assessment of the effectiveness of the internal control structure.²⁷⁹ As discussed above, under the final amendments, paragraph (a)(7) of Rule 17g-3 provides that the report must contain a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each material weakness was addressed, and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.²⁸⁰ Consequently, under the final amendments, paragraph (b)(2) of Rule 17g-3 provides that the CEO or individual performing similar functions must state, in pertinent part, that the internal controls report fairly presents, in all material respects: an assessment by management of the effectiveness of the internal control structure during the fiscal year that includes a description of the responsibility of management in establishing and maintaining an effective internal control structure; a description of each material weakness in the internal control structure identified during the fiscal year, if any; a description, if applicable, of how each

²⁷⁸ See paragraph (b)(2) of Rule 17g-3. See also 15 U.S.C. 78o-7(c)(3)(B)(iii) (providing, in pertinent part, that the Commission shall prescribe rules requiring each NRSRO to submit to the Commission an internal controls report, which shall contain the attestation of the CEO, or equivalent individual, of the NRSRO).

²⁷⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33539.

²⁸⁰ See paragraph (a)(7)(i) of Rule 17g-3.

identified material weakness was addressed; and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.²⁸¹

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to reporting on internal control structures.²⁸² The baseline that existed before today's amendments was one in which NRSROs must establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.²⁸³ In addition, section 15E(t)(3)(C) of the Exchange Act requires the board of directors of the NRSRO to "oversee" the "effectiveness of the internal control system with respect to policies and procedures for determining credit ratings."²⁸⁴ However, before today's amendments, there were no requirements addressing: (1) the factors an NRSRO must consider when establishing, maintaining, enforcing, and documenting an internal control structure; and (2) the retention of the records documenting the NRSRO's internal control structure. In addition, there were no requirements to file an annual internal controls report with the Commission attested to by the NRSRO's CEO or equivalent individual describing the responsibility of the management of the NRSRO in establishing and maintaining an effective internal control structure and containing an assessment of the effectiveness of the internal control structure.

²⁸¹ See paragraph (b)(2) of Rule 17g-3.

²⁸² The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

²⁸³ See 15 U.S.C. 78o-7(c)(3)(A).

²⁸⁴ See 15 U.S.C. 78o-7(t)(3)(C).

Relative to the baseline, paragraph (d) of Rule 17g-8 requiring an NRSRO to consider certain factors when establishing, maintaining, enforcing, and documenting an internal control should result in benefits. As noted above, the exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.²⁸⁵ This should improve the overall effectiveness of the internal control structures of the NRSROs.

Relative to this baseline, the amendments to Rule 17g-2 requiring an NRSRO to retain a record documenting its internal control structure should result in benefits. Recordkeeping rules such as Rule 17g-2 are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws.²⁸⁶ Rule 17g-2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission's staff in monitoring, through its examination program, whether an NRSRO is complying with applicable securities laws, including the provisions of section 15E of the Exchange Act and the rules adopted under section 15E. The amendments to Rule 17g-2 are designed to assist the Commission staff in monitoring an NRSRO's compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to its policies, procedures, and methodologies for determining credit ratings.

²⁸⁵ See 15 U.S.C. 78o-7(c)(3)(A).

²⁸⁶ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33582.

Relative to the baseline, the amendments to Rule 17g-3 requiring NRSROs to file an internal controls report with the Commission should result in benefits. First, the annual report will facilitate the Commission's oversight of NRSROs by assisting the Commission in monitoring an NRSRO's compliance with the requirement in section 15E(c)(3)(A) of the Exchange Act 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. Compliance with the requirement to file the internal controls report may enhance the integrity of credit ratings by increasing the likelihood that NRSROs will adhere to their procedures and methodologies for determining credit ratings.

Second, the requirement that an NRSRO describe in the report any material weaknesses identified during the fiscal year and how any identified material weakness was addressed may incentivize an NRSRO to more closely monitor and make appropriate improvements to its internal control structure, which could improve the integrity and quality of its credit ratings. The requirements also could provide accountability for effective governance by the NRSRO's board and management, which also may improve the integrity of credit ratings.

Third, the requirement that the CEO or a person performing similar functions attest to the report should help to ensure that the report fairly presents the assessment by management of the effectiveness of the internal control structure. It also should promote greater focus within an NRSRO on establishing, maintaining, enforcing, and documenting an effective internal control structure, given the involvement of senior level management in attesting to the reported information. Further, because the person attesting to the report must represent that the person has responsibility for the report, there will be senior level accountability for the accuracy and

completeness of the report, which also should promote greater focus within an NRSRO on establishing, maintaining, enforcing, and documenting an effective internal control structure.

Paragraph (d) of Rule 17g-8 and the amendments to Rules 17g-3 and 17g-2 should promote the objective of ensuring that NRSROs comply with section 15E(c)(3)(A) of the Exchange Act (that is, establish, maintain, enforce, and document an effective internal control structure).²⁸⁷ This should mitigate the risk that an NRSRO may use a rating methodology that has not been implemented in accordance with its policies and procedures or that it issues a credit rating that was not determined in accordance with its policies, procedures, and methodologies for determining credit ratings. Again, the integrity and quality of credit ratings could increase as a result.

With respect to prescribing factors, commenters stated, in response to a question in the proposing release, that the Commission should not prescribe factors for an internal control structure because this would place a heavy burden on small NRSROs.²⁸⁸ The Commission believes the manner in which it has prescribed factors will address these concerns and, relative to the baseline, paragraph (d) of Rule 17g-8 should not result in costs. NRSROs already are required to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.²⁸⁹ In doing so, an NRSRO already must consider the types of controls that would be necessary to meet this statutory requirement. Paragraph (d) of Rule 17g-8 provides reference points for engaging in this exercise and may facilitate and focus the process. Moreover, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a

²⁸⁷ See 15 U.S.C. 78o-7(c)(3)(A).

²⁸⁸ See A.M. Best Letter; Kroll Letter.

²⁸⁹ See 15 U.S.C. 78o-7(c)(3)(A).

specific factor be implemented. Consequently, while NRSROs must consider the factors identified by the Commission, they can tailor and scale their internal control structures to their size and business activities.

Relative to the baseline, the amendments to Rule 17g-2 prescribing retention requirements for the documentation of the internal control structure will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g-2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the Paperwork Reduction Act ("PRA"),²⁹⁰ the Commission estimates that paragraph (b)(12) of Rule 17g-2 and the amendment to paragraph (c) of Rule 17g-2 will result in total industry-wide one-time costs to NRSROs of approximately \$12,000 and total industry-wide annual costs to NRSROs of approximately \$3,000.²⁹¹

Relative to the baseline, the amendments to Rule 17g-3 requiring that NRSROs file an annual internal controls report with the Commission will result in costs to NRSROs. An NRSRO will likely incur costs to engage outside counsel to analyze the requirements for the report and to assist in drafting and reviewing the report. These legal costs are expected to be greater for the filing of the first report and are expected to depend on the size and complexity of the operations of the NRSRO. NRSROs also will need to establish and maintain internal processes to gather and retain evidentiary information to support the report. However, NRSROs already have

²⁹⁰ 44 U.S.C. 3501 et seq.

²⁹¹ See section V.A. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

processes and controls for preparing and submitting the annual reports required by Rule 17g-3 before today's amendments. Therefore, the reporting costs of this rule will be incremental to the costs associated with these existing requirements. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a)(7) of Rule 17g-3 and the amendment to paragraph (b) of Rule 17g-3 will result in total industry-wide one-time costs to NRSROs of approximately \$400,000 and total industry-wide annual costs to NRSROs of approximately \$667,000.²⁹²

The amendments to Rule 17g-2 and Rule 17g-3 may result in other costs. For example, these requirements may affect the timeliness of credit ratings if they result in an NRSRO implementing internal controls that increase the time required to produce a credit rating. For example, an NRSRO may choose to implement controls which require the work of a lead credit analyst to be reviewed by other analysts. As a result, users of credit ratings may incur costs associated with having credit ratings that are less timely.

Paragraph (d) of Rule 17g-8 and the amendments to Rule 17g-3 and Rule 17g-2 could have a number of effects related to efficiency, competition, and capital formation.²⁹³ As stated above, these amendments could improve the integrity and quality of credit ratings. Consequently, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also improve if this information is reflected in asset prices. Consequently, capital formation could improve as capital may flow to more efficient uses with the benefit of this enhanced information. Alternatively, the timeliness of credit-related information may be diminished as discussed above. In this case, users of credit

²⁹² See section V.A. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.4. of this release.

²⁹³ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

ratings may have access to less timely credit-related information which could decrease the efficiency of their investment decisions and the efficiency of markets as it could delay the updating of asset prices to reflect available information. The amendments to Rule 17g-3 and Rule 17g-2 also will impose costs, some of which may have a component that is fixed in magnitude across NRSROs and does not vary with the size of the NRSRO. Therefore, the operating costs per rating of smaller NRSROs may increase relative to that of larger NRSROs, which could create adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as NRSROs might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

There are a number of reasonable alternatives to the amendments. First, the Commission could have deferred prescribing factors to be taken into consideration when establishing, maintaining, enforcing, and documenting an effective internal control structure. As explained above, the exercise of considering these factors will provide the NRSROs with an opportunity to critically evaluate the effectiveness of their existing internal control structures and new registrants a reference point for designing or modifying existing internal control structures to comply with the statutory requirement to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.²⁹⁴ This should improve the overall effectiveness of the internal control structures of the NRSROs. Moreover, the “catchall” provisions in the rule will mitigate the risk that an NRSRO treats the factors as a checklist or “safe harbor.” Moreover, as discussed

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See 15 U.S.C. 78o-7(c)(3)(A).

above, the Commission does not believe that prescribing factors will result in additional costs to NRSROs.

Second, the Commission could require that the annual internal controls report be made public, as suggested by one commenter.²⁹⁵ This alternative could improve the quality of credit ratings by providing additional information to issuers, subscribers, investors, and other users of credit ratings to assess the quality of an NRSRO's internal control structure and, thereby, promote the NRSROs' accountability to the market and the issuance of quality credit ratings by the NRSRO. However, as stated above, publicly disclosing the internal controls reports could cause NRSROs to be less detailed and candid. This could diminish the utility of the reports as a means for the Commission to monitor compliance with the requirements of section 15E(c)(3)(A) of the Exchange Act and for the boards of the NRSROs to meet their obligations under section 15E(t)(3)(C) of the Exchange Act to "oversee" the "effectiveness of the internal control system with respect to the policies and procedures for determining credit ratings."

Third, the Commission could require that the internal controls report be audited by a third party, as suggested by a commenter.²⁹⁶ As stated above, the final amendment does not require that the internal controls report be made public. Consequently, the report is not a public document that will be relied upon by investors and other users of credit ratings. Rather, it is a non-public report that will be used by Commission examiners. The Commission has taken these factors into consideration in balancing the benefits of having the internal controls report audited by a third party and the costs of such a requirement. The Commission examines each of the ten NRSROs currently registered with the Commission annually. At this time, the Commission

²⁹⁵ See CII Letter.

²⁹⁶ See Levin Letter.

believes that the annual examinations by the Commission staff will provide a sufficient means for reviewing the accuracy of the internal controls reports filed by the NRSROs.

B. SALES AND MARKETING CONFLICT OF INTEREST

Section 932(a)(4) of the Dodd-Frank Act added paragraph (3) to section 15E(h) of the Exchange Act.²⁹⁷ Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO.²⁹⁸ Section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission's rules shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.²⁹⁹ Section 15E(h)(3)(B)(ii) of the Exchange Act requires that the Commission's rules shall provide for the suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that: (1) the NRSRO has committed a violation of a rule issued under section 15E(h) of the Exchange Act; and (2) the violation affected a rating.³⁰⁰

The Commission proposed to implement sections 15E(h)(3)(A), 15E(h)(3)(B)(i), and 15E(h)(3)(B)(ii) of the Exchange Act by amending the NRSRO conflict of interest rule (Rule 17g-5).³⁰¹ The proposal would amend Rule 17g-5 by: (1) identifying a new prohibited conflict in

²⁹⁷ See Pub. L. No. 111-203, 932(a)(4); 15 U.S.C. 78o-7(h)(3).

²⁹⁸ 15 U.S.C. 78o-7(h)(3)(A).

²⁹⁹ 15 U.S.C. 78o-7(h)(3)(B)(i).

³⁰⁰ 15 U.S.C. 78o-7(h)(3)(B)(ii).

³⁰¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33425-33429. See also 17 CFR 240.17g-5. The Commission adopted and subsequently amended Rule 17g-5 pursuant, in part, to authority in section 15E(h)(2) of the Exchange Act (15 U.S.C. 78o-7(h)(2)). See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33595-33599 (June 18, 2007); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6465-6469 (Feb. 9, 2009); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63842-63850 (Dec. 4, 2009).

paragraph (c) of the rule relating to sales and marketing activities; (2) adding paragraph (f) to the rule to set forth the finding the Commission would need to make in order to grant a small NRSRO an exemption from the prohibition; and (3) adding paragraph (g) to the rule to set forth the standard for suspending or revoking an NRSRO's registration for violating a rule adopted under section 15E(h) of the Exchange Act.³⁰²

1. New Prohibited Conflict

Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO.³⁰³ The Commission proposed to implement this provision by identifying a new conflict of interest in paragraph (c) of Rule 17g-5.³⁰⁴ Paragraph (c) prohibits an NRSRO and a person within an NRSRO from having a conflict of interest identified in the paragraph under all circumstances (an "absolute prohibition").³⁰⁵ As proposed, paragraph (c)(8) of Rule 17g-5 would identify an additional absolute prohibition: issuing or maintaining a credit rating where a person within the NRSRO who participates in sales or marketing of a product or service of the NRSRO or a product or service of a person associated with the NRSRO also participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative or

³⁰² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33425-33429.

³⁰³ 15 U.S.C. 78o-7(h)(3)(A).

³⁰⁴ See paragraph (c)(8) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33426.

³⁰⁵ See 17 CFR 240.17g-5(c)(1) through (7). These absolute prohibitions are distinguished from the types of conflicts identified in paragraph (b) of Rule 17g-5, which are prohibited unless the NRSRO has taken the steps to address them as set forth in paragraph (a) of Rule 17g-5. See 17 CFR 240.17g-5(a) and (b). See also 17 CFR 240.17g-5(d) (defining the term person within an NRSRO to mean an NRSRO, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the NRSRO or its credit rating affiliates (or any person occupying a similar status or performing similar functions)).

quantitative models.³⁰⁶ In effect, this would prohibit persons who participate in sales and marketing activities from participating in determining or monitoring credit ratings or developing or approving rating procedures or methodologies.

Several commenters suggested that the requirements in the proposed amendment should be stronger.³⁰⁷ Commenters raised concerns that the amendment as proposed would not prohibit managers from seeking to inappropriately influence credit analysts and the personnel who develop and approve rating procedures and methodologies.³⁰⁸ For example, one commenter stated that the proposal could “be strengthened by barring NRSRO management from taking negative actions against analysts due to client complaints seeking better ratings, more lenient treatment of their products, or relief from providing information about a product being rated” and that such actions “inevitably lead to inaccurate and inflated ratings.”³⁰⁹ A second commenter stated that the requirement needs to apply “more broadly to any action by any rating agency employee that has the intent or effect of allowing sales and marketing considerations, including concern over building market share, to inappropriately influence the rating process or undermine ratings accuracy.”³¹⁰ The commenter stated that this was necessary to address practices such as “basing analysts’ performance evaluations or compensation on their success in building market share, allowing investment bankers to influence the selection of analysts involved in rating their deals, and delaying revisions to rating models because of concerns about their impact on market

³⁰⁶ See paragraph (c)(8) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

³⁰⁷ See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Levin Letter. See also CFA II Letter (stating that the rule should be re-proposed).

³⁰⁸ See, e.g., AFR II Letter; CFA II Letter; Levin Letter

³⁰⁹ See Levin Letter.

³¹⁰ See CFA/AFR Letter.

share.”³¹¹ A third commenter stated that motivations by management to increase profits and market share can lead to top-down policies and practices that emphasize higher credit ratings over improved accuracy and reliability.³¹²

Other commenters suggested that the proposed requirement be less restrictive.³¹³ These commenters recommended, among other things, that the proposed amendment require procedures to manage the conflict,³¹⁴ or apply only when sales and marketing considerations “influenced” the production of the credit rating.³¹⁵

After considering these comments, the Commission is revising the rule text to incorporate into the rule language that is both consistent with the statutory language and with the requirement in paragraph (a)(1)(iii) of Rule 17g-7³¹⁶ (discussed in section II.G.4. of the release), which would address sources of influence with respect to sales and marketing considerations in addition to persons involved in sales and marketing activities. Accordingly, the final amendment modifies the proposal to provide that an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring

³¹¹ See CFA/AFR Letter.

³¹² See CFA II Letter.

³¹³ A.M. Best Letter; S&P Letter; TradeMetrics Letter.

³¹⁴ See S&P Letter; TradeMetrics Letter.

³¹⁵ See A.M. Best Letter. This commenter suggested that if the Commission modified the proposed amendment to require “influence,” the Commission could, among other things, require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to prevent sales and marketing considerations of an NRSRO from influencing the production of credit ratings and specify that those procedures contain language providing that any communications between sales and marketing personnel and ratings personnel are subject to the broader recordkeeping requirements of Rule 17g-2.

³¹⁶ As discussed below in section II.G.4. of this release, paragraph (a)(1)(iii) of Rule 17g-7 provides that an NRSRO must attach to the form to accompany certain credit rating actions a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument. Sales and marketing are subparts of “business activities” and including it in paragraph (c)(8) of Rule 17g-5 is a relevant conforming change.

the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.³¹⁷

Under the first prong of the final amendment, an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO.³¹⁸ As with the proposal, this prong of the absolute prohibition is designed to address situations in which, for example, individuals within the NRSRO who engage in activities to sell products and services (both ratings-related and non-ratings-related) of the NRSRO or its affiliates could seek to influence a specific credit rating to favor an existing or prospective client or the development of a credit rating procedure or methodology to favor a class of existing or prospective clients. In practice, the Commission believes the amendment will require an NRSRO to prohibit personnel that have any role in the determination of credit ratings or the development or modification of rating procedures or methodologies from having any role in sales and marketing activities. It also will require an NRSRO to prohibit personnel that have any role in sales and marketing activities from having any role in the determination of credit ratings or the development or modification of rating procedures or methodologies. Consequently, these functions will need to be separate.

³¹⁷ Id.

³¹⁸ See paragraph (c)(8)(i) of Rule 17g-5.

Commenters suggested that the proposed requirement be less restrictive.³¹⁹ These commenters recommended, among other things, that the proposed amendment require procedures to manage the conflict,³²⁰ or apply only when sales and marketing considerations “influenced” the production of the credit rating.³²¹ In response, the Commission notes that section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of ratings by the NRSRO.³²² Moreover, section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission’s rules under section 15E(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.³²³ The Commission therefore believes that it is a reasonable interpretation of the statute to adopt a rule that requires the separation of the two functions. As stated above, in practice, the final amendment will require an NRSRO to prohibit the personnel that have any role in sales and marketing activities from having any role in the determination of credit ratings or the development or modification of rating procedures and methodologies. In addition, this approach establishes a particularly strong measure to address the sales and marketing conflict because, as discussed above, the final amendment establishes an absolute prohibition. Moreover, depending on the facts and circumstances, it would also violate the first prong of the rule as amended for an individual who participates in sales and marketing activities to seek to influence the determination of a credit

³¹⁹ A.M. Best Letter; S&P Letter; TradeMetrics Letter.

³²⁰ See S&P Letter; TradeMetrics Letter.

³²¹ See A.M. Best Letter.

³²² See 15 U.S.C. 78o-7(h)(3)(A) (emphasis added).

³²³ See 15 U.S.C. 78o-7(h)(3)(B)(i) (emphasis added).

rating or the rating procedures and methodologies used to determine a credit rating, even if the individual's conduct did not influence the credit rating or rating procedures or methodologies.

Further, Commission staff found as part of the examination of the activities of the three largest NRSROs in rating RMBS and CDOs linked to subprime mortgages that it appeared "employees responsible for obtaining ratings business would notify other employees, including those responsible for criteria development, about business concerns they had related to the criteria."³²⁴ As the Commission stated in the proposing release, the absolute prohibition was designed to insulate individuals within the NRSRO responsible for the analytic function from such sales and marketing concerns and pressures.³²⁵

The Commission shares the concerns raised by commenters about the potential inappropriate influence that managers may have over employees involved in the determination of credit ratings or the development or modification of rating procedures and methodologies.³²⁶ In response, the Commission notes that a manager who participates in sales and marketing activities and who seeks to influence a credit rating or the rating procedures and methodologies used to determine the credit rating would be "participating" in determining or monitoring the credit rating or in developing or approving the rating procedures or methodologies used to determine the credit rating under paragraph (a)(8) of Rule 17g-5, as adopted.³²⁷ Consequently, depending

³²⁴ See Summary Report of Issues Identified in the Commission Staff's Examination of Select Credit Rating Agencies, pp. 25-26. Commenters pointed to other sources to argue that the proposal should be stronger. See, e.g., CFA/AFR Letter; CFA II Letter.

³²⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33426.

³²⁶ See, e.g., CFA II Letter.

³²⁷ One commenter suggested that management "would not likely fall under the Commission's definition of 'participants' in either sales or marketing activities." See CFA II Letter. In response, the Commission notes that, as discussed above, a person within an NRSRO – including a manager – would participate in sales and marketing activities if, for example: the individual contacted a company that was about to issue debt and solicited the business of rating the issuance or met with company officials for business development purposes (for example, to "pitch" the NRSRO's services); the individual contacted an institutional investor and offered subscriptions to the NRSRO's credit ratings or credit analyses; or the

on the facts and circumstances, the rule as amended would be violated if it was established that an NRSRO issued or maintained a credit rating in a case in which managers involved in sales and marketing activities pressured or otherwise offered incentives to analysts working on the credit rating to take commercial concerns into account in determining the credit rating.

Similarly, depending on the facts and circumstances, it would violate the rule as amended for an NRSRO to issue or maintain a credit rating that managers involved in sales and marketing activities sought to influence by pressuring or offering incentives to personnel who developed or approved the rating procedures or methodologies used to determine the credit rating to take commercial concerns into account in developing or approving the procedures or methodologies. Moreover, depending on the facts and circumstances, because the rule is an absolute prohibition, this conduct would violate the rule, even if a manager did not successfully influence any credit rating or the rating procedures or methodologies used to determine the credit rating.

Commenters stated that the requirements of proposed paragraph (c)(8) of Rule 17g-5 are ambiguous and requested that the Commission clarify various aspects of the proposal.³²⁸ Five commenters raised concerns as to what it means to participate in sales and marketing activities under the proposed rule.³²⁹ Four of those commenters requested that the Commission provide additional guidance on this question.³³⁰ On the other hand, an NRSRO suggested that the Commission should not provide additional guidance and should allow the NRSRO to define participate.³³¹ Similarly, five commenters (including NRSROs) requested the Commission

individual was contacted by an issuer about the cost of rating its issuance or by an institutional investor about the cost of a subscription to the NRSRO's credit ratings or analyses and the individual provided information about these costs.

³²⁸ See A.M. Best Letter; COPERA Letter; DBRS Letter; Kroll Letter; Moody's Letter; TradeMetrics Letter.

³²⁹ See DBRS Letter; Kroll Letter; Kroll II Letter; Moody's Letter; S&P Letter; TradeMetrics Letter.

³³⁰ See DBRS Letter; Kroll Letter; Kroll II Letter; Moody's Letter; TradeMetrics Letter.

³³¹ See S&P Letter.

clarify what constitutes a sales and marketing activity,³³² while an NRSRO suggested that the Commission not provide additional guidance and allow the NRSRO to determine what constitutes a sales and marketing activity.³³³ One NRSRO stated that the rule should not contain definitions that “compel large size” by mandating, explicitly or implicitly, minimum numbers of employees or layers of management.³³⁴

In response to these comments requesting clarification of terms used in the amendment, the Commission notes that sales and marketing activities involve efforts by an NRSRO to sell or in any manner market its products and services to prospective customers.³³⁵ Participating in sales and marketing activities would clearly include certain actions. For example, a person within an NRSRO would participate in a sales and marketing activity if: (1) the individual contacted a company that was about to issue debt and solicited the business of rating the issuance or met with company officials for business development purposes (for example, to “pitch” the NRSRO’s services); (2) the individual contacted an institutional investor and offered subscriptions to the NRSRO’s credit ratings or credit analyses; (3) the individual was contacted by an issuer about the cost of rating its issuance or by an institutional investor about the cost of a subscription to the NRSRO’s credit ratings or analyses and the individual provided information about these costs.

The Commission recognizes that certain scenarios posed by commenters may not be as clear-cut as these examples in terms of whether the activities would be considered participating

³³² See A.M. Best Letter; COPERA Letter; Kroll Letter; Moody’s Letter; TradeMetrics Letter. For example, commenters argued that that, without clarification of these terms, the scope of the amendment could be applied too broadly. See A.M. Best Letter; Kroll Letter.

³³³ See S&P Letter.

³³⁴ See Kroll Letter.

³³⁵ The examples of what it means to participate in sales and marketing activities discussed in this section of the release are intended to assist NRSROs in understanding those terms as they are used in paragraph (c)(8) of Rule 17g-5.

in sales and marketing activities; each scenario will have to be evaluated based on the particular facts and circumstances.³³⁶ For example, if rating personnel engage in analytical discussions with persons outside the NRSRO, including with obligors and issuers who purchase credit rating services from the NRSRO or with investors and others who purchase subscriptions to the NRSRO's credit ratings, that would not constitute participating in a sales and marketing activity as long as the discussions do not involve commercial matters related to selling or marketing the NRSRO's services; however, if the discussions with ratings analysts involved such commercial matters, the analysts may be considered to be participating in sales and marketing activities.³³⁷ Similarly, if an issuer agrees to have only one meeting with an NRSRO to discuss both analytical matters relating to, and fees for, obtaining credit ratings for the securities it issues, the NRSRO could bring a team of analysts and a team of sales and marketing personnel to the meeting.³³⁸ If the sales and marketing team does not attend the portion of the meeting in which analytical matters are discussed, they would not have participated in the determination of a credit rating. Similarly, if the analytical team does not attend the portion of the meeting in which commercial matters are discussed, they would not have participated in a sales and marketing activity. Further, an analyst would not necessarily participate in a sales or marketing activity if the analyst gives a presentation at a conference attended by persons who could be prospective purchasers of the NRSRO's services.³³⁹ For example, the analyst would generally not be considered to be participating in a sales or marketing activity if the presentation avoided marketing the services offered by the NRSRO and focused solely on topics involving credit analysis (for example, the

³³⁶ See A.M. Best Letter; DBRS Letter; Moody's Letter.

³³⁷ See Moody's Letter.

³³⁸ See DBRS Letter.

³³⁹ See A.M. Best Letter.

analytical process used by the NRSRO to determine credit ratings, an analysis of the creditworthiness of one or more obligors or issuers, or a credit forecast for a particular industry sector).³⁴⁰ Similarly, the analyst would not participate in a sales or marketing activity if the analyst gave this type of presentation in the context of an interview with a news outlet. In each case, the determination whether the analytical team is participating in sales and marketing activity would turn on the facts and circumstances.

As noted above, the first prong of the absolute prohibition requires an NRSRO to separate its analytical functions from its sales and marketing functions. While this is a strong measure to address the sales and marketing conflict, the Commission also believes that it is appropriate to revise the rule text to incorporate language about persons participating in production of a credit rating being “influenced” by sales and marketing considerations.³⁴¹ Section 15E(h)(3)(A) of the Exchange Act provides that the Commission shall issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO.³⁴² Given the concerns raised by commenters, this statutory language, the language in section 15E(q)(2)(F) of the Exchange Act,³⁴³ and Rule 17 g-7, the

³⁴⁰ As discussed throughout this release, one of the objectives of the amendments and new rules being adopted today is to increase the transparency of the credit rating activities of NRSROs to promote competition among NRSROs on the basis of the quality of the credit ratings they produce and the procedures and methodologies they use to determine credit ratings. The persons within an NRSRO responsible for determining credit ratings and developing the procedures and methodologies used to determine credit ratings can promote this transparency, given their responsibilities and expertise. Consequently, the Commission does not intend the new absolute prohibition in paragraph (c)(8) of Rule 17g-5 to constrain them from helping market participants better understand the quality of an NRSRO’s credit ratings and procedures and methodologies an NRSRO uses to determine credit ratings.

³⁴¹ See AFR II Letter; AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Levin Letter. See also CFA II Letter (stating that the rule should be re-proposed).

³⁴² 15 U.S.C. 78o-7(h)(3)(A) (emphasis added). See also section 15E(q)(2)(F) .

³⁴³ Section 15(E)(q)(2)(F) provides that the Commission’s rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument). “Sales” and “marketing” are a subparts of “business activities.”

Commission is modifying the proposal to add a second prong to the absolute prohibition. Under the second prong, an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also is influenced by sales or marketing considerations.³⁴⁴ Thus, this prong of the absolute prohibition is consistent with the provision of Rule 17g-7 that specifically requires a statement that no part of the rating was “influenced” by business activities.

In connection with making the evaluation necessary for the second prong of the absolute prohibition, the Commission believes there are a number of possible channels of influence that should be considered, such as compensation arrangements that may incentivize analysts to produce inflated credit ratings to increase or retain the NRSRO’s market share, performance evaluation systems that reward analysts who produce inflated credit ratings to increase or retain the NRSRO’s market share, compliance personnel who unduly influence credit analysts to inflate credit ratings in response to complaints by clients, clients such as rated entities who pressure analysts to produce inflated credit ratings to retain their business, or managers who are not involved in sales and marketing activities but may seek to pressure analysts to produce inflated credit ratings to increase or retain the NRSRO’s market share.

In addition, the Commission notes that the sales and marketing prohibition is being added to a comprehensive set of existing requirements that address NRSRO conflicts and, as discussed below, the Commission is adopting additional measures to address conflicts.³⁴⁵ Consequently, the sales and marketing prohibition should not be viewed in isolation but rather as part of a set of

³⁴⁴ See paragraph (c)(8)(ii) of Rule 17g-5.

³⁴⁵ See 15 U.S.C. 78o-7(h); 17 CFR 240.17g-5.

requirements (both statutory and regulatory) pursuant to which NRSROs must disclose and manage conflicts of interest and, in some cases, avoid them altogether. For example, paragraph (b)(1) of Rule 17g-5 identifies the conflict of being paid by issuers or underwriters to determine credit ratings (the issuer-pay conflict), and under paragraph (a)(2) of Rule 17g-5 and section 15E(h)(1) of the Exchange Act, an NRSRO with this conflict must establish, maintain and enforce written policies and procedures reasonably designed to address and manage the conflict.³⁴⁶ An NRSRO that permits a corporate culture in which managers seek to inappropriately influence analysts and the personnel who develop and approve rating procedures and methodologies could not be viewed as having or enforcing policies and procedures reasonably designed to address the issuer-pay conflict and, consequently, this type of conduct would violate section 15E(h)(1) of the Exchange Act and Rule 17g-5.

Further, as discussed below in section II.G.4. of this release, the Commission is adopting a requirement that an NRSRO must attach to the form to accompany certain credit rating actions a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.³⁴⁷ If any of these requirements are not satisfied, such person would not be able to truthfully make this attestation.

The Commission made another modification to the proposal in response to a comment suggesting that the text of the amendment be revised to reference the “products or services of the

³⁴⁶ See 15 U.S.C. 78o-7(h); 17 CFR 240.17g-5.

³⁴⁷ See paragraph (a)(1)(iii) of Rule 17g-7.

NRSRO's affiliated entities" in place of the proposed reference to a "product or service of a person associated with the [NRSRO]."³⁴⁸ A "person associated" with the NRSRO includes natural persons.³⁴⁹ The commenter stated that, as proposed, the amendment could preclude a natural person from participating in the credit rating process "if he or she operates a completely different business (such as a photography studio on the side)."³⁵⁰ This would be an overly broad application of the amendment, as it is designed to prevent sales and marketing of products and services of the NRSRO or its affiliated companies from influencing the credit rating process. Consequently, the final amendment has been modified from the proposal to apply to products and services of the affiliates of the NRSRO (rather than persons associated with the NRSRO).³⁵¹ However, the Commission notes that outside businesses of employees can raise potential conflicts.³⁵² Consequently, pursuant to section 15E(h)(1) of the Exchange Act and Rule 17g-5, an NRSRO must have policies, procedures, and controls to address employees engaging in outside businesses if the NRSRO permits employees to operate outside businesses.³⁵³

Two commenters stated that paragraph (c)(8) of Rule 17g-5 may be redundant, given the existing absolute prohibition in paragraph (c)(6) of Rule 17g-5.³⁵⁴ In response, the Commission

³⁴⁸ See DBRS Letter.

³⁴⁹ See 15 U.S.C. 78c(a)(63).

³⁵⁰ See DBRS Letter.

³⁵¹ See paragraph (c)(8) of Rule 17g-5.

³⁵² For example, an analyst operating an outside business could seek to solicit business from persons employed by an obligor that the analyst rates or an issuer of securities the analyst rates.

³⁵³ See 15 U.S.C. 78o-7(h)(1) (requiring each NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of the NRSRO and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business); 17 CFR 240.17g-5 (prohibiting NRSROs from having conflicts of interest unless they disclose and manage the conflicts or, in some cases, absolutely prohibiting the conflict).

³⁵⁴ See DBRS Letter; Kroll Letter. Under paragraph (c)(6) of Rule 17g-5, an NRSRO is prohibited from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.

believes it is appropriate to retain paragraph (c)(6) because it complements paragraph (c)(8) of Rule 17g-5, as adopted. In particular, paragraph (c)(6) of Rule 17g-5 addresses the conflict that arises when persons within an NRSRO involved in determining credit ratings or developing or approving rating methodologies also negotiate, discuss, or arrange the fees paid for determining credit ratings.³⁵⁵ Thus, it focuses on preventing persons within the NRSRO responsible for credit analysis from being influenced by business considerations (for example, issuing ratings favorable to a client with whom they negotiated a substantial fee). Paragraph (c)(8) of Rule 17g-5, as adopted, addresses the conflict that arises when persons within an NRSRO involved in sales and marketing activities also participate in determining credit ratings or developing or approving rating procedures and methodologies. Thus, it focuses on preventing the persons within the NRSRO responsible for generating business for the NRSRO from influencing the work of the persons responsible for credit analysis (for example, pressuring them to develop rating procedures and methodologies that favor the NRSRO's clients or prospective clients).

Finally, several commenters stated that the proposed amendment would negatively impact smaller NRSROs.³⁵⁶ As discussed below, the final amendments to Rule 17g-5 provide a mechanism for small NRSROs to apply for an exemption from the absolute prohibition.³⁵⁷ Under the final amendment, the Commission may grant an exemption if it finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the

³⁵⁵ See Summary Report of Issues Identified in the Commission Staff's Examination of Select Credit Rating Agencies, p. 25 ("there were indications that analysts were involved in fee discussions with employees of the rating agency's billing department").

³⁵⁶ See A.M. Best Letter; Kroll Letter.

³⁵⁷ See paragraph (f) of Rule 17g-5.

production of credit ratings from sales and marketing activities and such exemption is in the public interest.³⁵⁸

For all of the reasons discussed above, the Commission is adopting the amendment with the modifications discussed above. Moreover, for those reasons, the Commission is not persuaded that it is necessary to re-propose the rule as suggested by one commenter.³⁵⁹ However, the Commission may consider further rulemaking to address conflicts of interest inherent in the NRSRO industry as appropriate and as circumstances warrant.

2. Exemption for “Small” NRSROs

Section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission’s rules under section 15E(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.³⁶⁰ To implement this provision, the Commission proposed to amend Rule 17g-5 by adding paragraph (f).³⁶¹ As proposed, paragraph (f) would provide a mechanism for a small NRSRO to apply in writing for an exemption from the absolute prohibition that would be established by adding paragraph (c)(8) to Rule 17g-5.³⁶² In particular,

³⁵⁸ Id.

³⁵⁹ See CFA II Letter (recommending that the Commission re-propose the rule).

³⁶⁰ See 15 U.S.C. 78o-7(h)(3)(B)(i).

³⁶¹ See paragraph (f) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33426-33427.

³⁶² See paragraph (f) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540. Section 36 of the Exchange Act provides that the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. 17 U.S.C. 78mm. Consequently, an NRSRO could request to be exempt from the sales and marketing prohibition pursuant to this more general authority in section 36. The Commission has established rules providing mechanisms for registrants – such as broker-dealers – to request an exemption from specific rule requirements. See, e.g., 17 CFR 240.15c3-1(b)(3); 17 CFR 240.15c3-3(k)(3); 17 CFR 240.17a-5(m)(3). The proposed amendment was modeled after these provisions. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

the proposed amendment provided that upon written application by an NRSRO, the Commission may exempt, either conditionally or unconditionally or on specified terms and conditions, such NRSRO from the provisions of paragraph (c)(8) of Rule 17g-5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.³⁶³

The Commission stated in the proposing release that in some cases the small size of an NRSRO could make a complete separation of the sales and marketing function from the credit rating analytical function inappropriate.³⁶⁴ For example, the NRSRO may not have enough staff (or the resources to hire additional staff) to establish separate functions.³⁶⁵ In this case, the Commission stated that it would entertain requests for relief, although it may impose conditions designed to preserve as much of the separation between these two functions as possible.³⁶⁶

The Commission is adding paragraph (f) to Rule 17g-5 substantially as proposed, but with a technical modification to the rule text in response to comments.³⁶⁷ In particular, the final amendment provides that, upon written application by an NRSRO, the Commission may exempt, either unconditionally or on specified terms and conditions, such NRSRO from the provisions of paragraph (c)(8) of Rule 17g-5 if the Commission finds that due to the small size of the NRSRO

³⁶³ See paragraph (f) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

³⁶⁴ Nationally Recognized Statistical Rating Organizations, 76 FR at 33427.

³⁶⁵ Id.

³⁶⁶ Id.

³⁶⁷ See paragraph (f) of Rule 17g-5. The Commission is modifying the proposal to remove redundant text, as suggested by a commenter. See DBRS Letter. The Commission originally proposed that “[u]pon written application by a [NRSRO], the Commission may exempt, either conditionally or unconditionally or on specified terms and conditions, such [NRSRO] from the provisions of paragraph (c)(8) of [Rule 17g-5].” The modification removes the phrase “conditionally or” as it is redundant of the phrase “on specified terms and conditions.” See paragraph (f) of Rule 17g-5.

it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.³⁶⁸

Several commenters expressed support for the objective of the proposed amendment.³⁶⁹ Supporters argued that it could be difficult for smaller NRSROs to maintain the strict separation of sales and marketing activities from the production of credit ratings, as would be required under paragraph (c)(8) of Rule 17g-5, as proposed.³⁷⁰ In contrast, several commenters expressed concerns with the proposed amendment, generally arguing that the proposed amendment should be narrowed or eliminated altogether because the size of an NRSRO does not affect whether the potential conflict could influence a credit rating.³⁷¹ For example, one of these commenters stated that “if a credit rating agency is too small to separate its rating process from its marketing process, it should not qualify as an NRSRO.”³⁷²

In response to concerns about providing for exemptions for small NRSROs, the Commission notes that section 15E(h)(3)(B)(i) of the Exchange Act provides that the Commission’s rules issued under section 15E(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate.³⁷³ The final amendment implements this statutory requirement but in a manner that will require the Commission to make a specific finding before granting an exemption; namely, that due to the small size of the

³⁶⁸ See paragraph (f) of Rule 17g-5.

³⁶⁹ See A.M. Best Letter; CFA/AFR Letter; DBRS Letter; Kroll Letter; Morningstar Letter; TradeMetrics Letter.

³⁷⁰ See CFA/AFR Letter; TradeMetrics Letter.

³⁷¹ See AFSCME Letter; Barnard Letter; Better Markets Letter; Levin Letter; S&P Letter.

³⁷² See Levin Letter.

³⁷³ See 15 U.S.C. 78o-7(h)(3)(B)(i) (emphasis added).

NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.³⁷⁴

The Commission considered the concerns expressed by commenters about granting any relief to small NRSROs in considering whether to adopt a self-executing exemption, which was suggested by a commenter.³⁷⁵ Under the final amendment, exemptions will be granted on a case-by-case basis, after analyzing the facts and circumstances the applying NRSRO presents in its request for relief and any other relevant facts and circumstances. Any exemptive relief granted can be tailored to the specific circumstances of the NRSRO and can include specific terms and conditions designed to mitigate the sales and marketing conflict and help ensure that any relief that may be provided to a small NRSRO does not undermine the overarching purpose of section of 15E(h)(3)(A) of the Exchange Act. The ability to tailor exemptive relief on a case-by-case basis will allow the Commission the flexibility to specify conditions that address the conflict in a way that takes into account the specific circumstances of the NRSRO requesting the relief (including its size, business model, and the steps it has taken to mitigate sales and marketing conflicts). For these reasons, the Commission does not believe it would be appropriate to establish a self-executing exemption.

Commenters addressed various aspects of potential exemption orders the Commission might grant under the proposed amendment. For example, several NRSROs commented on how the Commission should determine “small” for purposes of granting exemptions.³⁷⁶ Two commenters stated that all NRSROs that are smaller than the three largest NRSROs should be

³⁷⁴ See paragraph (f) of Rule 17g-5.

³⁷⁵ See Kroll Letter.

³⁷⁶ See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter; S&P Letter.

considered small.³⁷⁷ Three commenters suggested that annual revenue should be the metric for determining if an NRSRO is small.³⁷⁸ Two commenters stated that the Commission should make the size determination on a case-by-case basis,³⁷⁹ while one commenter suggested a self-executing exemption under which an NRSRO would be automatically exempt if its total revenue falls below a certain threshold.³⁸⁰ On the other hand, one opponent of the proposal stated that revenue is not an appropriate measure for granting an exemption and suggested, if the Commission proceeds with an exemption, that it be based on other metrics.³⁸¹

Commenters also addressed the duration of an exemption.³⁸² One supporter of granting exemptions under the proposal suggested that the Commission periodically re-evaluate whether the NRSRO continued to be small and provide it with a transition period in the event the Commission determines it is no longer small.³⁸³ Another commenter, opposing the proposal, suggested that if the Commission does grant an exemption, it should be very limited, and that if the Commission later determines the NRSRO is not small, it should have only a short transition period.³⁸⁴ This commenter added that an exempted NRSRO should have to publicly disclose the rules from which it is exempt.³⁸⁵

³⁷⁷ See A.M. Best Letter; Morningstar Letter (requesting that the Commission consider defining smaller NRSROs as it did in the proposing release for purposes of the Regulatory Flexibility Act).

³⁷⁸ See A.M. Best Letter (suggesting a \$250 million revenue threshold); Kroll Letter (suggesting a \$100 million revenue threshold); Morningstar Letter.

³⁷⁹ See A.M. Best Letter; DBRS Letter.

³⁸⁰ See Kroll Letter.

³⁸¹ See S&P Letter ("Other metrics, such as the number of personnel, or number of ratings issued in a practice area, may provide a more meaningful metric for the granting of any exemption").

³⁸² See Morningstar Letter; S&P Letter.

³⁸³ See Morningstar Letter.

³⁸⁴ See S&P Letter.

³⁸⁵ Id.

Several commenters addressed the conditions that should be part of an exemption order under the proposal.³⁸⁶ Some stated that even if an NRSRO is exempt, the amendments to Rule 17g-5 should make clear that NRSROs remain subject to the overarching prohibition against allowing sales and marketing considerations to influence credit ratings.³⁸⁷ Two commenters suggested that any exemption should be contingent upon the NRSRO adhering to certain requirements.³⁸⁸ Another commenter suggested that any NRSRO that is granted an exemption under the proposal should be required to indicate on the homepage of its website that it is a recipient of the exemption.³⁸⁹ One commenter that opposed the proposed exemption identified additional conditions the Commission should consider if it adopts the proposal.³⁹⁰

In making its finding for purposes of determining whether to grant an exemption, the Commission will evaluate the particular facts and circumstances of the application. In addition, the Commission may specify conditions designed to mitigate the sales and marketing conflict without imposing an absolute prohibition. Although the Commission is not modifying the exemption process from the proposal, suggestions by commenters may be helpful to the Commission in undertaking the analysis of whether a particular NRSRO should be considered “small” and in considering how to tailor the exemptive relief to mitigate the sales and marketing conflict.

³⁸⁶ See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; Fitch Letter; S&P Letter.

³⁸⁷ See Better Markets Letter; CFA/AFR Letter.

³⁸⁸ See AFSCME Letter (suggesting that the NRSRO should submit a detailed explanation of why it should be exempt and “concrete evidence, not just assertions” to support its claims that it cannot function under the requirement); CFA/AFR Letter (suggesting that the application should include a section on what steps the NRSRO is taking to ensure sales and marketing considerations do not influence rating decisions).

³⁸⁹ See Fitch Letter.

³⁹⁰ See S&P Letter (suggesting that the Commission should “specify the terms of the activities permitted and require that the NRSRO have policies to address the potential conflict, that the policies be transparent, and that compliance of the policies be well documented.”).

3. Suspending or Revoking a Registration

Section 15E(h)(3)(B)(ii) of the Exchange Act provides that the Commission's rules under section 15E(h) of the Exchange Act shall provide for suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that the NRSRO has committed a violation of "a rule issued under this subsection" and the violation of the rule affected a credit rating.³⁹¹ While section 15E(h)(3)(A) relates only to the conflict arising from sales and marketing activities, section 15E(h)(3)(B)(ii) – by using the term "subsection" – has a broader scope in that it refers to all rules issued under section 15E(h) of the Exchange Act. Consequently, the proposed amendment implementing section 15E(h)(3)(B)(ii) addressed violations of any rule adopted under section 15E(h). Section 15E(h)(3)(B)(ii) does not require that the violation of the rule under section 15E(h) be "willful."

Currently, the Commission can seek to suspend or revoke the registration of an NRSRO, in addition to other potential sanctions, under section 15E(d) of the Exchange Act.³⁹² In particular, section 15E(d) provides that the Commission shall, by order, censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of an NRSRO if the Commission finds, "on the record after notice and opportunity for a hearing," that such sanction is "necessary for the protection of investors and in the public interest" and the NRSRO, or a person associated with the NRSRO (whether prior to or subsequent to becoming so associated), has engaged in one or more of six categories of conduct specified in sections 15E(d)(1)(A) through (F) of the Exchange Act.³⁹³ Section 15E(d)(1)(A) specifies the first category of conduct: that the NRSRO or an associated

³⁹¹ See 15 U.S.C. 78o-7(h)(3)(B)(ii).

³⁹² See 15 U.S.C. 78o-7(d).

³⁹³ See 15 U.S.C. 78o-7(d)(1)(A) through (F).

person has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Exchange Act; has been convicted of any offense identified in section 15(b)(4)(B) of the Exchange Act; or has been enjoined from any action, conduct, or practice identified in section 15(b)(4)(C) of the Exchange Act.³⁹⁴ The acts enumerated in section 15(b)(4)(D) of the Exchange Act include that the person has willfully violated any provision of the Exchange Act or the rules or regulations under the Exchange Act.³⁹⁵ Therefore, the Commission has the authority, if it makes the finding under section 15E(d)(1)(A), to suspend or revoke the registration of an NRSRO for a willful violation of Rule 17g-5, but does not have the authority to do so under section 15E(d)(1)(A) for violations of Rule 17g-5 that are not willful.³⁹⁶

In addition to proceedings under section 15E(d)(1) of the Exchange Act, the Commission can take action under section 15E(d)(2).³⁹⁷ This section provides that the Commission may temporarily suspend or permanently revoke the registration of an NRSRO with respect to a particular class or subclass of securities, if the Commission finds, on the record after notice and

³⁹⁴ See 15 U.S.C. 78o-7(d)(1)(A); see also 15 U.S.C. 78o(b)(4)(A), (B), (C), (D), (E), (G), and (H). Section 15E(d)(1)(B) specifies the second category of conduct: that the NRSRO or an associated person has been convicted during the ten-year period preceding the date on which an application for registration is filed with the Commission, or at any time thereafter, of: (1) any crime that is punishable by imprisonment for one or more years, and that is not described in section 15(b)(4)(B); or (2) a substantially equivalent crime by a foreign court of competent jurisdiction. See 15 U.S.C. 78o-7(d)(1)(B). Section 15E(d)(1)(C) specifies the third category of conduct: that the NRSRO or an associated person is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. See 15 U.S.C. 78o-7(d)(1)(C). Section 15E(d)(1)(D) specifies the fourth category of conduct: that the NRSRO or an associated person fails to file the annual certification required under section 15E(b)(2) of the Exchange Act. See 15 U.S.C. 78o-7(d)(1)(D). Section 15E(d)(1)(E) specifies the fifth category of conduct: that the NRSRO or an associated person fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity. See 15 U.S.C. 78o-7(d)(1)(E). Finally, section 15E(d)(1)(F) specifies the sixth category of conduct: that the NRSRO or an associated person has failed reasonably to supervise, with a view to preventing a violation of the securities laws, an individual who commits such a violation, if the individual is subject to the supervision of that person. See 15 U.S.C. 78o-7(d)(1)(F).

³⁹⁵ See 15 U.S.C. 78o(b)(4)(D).

³⁹⁶ See 15 U.S.C. 78o-7(d)(1)(A); 15 U.S.C. 78o(b)(4)(D).

³⁹⁷ See 15 U.S.C. 78o-7(d)(2).

opportunity for a hearing, that the NRSRO does not have adequate financial and managerial resources to consistently produce credit ratings with integrity.³⁹⁸ Furthermore, section 21C of the Exchange Act provides the Commission with authority, among other things, to enter an order requiring, among other things, that a person cease and desist from continuing to violate, or future violations of, a provision of the Exchange Act or any rule or regulation thereunder.³⁹⁹

In the proposing release, the Commission stated its preliminary belief that a rule implementing section 15E(h)(3)(B)(ii) of the Exchange Act should work in conjunction with sections 15E(d) and 21C of the Exchange Act.⁴⁰⁰ Consequently, the Commission proposed adding paragraph (g) to Rule 17g-5.⁴⁰¹ This paragraph provided that in a proceeding pursuant to section 15E(d) or section 21C of the Exchange Act, the Commission shall suspend or revoke the registration of an NRSRO if the Commission finds in such proceeding that the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act, the violation affected a credit rating, and that suspension or revocation is necessary for the protection of investors and in the public interest.⁴⁰² This provision was proposed to be placed in Rule 17g-5, given that it is the predominant rule issued under section 15E(h) of the Exchange Act.⁴⁰³

³⁹⁸ See 15 U.S.C. 78o-7(d)(2)(A). Section 15E(d)(2)(B) provides that, in making any determination under section 15E(d)(2)(A), the Commission shall consider whether the NRSRO has failed over a sustained period of time, as determined by the Commission, to produce ratings that are accurate for that class or subclass of securities and such other factors as the Commission may determine. See 15 U.S.C. 78o-7(d)(2)(B).

³⁹⁹ See 15 U.S.C. 78u-3.

⁴⁰⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33428. See also 15 U.S.C. 78o-7(d); 15 U.S.C. 78u-3.

⁴⁰¹ See paragraph (g) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33427-33428.

⁴⁰² See paragraph (g) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540. See also 15 U.S.C. 78o-7(d); 15 U.S.C. 78o-7(h); 15 U.S.C. 78u-3.

⁴⁰³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33428. See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33595-33599; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6465-6469; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63842-

The first two findings in the proposed amendment mirrored the text of section 15E(h)(3)(B)(ii) of the Exchange Act.⁴⁰⁴ The final finding – that the suspension or revocation is necessary for the protection of investors and in the public interest – is a common finding that the Commission must make to take disciplinary action against a registered person or entity.⁴⁰⁵ It is not, however, a finding that the Commission must make in a proceeding under section 21C.⁴⁰⁶ Further, unlike section 15E(d) of the Exchange Act, the Commission can take action under section 21C for violations of the securities laws even if the violations are not willful.⁴⁰⁷ Moreover, section 15E(h)(3)(B)(ii) of the Exchange Act does not prescribe the maximum amount of time for which an NRSRO could be suspended, whereas section 15E(d) provides that a suspension shall not exceed twelve months.⁴⁰⁸ Consequently, a proceeding pursuant to paragraph (g) of Rule 17g-5 brought under section 21C could result in a suspension that exceeds twelve months. Given that section 21C of the Exchange Act has a lower threshold for intent to establish a violation, and given the substantial consequences of suspending or revoking a registration, the Commission stated a preliminary belief in the proposing release that the public interest finding would be an appropriate predicate to a suspension or revocation of an NRSRO's registration under section 21C of the Exchange Act.⁴⁰⁹

Two commenters addressed whether the Commission should adopt, pursuant to section 15E(h)(3)(B)(ii) of the Exchange Act, an independent and alternative process for suspending or

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⁴⁰⁴ See paragraph (g) of Rule 17g-5, as proposed; 15 U.S.C. 78o-7(h)(3)(B)(ii)(I) and (II).

⁴⁰⁵ See paragraph (g) of Rule 17g-5, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540. For example, the Commission must make this finding to take action under section 15E(d) of the Exchange Act. See 15 U.S.C. 78o-7(d).

⁴⁰⁶ See 15 U.S.C. 78u-3.

⁴⁰⁷ Compare 15 U.S.C. 78o-7(d), with 15 U.S.C. 78u-3.

⁴⁰⁸ Compare 15 U.S.C. 78o-7(h)(3)(B)(ii), with 15 U.S.C. 78o-7(d).

⁴⁰⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33428.

revoking an NRSRO's registration beyond the processes set forth in sections 15E(d) and 21C of the Exchange Act.⁴¹⁰ Both commenters agreed with the Commission's proposal that the processes for suspension or revocation currently available under the Exchange Act are sufficient.⁴¹¹ One commenter stated that section 15E(h)(3)(B)(iii) of the Exchange Act should work in conjunction with proceedings already available under sections 15E(d) and 21C of the Exchange Act.⁴¹² Similarly, a second commenter stated that proceedings currently available under the Exchange Act are adequate and that no alternative process is necessary, but stated that if the Commission does implement a separate process, there should be certain prerequisites to its decision to suspend or revoke a registration.⁴¹³

The Commission is persuaded that it is appropriate to adopt an amendment to Rule 17g-5 that incorporates the statutory provisions governing the suspension or revocation of an NRSRO's registration (rather than a stand-alone rule). Consequently, the Commission is incorporating the statutory provisions into paragraph (g) of Rule 17g-5, as proposed, but with modifications from the proposal.⁴¹⁴ Two commenters stated that the proposed rule should incorporate only section 15E(d) of the Exchange Act in response to the Commission's requests for comment on whether the amendment should incorporate section 15E(d) and section 21C.⁴¹⁵ One of these commenters added that the section 21C standard is "too low and its consequences too high" and is therefore inappropriate to use in considering suspension or revocation of an NRSRO's registration.⁴¹⁶ The

⁴¹⁰ See Morningstar Letter; S&P Letter.

⁴¹¹ See Morningstar Letter; S&P Letter.

⁴¹² See Morningstar Letter.

⁴¹³ See S&P Letter.

⁴¹⁴ The Commission is making one technical modification to the proposal by adding the word "credit" before the word "rating." See paragraph (g) of Rule 17g-5.

⁴¹⁵ See A.M. Best Letter; S&P Letter.

⁴¹⁶ See A.M. Best Letter (stating that the process under section 21C is inappropriate because it has no

other commenter stated that authority under section 15E(d) is “adequate,” making it unnecessary for the Commission to incorporate section 21C into the rule, and that not all of the provisions of section 21C are applicable to NRSROs.⁴¹⁷

The Commission believes that it is not necessary to incorporate section 21C of the Exchange Act into the provision governing the suspension or revocation of an NRSRO’s registration for violating a rule issued under section 15E(h) of the Exchange Act, but not for the reasons stated by the commenters. The Commission believes the rule can be modified in a way that achieves one objective of the proposal – providing for the suspension or revocation of the registration of an NRSRO for violations that are not willful – without incorporating section 21C. Instead, the rule can be modified from the proposal so that it includes a finding that the Commission must make in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F) of the Exchange Act. As discussed above, the finding specified in section 15E(d)(1)(A) is that the NRSRO or an associated person committed or omitted any act, or has been subject to an order or finding, enumerated in section 15(b)(4)(D) of the Exchange Act, among other sections.⁴¹⁸ The acts enumerated in section 15(b)(4)(D) of the Exchange Act include that the person has willfully violated any provision of the Exchange Act or the rules or regulations under the Exchange Act.⁴¹⁹ Therefore, the Commission has the authority, if it makes a finding under section 15E(d)(1)(A) of the Exchange Act, to suspend or revoke the registration of an NRSRO for a

requirement of a public interest finding and provides no suspension limits).

⁴¹⁷ See S&P Letter (stating that certain provisions of section 21C are applicable to brokers, dealers, and investment advisors, among others, but not to NRSROs).

⁴¹⁸ See 15 U.S.C. 78o-7(d)(1)(A). See also 15 U.S.C. 78o(b)(4)(A), (B), (C), (D), (E), (G), and (H).

⁴¹⁹ See 15 U.S.C. 78o(b)(4)(D).

violation of Rule 17g-5, but only if the violation is willful.⁴²⁰ The alternative finding does not require a finding that the violation was willful, and the Commission can therefore suspend or revoke the registration of an NRSRO using this alternative without a finding of willfulness and without the need to institute the proceeding under section 21C.

For these reasons, the Commission is modifying the rule from the proposal to establish a finding that must be made in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F).⁴²¹ In particular, paragraph (g) of Rule 17g-5, as adopted, provides that in a proceeding pursuant to section 15E(d)(1) of the Exchange Act, the Commission shall suspend or revoke the registration of an NRSRO if the Commission finds, in lieu of a finding required under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F) of the Exchange Act, that the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act (for example, Rule 17g-5) and that the violation affected a credit rating.⁴²²

The alternative finding includes the first two prongs of the proposed finding: (1) that the NRSRO has violated a rule issued under section 15E(h) of the Exchange Act; and (2) that the violation affected a credit rating. As discussed above and in the proposing release, these two prongs of the finding mirror the text of section 15E(h)(3)(B)(ii) of the Exchange Act.⁴²³ In addition, the alternative finding must be made in the context of a proceeding under section

⁴²⁰ See 15 U.S.C. 78o-7(d)(1)(A); 15 U.S.C. 78o(b)(4)(D).

⁴²¹ The Commission does not intend the final amendment to affect in any manner the Commission's ability to suspend or revoke the registration of an NRSRO under section 15E(d)(1) of the Exchange Act based upon a finding specified under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F).

⁴²² See paragraph (g) of Rule 17g-5.

⁴²³ 15 U.S.C. 78o-7(h)(3)(B)(ii) (providing that the Commission's rules under section 15E(h) of the Exchange Act shall provide for suspension or revocation of the registration of an NRSRO if the Commission finds, on the record, after notice and opportunity for a hearing, that the NRSRO has committed a violation of "a rule issued under this subsection" and the violation of the rule affected a credit rating).

15E(d)(1). Consequently, the Commission must find, “on the record after notice and opportunity for a hearing,” that suspension or revocation is “necessary for the protection of investors and in the public interest.”⁴²⁴ In this way, the alternative finding also incorporates the public interest finding that was part of the proposed finding, which the Commission continues to believe is appropriate given the severity of the sanction of suspending or revoking an NRSRO’s registration.⁴²⁵

The final amendment – because it incorporates section 15E(d) only – is different from the proposed amendment in that the Commission is limited to suspending a registration for a period not exceeding twelve months.⁴²⁶ The Commission does not view this as a significant difference. To the extent the Commission believes a credit rating agency should stop operating as an

⁴²⁴ 15 U.S.C. 78o-7(d).

⁴²⁵ A number of commenters addressed whether the Commission should be required to make a public interest finding to suspend or revoke an NRSRO’s registration in a proceeding under proposed paragraph (g) of Rule 17g-5 pursuant to section 21C of the Exchange Act. See AFSCME Letter; A.M. Best Letter; Better Markets Letter; FSR Letter; Morningstar Letter; S&P Letter. Four commenters supported the requirement. See A.M. Best Letter; FSR Letter; Morningstar Letter; S&P Letter. One commenter that supported this aspect of the proposal stated that a public interest finding is necessary “to consider whether, in fact, a violation had any impact on the public.” See A.M. Best Letter. A second commenter added that a public interest finding is appropriate because a sanction of suspension or revocation is significant and that NRSROs play an important role in the financial markets. See S&P Letter. In contrast, two commenters opposed the proposed required public interest finding. See AFSCME Letter; Better Markets Letter. One of these commenters stated that the finding could make it more difficult for the Commission to sanction an NRSRO, and that it provides NRSROs with additional defenses to potential sanctions. See Better Markets Letter. The other commenter suggested that the standard be changed from “necessary for the protection of investors and in the public interest” to “consistent with the public interest” to give the Commission more flexibility in the enforcement remedy. See AFSCME Letter. Both commenters suggested the increased threshold in the proposal to suspend or revoke an NRSRO’s registration was not the intent of Congress. See AFSCME Letter; Better Markets Letter. In response to these comments, the Commission believes – as indicated above – that the public interest finding is appropriate given the severity of the sanctions. In response to the commenter that suggested the standard be changed from “necessary for the protection of investors and in the public interest” to “consistent with the public interest” to give the Commission more flexibility in the enforcement remedy, the Commission notes that the standard “necessary for the protection of investors and in the public interest” is a standard used consistently throughout the Commission’s rules and the Exchange Act. The Commission is not persuaded it is necessary to use a different standard in this instance. Consequently, because the finding required under the final amendment must be made in the context of a proceeding under section 15E(d) of the Exchange Act, the final amendment incorporates the public interest finding in that section.

⁴²⁶ 15 U.S.C. 78o-7(d)(1).

NRSRO for a period longer than twelve months, the Commission can seek to revoke its registration.⁴²⁷

Finally, three commenters addressed the factual predicate necessary to support a finding that the violation affected a credit rating.⁴²⁸ The commenters generally stated that a finding that a rule violation affected a credit rating is only part of the appropriate analysis and is not, by itself, enough to suspend or revoke an NRSRO's registration.⁴²⁹ One commenter added that any suspension or revocation proceeding must "take into account all relevant factors of the particular circumstance at issue."⁴³⁰ The other two commenters recommended additional findings that should be considered in making a determination that a violation of a rule affected a credit rating.⁴³¹ In response, the Commission notes that to suspend or revoke an NRSRO's registration under section 15E(d)(1) of the Exchange Act the Commission must find, among other things, that doing so is necessary for the protection of investors and in the public interest.⁴³² This will

⁴²⁷ Commenters addressed whether the rule should limit the length of a suspension under section 21C of the Exchange Act. See A.M. Best Letter; Morningstar Letter; S&P Letter. Two commented that the ability to suspend the registration of an NRSRO for up to twelve months under section 15E(d) was sufficient and, therefore, a suspension proceeding under section 21C is unnecessary. See A.M. Best Letter; S&P Letter. One commenter stated that there should be a time limit for a suspension under section 21C and, while stating that the twelve month limit under section 15E(d) is sufficient, suggested an alternative approach based on the time horizon of the associated credit rating. See Morningstar Letter (suggesting, as an alternative, that the Commission "could use a multiple of the intended time horizon associated with the rating" as a maximum suspension). As discussed above, the finding required under the final amendment must be made in a proceeding under section 15E(d)(1), which limits suspensions to a period not to exceed twelve months. See 15 U.S.C. 78o-7(d)(1).

⁴²⁸ See A.M. Best Letter; Morningstar Letter; S&P Letter.

⁴²⁹ See A.M. Best Letter; Morningstar Letter; S&P Letter.

⁴³⁰ See A.M. Best Letter.

⁴³¹ See Morningstar Letter (stating that the findings should be "supported by Commission evidence that the undue influence...resulted in the NRSRO issuing a credit rating without conforming to its documented procedures and methodologies and that investors who relied on those ratings were harmed."); S&P Letter (stating that the following factors should be a factual predicate to support the finding that the violation affected a rating: "(i) there was an appropriate attempt to influence the rating decision; (ii) the NRSRO did not adhere in material respects to its applicable policies and procedures; and (iii) the rating decision was not honestly held by the rating committee analysts who voted for it at the time it was issued.").

⁴³² See 15 U.S.C. 78o-7(d)(1).

entail consideration of the particular facts and circumstances of each case in crafting an appropriate remedy.

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments relating to the sales and marketing conflict of interest.⁴³³ The baseline that existed before today's amendments was one in which an NRSRO was not explicitly prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations. However, section 15E(h)(1) of the Exchange Act and Rule 17g-5, thereunder, require NRSROs to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage any conflicts of interest that can arise from the business of the NRSRO.⁴³⁴ In addition, paragraph (c)(6) of Rule 17g-5 prohibits an NRSRO from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models. Rule 17g-6 prohibits an NRSRO from engaging in certain

⁴³³ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

⁴³⁴ See 15 U.S.C. 78o-7(h)(1); 17 CFR 240.17g-5.

unfair, coercive, or abusive practices such as conditioning the issuance of a credit rating on the purchase of other services or products of the NRSRO.⁴³⁵

Relative to this baseline, paragraph (c)(8) of Rule 17g-5, as amended, should result in benefits. For example, the amendment should decrease the probability that undue influences on credit analysts based on sales and marketing considerations could impact the objectivity of an NRSRO's credit rating process.⁴³⁶ Certain academic studies suggest that NRSROs may have engaged in "ratings catering" in which an NRSRO will deliberately inflate a credit rating in order to induce the purchase of the credit rating by the issuer, sponsor, or underwriter of the rated security.⁴³⁷ Involving credit analysts in sales and marketing activities (which are designed to obtain business) could potentially influence them to inappropriately take business considerations into account when determining credit ratings. Such influence may also arise from other channels, such as compensation arrangements that may incentivize analysts to produce inflated credit ratings to increase or retain the NRSRO's market share, performance evaluation systems that reward analysts who produce inflated credit ratings to increase or retain the NRSRO's market share, clients such as rated entities who pressure analysts to produce inflated credit ratings to retain their business, or managers that are not involved in sales and marketing activities but may seek to pressure analysts to produce inflated credit ratings to increase or retain the NRSRO's market share. The two-pronged absolute prohibition is designed to insulate credit

⁴³⁵ See 17 CFR 240.17g-5(c)(6); 17 CFR 240.17g-6(a)(1).

⁴³⁶ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33598-33599, 33613 (discussing objectives and benefits of paragraph (c) of Rule 17g-5 when it was adopted); see also Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6465-6469, 6474-6475 (discussing objectives and benefits of paragraph (c) of Rule 17g-5 when it was amended).

⁴³⁷ See Griffin, Nickerson, and Tang, Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Ratings, Bolton, Freixas, and Shapiro, The Credit Ratings Game.

analysts from sales and marketing concerns and pressures that may arise through any channel. This could enhance the integrity and quality of credit ratings.

Relative to the baseline, paragraph (c)(8) of Rule 17g-5 will result in costs to NRSROs. For example, some NRSROs may incur costs for hiring additional personnel, given the need to separate the analytical and sales and marketing functions. Commenters did not provide data for this specific cost. However, some NRSROs may choose to reallocate responsibilities among existing staff in order to meet the requirement. This cost of hiring additional personnel will likely vary significantly with the size of the NRSRO and the degree of existing separation between analytical staff and sales and marketing personnel.⁴³⁸ NRSROs may also incur costs to make other operational changes, such as changes to communication policies, to ensure that credit analysts are not influenced by sales or marketing considerations from other channels. These incremental costs may vary based on the current operational structure of NRSROs. It is also possible that NRSROs may incur costs related to changes in the compensation arrangements of credit analysts.⁴³⁹

An NRSRO also will incur costs for updating its written policies and procedures to address and manage conflicts of interest required under section 15E(h) of the Exchange Act and Rule 17g-5 and to file with the Commission an update of its registration on Form NRSRO to account for the updated policies and procedures. Based on analysis for purposes of the PRA, the

⁴³⁸ The Commission estimates the cost of hiring an additional credit analyst to be \$55,600 on a one-time basis and \$591,000 per year thereafter (2080 work hours per year x \$284 for a fixed income research analyst (intermediate) = \$591,000; 200 hours x \$278 for a senior human resources representative = \$55,600). The Commission estimates the cost of hiring an additional sales and marketing staff member to be \$55,600 on a one-time basis and \$528,000 per year thereafter (2080 work hours per year x \$254 for a marketing manager = \$528,000; 200 hours x \$278 for a senior human resources representative = \$55,600). The salary figures provided in this release are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for a 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

⁴³⁹ The cost of changes to operational and compensation arrangements have been reflected in the PRA burdens discussed in section IV.D.5. and section IV.D.6. of this release.

Commission estimates that paragraph (c)(8) of Rule 17g-5 will result in total industry-wide one-time costs to NRSROs of approximately \$354,000.⁴⁴⁰

Relative to the baseline, paragraph (f) of Rule 17g-5 will result in costs to NRSROs to the extent they expend resources to draft and submit a written request for an exemption under paragraph (f) of Rule 17g-5. The Commission believes that an NRSRO would likely engage outside counsel to assist in drafting the request. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (f) of Rule 17g-5 will result in costs to NRSROs of approximately \$62,000 per request.⁴⁴¹ However, if a small NRSRO is granted an exemption from the absolute prohibition, it could avoid having to hire additional personnel to undertake sales and marketing activities that were otherwise undertaken by individuals involved in the production of credit ratings.

Relative to the baseline, paragraph (g) of Rule 17g-5 should not result in additional costs to NRSROs. NRSROs already are subject to the remedy of suspension or revocation under section 15E(d) the Exchange Act.

The amendments to Rule 17g-5 also may result in other costs. For example, prohibiting persons within an NRSRO who participate in determining or monitoring the credit ratings, or developing or approving rating procedures or methodologies from participating in sales and marketing activities may diminish the effectiveness of an NRSRO's sales and marketing efforts. For example, the revenues of an NRSRO may decrease if existing sales and marketing staff lack the expertise to communicate technical information about the NRSRO's rating procedures and

⁴⁴⁰ See section V.B. of this release (discussing implementation and annual compliance considerations). The one-time costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

⁴⁴¹ See section V.B. of this release (discussing implementation and annual compliance considerations). The cost per request is determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

methodologies to clients and potential clients. However, as discussed above, the final amendment does not preclude credit analysts from having these discussions with clients as long as the analysts do not discuss commercial matters and are not influenced by, for example, any pressure imposed by clients to produce inflated credit ratings.

The amendments to Rule 17g-5 should have a number of effects related to efficiency, competition, and capital formation.⁴⁴² First, these amendments could improve the quality of credit-related information. As a result, users of credit ratings could make more efficient investment decisions based on this better-quality information. Market efficiency also could improve if this information is reflected in asset prices. Consequently, capital formation could improve as capital may flow to more efficient uses with the benefit of this enhanced information. These amendments also provide for an exemption based on size, which may decrease the burden of these requirements on small NRSROs. However, these amendments could still create adverse effects on competition as exempted NRSROs potentially may be more prone to engage in “ratings catering” and, thereby, obtain more business as a result.⁴⁴³ More specifically, exempted NRSROs may be more likely to produce credit ratings that favor their clients as a result of allowing persons involved in sales and marketing activities to participate in analytical processes.

As explained above, commenters suggested a number of alternatives to the proposed amendments to Rule 17g-5. Several commenters suggested that the amendments be less restrictive. One reasonable alternative suggested by commenters would be for the Commission not to adopt an absolute prohibition but rather to require an NRSRO to disclose and have

⁴⁴² See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

⁴⁴³ As part of its 2012-2013 NRSRO examinations, Commission staff found that four smaller NRSROs did not have sufficient procedures and controls for separating business and analytical functions or for preventing rating analysts from being involved in fee discussions and from having access to rating fee information. See 2013 Annual Staff Inspection Report, pp. 11-12.

procedures to manage the conflict.⁴⁴⁴ This alternative might reduce costs for NRSROs related to, for example, hiring additional personnel. However, as explained above, the absolute prohibition was designed to insulate individuals within the NRSRO responsible for the analytic function from any sales and marketing concerns and pressures. Another less restrictive alternative would be, as proposed, to adopt only the first prong of the prohibition. This alternative may reduce the scope of policies and procedures that an NRSRO may need to revise to ensure compliance with the amendments. However, as discussed above, there are several potential channels through which sales and marketing considerations could influence credit analysts that would not be addressed by the first prong of the prohibition. Any less restrictive alternative may reduce the benefit of improved credit ratings quality if this alternative fails to mitigate conflicts of interest as effectively as the requirements of the final amendment.

One commenter suggested a self-executing exemption where an NRSRO would be automatically exempt if its total revenue falls below a certain threshold.⁴⁴⁵ This alternative would eliminate the need and associated cost for certain NRSROs to apply to the Commission for exemptive relief. However, this alternative would eliminate the flexibility of the Commission to tailor exemptive relief. Under the final amendment, exemptions will be granted on a case-by-case basis, after analyzing the facts and circumstances concerning the NRSRO seeking the relief. Any exemptive relief granted can be tailored to the specific circumstances of the NRSRO requesting the relief and include specific terms and conditions designed to mitigate the sales and marketing conflict. The ability to tailor exemptive relief on a case-by-case basis will allow the Commission the flexibility to specify conditions that address the conflict in a way that takes into account the specific circumstances of the NRSRO requesting the relief (including

⁴⁴⁴ See S&P Letter; TradeMetrics Letter.

⁴⁴⁵ See Kroll Letter.

its size and business model). For this reason, the Commission does not believe it would be appropriate to establish an automatic self-executing exemption.

Commenters also suggested that the rule not require that the Commission make a public interest finding to suspend or revoke an NRSRO's registration for violating a rule issued under section 15E(h) of the Exchange Act, as this would weaken the enforcement remedy.⁴⁴⁶ This alternative might benefit users of credit ratings by improving the quality of credit ratings. In particular, NRSROs may have higher incentives to conform to these requirements as a result of a lower threshold for revoking or suspending their registration. However, this alternative may result in costs for NRSROs by subjecting them to more frequent suspensions and revocations, which could reduce the number of NRSROs producing credit ratings. In addition, as stated above, among other things, the Commission believes that the public interest finding is appropriate given the severity of the sanctions.

C. "LOOK-BACK" REVIEW

Section 932(a)(4) of the Dodd-Frank Act amended section 15E(h) of the Exchange Act to add a paragraph (4).⁴⁴⁷ Section 15E(h)(4)(A) provides that an NRSRO must establish, maintain, and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the NRSRO, or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken with respect to the credit rating, the NRSRO shall: (1) conduct a review (a "look-back review") to determine whether any conflicts of interest of the employee influenced

⁴⁴⁶ See AFSCME Letter; Better Markets Letter.

⁴⁴⁷ See Pub. L. No. 111-203, 932(a)(4); 15 U.S.C. 78o-7(h)(4).

the credit rating;⁴⁴⁸ and (2) take action to revise the credit rating, if appropriate, in accordance with such rules as the Commission shall prescribe.⁴⁴⁹

Section 15E(h)(4)(A) of the Exchange Act contains a self-executing provision requiring an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO will conduct look-back reviews.⁴⁵⁰ The Commission proposed paragraph (c) of new Rule 17g-8 and proposed adding paragraph (a)(9) to Rule 17g-2 to implement rulemaking required in section 15E(h)(4)(A)(ii) of the Exchange Act.⁴⁵¹ The Commission is adopting paragraph (c) of Rule 17g-8, with modifications, and adding paragraph (a)(9) to Rule 17g-2 as proposed.⁴⁵²

1. Paragraph (c) of New Rule 17g-8

As proposed, paragraph (c) of Rule 17g-8 provided that the policies and procedures an NRSRO establishes, maintains, and enforces pursuant to section 15E(h)(4)(A) of the Exchange Act must address instances in which a look-back review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or money market instrument.⁴⁵³

⁴⁴⁸ See 15 U.S.C. 78o-7(h)(4)(A)(i).

⁴⁴⁹ See 15 U.S.C. 78o-7(h)(4)(A)(ii).

⁴⁵⁰ See 15 U.S.C. 78o-7(h)(4)(A)(i).

⁴⁵¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33429-33432.

⁴⁵² See paragraph (c) of Rule 17g-8, and paragraph (a)(9) of Rule 17g-2. In addition, Rule 17g-8 consolidates requirements that NRSROs have policies and procedures in a number of areas. As discussed in section II.F.1. of this release, paragraph (a) of Rule 17g-8 requires an NRSRO to establish policies and procedures with respect to credit rating procedures and methodologies. See paragraph (a) of Rule 17g-8. Further, as discussed in section II.J.1. of this release, paragraph (b) of Rule 17g-8 requires an NRSRO to establish policies and procedures with respect to the use of credit rating symbols, numbers, and scores. See paragraph (b) of Rule 17g-8.

⁴⁵³ See paragraph (c) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

Specifically, paragraph (c)(1) of Rule 17g-8, as proposed, provided that an NRSRO must have procedures reasonably designed to ensure that, upon the NRSRO's discovery that a former employee's conflict influenced a credit rating, it immediately publishes a rating action placing the applicable credit ratings of the obligor, security, or money market instrument on credit watch or review.⁴⁵⁴ Proposed paragraph (c)(1) also provided that the policies and procedures must be reasonably designed to ensure the NRSRO includes the information required by proposed paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7 in the form to accompany a credit rating with the publication of the rating action placing the credit rating on credit watch.⁴⁵⁵ Specifically, paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7, as proposed, would have required the NRSRO to provide in the form published with the rating action an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest and the date and associated credit rating of each prior rating action the NRSRO currently has determined was influenced by the conflict.⁴⁵⁶

Paragraph (c)(2) of Rule 17g-8, as proposed, provided that the NRSRO must have procedures reasonably designed to ensure that it promptly determines whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.⁴⁵⁷ The proposed

⁴⁵⁴ See paragraph (c)(1) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

⁴⁵⁵ See paragraph (c)(1) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

⁴⁵⁶ See paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

⁴⁵⁷ See paragraph (c)(2) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations,

approach was intended to ensure that, as soon as possible, the assigned credit rating will become solely a product of the NRSRO's procedures and methodologies for determining credit ratings (that is, no longer influenced by the conflict).⁴⁵⁸

Paragraph (c)(3) of Rule 17g-8, as proposed, provided that the NRSRO must have procedures reasonably designed to ensure it promptly publishes a revised credit rating, if appropriate, or an affirmation of the credit rating, if appropriate, based on the determination of whether the current credit rating assigned to the obligor, security, or money market instrument must be revised.⁴⁵⁹ Paragraph (c)(3), as proposed, also provided that the NRSRO's procedures must be reasonably designed to ensure that information required pursuant to paragraphs (a)(1)(ii)(J)(3)(ii) and (iii) of Rule 17g-7, as proposed, is included in the form to accompany the publication of a revised credit rating or a credit rating affirmation.⁴⁶⁰ In the case of a revised credit rating, paragraph (a)(1)(ii)(J)(3)(ii) of Rule 17g-7, as proposed, would require the NRSRO to provide in the form an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and an estimate of the impact the conflict had on each such prior rating action.⁴⁶¹ Similarly, in the case of an affirmed credit rating, paragraph (a)(1)(ii)(J)(3)(iii) of Rule 17g-7, as proposed, would require the

76 FR at 33543.

⁴⁵⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33430.

⁴⁵⁹ See paragraphs (c)(3)(i) and (ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

⁴⁶⁰ See paragraphs (c)(3)(i) and (ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543. See also paragraphs (a)(1)(ii)(J)(3)(ii) and (iii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

⁴⁶¹ See paragraph (a)(1)(ii)(J)(3)(ii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

NRSRO to provide an explanation of why no rating action was taken to revise the credit rating notwithstanding the conflict, the date and associated credit rating of each prior rating action the NRSRO has determined was influenced by the conflict, and an estimate of the impact the conflict had on each such prior rating action.⁴⁶²

As discussed in more detail below, the Commission is adopting paragraph (c) of Rule 17g-8, with modifications from the proposal in response to comments.⁴⁶³ The modifications eliminate the requirement to immediately place the credit rating on credit watch or review and make certain technical changes. The Commission is adopting paragraph (a)(1)(ii)(J)(3) of Rule 17g-7 with modifications from the proposal in response to comments.⁴⁶⁴ The modifications eliminate the required disclosure that would have accompanied the placement of the credit rating on credit watch, revise the disclosure requirement with respect to estimating the impact of the conflict, and make certain technical changes.⁴⁶⁵

The Commission is adopting the prefatory language to paragraph (c) of Rule 17g-8 as proposed.⁴⁶⁶ Consequently, the final rule provides, in pertinent part, that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act must address instances in which a review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or money market instrument by including, at a minimum,

⁴⁶² See paragraph (a)(1)(ii)(J)(3)(iii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

⁴⁶³ See paragraph (c) of Rule 17g-8.

⁴⁶⁴ See paragraph (a)(1)(ii)(J)(3) of Rule 17g-7.

⁴⁶⁵ As discussed below in section II.G.1. of this release, the form to accompany a rating action need not be published when a credit rating is put on watch or review.

⁴⁶⁶ See prefatory paragraph (c) of Rule 17g-8.

procedures that are reasonably designed to ensure that the NRSRO will take the steps discussed below.⁴⁶⁷

Two commenters stated that the Commission should define what it means for a conflict of interest to influence a credit rating.⁴⁶⁸ One of these commenters stated that any definition should not require “proof of subjective intent or motivation on the part of the NRSRO employee” since it would be difficult to discern.⁴⁶⁹ On the other hand, two NRSROs stated that the Commission should not provide a definition.⁴⁷⁰ One stated that a finding of influence should only be required “where the NRSRO determines that, absent the conflict, the NRSRO would have issued a different rating” because this is the only “influence” that has “practical consequences for the users of the affected credit rating.”⁴⁷¹ The other NRSRO stated that any definition should “include situations where a primary analyst or voting member of a credit rating committee succeeded in persuading other committee members to agree to a ratings determination that was inconsistent with the NRSRO’s ratings criteria, procedures and methodologies.”⁴⁷²

The Commission does not believe it is necessary at this time to define in the rule what it means to influence a credit rating because the provisions of the rule provide sufficient guidance in this respect. In particular, the rule provides that the NRSRO must determine whether a conflicted credit rating must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to

⁴⁶⁷ See paragraph (c) of Rule 17g-8.

⁴⁶⁸ See AFSCME Letter; Harrington Letter.

⁴⁶⁹ See AFSCME Letter.

⁴⁷⁰ See DBRS Letter; S&P Letter.

⁴⁷¹ See DBRS Letter.

⁴⁷² See S&P Letter.

determine credit ratings.⁴⁷³ Thus, the rule contains a standard that can be used for purposes of making the influence determination required by section 15E(h)(4)(A) of the Exchange Act: namely, whether the credit rating is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings. As one commenter stated, a finding of influence should only be required “where the NRSRO determines that, absent the conflict, the NRSRO would have issued a different rating.”⁴⁷⁴ The Commission believes that this is an appropriate framework for assessing whether a conflict influenced a credit rating under section 15E(h)(4)(A). Moreover, it is consistent with the standard to be used in paragraph (c) of Rule 17g-8, as adopted, for determining whether the credit rating must be revised.⁴⁷⁵

One commenter stated that the rule should require the NRSRO to review whether a conflict influenced the determination of its rating methodologies or procedures.⁴⁷⁶ This suggestion is outside the scope of the proposal. However, section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such NRSRO and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business.⁴⁷⁷ Further, Rule 17g-5, among other things, prohibits an NRSRO from having conflicts of interest unless they are disclosed and managed through policies and procedures.⁴⁷⁸ Thus, the statute and rule cover the conflict that arises when the prospective employment of an NRSRO’s employee influenced a credit rating methodology (as

⁴⁷³ See paragraph (c)(1) of Rule 17g-8.

⁴⁷⁴ See DBRS Letter.

⁴⁷⁵ See paragraph (c)(1) of Rule 17g-8.

⁴⁷⁶ See CFA/AFR Letter.

⁴⁷⁷ See 15 U.S.C. 78o-7(h)(1).

⁴⁷⁸ See also 17 CFR 240.17g-5.

opposed to a credit rating). For these reasons, an NRSRO would need to address the conflict pursuant to section 15E(h)(1) and Rule 17g-5 if it concluded in connection with a look-back review conducted pursuant to section 15E(h)(4)(A) of the Exchange Act that the prospect of future employment inappropriately influenced a credit rating procedure or methodology of the NRSRO.

One commenter stated that the Commission should specify minimum steps that the NRSRO must follow to determine if a former employee's conflict of interest influenced a credit rating because an "NRSRO's initial review" to determine whether a conflict influenced a rating is "at least as important as the process for revising a rating."⁴⁷⁹ One NRSRO stated that the NRSRO should review credit ratings "upon a discovery that they may have been influenced by a conflict" but that convening a new rating committee each time a potential conflict is discovered should not be required because it could impact the timeliness of ratings determinations.⁴⁸⁰

These comments address the self-executing provisions of section 15E(h)(4)(A)(i) of the Exchange Act.⁴⁸¹ The Commission did not propose rules to implement this part of the statute as the statute itself directly prescribes specific requirements for NRSROs.⁴⁸² However, the Commission notes that the statute requires the look-back review policies and procedures to be

⁴⁷⁹ See Better Markets Letter.

⁴⁸⁰ See S&P Letter.

⁴⁸¹ See 15 U.S.C. 78o-7(h)(4)(A)(i) (requiring an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the NRSRO or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken with respect to the credit rating, the NRSRO shall conduct a look-back review to determine whether any conflicts of interest of the employee influenced the credit rating).

⁴⁸² As discussed throughout this section, the Commission is implementing the part of the statute that addresses the steps to be taken if the look-back review determines that a conflict of interest of the employee influenced the credit rating. See 15 U.S.C. 78o-7(h)(4)(A)(ii) (providing that the NRSRO must take action to revise the credit rating, if appropriate, in accordance with such rules as the Commission shall prescribe).

reasonably designed. Consequently, while the Commission is not prescribing by rule how an NRSRO must conduct a look-back review, an NRSRO must establish, maintain, and enforce policies and procedures that are reasonably designed to achieve the objectives set forth in the statute.

A number of commenters addressed proposed paragraph (c)(1) of Rule 17g-8, which would have required NRSROs to immediately publish a rating action placing applicable credit ratings on credit watch or review based on the discovery that a former employee's conflict influenced a credit rating.⁴⁸³ Several commenters, including NRSROs, stated that the proposed requirements may cause volatility, confusion, or disruption in the market,⁴⁸⁴ and one NRSRO stated that the placement of credit ratings on credit watch may force investment managers to sell securities, pursuant to investment guidelines.⁴⁸⁵ Two NRSROs stated that the NRSRO should be allowed to determine whether and when to place a credit rating on credit watch, in accordance with its analytical criteria and procedures.⁴⁸⁶ One of these NRSROs stated that mandating that the NRSRO place a credit rating on credit watch may impact the timeliness of credit rating determinations and may constitute regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in violation of section 15E(c)(2) of the Exchange Act.⁴⁸⁷ Another NRSRO suggested that the Commission "provide a timeframe for the NRSRO to revise and affirm the rating when a conflict arises" before requiring

⁴⁸³ See A.M. Best Letter; AFSCME Letter; DBRS Letter; FSR Letter; Moody's Letter; Morningstar Letter; S&P Letter.

⁴⁸⁴ See A.M. Best Letter; DBRS Letter; FSR Letter; Morningstar Letter; S&P Letter.

⁴⁸⁵ See S&P Letter.

⁴⁸⁶ See DBRS Letter; S&P Letter.

⁴⁸⁷ See S&P Letter.

it to place the credit rating on credit watch.⁴⁸⁸ Several commenters stated that a credit rating should be placed on credit watch only after the NRSRO determines that a conflict of interest has influenced the credit rating.⁴⁸⁹

The Commission is persuaded that the proposed requirement to immediately place the credit rating on watch or review could lead to potential market disruption and confusion, possibly harming investors and issuers, at a time when it is not clear that the credit rating will be changed. However, the Commission also believes that investors and other users of an NRSRO's credit ratings should be notified that a prior credit rating was influenced by a conflict of interest within a reasonable period of time. As discussed below, an NRSRO must promptly determine whether the credit rating must be revised or affirmed and promptly revise or affirm the credit rating and include with the publication of the rating action revising or affirming the credit rating information about the existence of the conflict. In most cases, this process should provide investors and other users of the NRSRO's credit ratings with notice of the existence of the conflict in a timely manner.

However, if there is a delay in publishing the revised or affirmed credit rating, the Commission believes the NRSRO should provide notice of the existence of the conflict of interest through another means. Accordingly, paragraph (c) of Rule 17g-8, as adopted, has been modified to eliminate the requirement to immediately place credit ratings on credit watch or review based on the discovery of the conflict.⁴⁹⁰ Instead, the rule provides that the NRSRO must

⁴⁸⁸ See Morningstar Letter.

⁴⁸⁹ See A.M. Best Letter; AFSCME Letter; DBRS Letter; FSR Letter; Moody's Letter; S&P Letter. The rule, as proposed, required the NRSRO to place the credit rating on watch only after the NRSRO determined based on a look-back review that the credit rating was influenced by the conflict of interest.

⁴⁹⁰ The rule, as adopted, does not preclude an NRSRO from immediately placing credit ratings on credit watch or review based on the discovery of a conflict if such action is in accordance with the NRSRO's policies and procedures.

place the credit rating on watch or review if the credit rating is not revised or affirmed in accordance with the rule within fifteen calendar days of the date of the discovery that the credit rating was influenced by a conflict of interest.⁴⁹¹ This is designed to provide notice to users of the NRSRO's credit ratings of the existence of the conflict in a case where the NRSRO delays publishing a revision or affirmation of the credit rating. However, by prescribing a deadline of fifteen calendar days, the Commission is not suggesting that an NRSRO can meet its obligation to promptly revise or affirm a credit rating by waiting fifteen calendar days. As discussed below, an NRSRO must promptly revise or affirm the credit rating. The question of whether an NRSRO has met this standard will depend on the facts and circumstances.

Consistent with modifications to Rule 17g-7 discussed below in section II.G.1. of this release, the Commission is eliminating the related disclosure requirement in proposed paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7 that would need to have been made when the credit rating is put on watch or review.⁴⁹² Instead, paragraph (c)(2)(ii) of Rule 17g-8 provides that, if an NRSRO is required to place the credit rating on watch or review because it did not revise or affirm the credit rating within fifteen calendar days, the NRSRO must include with the publication an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest.

The Commission is adopting the requirement in proposed paragraph (c)(2) of Rule 17g-8 substantially as proposed, but is redesignating it as paragraph (c)(1) of Rule 17g-8.⁴⁹³ As

⁴⁹¹ See paragraph (c)(2)(ii) of Rule 17g-8. See also Morningstar Letter (suggesting that the Commission "provide a timeframe for the NRSRO to revise and affirm the rating when a conflict arises" before requiring it to place the credit rating on credit watch).

⁴⁹² As discussed below in section II.G.1. of this release, the Commission is eliminating the requirement to publish the form containing the required information about the rating action when an NRSRO places a credit rating on watch or review.

⁴⁹³ See paragraph (c)(1) of Rule 17g-8. The final rule modifies the proposal by re-designating paragraph (c)(2) as paragraph (c)(1) because the requirement to place a credit rating on credit watch, which would have been

adopted, the final rule requires that the NRSRO's policies and procedures under section 15E(h)(4)(A) of the Exchange Act be reasonably designed to ensure that the NRSRO will promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it is no longer influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.⁴⁹⁴

In the proposing release, the Commission asked whether the rule should be more prescriptive in terms of how an NRSRO would be required to determine whether to revise a credit rating by, for example, requiring an NRSRO to apply a de novo review of the rated obligor, security, or money market instrument using its rating procedures and methodologies.⁴⁹⁵ Three NRSROs stated that the Commission should not prescribe more requirements for how NRSROs must determine whether a rating must be revised.⁴⁹⁶ Two of these NRSROs stated that doing so may constitute regulating the substance of the credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act,⁴⁹⁷ and one of these NRSROs stated that the NRSRO "should retain the flexibility to conduct whatever analysis a particular situation calls for."⁴⁹⁸ On the other hand, one commenter stated that the Commission should be "more prescriptive in this area" and "require the NRSRO to apply de novo its procedures and methodologies" to determine whether a

codified in paragraph (c)(1) under the proposal, is being eliminated.

⁴⁹⁴ See paragraph (c)(1) of Rule 17g-8.

⁴⁹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33432.

⁴⁹⁶ See DBRS Letter; Moody's Letter; S&P Letter.

⁴⁹⁷ See Moody's Letter; S&P Letter.

⁴⁹⁸ See DBRS Letter.

credit rating must be revised.⁴⁹⁹ Another commenter stated that it is “essential” to require the NRSRO to “conduct a de novo analysis of the credit rating using its methodologies and procedures.”⁵⁰⁰ In implementing section 15E(h)(4)(A)(i) of the Exchange Act through Rules 17g-8 and 17g-7, the Commission has sought to strike an appropriate balance between adopting a measure designed to address the employment conflict with the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.⁵⁰¹ To strike this balance, the Commission believes that the rule should provide flexibility for the NRSRO to make this determination by applying procedures and methodologies that it designs to ensure that the credit rating is no longer influenced by the conflict of interest. Such procedures and methodologies could but may not necessarily require a de novo review of the rated obligor or obligation.

Two NRSROs stated that a conflict of interest may impact a number of other credit ratings, which would need to be revised and published.⁵⁰² Accordingly, one of these NRSROs suggested that the words “immediately” and “promptly” in the proposed requirements be replaced with “as soon as practicable” given that certain procedures may have to be followed.⁵⁰³ The other NRSRO suggested that paragraph (c)(2) of proposed Rule 17g-8 include a “reasonableness standard” for the term “promptly.”⁵⁰⁴ A third NRSRO suggested that a

⁴⁹⁹ See AFSCME Letter.

⁵⁰⁰ See Better Markets Letter.

⁵⁰¹ See 15 U.S.C. 78o-7(c)(2).

⁵⁰² See Moody’s Letter; S&P Letter.

⁵⁰³ See Moody’s Letter.

⁵⁰⁴ See S&P Letter.

“reasonable amount of time” be given to the NRSRO to “investigate the conflict and determine whether the rating must be revised.”⁵⁰⁵

In response, the Commission believes it is important that the NRSRO not delay completing the process that it will use to determine whether the credit rating must be revised to ensure that it is solely a product of the NRSRO’s procedures and methodologies for determining credit ratings (that is, not influenced by the conflict of interest). The longer the determination takes the longer that investors and other users of credit ratings will remain unaware of the important fact that the credit rating was influenced by a conflict. Consequently, the final rule retains the requirement that the NRSRO must “promptly determine” whether a credit rating must be revised.⁵⁰⁶ The Commission recognizes that the amount of time necessary to complete the determination will depend on facts and circumstances, including the number of credit ratings impacted, the degree to which the conflict influenced the credit ratings, and the complexity of the rating procedures and methodologies used to determine the credit ratings.⁵⁰⁷ However, the Commission expects that in each instance, the NRSRO will complete the process promptly in order to satisfy the “promptly determine” requirement and that the process, in many cases, will be expedited by the fact that much of the work to determine the impact, if any, and, if necessary, revise the credit rating would already be accomplished at the time an NRSRO determines that the credit rating was in fact influenced by a conflict. In such cases, the Commission would expect the revision or affirmation, as appropriate, to be issued promptly after the existence of the conflict was determined. The Commission notes that, as part of the annual examinations of each

⁵⁰⁵ See Morningstar Letter.

⁵⁰⁶ See paragraph (c)(1) of Rule 17g-8.

⁵⁰⁷ See Moody’s Letter; Morningstar Letter; S&P Letter.

NRSRO, Commission staff reviews the policies of the NRSRO governing the post-employment activities of former staff of the NRSRO.

The Commission is adopting the requirements in proposed paragraph (c)(3) of Rule 17g-8 substantially as proposed, with technical modifications, and is redesignating it as paragraph (c)(2)(i) of Rule 17g-8.⁵⁰⁸ As adopted, the final rule provides that the NRSRO must promptly publish, based on the determination of whether a current credit rating referred to in paragraph (c)(1) of Rule 17g-8 must be revised: (1) a revised credit rating, if appropriate, and include with the publication of the revised credit rating the information required by paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7; or (2) an affirmation of the credit rating, if appropriate, and include with the publication of the affirmation the information required by paragraph (a)(1)(ii)(J)(3)(ii) of Rule 17g-7.⁵⁰⁹ As discussed below, the Commission also is adopting the corresponding disclosure requirements to accompany the publication of a revised credit rating and an affirmation of a credit rating in paragraphs (a)(1)(ii)(J)(3)(i) and (ii) of Rule 17g-7, respectively, with modifications in response to comments.

One commenter stated that the NRSRO should publish a revised credit rating or affirmation, as appropriate, “as soon as practicable” instead of “promptly.”⁵¹⁰ As discussed above, paragraph (c)(1) of Rule 17g-8, as adopted, requires the NRSRO to promptly determine whether a credit rating discovered through a look-back review to have been influenced by a conflict of interest must be revised so that it is no longer influenced by the conflict and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit

⁵⁰⁸ See paragraph (c)(2)(i) of Rule 17g-8. The final rule modifies the proposal by re-designating paragraph (c)(3) as paragraph (c)(2)(i) because, as discussed above, the requirement in paragraph (c)(1) of Rule 17g-8, as proposed, is being eliminated. In addition, the final rule modifies the proposal by revising the text to specifically reference the credit rating “in paragraph (c)(1)”.

⁵⁰⁹ See paragraph (c)(2) of Rule 17g-8.

⁵¹⁰ See Moody’s Letter.

ratings. Having made the determination, paragraph (c)(2) of Rule 17g-8, as adopted, sets forth the next steps the NRSRO must take: promptly publish a revised credit rating or an affirmation of the credit rating and provide users of the NRSRO's credit ratings information about the reasons for taking either action. These steps are an important component of the look-back review process. They are designed to ensure that the NRSRO promptly addresses any impact the conflict had on the credit rating and alerts the users of its credit ratings about the existence of the conflict and its resolution. As stated above, failing to act when a conflict has influenced a credit rating creates the risk that investors and other users of credit ratings will use a conflicted credit rating when making an investment or other credit-related decision. Thus, paragraph (c)(2) of Rule 17g-8, as adopted, retains the requirement that the NRSRO must act promptly.

Commenters addressed whether the NRSRO should be required to publish a rating affirmation,⁵¹¹ including whether such a requirement would constitute regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act.⁵¹² The Commission does not expect (and the final rule does not require) an NRSRO to revise a credit rating in every circumstance in which an earlier rating action was influenced by a conflict of interest. Section 15E(h)(4)(A)(ii) of the Exchange Act provides that the NRSRO's policies and procedures shall be reasonably designed to, among other things, ensure that the NRSRO takes action to revise the credit rating "if appropriate."⁵¹³ It is possible, for example, that in the period since the NRSRO published the conflicted credit rating, events unrelated to the conflict occurred that, when taken into account by the NRSRO's procedures and methodologies for determining credit ratings,

⁵¹¹ See DBRS Letter; S&P Letter.

⁵¹² See Moody's Letter. See also 15 U.S.C. 78o-7(c)(2).

⁵¹³ 15 U.S.C. 78o-7(h)(4)(A)(ii).

would produce a credit rating at the same notch in the rating scale of the NRSRO as the credit rating that was influenced by the conflict.⁵¹⁴ A requirement that the NRSRO nonetheless revise the credit rating could interfere with the NRSRO's procedures and methodologies for determining credit ratings in that it would force the NRSRO to change the credit rating assigned to the obligor, security, or money market instrument to a different notch in the rating scale than would be the case if the credit rating were solely a product of the NRSRO's procedures and methodologies. Consequently, a mandatory revision requirement could, in effect, require the NRSRO to publish a credit rating that was not consistent with those procedures and methodologies. Accordingly, the final rule permits the NRSRO to publish an affirmation of the credit rating as an alternative to revising the credit rating, if appropriate. As discussed below, the Commission is requiring that an NRSRO publish an affirmation if the credit rating is not going to be revised because this will be the mechanism for disclosing the fact that a conflict at one time influenced the credit rating.

Commenters suggested that if the credit rating is not going to be revised there should not be a requirement to publish an affirmation.⁵¹⁵ One commenter stated that such a requirement

⁵¹⁴ For example, assume that nine months ago an analyst upgraded the credit rating assigned to an issuer's securities from the BBB to AA. The analyst leaves the NRSRO to work for the issuer. The analyst's new employment triggers a look-back review of the rating action upgrading the credit rating from BBB to AA pursuant to section 15E(h)(4)(A)(i) of the Exchange Act. The look-back review determines the credit rating should not have been upgraded from BBB to AA at that point in time and the analyst's action in upgrading the credit rating was influenced by the prospect of employment with the issuer. The NRSRO performs a *de novo* review of the credit rating assigned to the issuer by applying its procedures and methodologies for determining credit ratings. This review – as required by the procedures and methodologies – takes into consideration favorable financial results the issuer reported three months ago. Consequently, the process of re-rating the issuer's securities determines that the current credit rating should remain AA.

⁵¹⁵ See, e.g., DBRS Letter (supporting the proposed requirement that NRSROs "promptly publish" a revised rating, but stating that an affirmation of a credit rating that was influenced by a conflict of interest should be published "only where the NRSRO has determined...to place the existing rating on credit watch"); S&P Letter ("we also support elimination of proposed Rule 17g-8(c)(3), to the extent that it would require NRSROs to publish ratings affirmations or other actions following a CreditWatch action required by proposed Rule 17g-8(c)(1).").

constitutes regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings in contravention of section 15E(c)(2) of the Exchange Act.⁵¹⁶ The Commission is not persuaded that the rule should require only the publication of a revised credit rating. If the rule did not require publication of an affirmation, the users of the NRSRO's credit ratings would not learn of the existence of the conflict. One of the goals of the registration and oversight program for NRSROs is to increase the transparency of their activities so that users of credit ratings can understand how they operate and can compare NRSROs. Disclosing the existence of the conflict with the publication of the revised credit rating or affirmation of the credit rating will provide users of the NRSRO's credit ratings with information to assess the adequacy of the NRSRO's policies, procedures, and controls designed to manage conflicts of interest and, more generally, the integrity of the NRSRO's credit rating process. Moreover, the required disclosures could be useful to users of the NRSRO's credit ratings in considering the potential risk of using the NRSRO's credit ratings to make investment or other credit-based decisions. Furthermore, in light of the prohibition against regulating the substance of credit ratings and rating procedures and methodologies in section 15E(c)(2) of the Exchange Act, the final rule has been carefully tailored to avoid interfering with the NRSRO's analytical process.⁵¹⁷ It is the NRSRO that will determine – using its own procedures and methodologies – whether the credit rating should be revised or affirmed. For these reasons, the Commission is adopting the requirement to publish an affirmation of the credit rating if the credit rating does not need to be revised.

The Commission is adopting the disclosure requirements in proposed paragraphs (a)(1)(ii)(J)(3)(ii) and (iii) of Rule 17g-7 with modifications and is redesignating them as

⁵¹⁶ See Moody's Letter.

⁵¹⁷ See 15 U.S.C. 78o-7(c)(2).

paragraphs (a)(1)(ii)(J)(3)(i) and (ii).⁵¹⁸ Commenters raised concerns about the proposed requirement to disclose an estimate of the impact of the conflict on each applicable prior credit rating.⁵¹⁹ One commenter stated that estimating the impact of a conflict on a credit rating may “create inefficiencies.”⁵²⁰ A second NRSRO stated that it may be “unduly burdensome,” delaying publication of a corrective rating.⁵²¹ A third NRSRO stated that it would be “practically impossible” to estimate the impact of a conflict on a prior rating and that the Commission should not require disclosure of the reasons for revising or affirming a credit rating.⁵²²

The Commission is persuaded by commenters that precisely quantifying the impact of the conflict could be difficult and that a more narrative disclosure would be appropriate. Consequently, the final amendments to Rule 17g-7 require the NRSRO to provide a description of the impact the conflict had on the prior rating action or actions.⁵²³ The Commission expects the description to be sufficient to provide investors and users of credit ratings with insight into the nature of the impact the conflict had on the credit rating. The Commission recognizes that this may entail a degree of judgment on the part of the NRSRO in terms of estimating the degree of the impact.

⁵¹⁸ See paragraphs (a)(1)(ii)(J)(3)(i) and (ii) of Rule 17g-7. Because the disclosure requirement with respect to placing a conflicted credit rating on credit watch is being eliminated, the final amendments modify the proposed rule text by re-designating paragraph (a)(1)(ii)(J)(3)(ii) as paragraph (a)(1)(ii)(J)(3)(i), and re-designating paragraph (a)(1)(ii)(J)(3)(iii) as paragraph (a)(1)(ii)(J)(3)(ii). Further, because paragraph (c)(3) of Rule 17g-8, as proposed, is being re-designated as paragraph (c)(2), the final amendments modify the references in paragraphs (a)(1)(ii)(J)(3)(ii) and (iii) of Rule 17g-7, as proposed, to refer to paragraph (c)(2) of Rule 17g-8. The final amendments modify the proposed rule text to make other minor changes to improve readability.

⁵¹⁹ See DBRS Letter; Moody's Letter; S&P Letter.

⁵²⁰ See S&P Letter.

⁵²¹ See DBRS Letter.

⁵²² See Moody's Letter.

⁵²³ See paragraphs (a)(1)(ii)(J)(3)(i) and (ii) of Rule 17g-7.

In addition, the text of paragraph (a)(1)(ii)(J)(3)(iii) of Rule 17g-7, as proposed, has been modified to reflect that the requirement to place the credit rating on watch and make a corresponding disclosure has been eliminated.⁵²⁴ As proposed, this paragraph would govern the disclosure to be made with an affirmation of the credit rating. The disclosure requirement was intended to follow the initial disclosure that would have been made when the credit rating was placed on watch. The initial disclosure would have included an explanation that the credit rating was placed on watch because of the discovery that the credit rating was influenced by a conflict of interest. Because this disclosure will not be required, the disclosure that accompanies an affirmation of a credit rating will need to include an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest.⁵²⁵ This will provide context for why the NRSRO is issuing the affirmation.⁵²⁶

One commenter stated that the rule should require disclosure about the nature of the conflict.⁵²⁷ In response, the Commission notes that the rule requires the NRSRO to include with a revised credit rating an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest.⁵²⁸ Similarly, the rule requires an NRSRO to include with an affirmation of a credit rating an explanation that the credit rating was influenced

⁵²⁴ Id.

⁵²⁵ Id.

⁵²⁶ A similar modification is not necessary for the disclosure that must accompany a revised credit rating because, as proposed, that disclosure would have needed to include an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest, thus providing the necessary context. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33541. The final amendments retain this disclosure requirement. See paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7.

⁵²⁷ See Better Markets Letter.

⁵²⁸ See paragraph (a)(1)(ii)(J)(3)(i) of Rule 17g-7.

by a conflict of interest.⁵²⁹ The Commission agrees with the commenter that the disclosure should provide some context for these explanations. Consequently, the Commission is modifying the rule text from the proposal to provide that the explanation of the conflict to be made with a revision of a credit rating or an affirmation of a credit rating must include a description of the nature of the conflict.⁵³⁰ For example, the description could disclose that a former employee was unduly influenced by the prospect of working for the issuer of the rated security and, as a consequence, did not adhere to the NRSRO's rating methodology in order to make the credit rating more favorable to the issuer.

Finally, two commenters stated that information regarding a credit rating influenced by a conflict of interest should be provided to former subscribers.⁵³¹ As discussed above, the disclosures are required to be made in the form to accompany a rating action under paragraph (a) of Rule 17g-7, as amended.⁵³² This form – as discussed below in section II.G.1. of this release – must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.⁵³³ This provision thereby accommodates both the issuer-pay business model in which rating actions generally are made publicly available and the subscriber-pay business model in which rating actions generally are made available to current subscribers only.⁵³⁴ Consequently, if the NRSRO makes its rating actions available only to

⁵²⁹ See paragraph (a)(1)(ii)(J)(3)(ii) of Rule 17g-7.

⁵³⁰ See paragraphs (a)(1)(ii)(J)(3)(i) and (ii) of Rule 17g-7.

⁵³¹ See AFSCME Letter; DBRS Letter.

⁵³² See paragraph (a)(1)(ii)(J)(3) of Rule 17g-7.

⁵³³ See paragraph (a) of Rule 17g-7.

⁵³⁴ See 15 U.S.C 78c(a)(61) (defining a credit rating agency, in pertinent part, as any person engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or a reasonable fee).

current subscribers, former subscribers will not have access to the form and the disclosure it contains about the conflict of interest. In considering the comments about disclosing the information to former subscribers, the Commission balanced the interest in providing users of credit ratings with information about a given NRSRO's credit ratings with the interest in promulgating rules that accommodate and integrate with the two predominant NRSRO business models. For example, since the final amendments to Rule 17g-7 require the disclosure to be made in the same manner as the disclosure of the credit rating that is the result or subject of the rating action, a requirement that the disclosure must be made to former subscribers (who normally would not have access to a rating action that was published after their subscription expired) would necessarily require a different process for the disclosure. For example, the disclosure could be made through publication on the NRSRO's website, but this method of disclosure may not be effective if former subscribers no longer view the website. Alternatively, the NRSRO could send the disclosure to former subscribers, but this could be burdensome and present practical difficulties. Because former subscribers are no longer using the NRSRO's credit ratings, the Commission believes at this time that it is not necessary to add a requirement that an NRSRO operating under the subscriber-pay model must make this disclosure to former subscribers.

2. Amendment to Rule 17g-2

The Commission proposed adding paragraph (a)(9) to Rule 17g-2 to require NRSROs to make and retain a record documenting the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of proposed Rule 17g-8.⁵³⁵ As a result, the policies and procedures would need to

⁵³⁵ See section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the

be documented and the record documenting them would be subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g-2.⁵³⁶ One NRSRO stated that it “supports the Commission’s proposal to include look-back policies and procedures as records that an NRSRO must retain under Rule 17g-2(a)(9).”⁵³⁷ The Commission is adding paragraph (a)(9) to Rule 17g-2 as proposed.⁵³⁸ This will provide a means for the Commission to monitor the NRSROs’ compliance with section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g-8. The record must be retained until three years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g-2 discussed above in section II.A.2. of this release.⁵³⁹

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule with respect to look-back reviews.⁵⁴⁰ The baseline that existed before today’s amendments and new rule was one in which section 15E(h)(4)(A)(i) of the Exchange Act, added by the Dodd-Frank Act, required NRSROs to establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO conducts look-back reviews in any case in which an employee of a person subject to a credit rating of the NRSRO or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO, was

public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

⁵³⁶ See 17 CFR 240.17g-2(c) through (f).

⁵³⁷ See DBRS Letter.

⁵³⁸ See paragraph (a)(9) of Rule 17g-2.

⁵³⁹ See paragraphs (a)(9) and (c) of Rule 17g-2.

⁵⁴⁰ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

employed by the NRSRO and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the one-year period preceding the date an action was taken with respect to the credit rating.⁵⁴¹ The Commission staff found during its 2013 examinations of NRSROs that all NRSROs had established written policies and procedures to address the look-back requirement.⁵⁴² However, the staff found that two larger and six smaller NRSROs did not consistently, in the staff's view, conduct adequate look-back searches or did not have adequate policies governing the searches.⁵⁴³

Section 15E(h)(4)(A)(ii) provides that an NRSRO must establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO will take action to revise the credit rating if appropriate, in accordance with such rules as the Commission shall prescribe.⁵⁴⁴ Before today's amendments and new rule, if the NRSRO found, after conducting the look-back review, that the credit rating was influenced by a conflict, the NRSRO would have needed to ensure that the credit rating was determined in accordance with the procedures and methodologies the NRSRO uses to determine credit ratings. However, the NRSRO was not required to "promptly" determine whether the current credit rating must be revised or "promptly" publish a revised credit rating or an affirmation of the credit rating, as appropriate. Further, there was no requirement that the NRSRO disclose information about the existence of the conflict with the publication of a revised credit rating, affirmation of the existing credit rating, or placement of the credit rating on watch or review if the credit rating is not revised or affirmed within fifteen calendar days of the discovery that the credit rating was influenced by a conflict. Finally, an

⁵⁴¹ See 15 U.S.C. 78o-7(h)(4)(A)(i).

⁵⁴² See 2013 Annual Staff Inspection Report, p. 22. The 2013 examinations generally focused on NRSRO activities for the period October 1, 2011 through December 31, 2012.

⁵⁴³ See 2013 Annual Staff Inspection Report, pp. 22-23.

⁵⁴⁴ See 15 U.S.C. 78o-7(h)(4)(A)(ii).

NRSRO was not required to make and retain a record documenting the policies and procedures required under section 15E(h)(4)(A).

The baseline that existed before today's amendments and new rule was one in which, pursuant to paragraph (c)(4) of Rule 17g-5, an NRSRO is prohibited from issuing or maintaining a credit rating where a credit analyst who participated in determining the credit rating is an officer or director of the person that is subject to the credit rating.⁵⁴⁵ Also, section 15E(h)(1) of the Exchange Act and Rule 17g-5 require NRSROs to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage any conflicts of interest that can arise from the business of the NRSRO.⁵⁴⁶

In addition, section 15E(h)(5)(A) of the Exchange Act requires NRSROs to report to the Commission any case in which a person associated with the NRSRO within the previous five years obtains employment with a rated entity or the issuer, underwriter, or sponsor of a rated instrument for which the NRSRO issued a credit rating during the twelve-month period prior to the employment if the employee was a senior officer of the NRSRO or participated, or supervised an employee that participated, in determining credit ratings for the new employer.⁵⁴⁷ Section 15E(h)(5)(B) requires that the Commission make the reports publicly available.⁵⁴⁸ The Commission received 244 of these reports between January 24, 2006 and December 31, 2013.⁵⁴⁹ One academic study examined these transition reports for three NRSROs (Fitch, Moody's, and S&P), which submitted 167 of these reports during that period.⁵⁵⁰ The study suggests that the

⁵⁴⁵ See 17 CFR 240.17g-5(c)(4).

⁵⁴⁶ See 15 U.S.C. 78o-7(h)(1).

⁵⁴⁷ See 15 U.S.C. 78o-7(h)(5)(A).

⁵⁴⁸ See 15 U.S.C. 78o-7(h)(5)(B).

⁵⁴⁹ The reports are available at http://www.sec.gov/divisions/marketreg/nrsro_etr.htm.

⁵⁵⁰ See Jess Cornaggia, Kimberly J. Cornaggia, and Han Xia, Revolving Doors on Wall Street (2014),

credit ratings assigned to the future employer by the NRSRO employing the transitioning employee were more likely to be upgraded and less likely to be downgraded than the ratings assigned to that future employer by other NRSROs in the year prior to the transition.⁵⁵¹

Relative to this baseline, the amendments and new rule should result in benefits. They are designed to require the NRSRO to evaluate whether a credit rating has been influenced by a conflict of interest and, if so, promptly address the conflicted credit rating. This could limit the potential risk that users of credit ratings might make investment or other credit-based decisions using incomplete, biased, or inaccurate information. As stated above, the disclosures also will increase transparency and provide users of NRSRO credit ratings with information to assess an NRSRO's ability to address conflicts and to compare NRSROs with respect to their ability to manage the conflicts. Further, the amendments and new rule – because they are designed to integrate with an NRSRO's existing policies and procedures for taking rating actions – could mitigate potential inefficiencies associated with the requirements. For example, the amendments and new rule are designed to work within the existing framework of an NRSRO's policies and procedures for taking rating actions but not to regulate the substance of the credit rating or the procedures and methodologies for determining credit ratings.

The records NRSROs must make and keep under the amendment to Rule 17g-2 will be used by Commission examiners to assess whether a given NRSRO's policies and procedures are reasonably designed and whether it appears that the NRSRO is complying with them.

Recordkeeping requirements are integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable

available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2150998.

⁵⁵¹ These authors state that “the difference between the ratings awarded by transitioning analysts and their benchmarks changes by an average of 0.23 notches during the last five quarters leading up to a transition.” Id.

securities laws.⁵⁵² Compliance by an NRSRO with its policies and procedures for look-back reviews and the oversight exercised by the Commission may benefit users of credit ratings by mitigating conflicts of interest, which may increase the integrity and quality of credit ratings.

Relative to the baseline, the amendments and new rule relating to look-back reviews will result in costs for NRSROs. NRSROs will need to expend resources to establish, make a record of, enforce, and periodically review and update (if necessary) the procedures they establish pursuant to section 15E(h)(4)(A) of the Exchange Act to ensure they comply with paragraph (c) of Rule 17g-8. They also will need to develop and periodically modify processes and systems for ensuring that, if the look-back review determines that a conflict of interest influenced the credit rating, a revised credit rating or an affirmation of the credit rating is promptly published (as appropriate) along with the corresponding disclosures required under paragraph (a)(1)(ii)(J)(3) of Rule 17g-7, or that the credit rating is placed on watch or review if the credit rating is not revised or affirmed within fifteen calendar days of the discovery that the credit rating was influenced by a conflict of interest. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (c) of Rule 17g-8 will result in total industry-wide one-time costs to NRSROs of approximately \$295,000 and total industry-wide annual costs to NRSROs of approximately \$71,000.⁵⁵³

Relative to the baseline, the amendments to Rule 17g-2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the

⁵⁵² See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33582.

⁵⁵³ See section V.C. of this release (discussing implementation and annual compliance considerations). These costs are derived by monetizing internal hour burdens identified in the PRA analysis in section IV.D.7. of this release. The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

recordkeeping requirements in Rule 17g-2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a)(9) of Rule 17g-2 and the amendment to paragraph (c) of Rule 17g-2 will result in total industry-wide one-time costs to NRSROs of approximately \$12,000 and total industry-wide annual costs to NRSROs of approximately \$3,000.⁵⁵⁴

The amendments and new rule by increasing the scrutiny of the work of former analysts could potentially decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process can improve the quality of ratings. In particular, an NRSRO may establish credit rating methodologies that diminish the ability of analysts to exercise subjective judgment in order to minimize the chance that in exercising judgment an analyst may be influenced by this conflict, which, in turn, will trigger the requirements in the amendments and new rule, including the requirement to disclose the existence of the conflict. If the ability to apply subjective analysis is diminished, the credit ratings issued by an NRSRO may not benefit fully from the expertise of the analysts.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.⁵⁵⁵ First, they could improve the quality of credit-related information. As a result, users of credit ratings may make more efficient investment decisions

⁵⁵⁴ See section V.C. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

⁵⁵⁵ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

based on this higher-quality information. Market efficiency also could improve if this information is reflected in asset prices. Consequently, capital formation could improve as capital may flow to more efficient uses with the benefit of this enhanced information. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the efficiency of investment decisions, market efficiency, and capital formation may also be adversely impacted if lower quality information is reflected in asset prices, which may impede the flow of capital to efficient uses. These amendments also will result in costs, some of which may have a component that is fixed in magnitude across NRSROs and does not vary with the size of the NRSRO. Therefore, the operating costs per rating of smaller NRSROs may increase relative to that of larger NRSROs, which could create adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as NRSROs might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

There are a number of reasonable alternatives to the amendments and new rule, as adopted. First, the Commission could require that NRSROs immediately place on credit watch or review credit ratings that are determined by a look-back review to have been influenced by a conflict of interest (as was proposed). This alternative might further benefit users of credit ratings by alerting them sooner of conflicted credit ratings, limiting the potential risk that investors and users of credit ratings might make credit-based decisions using incomplete, biased, or inaccurate information, and thereby reduce the risk of mispricing due to the use of such incomplete, biased, or inaccurate information. It also might increase the incentives of NRSROs to develop and adhere to rating policies and procedures that further decrease the chance that

conflicts of interest may influence credit ratings. The quality of credit ratings could increase as a result. This alternative also might decrease the quality of credit ratings in certain circumstances if it causes NRSROs to further reduce the use of subjective judgment in rating methodologies relative to the amendments and new rule. This alternative might also result in additional costs for NRSROs and users of credit ratings. First, the NRSRO would need to expend resources to develop, modify, and enforce policies and procedures ensuring that it immediately places such conflicted ratings on credit watch or review in addition to documenting and retaining these policies and procedures pursuant to the amendments to Rule 17g-2. Second, if a look-back review determined that a conflict influenced a credit rating, the NRSRO would need to expend resources to place the credit rating on watch or review. In addition, a number of academic studies indicate that both stock and bond prices of an issuer react adversely when credit ratings are placed on negative credit watch.⁵⁵⁶ Therefore, this alternative might also create mispricing and confusion in the market. In particular, a placement of a credit rating on credit watch creates uncertainty in the credit rating that is resolved when the credit rating is either revised or affirmed. As a result of unfamiliarity, users of credit ratings might not react rationally in the short term to the uncertainty introduced by placements of credit ratings on credit watch resulting from look-back reviews. Consequently, this alternative might result in costs for issuers and on market participants who may make non-optimal investment decisions as a result of mispricing

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See Kee H. Chung, Carol Ann Frost, and Myungsun Kim, Characteristics and Information Value of Credit Watches, FINANCIAL MANAGEMENT 119-158 (2012); Sugato Chakravarty, Chiraphol N. Chiyachantana, & Yen Teik Lee, On the Informativeness of Credit Watch Placements (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1252542; Christina E. Bannier and Christian W. Hirsch, The Economic Function of Credit Rating Agencies – What Does the Watchlist Tell Us?, J. OF BANKING AND FINANCE 3037-3049 (2010); John R.M. Hand, Robert W. Holthausen, Richard W. Leftwich, The Effect of Bond Rating Agency Announcements on Bond and Stock Prices, J. OF FINANCE 733-752 (1992); Robert W. Holthausen and Richard W. Leftwich, The Effect of Bond Rating Changes on Common Stock Prices, J. OF FIN. ECONOMICS 57-89 (1986).

and confusion. Several comment letters discussed these potential adverse consequences.⁵⁵⁷

However, these costs could arise if the NRSRO is required to place the credit rating on credit watch or review because it does not revise or affirm the credit rating within fifteen calendar days of the discovery of the conflict.

Other alternatives include those that would apply standards other than acting “promptly” with respect to the required timing of review and rating actions after a rating is determined to have been conflicted in a look-back review. For example, an NRSRO could be required to take these actions “as soon as practicable” rather than “promptly,” as suggested by one commenter.⁵⁵⁸ However, the Commission believes it is important that the NRSRO not delay completing the process that it will use to determine whether the credit rating must be revised to ensure that it is solely a product of the NRSRO’s procedures and methodologies for determining credit ratings and to publish a revised credit rating or an affirmation of the credit rating with the required disclosure of information about the existence of the conflict. The longer the NRSRO takes to complete these steps the greater the risk that investors and other users of credit ratings will rely on a conflicted credit rating when making an investment or credit-related decision.

Consequently, the final amendment retains the requirement that the NRSRO must “promptly determine” whether a credit rating must be revised. At the same time, the Commission recognizes that the amount of time necessary to complete the determination will depend on the facts and circumstances, including the number of credit ratings impacted, the degree to which the conflict influenced the credit ratings, and the complexity of the rating methodologies used to determine the credit ratings.⁵⁵⁹

⁵⁵⁷ See A.M. Best Letter; DBRS Letter; FSR Letter; Morningstar Letter; S&P Letter.

⁵⁵⁸ See Moody’s Letter.

⁵⁵⁹ See Moody’s Letter; Morningstar Letter; S&P Letter.

There are a number of other alternatives that would impose additional requirements for addressing a credit rating that is found through a look-back review to be influenced by a conflict of interest. One alternative suggested by commenters would be to require a de novo review of a credit rating that was determined through a look-back review to have been influenced by a conflict of interest.⁵⁶⁰ This alternative could produce higher-quality credit ratings because a de novo review may provide a higher level of assurance that the credit rating is no longer influenced by the conflict as the entire rating process would be undertaken (this time without the conflicted analyst participating). In other words, de novo reviews may be more likely to result in credit ratings that are in accordance with the NRSRO's procedures and methodologies for determining credit ratings.

On the other hand, this alternative might impose further costs as NRSROs may be able to conduct a sufficient review without taking all the steps necessary to perform a de novo review (for example, some of the prior work could have been undertaken by a credit analyst that was not influenced by the conflict). Requiring a de novo review also may implicate the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.⁵⁶¹ Further, this alternative might decrease the quality of credit ratings in certain circumstances if it caused NRSROs to eliminate or reduce the use of subjective judgment in rating procedures or methodologies as discussed earlier. In addition, the amendments and new rule provide flexibility for the NRSRO to make this determination by applying procedures and methodologies that it designs to ensure that the credit rating is no longer

⁵⁶⁰ See AFSCME Letter; Better Markets Letter.

⁵⁶¹ See 15 U.S.C. 78o-7(c)(2).

influenced by the conflict of interest, which could include procedures and methodologies that require a de novo review of the rated obligor or obligation in all or certain cases.

Commenters also proposed alternatives which would make the amendments and new rule less restrictive. One alternative suggested by commenters would be to not require publication of an affirmation after a credit rating has been determined to have been conflicted in a look-back review if, for example, in the period since the NRSRO published the credit rating, events unrelated to the conflict occurred that, when taken into account by the NRSRO's procedures and methodologies for determining credit ratings, would produce a credit rating at the same notch in the rating scale as the credit rating that was influenced by the conflict.⁵⁶² This alternative could benefit NRSROs by reducing the potential costs associated with publishing affirmations such as the cost of composing text to appear in the NRSRO's publications and press releases. This alternative also might increase the quality of credit ratings in certain circumstances if not having to disclose the existence of the conflict caused NRSROs to allow greater use of subjective judgment in rating methodologies as discussed earlier.

However, as discussed above, if the rule did not require publication of an affirmation, it would result in costs as users of the NRSRO's credit ratings would not learn of the existence of the conflict. Disclosing the existence of the conflict with the publication of the revised credit rating or affirmation of the credit rating will provide users of the NRSRO's credit ratings with information to assess the adequacy of the NRSRO's policies, procedures, and controls designed to manage conflicts of interest and, more generally, the integrity of the NRSRO's credit rating process. Moreover, the required disclosures could be useful to users of the NRSRO's credit

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See DBRS Letter; S&P Letter.

ratings in considering the potential risk of using the NRSRO's credit ratings to make investment or other credit-based decisions in comparison to other NRSROs.

D. FINES AND OTHER PENALTIES

1. Final Rule

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add subsection (p), which contains four paragraphs: (1), (2), (3), and (4).⁵⁶³ Section 15E(p)(4)(A) provides that the Commission shall establish, by rule, fines and other penalties applicable to any NRSRO that violates the requirements of section 15E of the Exchange Act and the rules under the Exchange Act.⁵⁶⁴

The Exchange Act already provides a wide range of fines, penalties, and other sanctions applicable to NRSROs for violations of any section of the Exchange Act (including section 15E) and the rules under the Exchange Act (including the rules under section 15E).⁵⁶⁵ For example, section 15E(d)(1) of the Exchange Act provides that the Commission shall censure an NRSRO, place limitations on the activities, functions, or operations of an NRSRO, suspend an NRSRO for a period not exceeding twelve months, or revoke the registration of an NRSRO if, among other reasons, the NRSRO violates section 15E of the Exchange Act or the Commission's rules under the Exchange Act.⁵⁶⁶ In addition, section 932(a)(3) of the Dodd-Frank Act amended section 15E(d) to explicitly provide additional potential sanctions.⁵⁶⁷ First, it provided the Commission with the authority to seek sanctions against persons associated with, or seeking to become

⁵⁶³ See Pub. L. No. 111-203, 932(a)(8); 15 U.S.C. 78o-7(p)(1) through (4).

⁵⁶⁴ See 15 U.S.C. 78o-7(p)(4)(A).

⁵⁶⁵ See 15 U.S.C. 78o-7(d); 15 U.S.C. 78u; 15 U.S.C. 78u; 15 U.S.C. 78u-2; 15 U.S.C. 78u-3; 15 U.S.C. 78ff.

⁵⁶⁶ See section 15E(d)(1)(A) through (F) of the Exchange Act (15 U.S.C. 78o-7(d)(1)(A) through (F)), as amended by the Dodd-Frank Act.

⁵⁶⁷ See Pub. L. No. 111-203, 932(a)(3); 15 U.S.C. 78o-7(d).

associated with, an NRSRO.⁵⁶⁸ The Commission can censure such persons, place limitations on the activities or functions of such persons, suspend such persons for a period not exceeding one year, or bar such persons from being associated with an NRSRO.⁵⁶⁹ Second, section 932(a)(3) of Dodd-Frank Act amended section 15E(d) to provide the Commission with explicit authority to temporarily suspend or permanently revoke the registration of an NRSRO in a particular class or subclass of credit ratings if the NRSRO does not have adequate financial and managerial resources to consistently produce credit ratings with integrity.⁵⁷⁰ Furthermore, sections 21, 21A, 21B, 21C, and 32 of the Exchange Act provide additional sanctions if an NRSRO violates the Exchange Act, including the self-executing provisions in section 15E of the Exchange Act, or rules under the Exchange Act.⁵⁷¹

In the proposing release, the Commission stated its preliminarily belief that these provisions of the Exchange Act, as amended by the Dodd-Frank Act, provide a sufficiently broad range of means to impose fines, penalties, and other sanctions on an NRSRO for violations of section 15E of the Exchange Act and the rules under the Exchange Act.⁵⁷² For example, the fines, penalties, and sanctions applicable to NRSROs are similar in scope to the fines, penalties, and sanctions applicable to other registrants under the Exchange Act, such as broker-dealers.

⁵⁶⁸ 15 U.S.C. 78o-7(d)(1).

⁵⁶⁹ Id.

⁵⁷⁰ See Pub. L. No. 111-203, 932(a)(3); 15 U.S.C. 78o-7(d)(2). Prior to this amendment, the Commission had the authority to suspend or revoke the registration of an NRSRO if it failed to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity. See section 15E(d)(5) of the Exchange Act (15 U.S.C. 78o-7(d)(5)) before being amended by the Dodd-Frank Act, which re-designated paragraph (d)(5) of section 15E as paragraph (d)(1)(E) (15 U.S.C. 78o-7(d)(1)(E)). Section 15E(d)(2) of the Exchange Act, however, provides explicit authority to target a suspension or registration revocation to a specific class or subclass of security. See 15 U.S.C. 78o-7(d)(2).

⁵⁷¹ See 15 U.S.C. 78o-7; 15 U.S.C. 78u; 15 U.S.C. 78u-1; 15 U.S.C. 78u-2; 15 U.S.C. 78u-3; 15 U.S.C. 78ff. In fact, the Dodd-Frank Act amended section 21B of the Exchange Act (15 U.S.C. 78u-2) to provide the Commission with the authority to assess money penalties in cease-and-desist proceedings under section 21C (15 U.S.C. 78u-3). See section 929P(a)(2) of the Dodd-Frank Act.

⁵⁷² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33433.

Moreover, since enactment of the Rating Agency Act of 2006, the Commission has not identified a specific need for a fine or penalty applicable to NRSROs not otherwise provided for in the Exchange Act. Consequently, in the proposing release, the Commission stated its preliminary belief that it would be appropriate at that time to defer establishing new fines or penalties in addition to those provided for in the Exchange Act.⁵⁷³ However, the Commission stated that, in the future, it may use the authority in section 15E(p)(4)(A) of the Exchange Act if a specific need to do so is identified.⁵⁷⁴

For the foregoing reasons, to implement section 15E(p)(4)(A) of the Exchange Act, the Commission proposed to amend the instructions to Form NRSRO by adding Instruction A.10.⁵⁷⁵ This instruction would provide notice to credit rating agencies applying for registration as an NRSRO and to NRSROs that an NRSRO is subject to applicable fines, penalties, and other available sanctions set forth in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act (15 U.S.C. 78o-7, 78u, 78u-1, 78u-2, 78u-3, and 78ff, respectively) for violations of the securities laws.⁵⁷⁶

Several comment letters addressed the proposal.⁵⁷⁷ Most commenters generally supported the Commission's proposal to defer establishing new fines or penalties in addition to those currently provided for in the Exchange Act,⁵⁷⁸ with one commenter specifically noting that it supports the Commission's proposal to add the new instruction to Form NRSRO.⁵⁷⁹

Commenters stated that the fines, penalties, and other sanctions currently applicable to NRSROs

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Id.

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Id.

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Id. at 33552.

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See Nationally Recognized Statistical Rating Organizations, 76 FR at 33552.

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See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.

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See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.

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See DBRS Letter.

under the Exchange Act are “sufficient,”⁵⁸⁰ and that no other additional fines or penalties are necessary or warranted.⁵⁸¹ However, one commenter suggested that, while other sections of the Exchange Act provide for appropriate penalties and sanctions, it is not appropriate to consider suspension or revocation of an NRSRO’s registration under section 21C of the Exchange Act.⁵⁸²

The Commission is adopting Instruction A.10 to Form NRSRO⁵⁸³ as proposed. As stated above, certain commenters agreed that the fines, penalties, and other sanctions currently applicable to NRSROs under the Exchange Act are sufficient and that additional fines, penalties, or other sanctions are not necessary or appropriate. Consequently, commenters supported the Commission’s proposal to add Instruction A.10 to Form NRSRO. While the Commission is adopting Instruction A.10 to Form NRSRO, it is deferring establishing new fines or penalties in addition to those provided for in the Exchange Act. The Commission may choose to use the authority to establish new fines or penalties in the future.⁵⁸⁴

2. Economic Analysis

The final amendments should not create any costs for NRSROs and may provide some benefits. It could benefit credit rating agencies applying for registration as NRSROs and NRSROs because it should notify them of the potential consequences of violating provisions of the Exchange Act and Commission rules.

⁵⁸⁰ See Morningstar Letter.

⁵⁸¹ See A.M. Best Letter; DBRS Letter; Morningstar Letter; S&P Letter.

⁵⁸² See A.M. Best Letter. As discussed above in section II.B.3. of this release, the Commission has modified the final amendments relating to suspending or revoking an NRSRO’s registration from the proposal so that it no longer incorporates section 21C of the Exchange Act.

⁵⁸³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33552.

⁵⁸⁴ One commenter recommended the Commission re-propose the rules and, in doing so, invoke its authority under section 15E(p)(4) of the Exchange Act to seek fines and the disgorgement of profits when an NRSRO persistently “issues non-standardized” credit ratings. See CFA II Letter.

E. DISCLOSURE OF INFORMATION ABOUT THE PERFORMANCE OF CREDIT RATINGS

Section 932(a)(8) of the Dodd-Frank Act added subsection (q) to section 15E of the Exchange Act.⁵⁸⁵ Section 15E(q)(1) provides that the Commission shall, by rule, require NRSROs to publicly disclose information on the initial credit ratings determined by the NRSRO for each type of obligor, security, and money market instrument, and any subsequent changes to such credit ratings, for the purpose of allowing users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different NRSROs.⁵⁸⁶ Section 15E(q)(2) provides that the Commission's rules shall require, at a minimum, disclosures that:

- are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs;⁵⁸⁷
- are clear and informative for investors having a wide range of sophistication who use or might use credit ratings;⁵⁸⁸
- include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the NRSRO;⁵⁸⁹
- are published and made freely available by the NRSRO, on an easily accessible portion of its website, and in writing, when requested;⁵⁹⁰
- are appropriate to the business model of an NRSRO;⁵⁹¹ and
- require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the credit rating was influenced by any other business activities, that the credit rating was based solely on the merits of the instruments being rated, and that such credit rating was an independent evaluation of the risks and merits of the instrument.⁵⁹²

⁵⁸⁵ See Pub. L. No. 111-203, 932(a)(8); 15 U.S.C. 78o-7(q).

⁵⁸⁶ See 15 U.S.C. 78o-7(q)(1).

⁵⁸⁷ See 15 U.S.C. 78o-7(q)(2)(A).

⁵⁸⁸ See 15 U.S.C. 78o-7(q)(2)(B).

⁵⁸⁹ See 15 U.S.C. 78o-7(q)(2)(C).

⁵⁹⁰ See 15 U.S.C. 78o-7(q)(2)(D).

⁵⁹¹ See 15 U.S.C. 78o-7(q)(2)(E).

⁵⁹² See 15 U.S.C. 78o-7(q)(2)(F). As discussed in section II.G.4. of this release, the Commission is including this attestation requirement in the rule the Commission is adopting to implement section 15E(s) of the

The rules in existence before today's amendments require NRSROs to publish two types of information about the performance of their credit ratings: (1) performance statistics⁵⁹³ and (2) rating histories.⁵⁹⁴ The Commission proposed to implement the rulemaking mandated in section 15E(q) of the Exchange Act, in substantial part, by significantly enhancing the requirements for generating and disclosing this information by amending the instructions to Form NRSRO as they relate to Exhibit 1 and the disclosure of transition and default statistics, and by amending Rule 17g-1, Rule 17g-2, and Rule 17g-7 with respect to the disclosure of rating histories.⁵⁹⁵ The Commission is adopting the amendments substantially as proposed, with modifications, in part, in response to comments received.

1. Amendments to Instructions for Exhibit 1 to Form NRSRO

a. Proposal

Exhibit 1 is part of the registration application a credit rating agency seeking to be registered as an NRSRO must submit to the Commission and that an NRSRO must file with the

Exchange Act, which requires, among other things, that the Commission adopt rules requiring an NRSRO to generate a form to be included with the publication of a credit rating. See 15 U.S.C. 78o-7(s); paragraph (a)(1)(iii) of Rule 17g-7.

⁵⁹³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33434. This type of disclosure shows the performance of an NRSRO's credit ratings in the aggregate through statistics. Specifically, it provides the percent of credit ratings assigned to obligors, securities, and money market instruments in each category of credit rating in a rating scale (for example, AAA, AA, A, BBB, BB, B, CCC, CC, and C) that over a given time period were downgraded or upgraded to another credit rating category ("transition rates") or classified as a default ("default rates"). The goal is to provide a mechanism for users of credit ratings to compare the performance statistics of credit ratings in each category across NRSROs.

⁵⁹⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33434. This type of disclosure shows the credit rating history of a given rated obligor, security, or money market instrument. Specifically, it shows the initial credit rating and all subsequent modifications to the credit rating (such as upgrades and downgrades) and the dates of such actions. The goal is to allow users of credit ratings to compare how different NRSROs rated an individual obligor, security, or money market instrument and how and when those ratings were changed over time. The disclosure of rating histories also is designed to provide "raw data" that can be used by third parties to generate independent performance statistics such as transition and default rates.

⁵⁹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33433-33452.

Commission, keep up-to-date, and publicly disclose.⁵⁹⁶ Section 15E(a)(1)(B)(i) of the Exchange Act requires that an application for registration as an NRSRO include performance measurement statistics over short-term, mid-term, and long-term periods (as applicable).⁵⁹⁷ The Commission implemented this requirement, in large part, through Exhibit 1 to Form NRSRO and the instructions for Exhibit 1.⁵⁹⁸ Section 15E(b)(1)(A) of the Exchange Act provides that the performance measurement statistics must be updated annually in the annual certification required by section 15E(b)(2).⁵⁹⁹ Paragraph (i) of Rule 17g-1 provides, among other things, that the

⁵⁹⁶ In particular, section 15E(a)(1)(A) of the Exchange Act requires an applicant to furnish an application for registration to the Commission, in such form as the Commission shall require, by rule or regulation. See 15 U.S.C. 78o-7(a)(1)(A). Section 15E(a)(1)(B) of the Exchange Act identifies information that must be included in the application for registration. See 15 U.S.C. 78o-7(a)(1)(B)(i) through (x). The Commission implemented sections 15E(a)(1)(A) and (B) of the Exchange Act by adopting Form NRSRO. See Form NRSRO available at <http://www.sec.gov/about/forms/formnrsro.pdf>; see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33569-33582. Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, shall require an NRSRO, upon being granted registration, to make the information and documents in its completed application for registration, or in any amendment to its application, publicly available on its website, or through another comparable, readily accessible means, except for certain information that is submitted on a confidential basis. See 15 U.S.C. 78o-7(a)(3). The Commission implemented this provision by adopting paragraph (i) of Rule 17g-1. See 17 CFR 240.17g-1(i); see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33569. Section 15E(b)(1) requires an NRSRO to promptly amend its application for registration if any information or document provided therein becomes materially inaccurate; however, (as discussed below) certain information does not have to be updated and other information must be updated only on an annual basis. See 15 U.S.C. 78o-7(b)(1); 15 U.S.C. 78o-7(b)(1); 15 U.S.C. 78o-7(a)(1)(B)(ix). The Commission implemented this provision by adopting Form NRSRO and paragraph (e) of Rule 17g-1. See Form NRSRO; 17 CFR 240.17g-1(e). See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33567, 33569-33582.

⁵⁹⁷ See 15 U.S.C. 78o-7(a)(1)(B)(i).

⁵⁹⁸ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33628, 33634.

⁵⁹⁹ See 15 U.S.C. 78o-7(b)(1) and (2). In particular, section 15E(b) of the Exchange Act provides that not later than ninety days after the end of each calendar year, an NRSRO shall file with the Commission an amendment to its registration application, in such form as the Commission, by rule, may prescribe: (1) certifying that the information and documents in the application for registration continue to be accurate; (2) listing any material change that occurred to such information and documents during the previous calendar year; and (3) updating its credit ratings performance measurement statistics. See 15 U.S.C. 78o-7(b). The Commission implemented these provisions by adopting Form NRSRO and paragraph (f) of Rule 17g-1. See Instruction F to Form NRSRO; 17 CFR 240.17g-1(f). See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33567, 33569-33582.

NRSRO must make the annual certification publicly available within ten business days of furnishing the annual certification to the Commission.⁶⁰⁰

Before today's amendments, the instructions for Exhibit 1 required the applicant or NRSRO to provide performance statistics for the credit ratings of the applicant or NRSRO, including performance statistics for each class of credit ratings for which the applicant is seeking registration or the NRSRO is registered.⁶⁰¹ The classes of credit ratings for which an NRSRO can be registered are enumerated in the definition of nationally recognized statistical rating organization in section 3(a)(62) of the Exchange Act: (1) financial institutions, brokers, or dealers;⁶⁰² (2) insurance companies;⁶⁰³ (3) corporate issuers;⁶⁰⁴ (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, "as in effect on the date of enactment of this paragraph");⁶⁰⁵ and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.⁶⁰⁶

⁶⁰⁰ See 17 CFR.240.17g-1(i).

⁶⁰¹ As used throughout this release, the term category of a credit rating scale refers to a distinct level in a rating scale represented by a unique symbol, number, or score. For example, if a rating scale consists of symbols (for example, AAA, AA, A, BBB, BB, B, CCC, CC, and C), each unique symbol would represent a category in the rating scale. Similarly, if a rating scale consists of numbers (for example, 1, 2, 3, 4, 5, 6, 7, 8, and 9), each number would represent a category in the rating scale. Each category also represents a notch in the rating scale. In addition, some NRSRO rating scales attach additional symbols or numbers to the symbols representing categories in order to denote gradations within a category. For example, a rating scale may indicate gradations within a category by attaching a plus or a minus or a number to a rating symbol. For example, AA+, AA, and AA- or AA1, AA2, and AA3 would be three gradations within the AA category. If a rating scale has gradations within a category, each category and gradation within a category would constitute a notch in the rating scale. For example, the following symbols would each represent a notch in the rating scale in descending order: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, CCC+, CCC, CCC-, CC, C, and D. Furthermore, for the purposes of this release, changing a credit rating (for example, upgrading or downgrading the credit rating) means assigning a credit rating at a different notch in the rating scale (for example, downgrading an obligor assigned an AA rating to an AA- rating or an A+ rating).

⁶⁰² See 15 U.S.C. 78c(a)(62)(A)(i).

⁶⁰³ See 15 U.S.C. 78c(a)(62)(A)(ii).

⁶⁰⁴ See 15 U.S.C. 78c(a)(62)(A)(iii).

⁶⁰⁵ See 15 U.S.C. 78c(a)(62)(A)(iv). The instructions for Exhibit 1 in existence before today's amendments broadened this class of credit rating to include a credit rating of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. The intent

In addition, the instructions required that the performance statistics “must at a minimum show the performance of credit ratings in each class over 1-year, 3-year, and 10-year periods (as applicable) through the most recent calendar year-end, including, as applicable: historical ratings transition and default rates within each of the credit rating categories,⁶⁰⁷ notches, grades, or rankings used by the applicant or NRSRO as an indicator of the assessment of the creditworthiness of an obligor, security, or money market instrument in each class of credit rating.”

Before today’s amendments, the instructions for Exhibit 1 did not prescribe the methodology an applicant or NRSRO must use to calculate the performance statistics or the format by which they must be disclosed; nor did the instructions limit the type of information that can be disclosed in Exhibit 1.⁶⁰⁸ Consequently, as stated in a 2010 report of the GAO,

of the instruction was to include in the class (and, therefore, in the performance statistics for the class) credit ratings for structured finance products that are outside the scope of the definition referenced in section 3(a)(62)(A)(iv) of the Exchange Act. See 15 U.S.C. 78c(a)(62)(A)(iv); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6458. As discussed below, the final amendments to the instructions for Exhibit 1 continue to use this broadened definition.

⁶⁰⁶ See 15 U.S.C. 78c(a)(62)(A)(v). With respect to this class of credit ratings, the instructions for Exhibit 1 in existence before today’s amendments required the applicant or NRSRO to provide performance measurement statistics for the following three subclasses (as opposed to the class as a whole): sovereigns, U.S. public finance, and international public finance. As discussed below, the final amendments to the instructions for Exhibit 1 continue to require performance statistics for these subclasses.

⁶⁰⁷ The transition rate is the percent of credit ratings at a given rating notch that transition to another specified rating notch over a given time period. Only credit ratings that were outstanding at the beginning of the time period are used in the calculation of the transition rate. Transition rates are generally used to measure the stability of credit ratings. The default rate is the percent of credit ratings at a given rating notch that have defaulted over a given time period. Only the credit ratings that were outstanding at the beginning of the time period are used in the calculation.

⁶⁰⁸ When adopting Form NRSRO, the Commission explained that the instructions would not prescribe how NRSROs must calculate transition rates and default rates, noting that commenters had opposed a standard approach because NRSROs use different methodologies to determine credit ratings. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33574. The Commission stated that it intended to continue to consider the issue “to determine the feasibility, as well as the potential benefits and limitations, of devising measurements that would allow reliable comparisons of performance between NRSROs.” Id. The Commission took an incremental step toward standardizing the disclosure requirements in Exhibit 1 by amending the Form in 2009 to require an NRSRO to disclose transition and default rates for each class of credit rating for which it was registered and for 1-year, 3-year, and 10-year periods. See Amendments to Rules for Nationally Recognized Statistical Rating Organizations 74 FR at 6457-6459.

NRSROs at that time used different techniques to produce performance statistics, which limited the ability of investors and other users of credit ratings to compare the performance of credit ratings across NRSROs.⁶⁰⁹ In addition, several NRSROs included substantial amounts of information in Exhibit 1 about performance statistics, in addition to transition and default rates.

As noted above, NRSROs have produced and presented performance statistics in various ways. For example, for the calendar year 2009 performance statistics published by the NRSROs, some NRSROs used a “single cohort approach” to determine transition rates for their credit ratings.⁶¹⁰ Under this approach, an NRSRO would calculate transition rates for the most recent 1-year, 3-year, or 10-year period. For example, for its 2009 3-year transition rates for corporate issuers using the single cohort approach, an NRSRO would calculate transition rates for the class of corporate issuers for the period December 31, 2006 through December 31, 2009. Other NRSROs used an “average cohort approach.”⁶¹¹ Under this approach, an NRSRO would calculate transition rates for multiple 1-year, 3-year, or 10-year periods and then average them. For example, for its 2009 3-year transition rates for corporate issuers using the average cohort approach, an NRSRO would calculate 3-year transition rates for the class of corporate issuers for multiple 3-year periods (for example, 3-year periods from 1981 to 2009) and then average them. Two NRSROs also published “Lorenz curves,” which are “visual tools for assessing the accuracy of the rank ordering of creditworthiness that a set of ratings provides.”⁶¹² The GAO found that

⁶⁰⁹ See, e.g., GAO, Securities and Exchange Commission: Action Needed to Improve Rating Agency Registration Program and Performance Related Disclosures, Report 10-782 (Sept. 2010) (“GAO Report 10-782”). Section 7 of the Rating Agency Act required the GAO to review the implementation of the Rating Agency Act of 2006. See Pub. L. No. 109-291, 7. Among other things, the report evaluated the performance-related NRSRO disclosures required by Commission rules under the Exchange Act. See GAO Report 10-782, pp. 24-46.

⁶¹⁰ See GAO Report 10-782, p. 28.

⁶¹¹ Id.

⁶¹² Id. at 25, note 38 (“[Lorenz curves] are considered useful for comparing the relative accuracy of different rating systems or the relative accuracy of a single rating system measured at different points of time for

the variability in how NRSROs produce performance statistics limited the ability of investors and other users of credit ratings to compare the performance of credit ratings across NRSROs.⁶¹³

As described by the GAO, the single cohort approach uses information from the most recent time periods, while the average cohort approach uses information from multiple time periods. The GAO stated that the single cohort approach may be useful to predict the performance of credit ratings under similar circumstances, while the average cohort approach may be useful to predict future transition rates under different economic and other conditions.⁶¹⁴ The GAO also found that “[b]oth approaches are valid, depending on the needs of the user, but they do not yield comparable information.”⁶¹⁵

As indicated above, before today’s amendments, the instructions for Exhibit 1 permitted NRSROs to use differing methods to calculate performance statistics and to include additional information in Exhibit 1. This created the potential that the presentation of information in the exhibits would be inconsistent across NRSROs. To address this issue and to implement section 15E(q) of the Exchange Act, the Commission proposed significant amendments to the instructions for Exhibit 1.⁶¹⁶ The proposed amendments would standardize the calculation of the performance statistics by requiring the applicant or NRSRO to calculate 1-year, 3-year, and 10-year transition and default rates for each applicable class and subclass of credit rating using a single cohort approach.⁶¹⁷ Further, the results would need to be presented in tabular form using a

different cohorts.”).

⁶¹³ Id. at 27-37.

⁶¹⁴ Id. at 27.

⁶¹⁵ Id. at 27.

⁶¹⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33434-33444. See also 15 U.S.C. 78o-7(q)(2)(A) (requiring that the Commission’s rules require disclosures that are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs).

⁶¹⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33556-33558.

standardized format (a “Transition/Default Matrix”).⁶¹⁸ Finally, the proposed amendments would specify that an applicant or NRSRO must not disclose information in the Exhibit that is not required to be disclosed.⁶¹⁹

Under the proposal, the “issuers of asset-backed securities” class of credit ratings would be divided into the following subclasses: RMBS; CMBS; collateralized loan obligations (“CLOs”); CDOs; asset-backed commercial paper (“ABCP”); other asset-backed securities (“other ABS”); and other structured finance products (“other SFPs”).⁶²⁰

As stated above, under the proposal the applicant or NRSRO would be required to use the single cohort approach to calculate transition and default rates in order to determine the percent of credit ratings at each notch in the rating scale for a given class or subclass and for the applicable time period (one, three, or ten years) that were rated at the same notch or transitioned to another notch as of the end of the period, and the percent of credit ratings at each notch that were classified as a default or paid off, or had been withdrawn for reasons other than being classified as a default or paid off during the period.⁶²¹ For example, a matrix containing 3-year transition and default rates for the class of corporate issuers would disclose the number of credit ratings of corporate issuers the applicant or NRSRO had outstanding as of the period start date that is three years prior to the most recent calendar year end at each notch in the rating scale used by the applicant or NRSRO, the percent of those credit ratings that were rated at the same notch and the percent that transitioned to each other notch in the rating scale as of the end of the 3-year

⁶¹⁸ See *id.* at 33557.

⁶¹⁹ See *id.* at 33556-33557.

⁶²⁰ See *id.* at 33556.

⁶²¹ See *id.* at 33556-33558.

period, and the percent that were classified as a default or paid off, or had been withdrawn at any time during the 3-year period.⁶²²

The Commission proposed that an applicant or NRSRO must classify the credit rating assigned to an obligor, security, or money market instrument as a default if, during the applicable period, either: (1) the obligor failed to timely pay principal or interest due according to the terms of an obligation or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument; or (2) the applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of default.⁶²³ The applicant or NRSRO would need to classify an obligor, security, or money market instrument as having gone into default even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of default or withdrew the credit rating on or after the event of default.⁶²⁴

As proposed, an applicant or NRSRO would classify a credit rating assigned to an obligor, security, or money market instrument as paid off if, during the applicable period: (1) an obligor extinguished the obligation by paying in full all outstanding principal and interest due on the obligation according to the terms of the obligation (for example, because the obligation matured, was called, or was prepaid) and the applicant or NRSRO withdrew the credit rating because the obligation was extinguished; or (2) the issuer of a security or money market instrument extinguished its obligation with respect to the security or money market instrument by paying in full all outstanding principal and interest due according to the terms of the security

⁶²² See id. at 33556-33558.

⁶²³ See id. at 33557-33558.

⁶²⁴ See id. at 33441-33442, 33557-33558.

or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid) and the applicant or NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.⁶²⁵

The proposal would require the applicant or NRSRO to determine and disclose the number of obligors, securities, and money market instruments assigned a credit rating as of the period start date for which the applicant or NRSRO withdrew a credit rating at any time during the applicable time period for a reason other than that the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid-off.⁶²⁶ The applicant or NRSRO would have to classify the credit rating assigned to the obligor, security, or money market instrument as withdrawn even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing the credit rating.⁶²⁷

Finally, the performance statistics would need to be presented in a “Transition/Default Matrix” in a format specified in the instructions, which included a sample matrix.⁶²⁸

b. Final Rule

Paragraph (1) of the instructions for Exhibit 1. The Commission is adopting paragraph (1) of the instructions for Exhibit 1 with two technical modifications from the proposal.⁶²⁹ This

⁶²⁵ See id. at 33557-33558.

⁶²⁶ See 15 U.S.C. 78o-7(q)(2)(C) (requiring that the disclosures include information for credit ratings withdrawn by the NRSRO).

⁶²⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33557-33558.

⁶²⁸ See id. at 33557.

⁶²⁹ See paragraph (1) of the instructions for Exhibit 1. One commenter stated that the phrase “up-to-date Exhibit 1” as used in proposed paragraph (1) of the instructions for Exhibit 1 was ambiguous. See Moody’s Letter. Specifically, as proposed, paragraph (1) of the instructions for Exhibit 1 would provide that the performance measurement statistics must be updated yearly in the NRSRO’s annual certification in accordance with section 15E(b)(1)(A) of the Exchange Act and paragraph (f) of Rule 17g-1 (in particular, a Form NRSRO with updated performance measurement statistics – the annual certification – must be filed with the Commission no later than ninety days after the end of the calendar year). The proposed instructions also would remind an NRSRO that, pursuant to paragraph (i) of Rule 17g-1, the annual certification with the updated performance measurement statistics must be made publicly and freely

paragraph requires the applicant or NRSRO to provide performance statistics for each class of credit ratings for which the applicant is seeking registration as an NRSRO or the NRSRO is registered and for the applicable subclasses of credit ratings listed in the paragraph.⁶³⁰

Specifically, it requires the applicant or NRSRO to provide transition and default rates for 1-year, 3-year, and 10-year periods for each applicable class or subclass of credit rating.⁶³¹ It further requires the applicant or NRSRO to produce and present three separate transition and default statistics for each applicable class or subclass of credit rating; namely, for 1-year, 3-year, and 10-year time periods through the most recent calendar year end. In addition, the applicant or NRSRO must present the transition and default rates for each time period together in tabular form using a standard format (a "Transition/Default Matrix").⁶³²

Paragraph (1) of the instructions for Exhibit 1 specifies the classes and subclasses of credit ratings for which the applicant or NRSRO must produce Transition/Default Matrices, as applicable.⁶³³ The identified classes reference the classes of credit ratings for which an NRSRO can be registered as enumerated in the definition of nationally recognized statistical rating organization in section 3(a)(62)(A) of the Exchange Act.⁶³⁴ As was the case prior to today's

available on an easily accessible portion of the NRSRO's corporate Internet website within ten business days after the filing and that the NRSRO must make its "up-to-date" Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit. The Commission agrees with the comment and is replacing the phrase "up-to-date Exhibit 1" with the phrase "most recently filed Exhibit 1" as suggested by the commenter. Further, as proposed, the instructions referenced the "classes and subclasses" for which an applicant is seeking registration or for which an NRSRO is registered. As discussed in section II.I.1. of this release, a commenter noted that applicants and NRSROs do not register in "subclasses" of credit ratings. See DBRS Letter. Paragraph (1) of the instructions for Exhibit 1 has therefore been modified to make this clear. See paragraph (1) of the Instructions for Exhibit 1.

⁶³⁰ See paragraph (1) of the instructions for Exhibit 1.

⁶³¹ See id.

⁶³² See id.

⁶³³ See id.

⁶³⁴ Compare 15 U.S.C. 78c(a)(62)(A)(i) through (v), with paragraphs (1)(A) through (E) of the instructions for Exhibit 1. As was the case prior to today's amendments, paragraph (1) of the instructions for Exhibit 1 divides the class of credit ratings enumerated in section 3(a)(62)(A)(v) of the Exchange Act (issuers of

amendments, the class of credit ratings enumerated in section 3(a)(62)(A)(iv) of the Exchange Act (issuers of certain asset-backed securities) is expanded to include a broader range of structured finance products than are within the scope of the definition in section 3(a)(62)(A)(iv).⁶³⁵ Moreover, this class has been divided into the following subclasses: RMBS;⁶³⁶ CMBS;⁶³⁷ CLOs;⁶³⁸ CDOs;⁶³⁹ ABCP;⁶⁴⁰ other ABS;⁶⁴¹ and other structured finance products.⁶⁴²

Regarding the proposed seven subclasses of asset-backed securities, one commenter stated that the proposed degree of granularity “would lead to the creation of sparse Transition/Default Matrices because many NRSROs do not have enough ratings for each proposed subclass to produce statistically significant results” and that the class of ABS ratings

government securities, municipal securities, or securities issued by a foreign government) into three subclasses: sovereign issuers; U.S. public finance; and international public finance. See paragraph (1) of the instructions for Exhibit 1.

⁶³⁵ See paragraph (1) of the instructions for Exhibit 1; 15 U.S.C. 78c(a)(62)(A)(iv). As was the case before today’s amendments, the instructions for Exhibit 1 broaden this class of credit rating to include a credit rating of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.

⁶³⁶ The instructions provide that RMBS means a securitization of primarily residential mortgages. See paragraph (1)(D)(i) of the instructions for Exhibit 1.

⁶³⁷ The instructions provide that CMBS means a securitization of primarily commercial mortgages. See paragraph (1)(D)(ii) of the instructions for Exhibit 1.

⁶³⁸ The instructions provide that CLO means a securitization of primarily commercial loans. See paragraph (1)(D)(iii) of the Instructions for Exhibit 1.

⁶³⁹ The instructions provide that CDO means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other ABS, and corporate bonds. See paragraph (1)(D)(iv) of the instructions for Exhibit 1.

⁶⁴⁰ The instructions provide that ABCP means short term notes issued by a structure that securitizes a variety of financial assets (for example, trade receivables, credit card receivables), which secure the notes. See paragraph (1)(D)(v) of the instructions for Exhibit 1.

⁶⁴¹ The instructions provide that other ABS means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, equipment loans, or equipment leases. See paragraph (1)(D)(vi) of the instructions for Exhibit 1.

⁶⁴² The instructions provide that other structured finance product means a structured finance product that does not fit into any of the other subclasses of structured products. See paragraph (1)(D)(vii) of the instructions for Exhibit 1.

should be divided into three classes: RMBS, CMBS, and “Other ABS.”⁶⁴³ Another NRSRO stated that dividing the class of credit ratings for structured finance products as proposed “would tend to further increase market transparency” and that the proposed subclasses are “suitable,” but that “greater stratification may in some cases produce subclasses that are too small to generate meaningful statistics.”⁶⁴⁴

In response, the Commission notes that the reason for dividing the broad class of structured finance products into these subclasses is to provide investors and other users of credit ratings with more useful information about the performance of an NRSRO’s structured finance credit ratings.⁶⁴⁵ Each subclass has characteristics that distinguish it from the other subclasses. Consequently, the separation of performance statistics into these subclasses will provide users of credit ratings with additional information and allow them to compare the performance of the credit ratings in each subclass among the NRSROs. Further, the NRSRO must disclose the number of credit ratings outstanding in each subclass at the beginning of the period, so users of credit ratings will be aware of the number of credit ratings the statistics are based upon.

Paragraph (2) of the instructions for Exhibit 1. The Commission is adopting paragraph (2) of the instructions for Exhibit 1 with modifications.⁶⁴⁶ This paragraph prescribes how the applicant or NRSRO must present the performance statistics and other required information in the Exhibit.⁶⁴⁷ Specifically, it requires that the Transition/Default Matrices for each applicable

⁶⁴³ See DBRS Letter.

⁶⁴⁴ See S&P Letter.

⁶⁴⁵ See, e.g., GAO Report 10-782, p. 36 (observing that the various structured finance sectors have risk characteristics that vary significantly and, therefore, presenting performance statistics for the class as a whole “may not be useful.”). During the recent crisis, NRSROs assigned credit ratings to RMBS and CDOs that performed far differently than credit ratings of some other types of securitizations. See, e.g., S&P, A Global Cross-Asset Report Card of Ratings Performance in Times of Stress (June 8, 2010).

⁶⁴⁶ See paragraph (2) of the instructions for Exhibit 1.

⁶⁴⁷ See id.

class and subclass of credit ratings be presented in the order that the classes and subclasses are identified in paragraphs (1)(A) through (E) of the instructions for Exhibit 1.⁶⁴⁸ In addition, the order of the Transition/Default Matrices for a given class or subclass must be: the 1-year matrix, the 3-year matrix, and then the 10-year matrix.⁶⁴⁹ Further, if the applicant or NRSRO did not issue credit ratings in a particular class or subclass for the length of time necessary to produce a Transition/Default Matrix for a 1-year, 3-year, or 10-year period, it must explain that fact in the location where the Transition/Default Matrix would have been presented in the Exhibit.⁶⁵⁰

The instructions require the applicant or NRSRO to clearly define in Exhibit 1, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the applicant or NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit.⁶⁵¹ The instructions also require the applicant or NRSRO to clearly explain the conditions under which it classifies obligors, securities, or money market instruments as being in default.⁶⁵² Further, the instructions require that the applicant or NRSRO provide in Exhibit 1 the uniform resource locator ("URL") of its corporate Internet website where the credit

⁶⁴⁸ See id.

⁶⁴⁹ See id.

⁶⁵⁰ See id. For example, if an NRSRO is registered in the corporate issuer class but has been issuing credit ratings for only seven years in that class, it could not produce a 10-year Transition/Default Matrix for the class. Instead, the NRSRO must provide an explanation in the location where a 10-year Transition/Default Matrix would have been located (namely, after the 3-year matrix) that it had not been issuing credit ratings in that class for a sufficient amount of time to produce a 10-year Transition/Default Matrix.

⁶⁵¹ See paragraph (2) of the instructions for Exhibit 1. As discussed in section II.J.2. of this release, the Commission is implementing section 938(a)(2) of the Dodd-Frank Act through paragraph (b)(2) of Rule 17g-8, which requires an NRSRO to have policies and procedures reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class of credit ratings for which the NRSRO is registered, including in Exhibit 1 to Form NRSRO. See Pub. L. No. 111-203, 938(a)(2); paragraph (b)(2) of Rule 17g-8.

⁶⁵² See paragraph (2) of the instructions for Exhibit 1.

rating histories required to be disclosed pursuant to paragraph (b) of Rule 17g-7 would be located (in the case of an applicant) or are located (in the case of an NRSRO).⁶⁵³

Finally, as proposed, the instructions provided that the Exhibit must contain no performance statistics or information other than as described in, and required by, the instructions for Exhibit 1; except that the applicant or NRSRO would be permitted to provide, after the presentation of all required Transition/Default Matrices and other required disclosures, Internet website URLs where other information relating to performance statistics of the applicant or NRSRO is located.⁶⁵⁴ This provision was intended to address the fact that some NRSROs included substantial amounts of information in Exhibit 1 about performance statistics, in addition to transition and default rates.⁶⁵⁵ As discussed in more detail below, some commenters stated that there are advantages and limitations to using the single cohort approach as compared to the average cohort approach to calculate the performance statistics.⁶⁵⁶ While the instructions for Exhibit 1 mandate the use of the single cohort approach, the Commission believes that, if an NRSRO also calculates performance statistics using the average cohort approach, it would be appropriate to disclose that fact in Exhibit 1 and provide an Internet URL where the performance statistics are located. This will provide additional information to evaluate the performance of the NRSRO's credit ratings. For these reasons, paragraph (2) of the instructions for Exhibit 1 has been modified to provide that Exhibit 1 must contain no performance measurement statistics or

⁶⁵³ See *id.* As discussed below in section II.E.3. of this release, the Commission is amending Rule 17g-2 and Rule 17g-7 to enhance the rating histories disclosure requirements currently codified in Rule 17g-2. Among other things, the amendments relocate the credit rating history disclosure requirements from Rule 17g-2 to Rule 17g-7.

⁶⁵⁴ See paragraph (2) of the instructions for Exhibit 1. To the extent that an NRSRO wishes to include other information that it believes is relevant for the purposes of drawing comparisons among credit ratings, the NRSRO could use an Internet website URL as a channel to provide the reader with additional information the NRSRO believes to be relevant.

⁶⁵⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33437.

⁶⁵⁶ The advantages and limitations of the single cohort approach as compared to the average cohort approach are also discussed in section II.E.4. of this release.

information other than as described in, and required by, the Instructions for Exhibit 1; except that the NRSRO may provide after the presentation of all required Transition/Default Matrices and other disclosures:

- A short statement describing the required method of calculating the performance measurement statistics in Exhibit 1 (the single cohort approach) and any advantages or limitations to the single cohort approach the NRSRO believes would be appropriate to disclose;
- A short statement that the NRSRO has calculated and published on an Internet website performance measurement statistics using the average cohort approach (if applicable), a description of the differences between the single cohort approach and the average cohort approach used to calculate the performance measurement statistics, and the Internet website URL where the performance measurements statistics calculated using the average cohort approach are located; and
- The Internet website URLs where any other information relating to performance measurement statistics of the NRSRO is located.⁶⁵⁷

Paragraph (3) of the instructions for Exhibit 1. The Commission is adopting paragraph (3) of the instructions for Exhibit 1 with modifications to make the disclosures more understandable to users of credit ratings.⁶⁵⁸ This paragraph prescribes the format for a Transition/Default Matrix and includes a sample matrix.⁶⁵⁹ Specifically, the prescribed format is designed to allow the applicant or NRSRO to show in the matrix the number of outstanding credit ratings in the class or subclass at each notch in the applicable rating scale at the period start-date, and the percent of those credit ratings that were rated at the same notch at the end of the period, the percent of those credit ratings that were rated at each different notch in the rating scale at the end of the period, and the percent of those credit ratings that were classified as a default or paid off or were withdrawn at any time during the period.⁶⁶⁰ The prescribed format

⁶⁵⁷ See paragraph (2) of the instructions for Exhibit 1.

⁶⁵⁸ See paragraph (3) of the instructions for Exhibit 1.

⁶⁵⁹ See *id.*

⁶⁶⁰ See *id.*

also is designed so that this information will be displayed in Exhibit 1 in a standard manner across the NRSROs to make it easier for users of NRSRO credit ratings and others to understand and compare the statistics.

One commenter suggested adding the heading “Status of those ratings at the end of the time period” to the Transition/Default Matrix because “less sophisticated investors” may not understand the term “transition,” and also suggested that it may be useful to highlight the box on the chart that corresponds with the credit rating being at the same notch at the end of the period as it was at the beginning.⁶⁶¹ The Commission agrees that these types of modifications could assist users to better understand the information disclosed in the Transition/Default Matrices. Consequently, the narrative instructions in paragraph (3) and the illustration of the sample Transition/Default Matrix have been modified to require highlighting of the cell in the matrix that corresponds with the credit rating being at the same notch at the end of the period as it was at the beginning and to require that the legends at the top of the matrix reflect that the first two columns represent the status of the credit ratings as of the period start date, the subsequent rating category columns represent the status of the credit ratings as of the period end date, and the Default, Paid Off, and Withdrawn (other) columns represent other outcomes that occurred during the period.⁶⁶²

As adopted, the sample Transition/Default Matrix in Figure 2 is the sample matrix provided in the instructions that the applicant or NRSRO must use as a model for its Transition/Default Matrices.

⁶⁶¹ See CFA/AFR Letter. One commenter also suggested that the Commission re-propose the rules and, in doing so, require NRSROs to present their performance statistics in a way that allows the public to compare and cross-reference different assets with the same credit rating. See CFA II Letter. The Commission believes the amendments being adopted today – by simplifying the presentation of the transition and default statistics and enhancing the rating history disclosures – will make it much easier for this kind of comparison to be made.

⁶⁶² See paragraph (3) of the instructions for Exhibit 1.

Figure 2
Corporate Issuers – 10-Year Transition and Default Rates
(December 31, 2000 through December 31, 2010)

Credit Ratings as of 12/31/2000		Credit Ratings as of 12/31/2010 (Percent)									Other Outcomes During 12/31/2000-12/31/2010 (Percent)		
Credit Rating	Number of Ratings Outstanding	AAA	AA	A	BBB	BB	B	CCC	CC	C	Default	Paid Off	Withdrawn (other)
AAA	10	50%	10%									40%	
AA	2000	1%	39%	12%	10%	8%	5%	4%			1%	19%	1%
A	4000		6%	34%	15%	10%	6%	4%	3%		2%	18%	2%
BBB	3600		2%	9%	28%	15%	10%	6%	5%	1%	4%	17%	3%
BB	1000			2%	4%	20%	14%	5%			2%	16%	37%
B	500			1%	3%	6%	20%	20%	15%		15%	15%	5%
CCC	300					4%	6%	15%	25%	20%	20%	4%	6%
CC	200						2%	8%	10%	38%	30%	2%	10%
C	160							2%	8%	10%	67%	1%	12%
Total	11,770												

Paragraph (4) of the instructions for Exhibit 1. The Commission is adopting paragraph (4) of the instructions for Exhibit 1 with the modifications discussed below.⁶⁶³ This paragraph prescribes how the applicant or NRSRO must calculate the performance statistics and enter information into the Transition/Default Matrices.⁶⁶⁴

Determining Start Date Cohorts

The final amendments (as was proposed) require the applicant or NRSRO to use the single cohort approach to calculate the transition and default rates.⁶⁶⁵ One NRSRO stated that the single cohort approach is a “reasonable approach” and “is the best approach as it is, in our opinion, the clearest way to calculate a meaningful default rate.”⁶⁶⁶ Another NRSRO requested that the Commission provide “fuller background” on decisions such as the determination to use the single cohort approach rather than an average cohort approach, with a description of potential

⁶⁶³ See paragraph (4) of the instructions for Exhibit 1.

⁶⁶⁴ See *id.*

⁶⁶⁵ See *id.*

⁶⁶⁶ See S&P Letter. This commenter also stated that a better way to measure the performance of rating systems “that do not define their ratings in terms of target default and transition rates” is “a measure of rank-ordering power, such as the Gini coefficient.”

benefits and limitations of those decisions.⁶⁶⁷ Some commenters suggested that the Commission use an average cohort approach in lieu of or in addition to the single cohort approach.⁶⁶⁸

The Commission recognizes that different methods of measuring the performance of credit ratings may have unique advantages in terms of the information provided. As the GAO noted in comparing the single cohort approach and the average cohort approach, “[b]oth approaches are valid, depending on the needs of the user, but they do not yield comparable information.”⁶⁶⁹ For example, the average cohort approach may provide better information about how credit ratings perform on average across a wider variety of economic conditions when compared to the single cohort approach.⁶⁷⁰ However, the single cohort approach, because it does not average out performance over multiple cohorts, may more readily highlight how a given NRSRO’s credit ratings have performed in more recent economic cycles.

Moreover, the single cohort approach is a simpler approach than the other methods noted by the GAO and, therefore, it may be easier for less sophisticated investors and other users of credit ratings to understand how the performance statistics were produced. As stated above, section (q)(2)(B) of the Exchange Act provides that the Commission’s rules shall require that the performance measurement disclosures be clear and informative for investors having a wide range of sophistication.⁶⁷¹ The Commission notes that one commenter stated that the single cohort approach “is the clearest way to calculate a meaningful default rate.”⁶⁷² In addition, it will be

⁶⁶⁷ See Kroll Letter.

⁶⁶⁸ See DBRS Letter (advocating use of the average cohort approach); CFA/AFR Letter (advocating using both approaches).

⁶⁶⁹ See, e.g., GAO Report 10-782, p. 28.

⁶⁷⁰ See section II.E.4. of this release (discussing in more detail the relative advantages of the single and average cohort approaches).

⁶⁷¹ See 15 U.S.C. 78o-7(q)(2)(B).

⁶⁷² See S&P Letter.

easier for NRSROs to produce performance statistics using this approach as it requires simpler calculations and, consequently, will be less burdensome than the other approaches.

One commenter stated that the single cohort approach could lead to results that are “significantly more volatile within the shorter time period, which will make interpreting those results more difficult.”⁶⁷³ This commenter stated further that “the volatility impact will be amplified for NRSROs with fewer ratings, which could lead to bias against smaller NRSROs.”⁶⁷⁴ The Commission has balanced this concern with the need to prescribe an easy to understand method for calculating the performance statistics. As discussed below, the requirements in the instructions for Exhibit 1 provide for very transparent disclosures about the number of credit ratings in the start date cohort and in the cohort for each notch in the credit rating scale of a given class or subclass.⁶⁷⁵ This transparency will provide persons reviewing the performance statistics with information to assess how the small number of credit ratings in a given cohort may have impacted the results.⁶⁷⁶ Moreover, as discussed above, the Commission has modified paragraph (2) of the instructions for Exhibit 1 to permit an NRSRO to include a statement about any advantages or limitations to the single cohort approach the firm believes would be appropriate to disclose and, if applicable, a statement disclosing that the NRSRO has calculated performance

⁶⁷³ See DBRS Letter.

⁶⁷⁴ See *id.*

⁶⁷⁵ See paragraph (4)(A) of the instructions for Exhibit 1 (requiring the applicant or NRSRO to enter into the second column of the Transition/Default Matrix the number of credit ratings in the start-date cohort for each notch in the rating scale). This disclosure is illustrated in the first and second columns of the Sample Transition/Default Matrix in Figure 2 (above).

⁶⁷⁶ For example, if the outcome for a notch with ten credit ratings is that five were classified as a default during the period, the default rate reflected on the Transition/Default Matrix for that notch would be 50%. Similarly, if the outcome of a notch with 5,000 credit ratings is that 2,500 were classified as a default during the period, the default rate for that notch would be 50% as well. Investors and other users of credit ratings might conclude that 2,500 credit ratings being classified as defaulting during the period reflects significantly worse performance than five credit ratings being classified as defaulting during the period.

statistics using the average cohort approach and identifying the Internet website URL where those statistics are located.

One commenter suggested that NRSROs should be required to calculate performance statistics using both the single cohort approach and the average cohort approach.⁶⁷⁷ One of the objectives of the amendments is to make the disclosures in Exhibit 1 to Form NRSRO shorter and easier to understand. Mandating two sets of 1-year, 3-year, and 10-year performance statistics (one based on the single cohort approach and one based on the average cohort approach) for each class or subclass of credit ratings would substantially increase the length and complexity of the disclosure in Exhibit 1. In addition, it would increase the compliance burden. However, as discussed above, NRSROs that also calculate performance statistics using the average cohort approach can disclose that fact in Exhibit 1.

Finally, one commenter stated that NRSROs should be required to use the single cohort approach for credit ratings of corporate and sovereign debt and a “static pool approach” for credit ratings of structured finance products.⁶⁷⁸ The Commission believes that doing so would make the disclosure unnecessarily complex and undermine the objective of making the performance statistics clear and informative for investors having a wide range of sophistication.⁶⁷⁹

For all the reasons discussed above, the final amendments require NRSROs to produce the performance statistics using the single cohort approach.⁶⁸⁰ However, in response to comments, the Commission is modifying the requirement with respect to identifying the credit

⁶⁷⁷ See CFA/AFR Letter.

⁶⁷⁸ See TradeMetrics Letter.

⁶⁷⁹ See 15 U.S.C. 78o-7(q)(2)(B).

⁶⁸⁰ See paragraph (4) of the instructions for Exhibit 1.

ratings that must be included in a start-date cohort. Several commenters addressed the proposed requirement that a start-date cohort consist of the obligors, securities, and money market instruments in the applicable class or subclass of credit ratings that were assigned a credit rating as of the beginning of the period. One NRSRO stated that “mixing units of study,” consisting of obligors, securities, and money-market instruments “can create mismatched data and potentially double counting.”⁶⁸¹ Similarly, another NRSRO recommended that, except for the structured finance class of credit ratings, the rule should require calculating a senior credit rating for a given issuer and using that rating in the construction of the cohort, as a single issuer can have many issuances, and including each one in the cohort may skew the performance statistics.⁶⁸² A third NRSRO stated that for the structured finance category of credit ratings, “the obligations/issues should be included in the start-date cohorts” because “those transactions do not have obligors in a traditional sense...”⁶⁸³ A fourth NRSRO agreed, stating that “the start-date cohorts should be comprised of obligors for corporate ratings and securities lines for the various subclasses of structured finance ratings.”⁶⁸⁴

The Commission agrees with these comments and has modified the instructions. The final amendments provide that, to determine the number of credit ratings outstanding as of the period start date for all classes of credit ratings other than the class of issuers of asset-backed securities, the applicant or NRSRO must: (1) identify each obligor that the applicant or NRSRO assigned a credit rating to as an entity where the credit rating was outstanding as of the period start date; (2) identify each additional obligor that issued securities or money market instruments

⁶⁸¹ See Kroll Letter.

⁶⁸² See Moody's Letter.

⁶⁸³ See S&P Letter.

⁶⁸⁴ See DBRS Letter.

that the applicant or NRSRO assigned credit ratings to where the credit ratings were outstanding as of the period start date; and (3) include in the start-date cohort only credit ratings assigned to an obligor as an entity, or, if the obligor is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt.⁶⁸⁵ All other credit ratings outstanding as of the period start date assigned to securities or money market instruments issued by the obligor must be excluded from the start-date cohort.⁶⁸⁶ For the class of issuers of asset-backed securities, the start-date cohort (as was proposed) must consist of credit ratings that the applicant or NRSRO assigned to all securities or money market instruments in the class where the credit ratings were outstanding as of the period start date, excluding expected or preliminary credit ratings.⁶⁸⁷

Finally, as proposed, the start date cohort for all classes of credit ratings must exclude credit ratings that the applicant or NRSRO classified as in default (using its own definition of default) as of the period start-date (and, as discussed above, expected or preliminary credit ratings).⁶⁸⁸ As explained in the proposing release, the Transition/Default Matrices should not

⁶⁸⁵ See paragraph (4)(A) of the instructions for Exhibit 1.

⁶⁸⁶ See id. For example, assume an obligor is assigned a credit rating of AA as an entity, and also has outstanding senior unsecured debt that is also rated AA and subordinated debt that is rated BBB, meaning there are a total of three credit ratings associated with the obligor. Under the final amendments, the obligor's credit rating as an entity must be included in the start-date cohort, and the credit ratings of the obligor's senior unsecured debt and subordinated debt must be excluded. Alternatively, if the obligor in the above example is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt must be included in the start-date cohort and the credit rating of the obligor's subordinated debt must be excluded.

⁶⁸⁷ See paragraph (4)(A) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33438. For example, assume a structured finance issuer has ten tranches of securities and the NRSRO has assigned credit ratings to six of the tranches. All six credit ratings must be included in the start-date cohort. As stated, "expected" or "preliminary" credit ratings must be excluded from the start-date cohort. These types of credit ratings most commonly are issued by an NRSRO with respect to a structured finance product at the time the issuer commences the offering and typically are included in pre-sale reports. Expected or preliminary credit ratings may include a range of credit ratings, or any other indications of a credit rating prior to the assignment of an initial credit rating for a new issuance. Consequently, they should be excluded from the start date cohort since the issuance of the initial credit rating is the first formal expression of the NRSRO's view of the relative creditworthiness of the obligor, security, or money market instrument.

⁶⁸⁸ See paragraph (4)(A) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33438-33439. The determination of whether the credit rating of the obligor,

include credit ratings of obligors, securities, and money market instruments the applicant or NRSRO has classified as in default because the firm is no longer assessing the relative likelihood that the obligor, security, or money market will continue to meet its obligations to make timely payments of principal and interest as they come due (that is, not default on its obligations).⁶⁸⁹ Consequently, as long as the obligor, security, or money market instrument continues to be classified as in default there is no credit rating performance to measure. However, if the credit rating is upgraded from the default category because, for example, the obligor emerges from a bankruptcy proceeding, the obligor's credit rating will need to be included in a Transition/Default Matrix that has a start date after the upgrade.⁶⁹⁰

security, or money market instrument should be excluded from the start-date cohort would be based on the definition of default used by the applicant or NRSRO. As discussed below, in determining the outcome of a credit rating assigned to an obligor, security, and money market instrument during the applicable time period covered by a Transition/Default Matrix, the applicant or NRSRO will need to use the standard definition of default in paragraph (4)(B)(iii) of the instructions for Exhibit 1 (as opposed to its own definition). The use of a standard definition of default to determine the outcome of a credit rating during the applicable time period could result in a credit rating of an obligor, security, or money market instrument being included in the start-date cohort that, as of the start date, would be classified as in default under the standard definition of default in paragraph (4)(B)(iii). This is because the applicant or NRSRO may not have classified the obligor, security, or money market instrument as in default as of the start date if it uses a definition of default that is narrower than the standard definition in paragraph (4)(B)(iii). In this case, the credit rating of the obligor, security, or money market instrument should be included in the start-date cohort since the applicant or NRSRO, as of the start date, had assigned it a credit rating representing a relative assessment of the likelihood of default (rather than a classification of default) on the start date. Thus, the performance of the applicant or NRSRO in rating that obligor, security, or money market instrument should be incorporated into the default rate shown on the Transition/Default Matrix.

⁶⁸⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33438-33439. This does not mean that the obligor, security, or money market instrument will never be reflected in default rates. For example, assume that as of the date ten years prior to the most recently ended calendar year-end an obligor in the corporate issuer class was assigned a credit rating of BBB. This credit rating will be included in the start-date cohort for the 10-year Transition/Default Matrix and grouped with the other BBB credit ratings. Further, assume that during the first seven years of the 10-year period, the credit rating of the obligor was downgraded from BBB to BB (in year two), from BB to B (in year five) and from B to CCC (in year seven). Having an outstanding credit rating of CCC in year seven, the obligor's credit rating will be included in the start-date cohort for the 3-year Transition/Default Matrix and grouped with the other CCC credit ratings. Finally assume the obligor defaults in year 8. For the purposes of the 10-year and 3-year Transition/Default Matrices, the obligor's credit rating will need to be classified as having defaulted and be included in the default rates calculated for those matrices. However, because the obligor will be in default as of the period start date for the 1-year Transition/Default Matrix, it will not be included in the start-date cohort for that matrix.

⁶⁹⁰ See paragraph (4)(A) of the instructions for Exhibit 1. For example, assume an obligor was classified as in default by the NRSRO as of the start date for the 10-year Transition/Default Matrix. The obligor's credit

After determining the credit ratings in the start-date cohort, the applicant or NRSRO must determine the number of credit ratings in the start-date cohort for each notch in the rating scale used for the class or subclass as of the period start date.⁶⁹¹ The final step is to enter these amounts, as well as the total number of credit ratings in the start-date cohort, in the second column of the Transition/Default Matrix.⁶⁹²

Calculating Transition and Default Statistics

Paragraph (4)(B) of the instructions for Exhibit 1 prescribes how the applicant or NRSRO must calculate the performance statistics and enter the results into the Transition/Default Matrices.⁶⁹³ More specifically, the instructions provide that each row representing a credit rating notch in the Transition/Default Matrix must contain percentages indicating the credit rating outcomes as of the period end date for all the credit ratings in the start-date cohort at that notch as of the period start date.⁶⁹⁴ The instructions also provide that the percentages in a row must

rating would be excluded from the start-date cohort for the matrix. Assume further that two years later the obligor emerged from a bankruptcy proceeding after a restructuring. At that point in time, the NRSRO upgraded the obligor from the default category by assigning it a credit rating of BBB. Assume that three years later the NRSRO upgraded the obligor's credit rating from BBB to A- and that it retained that rating for the next five years. In this case, the obligor must be included in the start-date cohorts for the 1-year and 3-year Transition/Default Matrices.

⁶⁹¹ See paragraph (4)(A) of the instructions for Exhibit 1. For the class of credit ratings in the Sample Transition/Default Matrix in Figure 2, this would mean determining how many credit ratings in the start-date cohort were assigned a credit rating of AAA, AA, A, BBB, BB, B, CCC, CC, and C as of the start date. For example, the Sample Transition/Default Matrix in Figure 2 shows a total start-date cohort of 11,770 credit ratings. Within this cohort and as of the December 31, 2000 start date, ten were AAA credit ratings, 2000 were AA credit ratings, 4000 were A credit ratings, 3600 were BBB credit ratings, 1000 were BB credit ratings, 500 were B credit ratings, 300 were CCC credit ratings, 200 were CC credit ratings, and 160 were C credit ratings.

⁶⁹² See paragraph (4)(A) of the instructions for Exhibit 1.

⁶⁹³ See paragraph (4)(B) of the instructions for Exhibit 1.

⁶⁹⁴ See *id.* For example, in the Sample Transition/Default Matrix in Figure 2, cumulative outcomes would need to be calculated for: the cohort of ten credit ratings at the AAA notch; the cohort of 2000 credit ratings at the AA notch; the cohort of 4000 credit ratings at the A notch; the cohort of 3600 credit ratings at the BBB notch; the cohort of 1000 credit ratings at the BB notch; the cohort of 300 credit ratings at the CCC notch; the cohort of 200 credit ratings at the CC notch; and the cohort of 160 credit ratings at the C notch.

add up to 100%.⁶⁹⁵ The final amendments (as was proposed) identify five potential outcomes for a credit rating in the start-date cohort: (1) it is assigned the same credit rating as of the period end date; (2) it is assigned a different credit rating as of the period end date; (3) it was classified as a default at any time during the period; (4) it was classified as paid off at any time during the period; or (5) the applicant or NRSRO withdrew the credit rating at any time during the period for a reason other than that the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid off.⁶⁹⁶ Because the percentages in a row must add up to 100%, each credit rating in a start-date cohort must be assigned one and only one outcome.⁶⁹⁷

The final amendments (as was proposed) require the applicant or NRSRO to determine the number of credit ratings in a given notch as of the period start date that were assigned the same credit rating as of the period end date.⁶⁹⁸ The instructions require that: (1) this number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date; (2) the percent must be entered in the column representing the same notch; and (3) the cell must be highlighted.⁶⁹⁹ An obligor, security, or money market instrument could have the same credit rating as of the period end date because the credit rating did not change between the start date and the end date or the credit rating transitioned to one or more other notches in the rating scale during the relevant period but transitioned back to the start-date notch where it

⁶⁹⁵ See paragraph (4)(B) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, the outcomes for the ten credit ratings in the AAA category are: 50% remained at the AAA category, 10% transitioned to the AA category, and 40% were paid off during the period.

⁶⁹⁶ See paragraphs (4)(B)(i) through (v) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33557-33558.

⁶⁹⁷ See paragraph (4)(B) of the instructions for Exhibit 1.

⁶⁹⁸ See paragraph (4)(B)(i) of the instructions for Exhibit 1.

⁶⁹⁹ For example, in the Sample Transition/Default Matrix in Figure 2, there were ten credit ratings in the AAA cohort as of the December 31, 2000 start date. Of these ten, five (or 50%) were assigned a credit rating of AAA as of the December 31, 2010 end date. Accordingly, 50% is entered in the AAA column.

remained as of the period end date. Consequently, the instructions provide that, to determine this number, the applicant or NRSRO must use the credit rating at the notch assigned to the obligor, security, or money market instrument as of the period end date and not a credit rating at any other notch assigned to the obligor, security, or money market instrument between the period start date and the period end date.⁷⁰⁰

The final amendments (as was proposed) require the applicant or NRSRO to determine the number of credit ratings in a given notch at the period start date that were assigned a credit rating at each other notch in the rating scale as of the period end date.⁷⁰¹ The instructions require that: (1) these numbers must be expressed as percentages of the total number of credit ratings at that notch as of the period start date; and (2) the percentages must be entered in the columns representing each notch.⁷⁰² The instructions in the paragraph clarify that, to determine these numbers, the applicant or NRSRO would need to use the credit rating at the notch assigned to the obligor, security, or money market instrument as of the period end date and not a credit rating at

⁷⁰⁰ See paragraph (4)(B)(i) of the instructions for Exhibit 1. For example, assume an obligor was assigned a credit rating of BBB as of the start date of a 10-year Transition/Default Matrix. Assume further that three years after the start date, the credit rating was upgraded to AA but then eight years after the start date the credit rating was downgraded to A, and nine years after the start date the credit rating was downgraded to BBB where it remained as of the period end date. For the purpose of the 10-year Transition/Default Matrix, the outcome assigned to this obligor would be that it had the same credit rating as of the period end date. However, the transitions that occurred in years eight and nine would be reflected, respectively, in the 3-year and 1-year Transition/Default Matrices for the class or subclass of credit ratings. In other words, the credit rating history for this obligor would reflect volatility over the short term but stability over the long term.

⁷⁰¹ See paragraph (4)(B)(ii) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33557-33558.

⁷⁰² See paragraph (4)(B)(ii) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, there were 2000 credit ratings in the AA cohort as of the December 31, 2000 start date. Of these 2000 credit ratings, as of the period end date: twenty (or 1%) transitioned to the AAA notch; 780 (or 39%) were at the AA notch as of the period end date; 240 (or 12%) transitioned to the A notch; 200 (or 10%) transitioned to the BBB notch; 160 (or 8%) transitioned to the BB notch; 100 (or 5%) transitioned to the B notch; and eighty (or 4%) transitioned to the CCC notch. Accordingly, 1% is entered into the AAA column, 39% is entered into the AA column, 12% is entered into the A column, 10% is entered into the BBB column, 8% is entered into the BB column, 5% is entered into the B column, and 4% is entered into the CCC column.

any other notch assigned to the obligor, security, or money market instrument between the period start date and the period end date.⁷⁰³

The final amendments (as was proposed) require the applicant or NRSRO to determine the total number of credit ratings in a given notch at the period start date that were classified as a default at any time during the applicable time period.⁷⁰⁴ The instructions require that: (1) this number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date; and (2) the percent must be entered in the Default column.⁷⁰⁵

As indicated, the applicant or NRSRO must treat the credit rating as a default if the credit rating was classified as a default at any time during the applicable period.⁷⁰⁶ This is different from the calculations of the percent of credit ratings that stayed at the same notch or transitioned to a different notch in the rating scale that are based on the end-date status of the credit rating.⁷⁰⁷ This period-long approach is designed to address concerns that an applicant or NRSRO might

⁷⁰³ See paragraph (4)(B)(ii) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33557-33558. As explained above, the applicant or NRSRO must reflect in the transition rate for a given notch the credit ratings at that notch as of the period end date (rather than any other credit ratings during the period). For example, in the Sample Transition/Default Matrix in Figure 2, there were 2000 credit ratings at the AA notch as of December 31, 2000. As of December 31, 2010, 4% (or 80) of the credit ratings were at the CCC notch. The path by which these credit ratings arrived at the CCC notch as of the period end date could have been through a series of rating actions that occurred during the ten year period (e.g., being downgraded to A, then BBB, then BB, then B, and then CCC). The credit ratings during the period, other than the CCC rating as of the period end, must not be reflected in the transition rate for the AA notch.

⁷⁰⁴ See paragraph (4)(B)(iii) of the instructions for Exhibit 1; Nationally Recognized Statistical Rating Organizations, 76 FR at 33557-33558.

⁷⁰⁵ See paragraph (4)(B)(iii) of the instructions for Exhibit 1. For example, in the Sample Transition/Default Matrix in Figure 2, there were 500 credit ratings in the B cohort as of the December 31, 2000 start date. Of these 500 credit ratings, seventy-five (or 15%) were classified as having gone into default during the period (December 31, 2000 through December 31, 2010). Accordingly, 15% is entered in the Default column.

⁷⁰⁶ See paragraph (4)(B)(iii) of the instructions for Exhibit 1.

⁷⁰⁷ See paragraphs (4)(B)(i) and (ii) of the instructions for Exhibit 1.

withdraw a credit rating that was classified as a default during the period in order to improve the default rates presented in the matrix.⁷⁰⁸

The Commission proposed a standard definition of default to be used to classify credit ratings as defaults for the purposes of calculating the default rates.⁷⁰⁹ The Commission's goal in proposing a standard definition was to make the default rates calculated and disclosed by the NRSROs more readily comparable.⁷¹⁰ The Commission was concerned that if applicants or NRSROs use their own definitions of default, differences in those definitions could result in applicants and NRSROs inconsistently classifying credit ratings as in default.⁷¹¹

A number of commenters addressed the proposed standardized definition of default. One NRSRO stated that it agreed "in principle that there may be value in having" a standard definition "so long as allowance is made for ratings that use a term such as 'default' in a non-standard way."⁷¹² Another NRSRO stated that the proposed definition of default would fail to classify as defaults non-payment events on all instruments that legally constitute equity,

⁷⁰⁸ See 15 U.S.C. 78o-7(q)(2)(C) (providing that the disclosures include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the NRSRO). The following provides an example of how withdrawals can be used to impact a default rate. In the Sample Transition/Default Matrix in Figure 2, the default rate over the 10-year period for the 3600 credit ratings at the BBB notch is 4%. This means that 144 credit ratings in this cohort were classified as a default during the period ($144/3600 = 4\%$). If the default rate was determined by the credit rating assigned to these 144 obligors as of the period end date, the NRSRO could withdraw, for example, 100 of these credit ratings after default. Consequently, only forty-four of the credit ratings would be classified as a default as of the period end-date and, therefore, the default rate for the BBB notch would be approximately 1.2% instead of 4% ($44/3600 = \text{approximately } 1.2\%$).

⁷⁰⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33440-33442, 33557-33558.

⁷¹⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33441. See also 15 U.S.C. 78o-7(q)(2)(A) (providing that the Commission's rules shall require disclosures that are comparable among NRSROs, to allow users of credit ratings to compare the performance of credit ratings across NRSROs).

⁷¹¹ See, e.g., GAO Report 10-782, p. 38 ("NRSROs can differ in how they define default. Therefore, some agencies may have higher default rates than others as a result of a broader set of criteria for determining that a default has occurred.").

⁷¹² See Kroll Letter.

including all securitization instruments that use “pass-through” trusts.⁷¹³ One NRSRO stated that requiring an NRSRO to classify a security as having gone into default when the NRSRO would not choose that classification under its definition “comes dangerously close to the prohibition against regulating the substance of credit ratings.”⁷¹⁴ This NRSRO also suggested that the proposed language be modified to clarify that the “terms of an obligation” include any grace periods within which an obligor or issuer might cure the default. Another commenter objected to the proposed definition of default, because by incorporating the definition used by the NRSRO it “defeats the aim of promoting uniformity in the performance data for credit ratings.”⁷¹⁵

The Commission is adopting a standard definition of default with a modification from the proposal to broaden the definition to capture certain events identified by one commenter. As adopted, the final amendments provide that the applicant or NRSRO must classify a credit rating as a default if any of the following conditions are met:

- The obligor failed to timely pay principal or interest due according to the terms of an obligation during the applicable period or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument during the applicable period;
- The security or money market instrument was subject to a write-down, applied loss, or other realized deficiency of the outstanding principal amount during the applicable period; or
- The applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of default during the applicable period.⁷¹⁶

The first and second prongs of the definition comprise the standard definition of default that must be used by the applicant or NRSRO.⁷¹⁷ The second prong was added to the definition

⁷¹³ See S&P Letter.

⁷¹⁴ See DBRS Letter.

⁷¹⁵ See Better Markets Letter.

⁷¹⁶ See paragraphs (4)(B)(iii)(a) through (c) of the instructions for Exhibit 1.

in response to a comment that the standard definition of default did not incorporate certain events generally viewed as defaults but that do not involve failure to timely pay principal or interest, such as events relating to securitization instruments that use pass-through trusts.⁷¹⁸ The legal terms of securitizations using pass-through trusts generally do not entitle the certificate holders to receive a greater amount than is collected by the trust. Therefore, failure to make payments to certificate holders in excess of the amounts collected would not constitute a payment default as contemplated under the first prong of the definition.

The second prong is meant to capture events – such as principal write-downs – that are generally viewed to be defaults on this type of security even though such events do not involve failure to timely pay principal or interest. For example, a securitization that uses a pass through trust may experience a write-down of its principal due to losses on underlying collateral backing the security, if those losses cause the security to become under-collateralized (i.e., the principal balance of the collateral is less than the principal balance owed to the holders of the security). Such a write-down results in an immediate loss to the certificate holders since the principal balance against which interest is calculated has been reduced. This is usually considered a situation of default for this type of security. The second prong would also capture distressed exchanges of preferred stock and other hybrid instruments where the principal amount due to preferred security holders is reduced, resulting in a loss to the security holders.

In response to the comment questioning whether the Commission should prescribe a standard definition of default,⁷¹⁹ the Commission notes that one objective of a standard definition

⁷¹⁷ See paragraphs (4)(B)(iii)(a) and (b) of the instructions for Exhibit 1.

⁷¹⁸ See S&P Letter. See also Nationally Recognized Statistical Rating Organizations, 76 FR at 33444 (soliciting comment on whether the proposed standard definition of default was sufficiently broad to apply to most, if not all, events commonly understood as constituting a default).

⁷¹⁹ See DBRS Letter.

is to avoid a situation in which NRSROs use differing definitions of default, which, as stated above, could result in some NRSROs using materially narrower definitions in order to produce more favorable default rates. Moreover, consistent with paragraph (q)(2)(A) of section 15E of the Exchange Act, the Commission sought to establish a rule that requires disclosures that are comparable among NRSROs and allows users of credit ratings to compare the performance of credit ratings across NRSROs.⁷²⁰ Further, the final amendments do not require that NRSROs use the standard definition of default in determining and monitoring credit ratings. The amendments only require that the standard definition be used in calculating credit rating default statistics. Consequently, the amendments do not regulate the substance of credit ratings or the procedures or methodologies an NRSRO uses to determine credit ratings.⁷²¹

The third prong of the definition applies if the applicant or NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of default.⁷²² In response to the comment questioning whether the rule should incorporate the applicant's or NRSRO's internal definition,⁷²³ the objective is to supplement the standard definition to address a situation in which the applicant's or NRSRO's definition of default is broader than the standard definition. In this case, the NRSRO potentially could classify a rated obligor, security, or money market instrument as having gone into default during the time period even though, under the standard definition, the applicant or NRSRO would not need to make a default classification. As stated above, each credit rating in the start date cohort must be assigned one of five potential outcomes: (1) it is assigned the same credit rating as of the period

⁷²⁰ See 15 U.S.C. 78o-7(q)(2)(A).

⁷²¹ See 15 U.S.C. 78o-7(c)(2); DBRS Letter.

⁷²² See paragraph (4)(B)(iii)(c) of the instructions for Exhibit 1.

⁷²³ See Better Markets Letter.

end date; (2) it is assigned a different credit rating as of the period end date; (3) it was classified as a default at any time during the period; (4) it was classified as paid off at any time during the period; or (5) the applicant or NRSRO withdrew the credit rating at any time during the period for a reason other than the credit rating assigned to the obligor, security, or money market instrument was classified as a default or paid off. If the NRSRO has classified the credit rating as a default, there is no other outcome other than default that would be appropriate. It would make the Transition/Default Matrices unnecessarily complex to specify a sixth outcome: that the NRSRO has classified the credit rating as a default but the standard definition did not. The standard definition is broad (particularly with the modification discussed above) and should apply to most cases commonly understood as a default. Consequently, it should rarely happen that an applicant or NRSRO classifies a credit rating as a default and the standard definition does not.⁷²⁴ For these reasons, the definition incorporates the applicant's or NRSRO's definition of default.

The Commission agrees with the comment suggesting that the "terms of an obligation" as used in the standard definition of default would include any grace period provided in those terms within which an obligor or issuer may cure the default.⁷²⁵ Consequently, an applicant or NRSRO need not classify a credit rating as a default under the standard definition if the obligor is within a grace period specifically provided for under the terms and conditions of the obligation and subsequently "cures the default."

⁷²⁴ The Commission recognizes that supplementing the standard definition of default with the definition used by the applicant or NRSRO creates the potential for inconsistent classifications. However, any such impact will increase the number of defaults for purposes of calculating the performance statistics (that is, the definition used by the applicant or NRSRO cannot narrow the standard definition). The Commission believes that the incremental increase in the number of credit ratings classified as default using the internal definition would be minimal given the broad scope of the standard definition and, therefore, would not have a material impact on the overall default rates.

⁷²⁵ See DBRS Letter.

Finally, as proposed, the final amendments provide that a credit rating must be classified as a default even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of default or withdrew the credit rating on or after the event of default.⁷²⁶ This is designed to make clear that the requirement that a credit rating classified as a default at any time during the period covered by the Transition/Default Matrix must be included in the default rate irrespective of any post-default rating actions taken by the NRSRO.

As discussed above, the Transition/Default Matrix must provide statistics on the number of credit ratings in the start-date cohort at a given rating notch that were classified as paid off at any time during the relevant period.⁷²⁷ The instructions require that: (1) this amount be expressed as a percent of the total number of a credit ratings in the start date cohort as of the period start date; and (2) the percent be entered in the Paid Off column.⁷²⁸ This classification must be made if the credit rating is classified as paid off at any time during the period.⁷²⁹

The proposed rule prescribed a standard definition of paid off with two prongs: (1) one applicable to obligors; and (2) one applicable to securities and money market instruments.⁷³⁰ One commenter stated that the paid off classification as applied to obligors "is not practicable" because some obligors do not have rated debt outstanding and it would be difficult to track whether all obligations of an obligor are paid off.⁷³¹ Further, as discussed above, the

⁷²⁶ See paragraph (4)(B)(iv) of the instructions for Exhibit 1.

⁷²⁷ See paragraph (4)(B)(iv) of the instructions for Exhibit 1.

⁷²⁸ Id. For example, in the Sample Transition/Default Matrix in Figure 2, there were 200 credit ratings in the CC cohort as of the December 31, 2000 start date. Of these 200 credit ratings, four (or 2%) were classified as paid off during the period (December 31, 2000 through December 31, 2010). Accordingly, 2% is entered in the Paid Off column.

⁷²⁹ See paragraph (4)(B)(iv) of the instructions for Exhibit 1.

⁷³⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33442, 33557-33558.

⁷³¹ See S&P Letter.

determination of the start-date cohorts for classes of credit ratings other than the issuer of asset-backed securities class will require – under the modifications to the proposal – that the applicant or NRSRO use the credit ratings of obligors as entities and exclude the credit ratings of securities issued by the obligor unless the obligor does not have an entity credit rating (in which case only the credit rating of the obligor’s senior unsecured debt must be included). A credit rating of an obligor as an entity does not relate to a single obligation with a maturity date but rather to the obligor’s overall ability to meet any obligations as they come due. Therefore, an obligor credit rating normally cannot be classified as paid off since it does not reference a specific obligation that will mature.

For these reasons, the Commission has modified the standard definition of paid off to eliminate the prong that applied to entity ratings of obligors. The final amendments provide that the applicant or NRSRO must classify the credit rating as paid off only if the issuer of the security or money market instrument extinguished its obligation with respect to the security or money market instrument during the applicable time period by paying in full all outstanding principal and interest due according to the terms of the security or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid); and the applicant or NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.⁷³²

As discussed above, the Transition/Default Matrix must provide statistics on the number of credit ratings in the start-date cohort at a given rating notch that were withdrawn for a reason other than they were classified as a default or paid-off.⁷³³ The instructions require that: (1) this amount be expressed as a percent of the total number of credit ratings at a given notch in the

⁷³² See paragraph (4)(B)(iv)(b) of the instructions for Exhibit 1.

⁷³³ See paragraph (4)(B)(v) of the instructions for Exhibit 1.

rating scale as of the period start date; and (2) the percent be entered in the Withdrawn (other) column.⁷³⁴ The instructions provide that the applicant or NRSRO must classify the credit rating as withdrawn even if the applicant or NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing the credit rating.⁷³⁵

There are legitimate reasons to withdraw a credit rating assigned to an obligor, security, or money market instrument. For example, an NRSRO might withdraw a credit rating because the rated obligor or issuer of the rated security or money market instrument stopped paying for the surveillance of the credit rating or because the NRSRO issued and was monitoring the credit rating on an unsolicited basis and no longer wanted to devote resources to monitoring it.

However, an applicant or NRSRO could withdraw a credit rating to make its transition or default rates appear more favorable.⁷³⁶ The Commission believes that the instructions with respect to withdrawn credit ratings permit NRSROs the flexibility to withdraw credit ratings for legitimate reasons, including those stated above, while helping to prevent manipulation that would make their transition or default rates appear more favorable.

The Commission did not propose that NRSROs be required to track obligors, securities, or money market instruments after they had withdrawn credit ratings assigned to them, but the

⁷³⁴ Id. For example, in the Sample Transition/Default Matrix in Figure 2, there were 4000 credit ratings in the A cohort as of the December 31, 2000 start date. Of these 4000 credit ratings, eighty (or 2%) were classified as withdrawn for other reasons during the period (December 31, 2000 through December 31, 2010). Accordingly, 2% is entered in the Withdrawn (other) column.

⁷³⁵ See paragraph (4)(B)(v) of the instructions for Exhibit 1.

⁷³⁶ For example, in the Sample Transition/Default Matrix in Figure 2, there were 3600 credit ratings in the BBB cohort as of the start date. The transition rates from a BBB rating to a lower rating are: 15% (BB), 10% (B), 6% (CCC), 5% (CC), and 1% (C). Taken together, this means that 37% (or 1332) of the credit ratings transitioned to a credit rating as of the end-date that was below BBB (that is, to categories commonly referred to as non-investment grade or speculative). An NRSRO could make its performance statistics appear better by decreasing the number of "investment grade" credit ratings that transition to "non-investment grade" credit ratings. For example, the credit ratings for 400 obligors, securities, or money market instruments assigned a BBB credit rating as of the start date could be withdrawn. This would reduce the transition rate of BBB credit ratings to credit ratings below BBB from 37% (1332/3600) to approximately 26% (932/3600).

Commission did seek comment on whether this should be required.⁷³⁷ Two NRSROs stated that NRSROs should not be required to track withdrawn ratings after withdrawal.⁷³⁸ The amendments, as adopted, do not require NRSROs to track the outcomes of obligors, securities, or money market instruments after the credit ratings assigned to them are withdrawn.

2. Amendments to Rule 17g-1

As discussed above, section 932(a)(8) of the Dodd-Frank Act added subsection (q) to section 15E of the Exchange Act.⁷³⁹ Section 15E(q)(2)(D) of the Exchange Act provides that the Commission's rules must require an NRSRO to publish the information about the performance of its credit ratings and make it freely available on an easily accessible portion of its Internet website, and in writing when requested.⁷⁴⁰ The Commission proposed to implement section 15E(q)(2)(D) by amending paragraph (i) of Rule 17g-1.⁷⁴¹

Before today's amendments, paragraph (i) of Rule 17g-1 required an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 publicly available on its Internet website or through another comparable, readily accessible means within ten business days of being granted an initial registration or a registration in an additional class of credit ratings, and within ten business days of furnishing a Form NRSRO to update information on the Form, to provide the annual certification, and to withdraw a registration.⁷⁴² These requirements implemented section 15E(a)(3) of the Exchange Act, which provides, among other things, that the Commission shall, by rule, require an NRSRO, upon the granting of a

⁷³⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR 33444-33445.

⁷³⁸ See Moody's Letter; S&P Letter.

⁷³⁹ See 15 U.S.C. 78o-7(q).

⁷⁴⁰ See 15 U.S.C. 78o-7(q)(2)(D).

⁷⁴¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33445-33446.

⁷⁴² See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33620.

registration, to make the information and documents submitted to the Commission in its completed application for registration, or in any amendment, publicly available on its Internet website, or through another comparable, readily accessible means.⁷⁴³

Although section 15E(q)(2)(D) addresses the disclosure of information about the performance of credit ratings (which NRSROs disclose in Exhibit 1 to Form NRSRO), the Commission proposed amending paragraph (i) of Rule 17g-1 to require an NRSRO to “make its current Form NRSRO and Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet website” to avoid having separate requirements for the Exhibit 1 performance statistics and the rest of Form NRSRO and the other public exhibits.⁷⁴⁴ In this regard, the Commission stated that it believed that a Form NRSRO would be on an “easily accessible” portion of an Internet website if it could be accessed through a clearly and prominently labeled hyperlink to the form on the homepage of the NRSRO’s corporate Internet website.⁷⁴⁵

In addition, to implement section 15E(q)(2)(D) of the Exchange Act, the Commission proposed to amend paragraph (i) to provide that an NRSRO “must make its up-to-date Exhibit 1 to Form NRSRO freely available in writing to any individual who requests a copy of the Exhibit.”⁷⁴⁶

Because there were references in Form NRSRO and the Instructions for Form NRSRO to make Form NRSRO and information and documents submitted in Exhibits 1 through 9 “publicly available on [the NRSRO’s] website or through another comparable, readily accessible means,”

⁷⁴³ See 15 U.S.C. 78o-7(a)(3); Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33569.

⁷⁴⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33538.

⁷⁴⁵ See id. at 33445.

⁷⁴⁶ See id. at 33538.

the Commission proposed amending these references to mirror the text of the proposed amendment to paragraph (i).⁷⁴⁷

Several comment letters addressed the proposal.⁷⁴⁸ One NRSRO supported the proposal as long as it does not require the disclosure of confidential information.⁷⁴⁹ Three NRSROs stated that, as NRSROs are required to make public disclosures in addition to Form NRSRO, a link on the homepage of their corporate Internet website labeled “Regulatory Disclosures” (or similar language) to a section of the site that included Form NRSRO would be appropriate and would still provide easy access to Form NRSRO and Exhibits 1 through 9.⁷⁵⁰ Two NRSROs stated that there would be costs but no benefits in requiring that Exhibit 1 be made freely available in writing to any individual who requests a copy of the Exhibit, and these NRSROs suggested that NRSROs be able to charge reasonable postage and handling fees.⁷⁵¹

The Commission is adopting the proposed amendments to paragraph (i) of Rule 17g-1 substantially as proposed. In conformity with the modification (in response to comment) to the proposed instructions for Exhibit 1 to Form NRSRO,⁷⁵² the Commission is modifying the proposal to replace the phrase “up-to-date Exhibit 1” with the phrase “most recently filed Exhibit 1.” The Commission also is replacing the phrase “Web site” with the word “website,” consistent with the usage in other NRSRO rules.

The Commission agrees with the comments suggesting that NRSROs may charge reasonable postage and handling fees for sending a written copy of Exhibit 1 to individuals who

⁷⁴⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33445.

⁷⁴⁸ See DBRS Letter; Moody’s Letter; Morningstar Letter; S&P Letter.

⁷⁴⁹ See S&P Letter.

⁷⁵⁰ See DBRS Letter; Moody’s Letter; Morningstar Letter.

⁷⁵¹ See DBRS Letter; S&P Letter.

⁷⁵² See Moody’s Letter.

request it in written form.⁷⁵³ This should reduce the costs of the requirement and incentivize individuals to access the information using the NRSRO's Internet website, which is a more efficient method of obtaining the information.

The Commission also is making conforming amendments to Form NRSRO and the Instructions to Form NRSRO (as was proposed).⁷⁵⁴ Finally, the Commission agrees with commenters⁷⁵⁵ that a Form NRSRO and Exhibits 1 through 9 to Form NRSRO would be on an "easily accessible" portion of an NRSRO's corporate Internet website if it could be accessed through a clearly and prominently labeled hyperlink labeled "Regulatory Disclosures" on the homepage of the website.

3. Amendments to Rule 17g-2 and Rule 17g-7

a. Proposal

Paragraph (a)(8) of Rule 17g-2 requires an NRSRO to make and retain a record that, "for each outstanding credit rating, shows all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key ("CIK") number of the rated obligor."⁷⁵⁶ An NRSRO is required to retain this record for three years under paragraph (c) of Rule 17g-2.⁷⁵⁷

⁷⁵³ See DBRS Letter; S&P Letter.

⁷⁵⁴ See Item 5, the Note to Item 6.C, Item 8, and Item 9 of Form NRSRO; Instruction A.3 and Instruction H to Form NRSRO.

⁷⁵⁵ See DBRS Letter; Moody's Letter; Morningstar Letter.

⁷⁵⁶ 17 CFR 240.17-2(a)(8). A CIK number has ten digits and is assigned to uniquely identify a filer using the Commission's EDGAR system. CUSIP is an acronym for the Committee on Uniform Securities and Identification. A CUSIP number consists of nine characters that uniquely identify a company or issuer and the type of security.

⁷⁵⁷ See 17 CFR 240.17g-2(c).

Before today's amendments, paragraph (d)(2) of Rule 17g-2 (the "10% Rule") required an NRSRO to "make and keep publicly available on its corporate Internet website in an eXtensible Business Reporting Language ("XBRL") format" the information required to be documented pursuant to paragraph (a)(8) of Rule 17g-2 for 10% of the outstanding credit ratings, selected on a random basis, in each class of credit rating for which the NRSRO is registered if the credit rating was paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated ("issuer-paid" credit ratings) and the NRSRO has 500 or more such issuer-paid credit ratings outstanding in that class.⁷⁵⁸ Paragraph (d)(2) further provided that any ratings action required to be disclosed need not be made public less than six months from the date the action is taken; that if a credit rating made public pursuant to the rule is withdrawn or the rated instrument matures, the NRSRO must randomly select a new outstanding credit rating from that class of credit ratings in order to maintain the 10% disclosure threshold; and that in making the information available on its corporate Internet website, the NRSRO must use the List of XBRL Tags for NRSROs as specified on the Commission's Internet website.

Before today's amendments, paragraph (d)(3) of Rule 17g-2 (the "100% Rule") required an NRSRO to make publicly available on its corporate Internet website information required to be documented pursuant to paragraph (a)(8) of the rule for any credit rating initially determined by the NRSRO on or after June 26, 2007, the effective date of the Rating Agency Act of 2006.⁷⁵⁹ The 100% Rule applied to all types of credit ratings (as opposed to the 10% Rule, which was limited to issuer-paid credit ratings). However, the 100% Rule prescribed different grace periods for when an NRSRO must disclose a rating action depending on whether or not it involved an issuer-paid credit rating. For issuer-paid credit ratings, the grace period was twelve months after

⁷⁵⁸ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63864.

⁷⁵⁹ Id.

the date the rating action was taken, and for non-issuer paid credit ratings, the grace period was twenty-four months after the date the rating action was taken. The NRSRO was required to disclose the rating history information on its corporate Internet website in an XBRL format using the List of XBRL Tags for NRSROs as published by the Commission on its Internet website.⁷⁶⁰

The Commission proposed repealing the 10% Rule, significantly amending the 100% Rule, and codifying the revised 100% Rule in paragraph (b) of Rule 17g-7.⁷⁶¹ As discussed below in section II.E.3.b. of this release, these proposals took into account findings by the GAO.⁷⁶² As proposed to be amended, the 100% Rule would incorporate requirements in place before the proposed amendments and, in addition, would require that an NRSRO disclose rating history information on an “easily accessible” portion of its Internet website, add more rating histories to its disclosures, provide more information about each rating action, and not remove a rating history from the disclosure until twenty years after the NRSRO withdraws the credit rating.⁷⁶³

To add more rating histories to the disclosures, the 100% Rule, as proposed, would no longer be limited to the disclosure of histories for credit ratings that were initially determined on or after June 26, 2007.⁷⁶⁴ Instead, as proposed, the rule would apply to any credit rating that was outstanding as of June 26, 2007, but the rating histories disclosed for these credit ratings would not need to include information about actions taken before June 26, 2007. Moreover, in order to

⁷⁶⁰ Information about the List of XBRL Tags is located at the following page on the Commission’s website: <http://www.sec.gov/spotlight/xbrl/nrsro-implementation-guide.shtml>. The XBRL Tags identified by the Commission include mandatory tags with respect to the information identified in paragraph (a)(8) of Rule 17g-2. The XBRL Tags also identify additional information that could be tagged by the NRSRO.

⁷⁶¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33446-33452.

⁷⁶² See id. (discussing the GAO findings); GAO Report 10-782, pp. 40-46 (discussing, among other things, the limitations of the data fields specified in the original rule). See also section II.E.3.b. of this release.

⁷⁶³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33446-33452.

⁷⁶⁴ See paragraph (b)(1) of Rule 17g-7, as proposed (emphasis added); Nationally Recognized Statistical Rating Organizations, 76 FR at 33541-33542.

immediately include these credit ratings in the disclosure, the proposals would require the NRSRO to disclose the credit rating assigned to the obligor, security, or money market instrument and associated information as of June 26, 2007. The proposals provided that the rating actions that would need to be included in the history are the initial credit rating or the credit rating as of June 26, 2007 (if the initial credit rating was prior to that date) and any subsequent upgrades or downgrades of the credit rating (including a downgrade to, or assignment of, default), any placements of the credit rating on credit watch or review, any affirmation of the credit rating, and a withdrawal of the credit rating.

To provide more information about each rating action in a rating history, the proposals would increase the number and scope of the required data fields.⁷⁶⁵ Specifically, the 100% Rule, as proposed, would identify seven categories of data that would need to be disclosed when a credit rating action is published. The categories of information were:

- The identity of the NRSRO disclosing the rating action;
- The date of the rating action;
- If the rating action is taken with respect to a credit rating of an obligor as an entity, the following identifying information about the obligor, as applicable: (1) the CIK number of the rated obligor; and (2) the legal name of the obligor;
- If the rating action is taken with respect to a credit rating of a security or money market instrument, as applicable: (1) CIK number of the issuer of the security or money market instrument; (2) the legal name of the issuer of the security or money market instrument; and (3) the CUSIP of the security or money market instrument;
- A classification of the rating action as either: (1) a disclosure of a credit rating that was outstanding as of June 26, 2007 for purposes of the rule; (2) an initial credit rating; (3) an upgrade of an existing credit rating; (4) a downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable; (5) a placement of an existing credit rating on credit watch or review; (6) an affirmation of an existing credit rating; or (7) a withdrawal of an existing credit rating

⁷⁶⁵ See paragraph (b)(2) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541-33542.

and, if the classification is withdrawal, the reason for the withdrawal as either a default, the obligation was paid off, or the withdrawal was for other reasons;

- The classification of the class or subclass that applies to the credit rating as either: (1) financial institutions, brokers, or dealers; (2) insurance companies; (3) corporate issuers; (4) RMBS, CMBS, CLO, CDO, ABCP, other ABS, or another structured finance product (in the issuers of structured finance products class); or (5) sovereign issuer, U.S. public finance, or international public finance (in the issuers of government securities, municipal securities, or securities issued by a foreign government class); and
- The credit rating symbol, number, or score the NRSRO assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the rating action, the credit rating symbol, number, or score the NRSRO assigned to the obligor, security, or money market instrument as of the date of the rating action.⁷⁶⁶

The proposed amendments specified when a rating action and its related data would need to be disclosed by establishing two distinct grace periods: twelve months and twenty-four months.⁷⁶⁷ In particular, a rating action would need to be disclosed: (1) within twelve months from the date the action is taken, if the credit rating subject to the action was issuer-paid;⁷⁶⁸ or (2) within twenty-four months from the date the action is taken, if the credit rating subject to the action was not issuer-paid.⁷⁶⁹ These proposed separate grace periods for issuer-paid and non-issuer-paid credit ratings were consistent with the requirements of the 100% Rule prior to today's amendments.⁷⁷⁰

⁷⁶⁶ See paragraphs (b)(2)(i) through (vii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541-33542.

⁷⁶⁷ See paragraph (b)(4) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁷⁶⁸ See paragraph (b)(4)(i) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁷⁶⁹ See paragraph (b)(4)(ii) of Rule 17g-7; as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁷⁷⁰ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63837-63842 (discussing the 100% Rule and the reasons the Commission adopted distinct twelve and twenty-four month grace periods).

Finally, the proposed amendments provided that an NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument no earlier than twenty years after the date a rating action with respect to the obligor, security, or money market instrument is classified as a withdrawal.⁷⁷¹

b. Final Rule

As proposed, the Commission is eliminating the 10% Rule.⁷⁷² The 10% Rule did not permit comparability across NRSROs because it captured only issuer-paid credit ratings in a class of credit ratings where there are 500 or more such ratings and only if two or more NRSROs randomly select the same rated obligor, issuer, or money instrument to be included in the sample.⁷⁷³ Moreover, the 10% Rule did not produce sufficient “raw data” to allow third parties to generate independent performance statistics.⁷⁷⁴ The goal of the rule was to provide some information about how an NRSRO’s credit ratings performed, particularly ratings assigned to obligors, securities and money market instruments that had been rated for ten or twenty years. In light of the enhancements to the instructions for Exhibit 1 to Form NRSRO (discussed above in section II.E.1. of this release) and the 100% Rule, retaining the 10% Rule would provide little, if any, incremental benefit to investors and other users of credit ratings in terms of providing information about the performance of a given NRSRO’s credit ratings. Several commenters addressed the proposal to eliminate the 10% Rule.⁷⁷⁵ All of these commenters supported its elimination.

⁷⁷¹ See paragraph (b)(5) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁷⁷² See paragraph (d) of Rule 17g-2.

⁷⁷³ See, e.g., GAO Report 10-782, pp. 40-47.

⁷⁷⁴ See id.

⁷⁷⁵ See CFA/AFR Letter; DBRS Letter; S&P Letter.

The Commission is adopting the amendments to the 100% Rule (including moving its provisions from Rule 17g-2 to Rule 17g-7) with modifications, in part, in response to comments.⁷⁷⁶ Two commenters generally supported the proposed amendments to the 100% Rule.⁷⁷⁷ On the other hand, one NRSRO objected to the Commission's proposal to expand the 100% Rule "until a more thorough cost-benefit analysis" has been conducted.⁷⁷⁸ This NRSRO stated that on average only one person per month is accessing its rating history disclosures, but that it incurs substantial costs to make the information available. Further, it stated that constantly updating the database for the 100% Rule "would impose an unwarranted burden on NRSROs" and that the Commission has "substantially underestimated the costs" of the proposal. Another NRSRO also did not support the proposal, stating that it would impose significant costs on NRSROs, that lost subscription revenue due to the requirement to provide historical data for free will limit NRSROs' ability to innovate, and that industry competition will be undermined, particularly for smaller NRSROs who may be more dependent on subscription fees.⁷⁷⁹ Among other benefits, the modification to the proposal – as discussed below – should address some of the practical and burden concerns raised by NRSROs.

The final amendments (as was proposed) require that the NRSRO publicly disclose the rating histories for free on an easily accessible portion of its corporate Internet website.⁷⁸⁰ It also

⁷⁷⁶ See paragraph (b) of Rule 17g-7.

⁷⁷⁷ See CFA/AFR Letter; Levin Letter.

⁷⁷⁸ See DBRS Letter.

⁷⁷⁹ See Fitch Letter.

⁷⁸⁰ See paragraph (b)(1) of Rule 17g-7. As discussed above, section 15E(q)(2)(D) of the Exchange Act provides that the Commission's rules shall require the information about the performance of credit ratings be published and made freely available by the NRSRO on an easily accessible portion of its website and in writing when requested. See 15 U.S.C. 78o-7(q)(2)(D). The Commission did not propose that the "in writing" requirement apply to the disclosures of rating histories because such a requirement would not be feasible. See Nationally Recognized Statistical Rating Organizations, 76 FR 33447, n.264. Consistent with the proposal, the final amendments do not apply the "in writing" requirement to the disclosures of rating histories. First, the data file containing the disclosures would need to be updated by the NRSRO as new

broadens the scope of credit ratings that will be subject to the disclosure requirements (as was proposed).⁷⁸¹ The objective is to require the disclosure of information about all outstanding credit ratings in each class and subclass of credit ratings for which the NRSRO is registered but within certain prescribed timeframes.

In addition to general burden concerns noted above, commenters raised significant concerns about the proposal to include all credit ratings that were outstanding as of June 26, 2007 and information about credit ratings that is more than three years old (that is, outside the record retention requirements of Rule 17g-2).⁷⁸² For example, one NRSRO stated that it may not have, or may find it difficult to obtain, the additional information required by the amendments.⁷⁸³ A second NRSRO that generally supported the amendments also stated that NRSROs may not be able to provide XBRL information as of June 26, 2007, since those rating actions are beyond the scope of the 3-year record retention requirement.⁷⁸⁴ A third NRSRO stated that – because it does not consider affirmations, confirmations, placement of credit ratings on watch or review, and assignment of default status to be credit rating actions and does not subdivide withdrawn ratings into the subcategories of withdrawn due to default, withdrawn because the obligation was paid in full, and withdrawn for “other” reasons – it does not capture that information in a format that is

rating actions are added. Thus, it would not remain static like the Exhibit 1 performance measurement statistics, which are updated annually. Consequently, by the time a party received a written copy of the disclosure, it may not be up to date. Second, the amount of information in the data file would be substantial (particularly for NRSROs that have issued hundreds of thousands of credit ratings) and would increase over time. For these reasons, converting the information in the electronic disclosure to written form and mailing it to the party making the request would be impractical. In terms of utility, as discussed below, the electronic disclosure of the data must be made using an XBRL format. This is a much more efficient and practical medium for accessing and analyzing the information rather than obtaining it in paper form.

⁷⁸¹ See paragraphs (b)(1)(i) and (ii) of Rule 17g-7.

⁷⁸² See DBRS Letter; Fitch Letter; Moody's Letter; Morningstar Letter.

⁷⁸³ See S&P Letter.

⁷⁸⁴ See Morningstar Letter.

readily retrievable.⁷⁸⁵ Consequently, the commenter recommended that the amendment exempt an NRSRO from providing historical data to the extent it does not already capture the data in a readily retrievable format.

The Commission is persuaded that the proposal raises legitimate practical concerns (for example, the additional information may not be available) and would impose a substantial burden. Accordingly, the final amendments have been modified from the proposal so that an NRSRO need only retrieve information that is no more than three years old.⁷⁸⁶ In particular, under the final amendments, for a class of credit rating in which the NRSRO is registered with the Commission as of the effective date of the rule, the disclosure requirement applies to a credit rating in the class that was outstanding as of, or initially determined on or after, the date three years prior to the effective date of the rule.⁷⁸⁷ Further, for a class of credit rating in which the NRSRO is registered with the Commission after the effective date of the rule, the disclosure requirement applies to a credit rating in the class that was outstanding as of, or initially determined on or after, the date three years prior to the date the NRSRO is registered in the class.⁷⁸⁸ Consequently, an NRSRO that is registered in a particular class of credit ratings as of the rule's effective date will need to begin complying with the rule by disclosing information about all credit ratings in that class that were outstanding as of the date three years prior to the effective date or that were initially determined on or after that date, subject to the grace periods discussed below. After the effective date of the rule, a credit rating agency that becomes registered with the Commission as an NRSRO or an NRSRO that adds a class of credit ratings to

⁷⁸⁵ See Moody's Letter (also stating that collecting data for past rating actions would require "tens of thousands of hours of analysis").

⁷⁸⁶ See paragraphs (b)(1)(i) and (ii) of Rule 17g-7.

⁷⁸⁷ See paragraph (b)(1)(i) of Rule 17g-7. Rule 17g-2 requires certain rating history information to be retained for a period of three years. See, e.g., 17 CFR 240.17g-2(a)(8).

⁷⁸⁸ See paragraph (b)(1)(ii) of Rule 17g-7.

its NRSRO registration will need to begin complying with the rule by disclosing information about all credit ratings in the classes for which it is registered that were outstanding as of the date three years prior to the registration date or that were initially determined on or after that date, subject to the grace periods. This aligns the retrieval requirement for all NRSROs regardless of when they are registered in a class of credit ratings.⁷⁸⁹ It also substantially reduces the burden of adding past rating actions to the rating histories because the NRSRO will need to provide only three years of historical information initially, which should mitigate, to some degree, concerns about having to retrieve information that was not retained by the NRSRO.⁷⁹⁰

Under the proposal, if a credit rating was added to the rating histories disclosure either because it was outstanding as of June 26, 2007 or was initially determined on or after that date, the rating history for the credit rating needed to include every subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), any placements of the credit rating on credit watch or review, any affirmation of the credit rating, and a withdrawal of the credit rating.⁷⁹¹ Several commenters raised concerns about the proposed types of rating actions that would trigger the disclosure requirements, including rating affirmations.⁷⁹² One

⁷⁸⁹ For example, under the proposal, NRSROs registered with the Commission in a class of credit ratings when the rule went effective would need to have retrieved information about the credit ratings in that class covering a period from June 26, 2007 to the effective date of the rule. The span of time between June 26, 2007 and the effective date of the rule would be fixed at that point and all NRSROs registered in one or more classes of securities on the effective date would need to retrieve information spanning the same period of time. However, any NRSRO registered after the effective date, or an NRSRO adding a class of credit ratings to its registration after the effective date, would need to retrieve information spanning a longer period of time and, as time progressed, the retrieval period would increase as would the burden of retrieval.

⁷⁹⁰ As indicated above, one commenter recommended that the rule exempt an NRSRO from providing historical data to the extent it does not already capture the data in a readily retrievable format. See Moody's Letter. While the Commission believes the modifications discussed above will address the commenter's concerns to a large degree, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act. See 17 U.S.C. 78mm.

⁷⁹¹ See paragraph (b)(1) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁷⁹² See ABA Letter; Deloitte Letter; Moody's Letter; Morningstar Letter; TradeMetrics Letter.

NRSRO suggested that the disclosure rules apply only to initial ratings because subscription-based NRSROs will likely have significantly more rating actions, and the proposed rule may encourage these NRSROs to provide less frequent surveillance.⁷⁹³ Another commenter stated that a rating affirmation should not be included in rating actions as the required disclosures may make NRSROs less likely to provide confirmations of credit ratings, which may make it impossible to amend transaction documents.⁷⁹⁴ An NRSRO stated that including affirmations in rating actions would significantly increase the burden on NRSROs.⁷⁹⁵ The commenter recommended that if affirmations were included, the Commission should state that the term affirmation refers only to a published announcement, or written communication in the case of a private or confidential credit rating, by an NRSRO that it is maintaining the credit rating at its current level, and that the term should not include any purely internal discussions by an NRSRO about a credit rating.

The Commission is persuaded by the comments that the types of rating actions triggering the disclosure requirement can be reduced and the 100% Rule can still meet the objective of allowing users of credit ratings and others to compare the performance of credit ratings among NRSROs and generate their own performance statistics. Consequently, to focus the disclosure on the rating actions that are most relevant to evaluating performance, the final amendments provide that the history of a credit rating must include, in addition to the initial credit rating or the initial entry of the credit rating into the history, any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default) and a withdrawal of the credit

⁷⁹³ See Morningstar Letter.

⁷⁹⁴ See ABA Letter.

⁷⁹⁵ See S&P Letter.

rating.⁷⁹⁶ These are the rating actions necessary to calculate transition and default rates. With this modification, the final amendments eliminate the requirement to include placements on watch and affirmations (and the required data associated with those actions) in the rating histories. In addition to reducing the burden of the rule, this may alleviate concerns that requiring NRSROs to disclose rating histories (even with the grace periods) may cause subscribers to stop paying for access to credit ratings or for downloads of credit rating actions and instead to use the disclosures of rating histories as a substitute for these types of subscriptions. For example, information about placements of credit ratings on watch and credit rating affirmations may be information that subscribers value as part of their subscriptions.

The final amendments (as was proposed) increase the information that must be disclosed about a rating action.⁷⁹⁷ Specifically, paragraph (b)(2) of Rule 17g-7 specifies seven categories of data that must be disclosed with a rating action.⁷⁹⁸ The objective of these enhancements is to make the disclosures more useful in terms of the amount of information provided, the ability to search and sort the information, and the ability to compare historical rating information across NRSROs.⁷⁹⁹ As discussed below, the Commission has made some modifications to the required data categories in response to suggestions by commenters and to correspond to the modifications discussed above that change the scope of the credit ratings and rating actions covered by the disclosure requirement.

⁷⁹⁶ See paragraphs (b)(1)(i) and (ii) of Rule 17g-7.

⁷⁹⁷ See paragraph (b)(2) of Rule 17g-7.

⁷⁹⁸ The Commission will update the List of XBRL Tags to include some of the new data fields. Other fields are covered by existing Tags, including by some of the voluntary Tags.

⁷⁹⁹ See, e.g., GAO Report 10-782, p. 41 ("First, SEC [sic] did not specify the data fields the NRSROs were to disclose in the rule, and the data fields provided by the NRSROs were not always sufficient to identify a complete rating history for ratings in each of the seven samples. If users cannot identify the rating history for each rating in the sample, they cannot develop performance measures that track how an issuer's credit rating evolves.").

Paragraphs (b)(2)(i) and (ii) of Rule 17g-7 are being adopted as proposed.⁸⁰⁰ Paragraph (b)(2)(i) identifies the first category of data that must be disclosed with each rating action: the identity of the NRSRO disclosing the rating action.⁸⁰¹ Because the NRSRO must assign an XBRL Tag to each item of information, including and tagging the identity of the NRSRO will assist users who download and combine data files of multiple NRSROs to sort credit ratings by a given NRSRO. Paragraph (b)(2)(ii) identifies the second category of data: the date of the rating action.⁸⁰² This will allow a person reviewing the credit rating histories of the NRSROs to reach conclusions about their relative capabilities in making appropriate and timely adjustments to their credit ratings.⁸⁰³

Paragraph (b)(2)(iii) of Rule 17g-7, as proposed, would identify the third category of data that must be disclosed: (1) the CIK number of the rated obligor; and (2) the name of the obligor.⁸⁰⁴ Under the proposal, the information in this category would need to be disclosed only if the rating action is taken with respect to a credit rating of an obligor as an entity (as opposed to a credit rating of a security or money market instrument).⁸⁰⁵

Commenters raised concerns about requiring disclosure of the CIK number.⁸⁰⁶ One NRSRO questioned the cost-effectiveness of the requirement and recommended that the requirement to provide CIK numbers be eliminated.⁸⁰⁷ Another NRSRO stated that it was

⁸⁰⁰ See paragraphs (b)(2)(i) and (ii) of Rule 17g-7.

⁸⁰¹ See paragraph (b)(2)(i) of Rule 17g-7.

⁸⁰² See paragraph (b)(2)(ii) of Rule 17g-7.

⁸⁰³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33448-33449.

⁸⁰⁴ See paragraph (b)(2)(iii) of Rule 17g-2, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁰⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33449.

⁸⁰⁶ See DBRS Letter; Moody's Letter (suggesting use of the LEI).

⁸⁰⁷ See DBRS Letter.

“unnecessarily burdensome” to require the use of identifiers that may become obsolete, that require NRSROs to pay a fee, or that may not be used outside the United States, as long as NRSROs “use some kind of identifier system sufficient to identify the rated obligor and obligation,” for example, “an internationally recognized LEI [Legal Entity Identifier] system.”⁸⁰⁸

The Commission believes that the use of an LEI can promote accuracy and standardization of NRSRO data, and therefore can further the purpose of allowing users of credit ratings to compare the performance of credit ratings by different NRSROs.⁸⁰⁹ The effort to standardize a universal LEI has progressed significantly over the last few years, and an international standard was published by the International Organization for Standardization (“ISO”) in June 2012, which set out the elements of a working system.⁸¹⁰

The Commission is modifying the proposal to require, with respect to a rating action involving a credit rating of an obligor as an entity, the disclosure of the obligor’s LEI issued by a utility endorsed or otherwise governed by the Global LEI Regulatory Oversight Committee⁸¹¹ or the

⁸⁰⁸ See Moody’s Letter. The LEI is a reference code to uniquely identify a legally distinct entity that engages in a financial transaction. Further information about LEI is available at http://www.treasury.gov/initiatives/wsr/ofr/Documents/LEI_FAQs_August2012_FINAL.pdf.

⁸⁰⁹ The Commission has prescribed the use of an LEI for the purposes of reporting information on Form PF. See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Adviser Act of 1940 Release No. 3308 (Oct. 31, 2011), 76 FR 71128 (Nov. 16, 2011). Form PF is available at <http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf>. The glossary of terms for the form provides the following definition of LEI: “With respect to any company, the ‘legal entity identifier’ assigned by or on behalf of an internationally recognized standards setting body and required for reporting purposes by the U.S. Department of the Treasury’s Office of Financial Research or a financial regulator. In the case of a financial institution, if a ‘legal entity identifier’ has not been assigned, then provide the RSSD ID assigned by the National Information Center of the Board of Governors of the Federal Reserve System, if any.”

⁸¹⁰ See ISO 17442:2012, Financial services – Legal Entity Identifier (LEI). A copy of the standard can be purchased at http://www.iso.org/iso/home/store/catalogue_tc/catalogue_detail.htm?csnumber=59771. See also CFTC, Amended Order Designating The Provider Of Legal Entity Identifiers To Be Used In Recordkeeping And Swap Data Reporting Pursuant To The Commission’s Regulations, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/leiamendedorder.pdf> (order expanding, through mutual acceptance by international regulators, the list of identifiers that can be used by registered entities and swap counterparties in complying with the CFTC’s swap data reporting regulations).

⁸¹¹ See www.leiroc.org.

Global LEI Foundation, if available, or, if the LEI is not available, the disclosure of the obligor's CIK, if available.⁸¹² The Commission believes that having some method of identifying the obligor – in addition to its name – is appropriate as it will make the data searchable and comparable across NRSROs. Coded identifiers like the LEI and CIK will add a level of standardization to the credit rating history data, making for easier electronic querying and processing.

An NRSRO recommended not requiring inclusion of the legal name of the issuer because inconsistent use of abbreviations has made this problematic.⁸¹³ The Commission believes that the name of the obligor provides a more intuitive means of searching for a specific credit rating history in comparison to the LEI or CIK number. The Commission does not, however, view the LEI or CIK as a replacement for a name. For example, the user of the data can search for the name if the user does not know the LEI or CIK number. The Commission agrees with the commenter that requiring the specific legal name can be problematic. Consequently, the proposal has been modified to require the NRSRO to provide the obligor's "name" rather than "legal name."⁸¹⁴ An NRSRO must disclose a name that clearly identifies the obligor and use that name consistently.⁸¹⁵ For these reasons, the final amendments require the disclosure of the obligor's name.⁸¹⁶

⁸¹² See paragraph (b)(2)(iii)(A) of Rule 17g-7. The proposal is modified by separating the LEI and CIK disclosure requirements in paragraph (b)(2)(iii)(A) and the legal name disclosure requirement in paragraph (b)(2)(iii)(B). See paragraphs (b)(2)(iii)(A) and (B) of Rule 17g-7. While the description of the LEI in Rule 17g-7 is different than the description in the glossary of terms for Form PF, it is intended to have the same meaning. The description in Rule 17g-7 is designed to be more generic and, therefore, address future changes in the organizations administering LEIs.

⁸¹³ See S&P Letter.

⁸¹⁴ See paragraph (b)(2)(iii)(B) of Rule 17g-7.

⁸¹⁵ As discussed below in section II.G.3. of this release, the Commission is taking a similar approach to the identification of the obligor's name in the form to accompany a credit rating.

⁸¹⁶ See paragraph (b)(2)(iii)(B) of Rule 17g-7.

Paragraph (b)(2)(iv) of Rule 17g-7, as proposed, would identify the fourth category of data to be disclosed with a rating action: (1) the CIK number of the issuer of the security or money market instrument; (2) the name of the issuer of the security or money market instrument; and (3) the CUSIP of the security or money market instrument.⁸¹⁷ The information in this category would need to be disclosed when the rating action is taken with respect to a security or money market instrument. The Commission is adopting paragraph (b)(2)(iv) of Rule 17g-7 with modifications from the proposal.

First, the paragraph requires an NRSRO to disclose the LEI of the issuer, if available, or, if an LEI is not available, the CIK number of the issuer, if available.⁸¹⁸ This will make paragraph (b)(2)(iv) consistent with paragraph (b)(2)(iii), which, as discussed above, requires the disclosure of the LEI of the obligor, if available, or, if an LEI is not available, the CIK number of the issuer, if available. Second, as adopted, the paragraph requires the NRSRO to disclose the “name” of the issuer, rather than the “legal name” as was proposed.⁸¹⁹ This also will make paragraph (b)(2)(iv) consistent with paragraph (b)(2)(iii).

The Commission is adopting the requirement to disclose the CUSIP of the security or money market instrument as was proposed.⁸²⁰ One NRSRO stated that the cost of adding CUSIP data should be included in the Commission’s cost-benefit analysis.⁸²¹ In response, the Commission notes that the requirement to disclose the CUSIP of the security or money market

⁸¹⁷ See paragraph (b)(2)(iii) of Rule 17g-2, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸¹⁸ See paragraph (b)(2)(iv)(A) of Rule 17g-7.

⁸¹⁹ See paragraph (b)(2)(iv)(B) of Rule 17g-7.

⁸²⁰ See paragraph (b)(2)(iv)(C) of Rule 17g-7.

⁸²¹ See DBRS Letter.

instrument was required by the 100% Rule before today's amendments.⁸²² When adopting the 10% Rule and the 100% Rule, the Commission considered the costs associated with the CUSIP requirement.⁸²³ The Commission recognizes that the continued requirement to disclose the CUSIP number of the security or money market instrument subject to the rating action imposes licensing costs. However, without the CUSIP requirement, the disclosures could be of little utility as there would be no standard identifier with which to search for a specific security or money market instrument. This would make it difficult for users of the rating history disclosures to locate and compare the rating history for a given security or money market instrument. The Commission has balanced the cost of the requirement with the benefit of making the disclosures readily searchable and, therefore, enhancing their utility. For these reasons, the final amendments retain the CUSIP disclosure requirements.⁸²⁴

Paragraph (b)(2)(v) of Rule 17g-7, as proposed, would identify the fifth category of data to be disclosed with a rating action: a classification of the type of rating action.⁸²⁵ Under the proposal, the NRSRO would be required to select one of seven classifications to identify the type of rating action.⁸²⁶ In particular, the seven possible classifications were:

- A disclosure of a credit rating that was outstanding as of June 26, 2007;⁸²⁷

⁸²² See 17 CFR 240.17g-2(a)(8) and (d)(3).

⁸²³ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6477 (adopting the 10% Rule); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63859 (adopting the 100% Rule).

⁸²⁴ If securities or money market instruments are assigned LEIs, the Commission would consider replacing the CUSIP requirement with an LEI requirement.

⁸²⁵ See paragraph (b)(2)(v) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations.

⁸²⁶ The required disclosure would need to be the type of rating action and not the credit rating resulting from the rating action. For example, if the rating action was a downgrade, the NRSRO would need to classify it as a "downgrade" and not, for example, a change of the current credit rating from the AA notch to the AA- notch or from the C notch to default. This would allow users of the disclosures to sort the information by, for example, initial credit ratings, upgrades, and downgrades.

⁸²⁷ See paragraph (b)(2)(v)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542. As discussed above, under the proposal, all credit ratings outstanding as of

- An initial credit rating;⁸²⁸
- An upgrade of an existing credit rating;⁸²⁹
- A downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable;⁸³⁰
- A placement of an existing credit rating on credit watch or review;⁸³¹
- An affirmation of an existing credit rating;⁸³² or
- A withdrawal of an existing credit rating and, if the classification is withdrawal, the reason for the withdrawal as: (1) the obligor defaulted, or the security or money market instrument went into default; (2) the obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or (3) the credit rating was withdrawn for reasons other than those set forth in items (1) or (2) above.⁸³³

The Commission is adopting paragraph (b)(2)(v) of Rule 17g-7 with modifications. First, the final amendments eliminate the rating action classifications with respect to placing a credit rating on watch or review and with respect to affirming a credit rating.⁸³⁴ As discussed above,

June 26, 2007 and associated information as of that date would need to be disclosed to establish the first data point in the rating history of a credit rating that was outstanding as of that date. This would have meant that thousands, if not hundreds of thousands, of rating histories each beginning on June 26, 2007 would be disclosed. The proposed classification was designed to alert users of the disclosures that the proposed rule caused the June 26, 2007 entry in the rating history of the obligor, security, or money market instrument and not because, for example, a credit rating was initially determined for the obligor, security, or money market instrument on that date.

⁸²⁸ See paragraph (b)(2)(v)(B) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542. An NRSRO would select this classification if the rating action was the first credit rating determined by the NRSRO with respect to the obligor, security, or money market instrument.

⁸²⁹ See paragraph (b)(2)(v)(C) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸³⁰ See paragraph (b)(2)(v)(D) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸³¹ See paragraph (b)(2)(v)(E) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸³² See paragraph (b)(2)(v)(F) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸³³ See paragraph (b)(2)(v)(G) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸³⁴ See paragraph (b)(2)(v) of Rule 17g-7. As a result of these modifications, paragraph (b)(2)(v)(G) of Rule

the amendments do not require the rating histories disclosure to include these types of rating actions.

Second, paragraph (b)(2)(v)(A) of Rule 17g-7 has been modified.⁸³⁵ As discussed above, this provision was designed to alert a user of the rating histories disclosure that the credit rating and related information about the credit rating was added to the history because of the requirement in the proposal to add all credit ratings outstanding as of June 26, 2007. The final amendments – as discussed above – modify this requirement from the proposal so that an NRSRO must include with each credit rating disclosed under paragraph (b)(1) of Rule 17g-7 a classification of the rating action, if applicable, as an addition to the rating history disclosure: (1) because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in paragraph (b) of Rule 17g-7; or (2) because the credit rating was outstanding as of the date three years prior to the date the NRSRO became registered in the class of credit ratings.⁸³⁶ Consequently, paragraph (b)(2)(v)(A) of Rule 17a-7, as adopted, is modified to conform to this change.⁸³⁷

Paragraph (b)(2)(v)(E) of Rule 17g-7, as adopted, requires the NRSRO, in the case of a withdrawal, to classify the reason for the withdrawal as either: (1) the obligor defaulted, or the security or money market instrument went into default; (2) the obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or (3) the credit rating was withdrawn for

17g-7, as proposed, is re-designated paragraph (b)(2)(v)(E) of Rule 17g-7.

⁸³⁵ See paragraph (b)(2)(v)(A) of Rule 17g-7.

⁸³⁶ See paragraph (b)(1) of Rule 17g-7.

⁸³⁷ See paragraph (b)(2)(v)(A) of Rule 17g-7. The final amendments identify the classification as an addition to the rating history disclosure because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in the amendments or because the credit rating was outstanding as of the date three years prior to the NRSRO becoming registered in the class of credit ratings. Id.

reasons other than those set forth in (1) and (2) above.⁸³⁸ These sub-classifications parallel, in many respects, the outcomes identified in paragraphs (4)(B)(iii), (iv), and (v) of the instructions for Exhibit 1 to Form NRSRO discussed above in section II.E.1.b. of this release. However, unlike the instructions for Exhibit 1, the final amendments do not prescribe standard definitions of default and paid-off for the purposes of making these classifications in the rating histories disclosure. The rating histories disclosure requirement is designed to allow investors and other users of credit ratings to compare how each NRSRO treats a commonly rated obligor, security, or money market instrument. In other words, unlike the production of performance statistics where standard definitions are necessary to promote comparability of aggregate statistics, the historical rating information should indicate on a granular level the differences among the NRSROs with respect to the rating actions they take for a commonly rated obligor, security, or money market instrument, including their differing definitions of default. This will allow investors and other users of credit ratings to review, for example, when one NRSRO downgraded an obligor to the default category as compared to another NRSRO or group of NRSROs. Among other things, investors and other users of credit ratings could review the data to identify NRSROs that are either quick or slow to downgrade obligors, securities, or money market instruments to default. In addition, an NRSRO with a very narrow definition of default might continue to maintain a security at a notch in its rating scale above the default category when other NRSROs, using broader definitions, had classified the security as having gone into default. Creating a mechanism to identify these types of variances is a goal of the enhancements to the 100% Rule.

The Commission believes a default and the extinguishment of an obligation because it was paid in full are the most frequently occurring reasons for an NRSRO to withdraw a credit

⁸³⁸ See paragraph (b)(2)(v)(G) of Rule 17g-7.

rating. As discussed above in section II.E.1. of this release, there are other reasons an NRSRO might withdraw a credit rating, including that the rated obligor or issuer of the rated security or money market instrument stopped paying for the surveillance of the credit rating or the NRSRO decided not to devote resources to continue to perform surveillance on the credit rating on an unsolicited basis. However, the withdrawal of credit ratings could be used to make performance statistics appear more favorable. Consequently, as with the Transition/Default Matrices in Exhibit 1 to Form NRSRO, an NRSRO would be required to identify when a credit rating was withdrawn for reasons other than default or the extinguishment of the obligation upon which the credit rating is based. Similar to the Transition/Default Matrices, persons using the rating history information could analyze how often an NRSRO withdraws a credit rating for other reasons in a class or subclass of credit ratings.

One NRSRO stated that it does not subdivide withdrawn ratings into the subcategories of: (1) withdrawn due to default; (2) withdrawn because the obligation paid in full; and (3) withdrawn for “other” reasons.⁸³⁹ This NRSRO also stated that since it does not monitor withdrawn ratings, it could not certify with confidence that its performance statistics include all defaults with respect to withdrawn ratings, and requiring such monitoring might constitute regulation of the substance of an NRSRO’s rating procedures. However, section 15E(q)(2)(C) of the Exchange Act requires that the Commission’s rules require the disclosure of performance information for a variety of credit ratings, including for credit ratings withdrawn by an NRSRO.⁸⁴⁰ As discussed above, the reason an NRSRO withdraws a credit rating is important information in terms of assessing the performance of an NRSRO’s credit ratings. For these reasons, the final amendments retain the requirement to classify the reason for the withdrawal.

⁸³⁹ See Moody’s Letter.

⁸⁴⁰ See 15 U.S.C. 78o-7(q)(2)(C).

In response to comment,⁸⁴¹ as stated above with respect to the amendments to the instructions for Exhibit 1 to Form NRSRO, the Commission is clarifying that the amendments as adopted do not require NRSROs to monitor withdrawn credit ratings for a period of time after withdrawal. A withdrawn credit rating is categorized at the time of withdrawal. There is no requirement to update the rating history thereafter.

Paragraph (b)(2)(vi) of Rule 17g-7, as proposed, would identify the sixth category of data that must be disclosed with a rating action: a classification of the class or subclass of the credit rating.⁸⁴² The Commission is adopting this paragraph as proposed.⁸⁴³ The classifications for the classes of credit ratings are based on the definition of nationally recognized statistical rating organization in section 3(a)(62) of the Exchange Act.⁸⁴⁴ Consequently, the first classification is financial institutions, brokers, or dealers.⁸⁴⁵ The second classification is insurance companies.⁸⁴⁶ The third classification is corporate issuers.⁸⁴⁷

The fourth classification is issuers of structured finance products.⁸⁴⁸ If the credit rating falls into this class, the NRSRO must disclose which of the following sub-classifications it falls

⁸⁴¹ See Moody's Letter; S&P Letter.

⁸⁴² See paragraph (b)(2)(vi) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁴³ See paragraph (b)(2)(vi) of Rule 17g-7.

⁸⁴⁴ See 15 U.S.C. 78o-7(a)(62). This is consistent with how the classes of credit ratings are identified for the purposes of the performance statistics that must be disclosed in Exhibit 1 to Form NRSRO. Compare paragraphs (b)(2)(vi)(A) through (E) of Rule 17g-7, with paragraphs (1)(A) through (E) of the instructions for Form NRSRO.

⁸⁴⁵ See paragraph (b)(2)(vi)(A) of Rule 17g-7; 15 U.S.C. 78o-7(a)(62)(B)(i).

⁸⁴⁶ See paragraph (b)(2)(vi)(B) of Rule 17g-7; 15 U.S.C. 78o-7(a)(62)(B)(ii).

⁸⁴⁷ See paragraph (b)(2)(vi)(C) of Rule 17g-7; 15 U.S.C. 78o-7(a)(62)(B)(iii).

⁸⁴⁸ See paragraph (b)(2)(vi)(D) of Rule 17g-7; 15 U.S.C. 78o-7(a)(62)(B)(iv). Consistent with the instructions for Exhibit 1 to Form NRSRO, this class of credit rating is broader than the class identified in section 15E(a)(62)(B)(iv) of the Exchange Act.

into: RMBS;⁸⁴⁹ CMBS;⁸⁵⁰ CLOs;⁸⁵¹ CDOs;⁸⁵² ABCP;⁸⁵³ other asset-backed securities;⁸⁵⁴ or other structured finance products.⁸⁵⁵ The sub-classifications are the same subclasses for structured finance credit ratings an applicant and NRSRO must use for the purposes of the Transition/Default Matrices to be disclosed in Exhibit 1 to Form NRSRO.⁸⁵⁶

The fifth classification is issuers of government securities, municipal securities, or securities issued by a foreign government.⁸⁵⁷ If the credit rating falls into this class, the final amendments require the NRSRO to identify a sub-classification as well.⁸⁵⁸ The sub-classifications are the same as the sub-classifications for this class in the instructions for Exhibit 1 to Form NRSRO: (1) sovereign issuers; (2) U.S. public finance; or (3) international public finance.⁸⁵⁹

⁸⁴⁹ See paragraph (b)(2)(vi)(D)(1) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term RMBS for the purposes of the rule means a securitization primarily of residential mortgages.

⁸⁵⁰ See paragraph (b)(2)(vi)(D)(2) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term CMBS for the purposes of the rule means a securitization primarily of commercial mortgages.

⁸⁵¹ See paragraph (b)(2)(vi)(D)(3) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term CLO for the purposes of the rule means a securitization primarily of commercial loans.

⁸⁵² See paragraph (b)(2)(vi)(D)(4) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term CDO for the purposes of the rule means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds.

⁸⁵³ See paragraph (b)(2)(vi)(D)(5) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term ABCP for the purposes of the rule means short term notes issued by a structure that securitizes a variety of financial assets (for example, trade receivables or credit card receivables), which secure the notes.

⁸⁵⁴ See proposed paragraph (b)(2)(vi)(D)(6) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term other asset backed security for the purposes of the rule means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, equipment loans, or equipment leases.

⁸⁵⁵ See proposed paragraph (b)(2)(vi)(D)(7) of Rule 17g-7. Consistent with Exhibit 1 to Form NRSRO, the term other structured finance product for the purposes of the rule means a structured finance product not identified in the other sub-classifications of structured finance products.

⁸⁵⁶ See paragraphs (b)(2)(vi)(D)(1) through (7) of Rule 17g-7; paragraphs (1)(D)(i) through (vii) of the instructions for Exhibit 1 to Form NRSRO.

⁸⁵⁷ See paragraph (b)(2)(vi)(E) of Rule 17g-7; 15 U.S.C. 78o-7(a)(62)(B)(v).

⁸⁵⁸ See paragraphs (b)(2)(vi)(E)(1) through (3) of Rule 17g-7.

⁸⁵⁹ See paragraphs (b)(2)(vi)(E)(1) through (3) of Rule 17g-7; paragraphs (1)(E)(i) through (iii) of the instructions for Exhibit 1.

Paragraph (b)(2)(vii) of Rule 17g-7, as proposed, would identify the seventh category of data that must be disclosed with a rating action: the credit rating symbol, number, or score in the applicable rating scale of the NRSRO assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the action, the credit rating symbol, number, or score in the applicable rating scale of the NRSRO assigned to the obligor, security, or money market instrument as of the date of the rating action.⁸⁶⁰ The NRSRO also would have to indicate whether the credit rating is in a default category. The Commission is adopting this paragraph as proposed.⁸⁶¹ The rating symbol, number, or score is a key component of the data that must be disclosed as it reflects the NRSRO's view of the relative creditworthiness of the obligor, security, or money market instrument subject to the rating as of the date the action is taken.

Paragraph (b)(3) of Rule 17g-7, as proposed, would provide that the information identified in paragraph (b)(2) of Rule 17g-7 must be disclosed in an interactive data file that uses an XBRL format and the List of XBRL Tags for NRSROs as published on the Internet website of the Commission.⁸⁶² One commenter stated that constantly updating the database for the 100% Rule "would impose an unwarranted burden on NRSROs" and requested that the Commission confirm that it may update the database monthly.⁸⁶³ The Commission agrees that the rule should prescribe a standard timeframe within which the XBRL data file must be updated and that the standard should take into account the burden of updating the file. Consequently, the final

⁸⁶⁰ See paragraph (b)(2)(vii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁶¹ See paragraph (b)(2)(vii) of Rule 17g-7. Because the final amendments eliminate rating affirmations from the rating histories, this requirement will be triggered only when an NRSRO withdraws a credit rating that had not changed.

⁸⁶² See paragraph (b)(3) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁶³ See DBRS Letter.

amendments provide that the XBRL data file must be updated no less frequently than monthly consistent with the commenter's proposal.⁸⁶⁴

Paragraph (b)(4) of Rule 17g-7, as proposed, would specify when a rating action would need to be disclosed by establishing two distinct grace periods: twelve months and twenty-four months.⁸⁶⁵ In particular, a rating action would need to be disclosed: (1) within twelve months from the date the action is taken, if the credit rating subject to the action was paid for by the obligor being rated or by the issuer, underwriter, depositor, or sponsor of the security being rated;⁸⁶⁶ or (2) within twenty-four months from the date the action is taken, if the credit rating subject to the action is not a rating described above.⁸⁶⁷ These separate grace periods are consistent with the requirements of the 100% Rule before today's amendments.⁸⁶⁸ Commenters expressed opposing views on the appropriate length of the grace periods and whether there should be one grace period for all NRSROs.⁸⁶⁹ One NRSRO stated that the grace periods are "appropriate."⁸⁷⁰ Another NRSRO stated that the Commission should consider a three-year grace period for rating histories of subscriber-paid credit ratings.⁸⁷¹ Two NRSROs were opposed to having two grace periods,⁸⁷² and one of these NRSROs stated that there should be an eighteen

⁸⁶⁴ See paragraph (b)(3) of Rule 17g-7.

⁸⁶⁵ See paragraph (b)(4) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁶⁶ See paragraph (b)(4)(i) of Rule 17g-7, as proposed.

⁸⁶⁷ See paragraph (b)(4)(ii) of Rule 17g-7, as proposed.

⁸⁶⁸ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63837-63842 (discussing the 100% Rule and the reasons the Commission adopted distinct twelve and twenty-four month grace periods).

⁸⁶⁹ See DBRS Letter; ICI Letter; Kroll Letter; Morningstar Letter; S&P Letter.

⁸⁷⁰ See Morningstar Letter.

⁸⁷¹ See Kroll Letter.

⁸⁷² See DBRS Letter; S&P Letter.

month grace period for all NRSROs “if the goal is to foster comparability among NRSROs.”⁸⁷³

Another commenter was “disappointed” that the Commission was retaining the twelve and twenty-four month grace periods, because “such delay is excessive and severely diminishes the usefulness of the information.”⁸⁷⁴

The Commission believes that the twelve and twenty-four month grace periods strike an appropriate balance between the interests of users of credit ratings and the interests of NRSROs with various business models.⁸⁷⁵ In particular, the longer grace period for NRSROs operating under the subscriber-paid business model is premised on the fact that the revenues earned by these NRSROs for their credit rating activities are derived largely from subscriptions to access their credit ratings and related analyses. NRSROs operating under the issuer-pay business model earn revenues largely from the fees paid by obligors and issuers to determine credit ratings for the obligor as an entity or for the issuer’s securities or money market instruments. These issuer-paid credit ratings typically are publicly disclosed. For these reasons, subscriber-paid NRSROs would be disproportionately impacted if the rating histories disclosure requirement resulted in subscribers canceling subscriptions. Consequently, the Commission continues to believe the longer twenty-four month grace period is appropriate to limit the disproportionate impact on subscriber-paid NRSROs.

Finally, paragraph (b)(5) of Rule 17g-7, as proposed, would provide that an NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument no earlier than twenty years after the date a rating action with respect to the obligor, security, or money

⁸⁷³ See DBRS Letter.

⁸⁷⁴ See ICI Letter.

⁸⁷⁵ Section 15E(q)(2)(E) of the Exchange Act provides that the Commission’s rules must require that the credit rating performance disclosures are appropriate for various business models of NRSROs. See 15 U.S.C. 78o-7(q)(2)(E).

market instrument is classified as a withdrawal of the credit rating, provided no subsequent credit ratings are assigned to the obligor, security, or money market instrument after the withdrawal classification.⁸⁷⁶ This proposed requirement was designed to ensure that information about credit ratings that are withdrawn for any reason would remain a part of the disclosure for a significant period of time. Two NRSROs commented on this aspect of the proposal.⁸⁷⁷ One NRSRO stated that ten years is sufficient, consistent with the Transition/Default Matrices in Exhibit 1 to Form NRSRO, and that the Commission should perform a cost/benefit analysis of the requirement periodically to confirm that the benefits outweigh the costs.⁸⁷⁸ The other NRSRO stated that the information would become less useful to investors as the volume of information on withdrawn ratings increases.⁸⁷⁹ The Commission agrees at this time that a shorter retention period is appropriate considering the costs and benefits of retaining rating histories with respect to withdrawn ratings. Consequently, the final amendments provide that the NRSRO may cease disclosing a rating history of an obligor, security, or money market instrument if at least fifteen years has elapsed since a rating action classified as a withdrawal of a credit rating pursuant to paragraph (b)(2)(v)(E) of Rule 17g-7 was disclosed in the rating history of the obligor, security, or money market instrument.⁸⁸⁰

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments

⁸⁷⁶ See paragraph (b)(5) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁸⁷⁷ See DBRS Letter; S&P Letter.

⁸⁷⁸ See DBRS Letter.

⁸⁷⁹ See S&P Letter.

⁸⁸⁰ See paragraph (b)(5) of Rule 17g-7.

relating to the disclosure of information about the performance of credit ratings.⁸⁸¹ The baseline that existed before today's amendments was one in which NRSROs were required to make publicly available two types of information about the performance of their credit ratings: (1) transition and default statistics; and (2) rating histories for certain subsets of the obligors, securities, and money-market instruments that they have rated.⁸⁸²

Before today's amendments, the instructions for Exhibit 1 required the applicant or NRSRO to provide performance statistics for the credit ratings of the applicant or NRSRO, including performance statistics for each class of credit ratings for which the applicant is seeking registration or the NRSRO is registered. In addition, the instructions required that the performance statistics must, at a minimum, show the performance of credit ratings in each class over one-year, three-year, and ten-year periods (as applicable) through the most recent calendar year-end, including transition and default rates within each of the credit rating categories, notches, grades, or rankings used by the applicant or NRSRO. Before today's amendments, the instructions for Exhibit 1 did not prescribe the methodology to be used to calculate the performance statistics or the format in which they must be disclosed; nor did the instructions limit the type of information that can be disclosed in the Exhibit. The instructions did, however, require an applicant or NRSRO to define the credit rating categories, notches, grades, or rankings it used and to explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics. Disclosures provided in Exhibit 2, which require a "general description of the procedures and methodologies used" by the NRSRO in determining credit ratings, may have provided additional context for comparing the performance

⁸⁸¹ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

⁸⁸² See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6483; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63864.

statistics of different NRSROs. NRSROs made their most recent Forms NRSRO and Exhibits 1 through 9 to the forms available on their corporate Internet websites, though they were also permitted to make the disclosures publicly available through another comparable, readily accessible means. They were not required to provide Exhibit 1 in writing when requested.

NRSROs also voluntarily provided additional performance statistics in Exhibit 1 or elsewhere on their public Internet websites, such as transition and default statistics for particular asset sub-classes, geographies, or industries, or alternative analyses such as Lorenz curves. The voluntary disclosures of such statistics have varied, and some NRSROs, particularly larger ones, may have been able to provide more supplementary statistics at a granular level because they had more credit ratings, over a longer historical period, to analyze.⁸⁸³

In characterizing the baseline, it is useful to consider the performance statistics disclosed in NRSROs' annual certifications for the 2009 calendar year, as reviewed by the GAO in its 2010 report. While the disclosures from that year may not be representative of current NRSRO practices, they provide insight into NRSRO practices in 2009 under the rules governing the disclosure of performance statistics before today's amendments. Reviewing the 2009 disclosures of the ten NRSROs then registered, the GAO found significant differences across NRSROs in the computation of performance statistics, which limited their comparability.⁸⁸⁴ These differences included, among other things: (1) whether a single cohort approach or an average cohort approach was used; (2) whether or not statistics were adjusted to exclude withdrawn credit ratings; (3) whether default rates were indicated relative to initial credit ratings or credit ratings as of the beginning of a given period, and (4) whether default statistics were adjusted

⁸⁸³ See GAO Report 10-782, p. 25.

⁸⁸⁴ See *id.* at 24.

based on the time to default.⁸⁸⁵ The GAO found that five NRSROs did not provide the number of credit ratings in each rating category, which made it impossible either to re-calculate more comparable statistics or to judge the reliability of the performance statistics.⁸⁸⁶ The GAO also found that the asset-backed security class of credit ratings may have been too broad for performance statistics for this class as a whole to be meaningful.⁸⁸⁷ The GAO concluded that “the disclosure of these statistics has not had the intended effect of increasing transparency for users.”⁸⁸⁸

Before today’s amendments, the requirements for NRSROs to make certain rating histories publicly available (the 10% Rule and the 100% Rule) were contained in paragraphs (d)(2) and (d)(3) of Rule 17g-2, respectively. The 10% Rule applied only to NRSROs operating under the issuer-pays model, and required the disclosure of rating actions for a random 10% sample of outstanding credit ratings in each class in which an NRSRO was registered and for which the NRSRO had more than 500 issuer-paid credit ratings outstanding. The 100% Rule applied to all NRSROs, and required the disclosure of rating actions for any credit ratings initially determined by the NRSRO on or after June 26, 2007. Under both rules, the rating action information required to be disclosed was consistent with the information required to be retained pursuant to paragraph (a)(8) of Rule 17g-2. The rating actions that were required to be included in the histories were initial ratings, upgrades, downgrades, placements on credit watch, and

⁸⁸⁵ See *id.* at 27-37. See also *id.* at 22-23 (“For the transition rates, they differed by whether they (1) were for a single cohort or averaged over many cohorts, (2) constructed cohorts on an annual basis or monthly basis, (3) were adjusted for entities that have had their ratings withdrawn or unadjusted, and (4) allowed entities to transition to default or not.”); *Id.* at 30-31 (“NRSROs also used different methodologies for calculating default rates. In general, default rates differed by whether they were (1) relative to ratings at the beginning of a given time period or relative to initial ratings, (2) adjusted for entities that had their ratings withdrawn or unadjusted, (3) adjusted for how long entities survived without defaulting or unadjusted, (4) calculated using annual or monthly cohorts, and (5) calculated for a single cohort or averaged over many cohorts.”).

⁸⁸⁶ See GAO Report 10-782, pp. 28, 36.

⁸⁸⁷ *Id.* at 36.

⁸⁸⁸ *Id.* at 94.

withdrawals, and the information required to be disclosed for each such rating action was the rating action, date of the action, the name of the security or obligor, and, if applicable, the CUSIP of the security or CIK number of the obligor. The 10% Rule included a six-month grace period after ratings actions were taken before disclosure was required, while the 100% Rule included a twelve-month grace period for issuer-paid credit ratings and a twenty-four-month grace period for all other credit ratings. NRSROs made the required rating histories publicly available on their corporate Internet websites.

In characterizing the baseline, it is useful to consider, as in the case of performance statistics, the conclusions of the GAO in its 2010 report with respect to the disclosure of rating histories by NRSROs. While the disclosures from that period may not be representative of current NRSRO practices, the GAO study provides insight into NRSRO practices at the time of the report and into the limitations of the 10% Rule and 100% Rule before today's amendments. The GAO stated its view that the rating histories provided at that time could not be used to generate reliable performance statistics because, among other things: (1) the 10% samples were being generated in ways that did not make them representative of the total population of credit ratings produced by the NRSROs; (2) the 100% samples were also unrepresentative, because, for example, they were missing the issuer credit ratings of many major American corporations because these credit ratings were initiated before 2007; (3) the data fields provided were insufficient; and (4) not all NRSROs disclosed defaults in these histories.⁸⁸⁹ The GAO also

⁸⁸⁹ See GAO Report 10-782, p. 40-46 (stating, for example, with respect to the 10% samples, that the GAO "could not use these samples to generate reliable performance statistics for the NRSROs, as the rule intended, for the following reasons: (1) the data fields the NRSROs included in their disclosures were not always sufficient to identify complete ratings histories for the rated entities comprising each sample, (2) the data fields did not always give us enough information to identify specific types of ratings for making comparisons, (3) the data fields did not always give us enough information to identify the beginning of the ratings histories in all of the samples, (4) SEC rules do not require the NRSROs to publish a codebook or any explanation of the variables used in the samples, (5) not all NRSROs are disclosing defaults in the ratings histories provided as part of their 10 percent samples, and (6) SEC guidance to the NRSROs for

stated, in explaining why the 10% and 100% samples were unrepresentative of the universe of credit ratings, that these samples were not required to include credit ratings that had been withdrawn in prior periods, leading to a sample in which cases of defaults would be underrepresented.⁸⁹⁰ The GAO concluded that it was unlikely that the required rating histories could be used to generate performance measures and studies to evaluate and compare NRSRO performance.⁸⁹¹

Relative to the baseline, the amendments to the instructions for Exhibit 1 to Form NRSRO, Rule 17g-1, Rule 17g-2, and Rule 17g-7 with respect to the disclosure of performance statistics and rating histories should result in benefits for users of credit ratings. The amendments, which implement the provisions of section 15E(q) of the Exchange Act and, as discussed in sections II.E.1. and II.E.3. of this release, took into account findings by the GAO, should result in performance statistics that are more directly comparable across NRSROs and ratings histories that are more useful for performance analyses than those provided under the baseline requirements.⁸⁹² To the extent that the new disclosures therefore facilitate the evaluation of the performance of an NRSRO's credit ratings and comparisons of rating performance across NRSROs – including direct comparisons of different NRSROs' treatment of

generating the random samples does not ensure that the methods used will create a sample that is representative of the population of credit ratings produced by each NRSRO.”).

⁸⁹⁰ See GAO Report 10-782, p. 46.

⁸⁹¹ See *id.* at 95.

⁸⁹² While the amendments are designed to facilitate comparisons across NRSROs, differences in the meanings of the credit ratings of different NRSROs and in the procedures and methodologies they use to determine credit ratings will likely influence the ability to make perfect comparisons. For example, there is variability across NRSROs with respect to the information that is reflected in a credit rating. See, e.g., *S&P Letter*; GAO Report 10-782, p. 37-39. Some credit ratings, for example, reflect relative assessments of the likelihood an obligor or issuer will default on the “first dollar” owed, whereas other credit ratings also reflect the expected loss in the case of default. In interpreting the performance statistics and rating histories, users of credit ratings may thus need to account for additional contextual information, such as the general description of the procedures and methodologies used by the NRSRO to determine credit ratings required to be disclosed in Exhibit 2, in order to understand the limits to the comparability of the disclosures.

the same obligor or instrument – the amendments may benefit users of credit ratings by allowing them to better assess the reliability and information content of credit ratings from different NRSROs and, in the case of subscriber-paid credit ratings, make more informed decisions regarding whether to subscribe to the credit ratings of particular NRSROs.

Specifically, the amendments to the instructions for Exhibit 1 requiring a standardized calculation of performance statistics – using specified definitions and the single cohort approach – to be presented in a standardized format and specifying that an applicant or NRSRO must not disclose information in the Exhibit that is not required to be disclosed are expected to result in simpler, more standardized disclosures relative to the disclosures produced under the baseline requirements. Moreover, the single cohort approach involves simpler computations than other approaches, so it may be easier for users of credit ratings to understand how the statistics were produced. Also, requiring all NRSROs to use the single cohort approach ensures that the cohorts being analyzed will be aligned across NRSROs, increasing the comparability of the statistics versus other computation methods (such as the average cohort approach). The amendments therefore may allow users of credit ratings, including users with a wide range of sophistication, to more readily compare the performance of credit ratings of different NRSROs than they could previously. The new requirement to divide the class of issuers of asset-backed securities into subclasses and the requirement to separately disclose the number of credit ratings that are withdrawn because the obligation has been paid in full, because the obligor defaulted, and for other reasons, as well as to report the total number of credit ratings in the start-date cohort in each category, should provide users of credit ratings with additional information that may help

them better interpret the transition and default rates for the purpose of evaluating and comparing performance.⁸⁹³

In addition, the new requirements that expand the scope of credit ratings that must be included in the rating histories should, over time, generate databases that will include a comprehensive sample of rating actions (in contrast to the data disclosed under the baseline requirements). The databases also will include information about cohorts of credit ratings beyond those reflected in the performance statistics disclosed in Exhibit 1. Thus, the enhanced rating histories can be used to generate alternative statistics for evaluating and comparing NRSRO performance, including certain transition and default statistics using average cohort approaches (though, as discussed below, these statistics will likely be based on fewer cohorts than were used by NRSROs that disclosed performance statistics in Exhibit 1 using the average cohort approach before today's amendments). Because the data will be more comprehensive than that disclosed in the baseline, it should also be more likely, relative to the baseline, that rating histories of different NRSROs with respect to the same obligor or instrument will be available. Therefore, users of credit ratings should have more opportunities to directly compare and analyze different NRSROs' treatment of the same obligor or instrument over time. The requirements regarding the enhanced data fields to be included with a rating action should make any analyses using the rating histories more practicable than was the case with the more limited data fields produced under the baseline requirements.⁸⁹⁴

⁸⁹³ While the standard definition of default is intended to facilitate comparisons across NRSROs, there may continue to be differences across NRSROs in the identification of defaults in the performance statistics which may reduce somewhat the comparability of these statistics. When an event occurs that does not meet the standardized definition of default in Exhibit 1, it may still be categorized as a default by an NRSRO under its own definition of default, which is incorporated into the Exhibit 1 definition. In interpreting the performance statistics, users of credit ratings may thus need to account for additional contextual information such as the new requirement to "clearly explain" the usage of the term default directly after the performance statistics.

⁸⁹⁴ There may be differences across NRSROs in the identification of defaults and paid off obligations in the

However, the benefits of the amendments in facilitating the evaluation and comparisons of NRSROs may be constrained by limits on the information required by the final rules, which, as discussed in this section, are intended to reduce the burdens on NRSROs resulting from the amendments and, with respect to the performance statistics, make them easier for users of credit ratings to understand how the statistics were produced. For example, while mandating that only single cohort statistics be presented fosters comparability, the resulting disclosures will present the performance of only three particular cohorts of credit ratings (beginning one, three, and ten years prior to the end of the fiscal year). These statistics therefore may be subject to substantial volatility, particularly for NRSROs with fewer credit ratings.⁸⁹⁵ The fact that the credit ratings of particular NRSROs may be more heavily weighted towards particular industries, geographies, or other sectors that might experience more defaults or other changes in creditworthiness over a particular measurement period also may exacerbate volatility in their performance statistics and make it difficult to separate differences in NRSRO performance from the effects of recent conditions.⁸⁹⁶ NRSROs are only required to provide their current Form NRSRO on their

rating histories which reduce somewhat the comparability of this data across NRSROs, since the amendments do not prescribe definitions of these terms for the purpose of the rating histories. In interpreting the rating histories, users of credit ratings may thus need to account for additional contextual information such as the new requirement to “clearly explain” the conditions under which an NRSRO classifies obligors, securities, or money market instruments as being in default after the performance statistics presented in Exhibit 1.

⁸⁹⁵ Averages over a smaller sample size are more susceptible to being skewed by individual extreme data points. See also DBRS Letter (stating that “results will be significantly more volatile within the shorter time period, which will make interpreting those results more difficult” and that “the volatility impact will be amplified for NRSROs with fewer ratings”).

⁸⁹⁶ A particular industry, geography, or other sector of the market may experience a period of poor performance common to all issuers and securities in that group, resulting in high default rates in that period. Economy-wide default rates are likely to be less volatile than the default rates for these individual groups since they reflect an average across many such groups, which may face downturns at different times. Thus, when considering performance over a short period, as in the case of the single cohort approach, the performance of NRSROs that focus on fewer industries, geographies, or other sectors may be skewed by any recent extremes in performance experienced by these sectors, leading to more volatile performance statistics. When such NRSROs are compared to other NRSROs, it may be difficult to interpret whether differences in their single cohort performance statistics may be due to the recent performance of the sectors they focus on or whether they reflect differences in the ability of the NRSROs to produce accurate ratings.

websites, so users of credit ratings may not have access to previous Forms NRSRO in order to consider the cohorts analyzed in these other years.⁸⁹⁷

The rating histories may be helpful to users of credit ratings in addressing the limitations of the performance statistics both in that information about many additional cohorts may be available and also through the ability to directly compare NRSRO performance with respect to the same obligor or instrument. Such direct comparisons should not be skewed by the industry or sector focus of a given NRSRO. However, the final rules require only one or two years of history to be disclosed initially, depending on the applicable grace periods, so the benefits of these histories will be delayed until the histories grow to a length suitable for analysis. Also, as discussed below, even as data for additional years becomes available, the ability of NRSROs to remove a rating history from the data file fifteen years after the credit rating is withdrawn will limit the amount of historical information in the data file and, therefore, limit analyses by users of credit ratings that require a representative sample of credit ratings over an extended period of time. On the other hand, users of credit ratings that are interested in comparing NRSRO performance over time with respect to the same obligor or instrument should not face the same limitation and, therefore, should be able to take advantage of the full length of histories provided under the amendments.

A potential consequence of selecting one approach to be used for purposes of the Exhibit 1 disclosures is that it may impact the disclosures NRSROs make using other approaches. For example, even though the amendments require NRSROs to use the single cohort approach, NRSROs may continue on a voluntary basis to provide, not directly in Exhibit 1 but by reference

⁸⁹⁷ In the future, users of credit ratings will have access to certain previous Forms NRSRO, including Exhibits 1 through 9 to these Forms. As discussed below in section II.L. of this release, the amendments to Rule 101 of Regulation S-T will require an NRSRO to submit Form NRSRO and Exhibits 1 through 9 to the Form electronically through the EDGAR system. Submission through the EDGAR system will maintain the public availability of a Form NRSRO even after updated versions are submitted.

to an Internet website address in this exhibit, disclosures of additional performance statistics such as statistics using the average cohort approach. These supplementary statistics may address some of the aforementioned limitations of statistics using the single cohort approach in that they may provide users of credit ratings with information about many more cohorts of credit ratings. However, NRSROs that previously disclosed average cohort statistics to fulfill their Exhibit 1 requirements might not continue to report these statistics voluntarily or might report them in an even less standardized fashion than previously (for example, for performance periods different from the one-year, three-year, and ten-year periods required in Exhibit 1). Importantly, NRSROs might be less likely to voluntarily disclose such additional statistics when they do not compare favorably to the performance of competitors.

The amendments may result in other benefits to users of credit ratings and NRSROs by enhancing accountability, competition, and efficiency. As has been widely documented, the most common NRSRO business model – the issuer-pay revenue model – creates an inherent conflict of interest.⁸⁹⁸ Given this conflict, and because the demand for an NRSRO's credit ratings depends on its reputation for producing credit ratings of high quality, reputation is thought to play a particularly important disciplinary role in this industry.⁸⁹⁹ To the extent that the amendments facilitate the external monitoring and comparative analysis of NRSROs, they may allow users of credit ratings to develop more refined views of NRSRO performance and thereby indirectly increase accountability and encourage integrity in the production of credit

⁸⁹⁸ See, e.g., Lawrence White, Markets: The Credit Rating Agencies, J. OF ECONOMIC PERSPECTIVES (Spring 2010), Volume 24, Number 2, p. 211–226.

⁸⁹⁹ See, e.g., Jerome Mathis, James McAndrews, and Jean-Charles Rochet, Rating the Raters: Are Reputation Concerns Powerful Enough to Discipline Rating Agencies?, J. OF MONETARY ECONOMICS (July 2009), p. 657–674; Lawrence White, Markets: The Credit Rating Agencies, J. OF ECONOMIC PERSPECTIVES (Spring 2010), Volume 24, Number 2, p. 211–226; Daniel M. Covitz and Paul Harrison, Testing Conflicts of Interest at Bond Rating Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate, Federal Reserve Board (Dec. 2003), available at <http://www.federalreserve.gov/pubs/feds/2003/200368/200368pap.pdf>.

ratings, since NRSROs should have the incentive to maintain reputations for producing credit ratings of high quality in order to remain competitive. More comparable performance data also may help smaller NRSROs and new and recent entrants into the industry, including subscriber-paid NRSROs, to attract attention to their track records of issuing and monitoring credit ratings. If they produce track records comparable or superior to those of other NRSROs, this could enhance their ability to develop a reputation for producing high quality credit ratings. Such a reputation may allow them to better compete with more established competitors. The enhanced ability of users of credit ratings to evaluate the performance of NRSROs also may increase their ability to accurately interpret the information conveyed by credit ratings, potentially resulting in more efficient investment decisions. Market efficiency could also improve if this information is reflected in asset prices.⁹⁰⁰

The amendments to Rule 17g-1 and Rule 17g-7 requiring that these disclosures be published on an “easily accessible” portion of the NRSRO’s Internet website could result in incremental benefits relative to the baseline. As mentioned above, the Commission agrees with commenters that the disclosures would be on an “easily accessible” portion of an NRSRO’s Internet website if they could be accessed through a clearly and prominently labeled hyperlink labeled “Regulatory Disclosures” on the homepage of the website. Some NRSROs may already provide Form NRSRO, Exhibits 1 through 9 to the form, and rating histories in such a location. However, to the extent that these amendments result in NRSROs moving the disclosures to a more prominent location on their Internet websites to fulfill the requirement that they be “easily accessible,” they may incrementally assist users of credit ratings in locating these disclosures.

⁹⁰⁰ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

Requiring that Exhibit 1 be made available in writing when requested may benefit any users of credit ratings who do not have access to the Internet.

Relative to the baseline, the amendments with respect to the disclosure of performance statistics and rating histories will impose costs on applicants and NRSROs. In particular, while all NRSROs currently disclose transition and default rates, the content and presentation of these performance statistics differ, to varying degrees, from the information required and the format prescribed by the rules. The revised requirements therefore will require the initial collection and analysis of certain additional historical data (for example, whether issuers or instruments defaulted under the standard definition) as well as changes in systems and procedures to collect and present this information according to the amendments going forward. The Commission's estimates of these costs – which are based on analyses for purposes of the PRA – are provided below.

Two NRSROs have commented that, in some cases, collecting certain historical information would require substantial cost or could be impossible.⁹⁰¹ The historical information required for the transition and default statistics which NRSROs may not have stored (or stored in a readily retrievable format) consists of, over a ten year history, the more detailed categorization of any withdrawn credit ratings and the assignment of credit ratings in the asset-backed securities class into sub-classes. As discussed above, the Commission has modified the amendments to reduce the amount of historical information that may need to be retrieved with respect to withdrawn credit ratings. In particular, the amendments provide that, except in the case of the asset-backed securities class of credit ratings, the transition and default statistics must include only credit ratings assigned to an obligor as an entity or, if there is no such credit rating, the

⁹⁰¹ See, e.g., Moody's Letter (stating that collecting certain data for past rating actions would have to be done manually); S&P Letter (stating that "it may not be possible to track" the distinction between ratings withdrawn for different reasons "retroactively").

credit rating of the obligor's senior unsecured debt, instead of all credit ratings of securities or money-market instruments in the respective class or subclass. The Commission has also revised the standard definition of paid off to eliminate the prong that applied to credit ratings of obligors as entities. Because the Commission has narrowed the scope of the credit ratings that must be included in the performance statistics for four of the five classes of credit ratings, and has revised the standard definition of paid off so that it does not apply to entity credit ratings, the cost of categorizing historical withdrawals based on the standard definitions of default and paid off and withdrawals for other reasons should be substantially reduced. The modifications from the proposal should therefore mitigate concerns to some degree about having to obtain information that was not traditionally retained by the NRSRO because it will significantly narrow the scope of such information that will need to be collected in order to calculate the performance statistics. While the Commission believes that these modifications may substantially reduce the amount of historical data to be collected, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act.

The costs of the compliance efforts described above should vary across NRSROs due to: (1) differences in the quantity of credit ratings they issue and the number of classes of credit ratings for which they issue credit ratings; (2) differences in terms of how their disclosures under the baseline requirements compare to the disclosures required under the amendments; (3) differences with respect to the historical information they currently store in a readily-retrievable format; (4) differences in the number of past years and number of historical credit ratings for which additional historical information will need to be collected; and (5) differences in the design and flexibility of their information systems. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to Exhibit 1 to Form NRSRO will

result in total industry-wide one-time costs to NRSROs of approximately \$737,000 and total industry-wide annual costs to NRSROs of approximately \$295,000.⁹⁰²

Under the amendments to paragraph (i) of Rule 17g-1, NRSROs are required to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet website and to provide a paper copy of Exhibit 1 to individuals who request a paper copy. NRSROs may need to re-configure their corporate Internet websites to comply with the amendments and will need to establish procedures and protocols for processing requests for a paper copy. Based on analysis for purposes of the PRA, the Commission estimates that the amendments to paragraph (i) of Rule 17g-1 will result in total industry-wide one-time costs to NRSROs of approximately \$150,000 and total industry-wide annual costs to NRSROs of approximately \$121,000.⁹⁰³

The amendments to the instructions for Exhibit 1 also may result in other costs to NRSROs. For some NRSROs, it is possible that using only the single cohort approach to produce the performance statistics in Exhibit 1 may lead users of credit ratings to misinterpret their performance, negatively impacting competition in the industry. Specifically, as discussed above, the single cohort approach will produce statistics about three particular cohorts of credit ratings and may thus be subject to volatility. Further, the statistics may be particularly volatile for certain NRSROs, such as those that have a small number of credit ratings in a given start date cohort or those that focus on particular industries, geographies, or other sectors within a class of credit ratings. The requirements of the final amendments (that is, showing the number of credit

⁹⁰² See section V.E. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.2. of this release.

⁹⁰³ See section V.E. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.1. of this release.

ratings in the start date cohort) are designed to provide persons reviewing the statistics with sufficient information to readily assess the impact that a small number of credit ratings can have on the statistics. Also, the disclosure of ratings histories should permit more refined comparisons of performance in cases where differences in performance statistics may reflect differences in the universe of obligors or instruments rated by NRSROs. However, some persons reviewing the transition and default rates could inappropriately view the volatility resulting from such factors unfavorably, potentially disadvantaging these NRSROs relative to the baseline to the extent that their reputation for producing quality credit ratings is negatively affected. The competitive position of small NRSROs may be further disadvantaged by the burden associated with establishing systems to produce the statistics, since this cost may not depend on the number of credit ratings in the start-date cohorts and thus may result in a higher relative burden for small NRSROs.⁹⁰⁴

Under the baseline requirements, NRSROs publicly disclosed certain rating histories data to fulfill the requirements of the 10% Rule and the 100% Rule, but the sample of credit ratings subject to the disclosure, the rating actions disclosed, the extent of the histories, and the included data fields differ, to varying degrees, from those required by the amendments. The amendments may thus require NRSROs to add more rating histories to their disclosures because in contrast to the baseline requirements the amendments: (1) apply to all credit ratings outstanding as of the specified date or initiated thereafter rather than a random sample of credit ratings; (2) do not exclude credit ratings that were outstanding as of the specified date but initiated before June 26, 2007; and (3) require the rating histories of withdrawn ratings to be retained in the file for fifteen years. Also, the amendments will require NRSROs to revise which rating actions are included

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See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

and to provide more information about each rating action in the rating histories. NRSROs initially will have to collect additional historical data and edit the history files to meet these requirements. Some of the required information which might not have been collected previously – such as the categorization of credit ratings in the asset-backed securities class into sub-classes – will be retrieved in the process of complying with the amended instructions for Exhibit 1 to Form NRSRO discussed above. NRSROs also will have to reprogram existing systems and make changes in procedures to collect and upload the information according to the amendments going forward. NRSROs may have to make changes to their corporate Internet websites to disclose the information on an “easily accessible” portion of their websites, though the incremental changes required beyond the website changes to disclose Form NRSRO discussed above may be minimal. On an ongoing basis, the cost of the procedures required to update the rating histories files at least monthly may exceed the annual burden previously imposed by the 10% Rule (which is being repealed) and the 100% Rule before today’s amendments, given the comprehensive nature of the data required. The Commission’s estimates of these costs – which are based on analyses for purposes of the PRA – are provided below.

One commenter stated that the Commission “substantially underestimated the costs” of the proposed amendments to the 100% Rule in the proposing release.⁹⁰⁵ Two other commenters raised concerns that retrieving the required historical data would require substantial cost or could be impossible.⁹⁰⁶ The Commission acknowledges that the amendments will impose significant costs on NRSROs, and has modified the proposal in a number of ways to mitigate costs. First, the final amendments eliminate the requirement to include information for all credit ratings

⁹⁰⁵ See DBRS Letter.

⁹⁰⁶ See, e.g., Moody’s Letter (stating that collecting certain data for past rating actions would have to be done manually and “would require tens of thousands of hours of analysis”); S&P Letter (stating that “it may not be possible to track” the distinction between ratings withdrawn for different reasons “retroactively”).

outstanding on June 26, 2007, and replace it with a standard three-year backward-looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This should significantly reduce the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures. Further, the final amendments eliminate two types of rating actions that would trigger a requirement to add information to a credit rating's history: placements of the credit rating on watch or review and affirmations of the credit rating. This may further reduce the cost of retrieving the historical information that must be disclosed in the rating histories, since a record of an affirmation of the credit rating may not previously have been stored (or stored in a readily retrievable format) by NRSROs.

Consequently, because of these modifications, NRSROs should not need to perform analyses to identify historical affirmations and reconstruct the information that would need to have been disclosed under the proposal in connection with each affirmation of the credit rating (for example, the date of the action). The remaining information that is required to be disclosed, but may not have been systematically stored by NRSROs previously (such as the required categorization of the reason for a withdrawal), generally will need to be collected only once for each rating history rather than for multiple rating actions within a history, as each rating history should, for example, have only one withdrawal (whereas a history could have multiple affirmations of the credit rating). The narrowing of the scope of the types of rating actions that are required to be included in the rating histories also should reduce the burden of updating the XBRL data file with new information in the future. While the Commission believes the modifications discussed above may substantially reduce the costs of retrieving historical data, an NRSRO can seek exemptive relief from the Commission under section 36 of the Exchange Act. The amendments also specify a standard for updating the file – no less frequently than monthly.

This should mitigate concerns that the file would need to be updated more frequently. Finally, the final amendments modify the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This should reduce the data retention and maintenance costs associated with the amendments compared to the proposal.

The costs of the compliance efforts described above with respect to the amended requirements for disclosing rating histories should vary across NRSROs due to: (1) differences in the quantity of credit ratings they issue and have issued in the historical years subject to disclosure; (2) differences in the data fields that they currently include in their rating histories; (3) differences with respect to the historical information they currently store in a readily-retrievable format; and (4) differences in the design and flexibility of their information systems. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to Rule 17g-2 and paragraph (b) of Rule 17g-7 will result in total industry-wide one-time costs to NRSROs of approximately \$393,000, and total industry-wide annual costs to NRSROs of approximately \$131,000.⁹⁰⁷

One commenter stated that the proposed amendments “may force NRSROs to incur increased licensing costs to add new CUSIP data.”⁹⁰⁸ The CUSIP Global Services’ license fees may vary based on the level of usage (that is, the number of CUSIPs databased and the licensee’s business lines and regions of operation where the data will be used) and the form of usage (such

⁹⁰⁷ See section V.F. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.6. of this release.

⁹⁰⁸ See DBRS Letter (“Expanding the ratings history universe, may also force NRSROs to incur increased licensing costs to add new CUSIP data. Any such costs should be factored into the Commission’s cost-benefit analysis of this proposal.”).

as the internal databasing of CUSIP data or the distribution of CUSIP data).⁹⁰⁹ The Commission believes that most NRSROs already have licensing agreements in place for their current usage of CUSIP data, but it is possible that these baseline licensing agreements may need to be expanded given the additional CUSIP data that may have to be stored and disclosed to comply with the amendments. The comment letter that highlighted these potential costs did not provide an estimate of these costs and did not provide data or analysis that would allow the Commission to estimate how NRSROs' CUSIP licenses would need to be changed to account for the new requirements.⁹¹⁰ Without information about the scope of the NRSROs' current licenses and the cost of obtaining updated licenses, it is not feasible for the Commission to develop an estimate of any such costs.⁹¹¹

Another potential cost to NRSROs is the potential loss of revenue from the sale of access to historical ratings data, as more of this data becomes publicly available. The Commission understands that revenue from this source may be significant for certain NRSROs, though commenters did not provide data or analysis that would allow the Commission to estimate the amount of revenue that could be lost.⁹¹² The Commission is unable to estimate the revenue attributable to the sale of access to historical ratings data from other sources because the information about NRSRO revenues available to the Commission is not broken down at this level of granularity and, in practice, access to such historical data may be bundled with access to analytical tools and other services. This potential loss of revenue may be mitigated by the grace

⁹⁰⁹ Information about CUSIP licenses is available at <http://www.cusip.com/cusip/cgs-license-fees.htm>.

⁹¹⁰ See DBRS Letter.

⁹¹¹ CUSIP Global Services does provide some information about potential license fees on its public website, but explicitly states that the disclosed fee schedule does not apply to "information providers, whose fees for their own usage and redistribution of CGS data are calculated using a different pricing model." The website also states that the "[f]inal determination of fees is at the judgment of CGS and consideration will be given to aspects of a customer's profile." See <http://www.cusip.com/cusip/cgs-license-fees.htm>.

⁹¹² See, e.g., Fitch Letter.

periods before disclosure, the fact that historical information before the three-year look-back period is not required to be disclosed, the exclusion of placements on credit watch and affirmations from the rating actions that must be disclosed in the public rating histories,⁹¹³ and the ability to remove a rating history from the public data file fifteen years after the credit rating is withdrawn. However, it is difficult to predict how subscribers will react to the change in the extent of publicly available data.

Because any such losses in revenue likely would disproportionately affect NRSROs that are more dependent on revenue from selling access to historical ratings data, and particularly NRSROs that operate on the subscriber-pay model, the disclosure requirement may disadvantage these NRSROs to the detriment of competition in the industry. Additional impacts on competition may result from the disproportionate burden on small NRSROs, given that some of the compliance costs are not likely to vary with size, and on NRSROs that have systems and data collection procedures that vary the most from the requirements of the amendments.

In addition to these effects, the amendments may affect capital formation. Some academic research indicates that credit rating agencies should not focus exclusively on ratings accuracy, but also should consider the feedback effects of their credit ratings on the probability of survival of an issuer.⁹¹⁴ Specifically, these theories suggest that if credit ratings can directly affect the default probability of an issuer, such as when a ratings downgrade itself makes it harder or more costly for a company to raise funds, then it may be optimal for credit rating agencies to delay credit rating downgrades in order to lessen the impact of such feedback on the

⁹¹³ For example, as discussed below, academic research suggests that placements on credit watch are significant information events, so some users of credit ratings may value information about historical NRSRO usage and timing of placements on credit watch.

⁹¹⁴ See, e.g., Gustavo Manso, Feedback Effects of Credit Ratings, J. OF FINANCIAL ECONOMICS (2013), Volume 109, p. 535–548.

company's prospects. If the adopted rules drive increased transparency with respect to performance, and this leads to pressures on NRSROs to assign more accurate credit ratings by making earlier downgrades, the amplified feedback effects could increase the default frequencies of issuers and other obligors.⁹¹⁵

The Commission has considered the costs and benefits of reasonable alternatives relative to today's amendments, including certain alternatives that have been raised by commenters and discussed above. One NRSRO requested that the Commission provide "fuller background" on decisions such as the determination to require the single cohort approach rather than an average cohort approach for performance statistics, with a description of potential benefits and limitations of those decisions.⁹¹⁶ As an alternative to the single cohort approach, the Commission could have required NRSROs to use the average cohort approach, or to present two sets of statistics using the average and single cohort approaches respectively, as suggested by commenters.⁹¹⁷ Statistics generated using the average cohort approach would provide information to users of credit ratings that is not available from statistics generated using the single cohort approach, specifically with regard to how credit ratings perform on average across a wider variety of economic conditions. Such information may be of use to users of credit ratings in evaluating and comparing the performance of NRSROs. However, variation in the length of histories available at the different NRSROs makes it difficult to produce a standardized methodology for computing average cohort statistics that would be comparable across NRSROs. Also, because the single cohort approach requires simpler calculations, it may be less burdensome for NRSROs to produce such statistics and easier for less sophisticated investors to

⁹¹⁵ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

⁹¹⁶ See Kroll Letter.

⁹¹⁷ See CFA/AFR Letter; DBRS Letter.

understand how such performance measurement statistics were produced. As discussed above, NRSROs will continue to be permitted to present alternative statistics on a voluntary basis on their public websites, and by reference to a URL in Exhibit 1.

A second alternative with respect to the performance statistics would be to require the disclosure of withdrawn credit ratings, without requiring that this category be separated into credit ratings that were withdrawn because the related obligation was paid off, because the obligor defaulted, or for other reasons. This alternative would be less burdensome than the approach in the amendments, because, as discussed by two commenters,⁹¹⁸ NRSROs that have not tracked this information historically likely would incur costs to collect the required information retroactively and change their systems to collect and report this information going forward. However, given that an applicant or NRSRO could withdraw a credit rating to make its transition or default rates appear more favorable, information about the reasons for withdrawal is likely to be useful to users of credit ratings in interpreting the performance statistics.

An alternative approach to the amendments regarding rating histories would be to require the inclusion of placements on credit watch in the rating histories, while still excluding ratings affirmations, which would be consistent with the rating actions subject to disclosure in histories under the baseline requirements. Among the three commenters that recommended that the scope of rating actions included in public rating histories be narrowed, two did not raise concerns about the inclusion of placements on credit watch.⁹¹⁹ Academic research has found that credit watch

⁹¹⁸ See Moody's Letter (stating that it does not "systematically capture data that sub-divides withdrawn credit ratings into the three sub-categories" and that collecting this data for past rating actions "would have to be done manually"); S&P Letter ("NRSROs may not currently distinguish between ratings on instruments that are paid off and withdrawn. Tracking this distinction going forward, to the extent it is not presently being done, will require significant systems changes. In addition, it may not be possible to track this distinction retroactively.").

⁹¹⁹ See ABA Letter; S&P Letter. Another commenter recommended that the Commission exclude both affirmations and placements on credit watch, as well as assignments of default status, from the definition of rating action. See Moody's Letter.

announcements are associated with abnormal stock and bond returns, indicating that placing a rating on credit watch is a significant information event.⁹²⁰ Including these announcements in rating histories would thus allow persons to, for example, judge which NRSROs have historically been more likely to provide, and more timely at providing, this information to the users of credit ratings, and thus may increase the accountability, time sensitivity, and judiciousness of NRSROs in placing credit ratings on credit watch. However, while making information about placements on credit watch publicly available in the rating histories may benefit users of credit ratings that value this information, the fact that some users of credit ratings may value this information also means that excluding such information from rating histories may make subscribers to NRSRO services that include access to historical ratings data (including placements on credit watch) somewhat less likely to stop subscribing as an increasing amount of historical ratings data becomes publicly available. The Commission therefore believes that excluding placements on credit watch from the rating histories may reduce potential losses in NRSRO revenues from services that include access to their credit ratings and/or rating histories while still permitting users of credit ratings to use the public rating histories to conduct certain analyses (such as calculating alternative transition and default statistics) to evaluate and compare NRSRO performance.

Additional alternatives with respect to rating history disclosure would be to not permit a rating history for a credit rating to be removed from the data file fifteen years after the credit rating is withdrawn, or to shorten the retention period to ten years as suggested by a commenter.⁹²¹ Under the first alternative, the retention period could be substantially increased or

⁹²⁰ See, e.g., Hand, Holthausen, and Leftwich, The Effect of Bond Rating Agency Announcements on Bond and Stock Prices; Chung, Frost, and Kim, Characteristics and Information Value of Credit Watches.

⁹²¹ See DBRS Letter.

a history could be required to be retained permanently. In particular, because the amendments allow credit ratings to be removed from the histories fifteen years after they are withdrawn, any data that becomes available for periods over fifteen years in the past will not reflect a representative sample of the credit ratings of the NRSRO, since withdrawn credit ratings, including credit ratings withdrawn because of default, will be underrepresented in the sample of outstanding credit ratings in the rating histories for a period that is more than fifteen years in the past.⁹²² Thus, the data files disclosed pursuant to the amendments will over time result in no more than fifteen years (and likely no more than thirteen or fourteen years, given the permitted grace periods) of data that is fully comprehensive and can therefore be used to calculate performance statistics or perform other analyses that require a representative sample of credit ratings. The data will, over time, become sufficient to produce, for example, five-year and twelve-year performance statistics using the single cohort approach or, for example, three-year performance statistics using the average cohort approach applied to the eleven annual cohorts beginning thirteen years ago. However, performance statistics using the data from ratings histories will be limited to cohorts of credit ratings over these thirteen or fourteen years of history and thus may not reflect as wide a variety of economic conditions as may be desired.

Increasing the retention period would therefore benefit users of credit ratings interested in using the rating histories to perform analyses that require a representative sample of the credit ratings of the NRSRO outstanding as of a date or a series of dates that are more than thirteen or fourteen years in the past. However, as in the case of excluding data with respect to placements on credit watch, applying a shorter retention period may reduce potential losses to NRSROs of

⁹²² See GAO Report 10-782, pp. 46, 98. See also *id.* at 98 (stating that “[t]o the extent that withdrawn ratings are not included in the data, users will not be able to generate withdrawal-adjusted statistics and the data will underrepresent defaulted issuers and issues” and recommending that “withdrawn ratings are not removed from these disclosures”).

revenue from selling access to historical ratings data. Also, one NRSRO stated that “the amount of data storage required” to comply with a twenty-year retention requirement for the public rating histories “would be considerable.”⁹²³ The Commission therefore believes that a fifteen-year retention requirement may reduce the burden on NRSROs, while still permitting users of credit ratings to use the public rating histories to conduct certain analyses (such as transition and default statistics that require up to thirteen or fourteen years of data, or comparisons over longer horizons of NRSRO performance with respect to the same obligor or instrument) to evaluate and compare NRSRO performance.

For these reasons, the Commission also does not believe it would be appropriate to shorten the retention period to ten years as suggested by one commenter.⁹²⁴ A ten year retention period (rather than a fifteen year retention period) would further limit the utility of the rating histories in terms of being able to use the data to generate performance statistics that are different than the performance statistics that must be disclosed in Exhibit 1 to Form NRSRO.

A further alternative for rating history disclosure would be to increase or decrease the grace periods relative to the twelve- and twenty-four-month grace periods that are permitted for issuer-paid and other credit ratings respectively under the amendments. Longer permitted grace periods likely would reduce potential losses experienced by NRSROs in revenues from services that include access to their credit ratings and/or rating histories. However, shorter grace periods would increase the benefits from the disclosure by making more, and more timely, information available to users of credit ratings for the purpose of evaluating and comparing the performance of NRSROs. The Commission believes it has appropriately balanced the costs and benefits of

⁹²³ See S&P Letter.

⁹²⁴ See DBRS Letter.

increasing or decreasing the grace periods in setting the grace periods permitted under the amendments.

F. CREDIT RATING METHODOLOGIES

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add subsection (r).⁹²⁵ Section 15E(r) of the Exchange Act provides that the Commission shall prescribe rules, for the protection of investors and in the public interest, with respect to the procedures and methodologies, including qualitative and quantitative data and models, used by NRSROs that require each NRSRO to ensure that objectives identified in section 15E(r) are met.⁹²⁶ The Commission proposed to implement section 15E(r) in large part, through paragraph (a) of Rule 17g-8, which would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure it meets the objectives identified in section 15E(r).⁹²⁷ The intent was to provide flexibility for an NRSRO to establish policies and procedures that can be integrated with its procedures and methodologies for determining credit

⁹²⁵ See Pub. L. No. 111-203, 932(a)(8); 15 U.S.C. 78o-7(r).

⁹²⁶ The objectives are: (1) to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are (A) approved by the board of the NRSRO or a body performing a similar function; and (B) in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies; (2) to ensure that when material changes to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models) are made, that (A) the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply; (B) to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule; and (C) the NRSRO publicly discloses the reason for the change; and (3) to notify users of credit ratings (A) of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating; (B) when a material change is made to a procedure or methodology, including to a qualitative model or quantitative inputs; (C) when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions; and (D) of the likelihood of a material change described in subparagraph (B) resulting in a change in current credit ratings. See 15 U.S.C. 78o-7(r)(1) through (3).

⁹²⁷ See paragraph (a) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33452-33465. As discussed below, the Commission proposed to implement section 15E(r)(3)(A) of the Exchange Act (which addresses notice of the version of a procedure or methodology used with respect to a particular credit rating) also through paragraph (a) of Rule 17g-7, as proposed. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459.

ratings, which vary across NRSROs.⁹²⁸ The proposed approach also was sensitive to the limitation in section 15E(c)(2) of the Exchange Act, given that the objectives set forth in section 15E(r) of the Exchange Act relate to the procedures and methodologies an NRSRO uses to determine credit ratings.⁹²⁹ The Commission also proposed an amendment to Rule 17g-2 to apply the record retention and production requirements of that rule to the documentation of the policies and procedures that would be required under proposed paragraph (a) of Rule 17g-8.⁹³⁰

1. Paragraph (a) of New Rule 17g-8

As proposed, paragraph (a) of Rule 17g-8 would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that it achieves the objectives identified in section 15E(r) of the Exchange Act.⁹³¹ In particular, the prefatory text of paragraph (a) would require an NRSRO to establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure that it meets the objectives identified in paragraphs (a)(1), (2), (3), (4), and (5).⁹³² The rule text in proposed paragraphs (a)(1), (2), (3), (4), and (5) of Rule 17g-8 largely mirrored the statutory text of section 15E(r) of the Exchange Act.⁹³³

⁹²⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33452.

⁹²⁹ See id. at 33452. See also 15 U.S.C. 78o-7(r); 15 U.S.C. 78o-7(c)(2) (providing, in pertinent part, that the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings).

⁹³⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33456.

⁹³¹ See proposed paragraph (a) of Rule 17g-8; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁹³² See proposed prefatory text of paragraph (a) of Rule 17g-8; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁹³³ Compare paragraphs (a)(1), (2), (3), (4), and (5) of Rule 17g-8, as proposed, with 15 U.S.C. 78o-7(r)(1) through (3).

The Commission is adopting the prefatory text of paragraph (a) of Rule 17g-8 as proposed.⁹³⁴ The final rule requires an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that it meets the objectives identified in paragraphs (a)(1), (2), (3), (4), and (5) of the rule.

One commenter stated that the proposal appropriately recognizes that procedures and methodologies vary across NRSROs and thus there is a need for flexibility to establish policies and procedures that can be integrated with the NRSRO's existing credit rating methodologies.⁹³⁵ Some commenters expressed general opposition to the proposal on the basis of cost.⁹³⁶ One of these commenters stated that certain aspects of the proposals, including those regarding credit rating methodologies, would compound barriers to entry, and that many of the rules would be expensive and burdensome to implement.⁹³⁷ More specifically, this commenter stated that the Commission should take into account the dominance of very large players and expand exemptions for small NRSROs designed to level the competitive field.⁹³⁸

In response, the Commission notes that the final rule is designed to meet the rulemaking mandate of section 15E(r) of the Exchange Act in a manner that provides flexibility to NRSROs to design the required policies and procedures. Consequently, an NRSRO can tailor and scale its policies and procedures to its business model, size, and the scope of its activities as well as to its

⁹³⁴ See prefatory text of paragraph (a) of Rule 17g-8.

⁹³⁵ See ICI Letter.

⁹³⁶ See A.M. Best Letter; Kroll Letter. Alternatively, another commenter expressed the view that rule should, in general, be strengthened by explicitly requiring NRSROs to assign higher risk to products issued by financial institutions with a track record of issuing poor quality assets. See Levin Letter. This recommendation is beyond the scope of the proposal and could implicate section 15E(c)(2) of the Exchange Act. See 15 U.S.C. 78o-7(c)(2) (which, among other things, prohibits the Commission from regulating the substance of credit ratings and the procedures and methodologies by which any NRSRO determines credit ratings).

⁹³⁷ See Kroll Letter.

⁹³⁸ See id.

procedures and methodologies for determining credit ratings, which should mitigate concerns to some degree about the costs of the final rule and its potential to create barriers to entry for small credit rating agencies. The Commission also believes that the policies and procedures required under section 15E(r), as implemented by the Commission in paragraph (a) of Rule 17g-8, will promote the integrity and transparency of the procedures and methodologies NRSROs use to determine credit ratings by, for example, promoting board oversight of these procedures and methodologies and requiring disclosure when material changes are made to them. Nonetheless, as discussed below in the economic analysis, the Commission acknowledges that these requirements will result in costs and that those costs could create competitive barriers.

As proposed, paragraph (a)(1) of Rule 17g-8 would implement section 15E(r)(1)(A) of the Exchange Act.⁹³⁹ This section identifies the objective of ensuring that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board.⁹⁴⁰ Paragraph (a)(1), as proposed, would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board.⁹⁴¹ The Commission intended this requirement to operate in conjunction with section 15E(t)(3)(A) of the Exchange Act, which establishes a

⁹³⁹ See paragraph (a)(1) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

⁹⁴⁰ See 15 U.S.C. 78o-7(r)(1)(A).

⁹⁴¹ See paragraph (a)(1) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

statutory requirement that the board of an NRSRO “shall oversee” the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings.⁹⁴²

The Commission is adopting paragraph (a)(1) of Rule 17g-8, as proposed.⁹⁴³ The final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that the procedures and methodologies it uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.⁹⁴⁴ In relation to this requirement in paragraph (a)(1), section 15E(t)(3)(A) of the Exchange Act (as discussed above) contains a self-executing requirement that the board of an NRSRO “shall oversee” the “establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings.”⁹⁴⁵ Consequently, as discussed in the proposing release, the policies and procedures required pursuant to paragraph (a)(1) of Rule 17g-8, as adopted, must be reasonably designed to ensure that the NRSRO’s board carries out this statutorily mandated responsibility.⁹⁴⁶ In addition, section 15E(t)(5) of the Exchange Act provides that the Commission may permit an NRSRO to delegate responsibilities required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small NRSRO.⁹⁴⁷ In this case, the policies and procedures required pursuant to paragraph (a)(1) of Rule 17g-8, as adopted, must be reasonably designed to ensure the NRSRO’s committee carries out the responsibility to oversee the establishment, maintenance,

⁹⁴² See 15 U.S.C. 78o-7(t)(3)(A); Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

⁹⁴³ See paragraph (a)(1) of Rule 17g-8.

⁹⁴⁴ See *id.*

⁹⁴⁵ See 15 U.S.C. 78o-7(t)(3)(A).

⁹⁴⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

⁹⁴⁷ See 15 U.S.C. 78o-7(t)(5).

and enforcement of the NRSRO's procedures and methodologies for determining credit ratings.⁹⁴⁸

One commenter stated that the proposal appropriately meets the Exchange Act mandate.⁹⁴⁹ Another commenter cited the high costs associated with having an independent board and stated that given those high costs the scope of board functions should not be inadvertently expanded.⁹⁵⁰ This commenter also stated that it would have been helpful for the final rule to provide greater guidance to confirm that the board is not required to approve or pass judgment on, for example, "qualitative and quantitative data and models."⁹⁵¹ A second commenter stated that a periodic approval process is more consistent with the board of directors' oversight role and provides the board of directors a better opportunity to provide well-planned and meaningful guidance that would be better at creating consistency in best practices across the NRSRO.⁹⁵² A third commenter stated that responsibility for the development of ratings criteria, methodologies, and models "should be in the hands of experienced ratings professionals" and that the board should be responsible for approving the policies and procedures that are used to develop the NRSROs' criteria, methodologies, and models.⁹⁵³ The commenter did not interpret the proposal to require the board to approve the criteria, methodologies, or models themselves, stating that any such requirement would not be feasible given the vast amounts of continually developing criteria used by NRSROs.⁹⁵⁴

⁹⁴⁸ See 15 U.S.C. 78o-7(t)(3)(A).

⁹⁴⁹ See S&P Letter.

⁹⁵⁰ See Kroll Letter. Section 15E(t)(2) of the Exchange Act prescribes a self-executing requirement that at least one half of the members of an NRSRO's board must be independent. See 15 U.S.C. 78o-7(t)(2).

⁹⁵¹ See Kroll Letter.

⁹⁵² See Morningstar Letter.

⁹⁵³ See S&P Letter.

⁹⁵⁴ See id.

In response to the comments, the Commission notes that section 15E(t)(3)(A) of the Exchange Act provides that the board of an NRSRO shall oversee the establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.⁹⁵⁵ Consequently, the self-executing requirement in the statute governs the responsibility of the board. Paragraph (a)(1) of Rule 17g-8 governs the responsibility of the NRSRO to have policies and procedures reasonably designed to ensure that the board carries out this responsibility. In terms of complying with the statutory requirement to oversee rating policies and procedures, the Commission recognizes that the board cannot be involved in managing the day-to-day affairs of the NRSRO. There must be an appropriate balance between the board's responsibilities as a governing body and the responsibilities of the NRSRO's managers as supervisors of the daily activities of the NRSRO. As a practical matter, an NRSRO will need to appropriately allocate responsibilities to the NRSRO's board and to the NRSRO's managers with respect to the implementation of rating procedures and methodologies, with the board exercising its statutory responsibility to oversee the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings. Consequently, the Commission does not expect board members to undertake the detailed work of developing rating procedures and methodologies.

Further, as discussed above, section 15E(t)(5) of the Exchange Act provides exception authority under which the Commission may permit an NRSRO to delegate responsibilities of the board required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small NRSRO.⁹⁵⁶ The ability to request an exception under section 15E(t)(5) provides a means for a small NRSRO to seek relief

⁹⁵⁵ See 15 U.S.C. 78o-7(t)(3)(A).

⁹⁵⁶ See 15 U.S.C. 78o-7(t)(5).

to delegate responsibilities to a committee if the potential costs and burdens associated with the requirements of section 15E(t) of the Exchange Act – including the requirement that the board oversee the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings – are an unreasonable burden.⁹⁵⁷

Commenters also questioned whether the board of directors would need to have members with expertise in rating methodologies.⁹⁵⁸ One of these commenters stated that the rule should require the NRSRO to appoint at least one board member with quantitative financial analysis expertise.⁹⁵⁹ Section 15E(t)(3)(A) of the Exchange Act, while mandating that the NRSRO's board must “oversee” the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings, does not address whether the board must include a member with specific expertise in this area.⁹⁶⁰ Similarly, section 15E(r)(1)(A) of the Exchange Act also does not address board expertise and, consequently, neither does paragraph (a)(1) of Rule 17g-8.⁹⁶¹ In complying with the statute and rule, an NRSRO and its shareholders will need to strike an appropriate balance between board members who have generalized experience and those who have more specific experience with aspects of the NRSRO's business activities, including with rating methodologies.

⁹⁵⁷ The Commission will respond to such requests in a manner similar to requests for relief under section 36 of the Exchange Act. See 15 U.S.C. 78mm. Further information about requesting relief under section 36 of the Exchange Act is available at <http://www.sec.gov/rules/exempt.shtml>.

⁹⁵⁸ See, e.g., AFSCME Letter (expressing concerns that the board may not possess the necessary expertise, particularly in quantitative analysis, to carry out the oversight function specified in paragraph (a)(1) of Rule 17g-8); COPERA Letter (expressing similar concerns); Morningstar Letter.

⁹⁵⁹ See AFSCME Letter.

⁹⁶⁰ See 15 U.S.C. 78o-7(t)(3)(A). The statute does require the NRSRO to have independent board members, some of whom must be users of credit ratings of NRSROs. See 15 U.S.C. 78o-7(t)(2)(A).

⁹⁶¹ See 15 U.S.C. 78o-7(r)(1)(A).

Paragraph (a)(2) of Rule 17g-8, as proposed, would implement section 15E(r)(1)(B) of the Exchange Act.⁹⁶² This section identifies the objective of ensuring that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies.⁹⁶³ As proposed, paragraph (a)(2) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the procedures and methodologies, including qualitative and quantitative data and models, that the NRSRO uses to determine credit ratings are developed and modified in accordance with the policies and procedures of the NRSRO.⁹⁶⁴

The Commission is adopting paragraph (a)(2) of Rule 17g-8 as proposed.⁹⁶⁵ Section 15E(c)(3)(A) of the Exchange Act requires an NRSRO 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.”⁹⁶⁶ Consequently, section 15E(c)(3)(A) establishes a statutory requirement that an NRSRO have an internal control structure that governs the implementation of rating procedures and methodologies.⁹⁶⁷ In addition, paragraph (a)(2) of Rule 17g-8 establishes a complementary requirement that an NRSRO have policies and procedures reasonably designed to ensure that rating procedures and

⁹⁶² See paragraph (a)(2) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

⁹⁶³ See 15 U.S.C. 78o-7(r)(1)(B).

⁹⁶⁴ See paragraph (a)(2) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542.

⁹⁶⁵ See paragraph (a)(2) of Rule 17g-8.

⁹⁶⁶ See 15 U.S.C. 78o-7(c)(3)(A) (emphasis added).

⁹⁶⁷ See id.

methodologies are developed and modified in accordance with the NRSRO's procedures for developing and modifying rating procedures and methodologies.⁹⁶⁸

Two commenters supported the proposal.⁹⁶⁹ In contrast, one commenter suggested the Commission take a different approach than was proposed in paragraph (a)(2) of Rule 17g-8.⁹⁷⁰ Specifically, this commenter recommended that the rule establish a "committee assessment function" devoted to analyzing the performance of rating committees.⁹⁷¹ In response, the Commission notes that the rulemaking mandate in section 15E(r)(1)(B) of the Exchange Act addresses ensuring that the NRSRO uses rating procedures and methodologies that are in accordance with the NRSRO's procedures and methodologies for developing and modifying such procedures and methodologies.⁹⁷² In other words, the statute is concerned with ensuring that the NRSRO follows its processes for developing and modifying rating procedures and methodologies. The commenter's suggestion for a committee assessment function addresses the performance of rating committees in determining credit ratings (that is, in applying the rating procedures and methodologies). Consequently, the Commission considers the commenter's proposal outside the scope of this rulemaking.

Paragraph (a)(3)(i) of Rule 17g-8, as proposed, would implement section 15E(r)(2)(A) of the Exchange Act.⁹⁷³ This section identifies the objective of ensuring that, when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), the changes are applied consistently to all credit ratings to which

⁹⁶⁸ See paragraph (a)(2) of Rule 17g-8.

⁹⁶⁹ See ICI Letter; S&P Letter.

⁹⁷⁰ See Harrington Letter.

⁹⁷¹ See id.

⁹⁷² See 15 U.S.C. 78o-7(r)(1)(B).

⁹⁷³ See paragraph (a)(3)(i) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

the changed procedures and methodologies apply.⁹⁷⁴ As proposed, paragraph (a)(3)(i) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are applied consistently to all credit ratings to which the changed procedures and methodologies apply.⁹⁷⁵

Paragraph (a)(3)(ii) of Rule 17g-8, as proposed, would implement section 15E(r)(2)(B) of the Exchange Act.⁹⁷⁶ This section identifies the objective of ensuring that when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule.⁹⁷⁷ As proposed, paragraph (a)(3)(ii) would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are, to the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to then-current credit ratings within a reasonable period of time taking into consideration the number of ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the

⁹⁷⁴ See 15 U.S.C. 78o-7(r)(2)(A).

⁹⁷⁵ See paragraph (a)(3)(i) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33542-33543.

⁹⁷⁶ See paragraph (a)(3)(ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33453-33454.

⁹⁷⁷ See 15 U.S.C. 78o-7(r)(2)(B).

type of obligor, security, or money market instrument being rated.⁹⁷⁸ The proposed rule text differed from the text of section 15E(r)(2)(B) of the Exchange Act because it provided that the changes must be applied to then-current credit ratings within a reasonable period of time taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.⁹⁷⁹

The Commission is adopting paragraphs (a)(3)(i) and (ii) of Rule 17g-8 with modifications to paragraph (a)(3)(i) to clarify the requirements of the rule in response to comment.⁹⁸⁰ Specifically, one commenter stated that the provision appropriately meets the requirements of the Exchange Act but asked the Commission to clarify that paragraph (a)(3)(i) is applicable only to changes to procedures and methodologies that may impact new credit ratings, and that the implementation of changes affecting existing ratings are addressed separately in paragraph (a)(3)(ii).⁹⁸¹ The commenter's interpretation of paragraph (a)(3)(i) is incorrect. The Commission intended this paragraph to address the procedures and methodologies an NRSRO uses to determine new credit ratings and to make adjustments to current credit ratings. Otherwise, the policies and procedures required under paragraph (a)(3)(i) would not address the consistent treatment of current credit ratings. However, to remove any ambiguity, the text of

⁹⁷⁸ See paragraph (a)(3)(ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

⁹⁷⁹ See paragraph (a)(3)(ii) of Rule 17g-8, as proposed; 15 U.S.C. 78o-7(r)(2)(B). The proposed rule text was designed to implement the rulemaking provision in section 15E(r)(2)(B) that the changes are to be applied to then-current credit ratings by the NRSRO within a reasonable time period determined by the Commission, by rule. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33453-33454.

⁹⁸⁰ See paragraph (a)(3)(i) and (ii) of Rule 17g-8.

⁹⁸¹ See S&P Letter.

paragraph (a)(3)(i) has been modified to clarify that the paragraph applies to “current and future credit ratings.”⁹⁸²

Another commenter questioned whether the provision was appropriate given the commenter’s view that an NRSRO cannot ensure that changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply because qualitative assessments differ from credit rating committee to credit rating committee.⁹⁸³ The Commission acknowledges that rating procedures and methodologies commonly incorporate qualitative analysis that introduces a degree of subjectivity to the rating process. The final rule is not intended to interfere with the qualitative process that is part of determining a credit rating. Rather, it is designed to ensure that an NRSRO does not apply different rating procedures and methodologies when determining credit ratings with respect to types of obligors or obligations that are intended to be subject to the same rating procedures and methodologies. If, for example, an NRSRO changes a rating procedure or methodology for determining initial credit ratings for RMBS, the policies and procedures of the NRSRO must be reasonably designed to ensure that the NRSRO does not continue to use the old procedure or methodology to determine initial credit ratings for some RMBS and the new procedure or methodology to determine initial credit ratings for other RMBS.⁹⁸⁴

The Commission is making modifications to paragraph (a)(3)(ii) of Rule 17g-8 from the rule text as proposed.⁹⁸⁵ As stated above, one commenter asked the Commission to clarify that

⁹⁸² See paragraph (a)(3)(i) of Rule 17g-8.

⁹⁸³ See Harrington Letter.

⁹⁸⁴ Similarly, if the NRSRO changes a procedure or methodology for monitoring credit ratings of RMBS, the policies and procedures of the NRSRO under paragraph (a)(3)(i) must be reasonably designed to ensure that it does not continue to use the old procedure or methodology to monitor some RMBS and the new procedure or methodology to monitor other RMBS.

⁹⁸⁵ See paragraph (a)(3)(ii) of Rule 17g-8.

paragraph (a)(3)(i) is applicable only to changes to procedures and methodologies that may impact new credit ratings, and that the implementation of changes affecting current ratings are addressed separately in paragraph (a)(3)(ii).⁹⁸⁶ As discussed above, the commenter's interpretation of paragraph (a)(3)(i) was not correct and the paragraph has been modified to clarify that it applies to current and future credit ratings. However, the commenter is correct that paragraph (a)(3)(ii) was intended to apply to current credit ratings. Specifically, the Commission intended paragraph (a)(3)(ii) to address the timeframe in which an NRSRO must apply an updated procedure or methodology for performing surveillance or monitoring of credit ratings to current credit ratings to which the changed procedure or methodology applies. For example, if the NRSRO changes the methodology for monitoring credit ratings of RMBS, paragraph (a)(3)(i) of the final rule requires the firm to have policies and procedures that are reasonably designed to ensure that it uses the updated methodology to monitor all RMBS credit ratings going forward.⁹⁸⁷

The change in methodology, however, may require the NRSRO to adjust the current credit ratings assigned to RMBS. Paragraph (a)(3)(ii), as proposed, was intended to address the timeframe in which an NRSRO must apply the updated methodology to current credit ratings to determine whether they should be adjusted. The Commission has modified the text of paragraph (a)(3)(ii) to make this more clear. Specifically, the final rule requires an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the NRSRO uses to determine credit ratings are, to the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable

⁹⁸⁶ See S&P Letter.

⁹⁸⁷ See paragraph (a)(3)(i) of Rule 17g-8.

period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.⁹⁸⁸

One commenter asked for clarification as to what time period constitutes a “reasonable period” for applying changed surveillance or monitoring procedures and methodologies to current credit ratings.⁹⁸⁹ Two commenters supported the decision not to prescribe a timeframe given the variables surrounding such a change (for example, number of impacted credit ratings).⁹⁹⁰ Another commenter acknowledged the need for flexibility with respect to the timeframe but expressed the concern that absent any guidance there would continue to be insufficient resources made available for surveillance and monitoring of credit ratings.⁹⁹¹ Two commenters argued that the Commission must establish a firm deadline for the application of revised rating methodologies or surveillance procedures to current credit ratings to ensure NRSROs act promptly.⁹⁹² Another commenter, more generally, urged the Commission to require prompt re-testing after the NRSRO makes any such material changes.⁹⁹³

In response to the comments that the rule should prescribe a specific timeframe in which the review must take place or prescribe what constitutes a reasonable period of time, the Commission is not persuaded that doing so would be feasible or appropriate. For example, some NRSROs have hundreds of thousands of credit ratings outstanding in certain classes of credit

⁹⁸⁸ See paragraph (a)(3)(ii) of Rule 17g-8 (emphasis added to highlight the modification).

⁹⁸⁹ See DBRS Letter.

⁹⁹⁰ See S&P Letter; DBRS Letter.

⁹⁹¹ See AFSCME Letter.

⁹⁹² See Better Markets Letter; CFA/AFR Letter.

⁹⁹³ See Levin Letter.

ratings, whereas others have fewer than one thousand.⁹⁹⁴ Consequently, if the specified timeframe was too short, an NRSRO with a large number of credit ratings might need to rush to meet the deadline. This could negatively impact the quality of the review of the credit ratings subject to the changed surveillance or monitoring procedures and methodologies and could result in adjustments to those credit ratings that were not the result of thorough analysis. If the specified timeframe was too long, an NRSRO with relatively few credit ratings would have a “safe harbor” that allowed the firm to act more slowly to apply the changed surveillance procedures and methodologies to current credit ratings than was necessary.⁹⁹⁵ Consequently, the final rule retains the proposed requirement that the updated surveillance or monitoring procedure or methodology must be applied to the current credit ratings to which the changed procedure or methodology applies within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated. The question of whether the NRSRO has acted within a reasonable period of time will depend on factors such as the number of credit ratings an NRSRO has outstanding that would be impacted by the change.

Another commenter stated that the Commission should clarify the manner in which changes in rating procedures and methodologies would apply to current credit ratings.⁹⁹⁶ More specifically, the commenter explained that proposed paragraph (a)(3)(i) of Rule 17g-8 did not address whether an NRSRO applying changed procedures or methodologies to outstanding credit ratings must re-rate the transaction based upon the information available at the time of the initial

⁹⁹⁴ See, e.g., 2013 Annual Staff Report on NRSROs, p. 8.

⁹⁹⁵ See Harrington Letter (raising this concern).

⁹⁹⁶ See FSR Letter.

rating or whether the process should include performance information received after that time.⁹⁹⁷

The commenter also stated that the NRSRO should not apply changes in procedures or methodologies to current credit ratings without a change in the performance of the credit rating.⁹⁹⁸ In response, the Commission notes that the final rule does not require the NRSRO to adjust the outstanding credit ratings impacted by the changed rating procedure or methodology; nor does it specify on what basis an NRSRO should adjust an outstanding credit rating.⁹⁹⁹

Rather, it requires the NRSRO to have policies and procedures reasonably designed to ensure that changes to surveillance or monitoring procedures and methodologies are applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable timeframe. The question of whether an outstanding credit rating must be adjusted after the application of the changed procedures or methodologies will depend solely on the NRSRO's procedures and methodologies. Based on those procedures and methodologies, the NRSRO may adjust an existing credit rating because of the change in the procedure or methodology, because of a change in circumstances that impacts the creditworthiness of the obligor or issuer that is subject to the credit rating, or a combination of these factors. This decision, however, will be based solely on the NRSRO's procedures and methodologies.¹⁰⁰⁰

Paragraph (a)(4)(i) of Rule 17g-8, as proposed, would implement sections 15E(r)(2)(C), 15E(r)(3)(B), and 15E(r)(3)(D) of the Exchange Act.¹⁰⁰¹ Section 15E(r)(2)(C) identifies the

⁹⁹⁷ See id.

⁹⁹⁸ See id.

⁹⁹⁹ As discussed above, in implementing section 15E(r) of the Exchange Act, the Commission has been sensitive to the limitation in section 15E(c)(2) of the Exchange Act. See 15 U.S.C. 78o-7(c)(2) (which, among other things, prohibits the Commission from regulating the substance of credit ratings and the procedures and methodologies by which any NRSRO determines credit ratings).

¹⁰⁰⁰ See 15 U.S.C. 78o-7(c)(2).

¹⁰⁰¹ See paragraph (a)(4)(i) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33454.

objective of ensuring that when material changes are made to rating procedures and methodologies (including changes to qualitative and quantitative data and models), the NRSRO publicly discloses the reason for the change.¹⁰⁰² Section 15E(r)(3)(B) identifies the objective of ensuring that an NRSRO notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input.¹⁰⁰³ Section 15E(r)(3)(D) identifies the objective of ensuring that the NRSRO notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input, of the likelihood the change will result in a change in current credit ratings.¹⁰⁰⁴ The Commission proposed to implement these sections in paragraph (a)(4)(i) of Rule 17g-8, which would require an NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet website material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any “current ratings.”¹⁰⁰⁵

The Commission is adopting paragraph (a)(4)(i) of Rule 17g-8 with a minor modification to make terminology throughout the rule consistent.¹⁰⁰⁶ As adopted, paragraph (a)(4)(i) requires the NRSRO to have policies and procedures that are reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet website

¹⁰⁰² See 15 U.S.C. 78o-7(r)(2)(C).

¹⁰⁰³ See 15 U.S.C. 78o-7(r)(3)(B).

¹⁰⁰⁴ See 15 U.S.C. 78o-7(r)(3)(D).

¹⁰⁰⁵ See paragraph (a)(4)(i) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁰⁰⁶ See paragraph (a)(4)(i) of Rule 17g-8. The modification adds the word “credit” after the word “current” and before the word “ratings” to consistently use the term “credit ratings” throughout the rule.

material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings.¹⁰⁰⁷

Paragraph (a)(4)(ii) of Rule 17g-8, as proposed, would implement section 15E(r)(3)(C) of the Exchange Act.¹⁰⁰⁸ This section provides that the Commission's rules shall require an NRSRO to notify users of credit ratings when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions.¹⁰⁰⁹ As proposed, paragraph (a)(4)(ii) would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet website significant errors identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change in the current ratings.¹⁰¹⁰

The Commission is adopting paragraph (a)(4)(ii) of Rule 17g-8 with a minor modification. As proposed, the rule provided, in pertinent part, that the NRSRO must publish "significant errors" identified in a rating procedure or methodology. The proposal was intended to notify users of the NRSRO's credit ratings when a significant error is identified.¹⁰¹¹ One potential reading of the text, however, was that it required publication of the actual error. This was not intended. Further, publication of the error without context – rather than notification that an error was identified – could diminish the value of the disclosure. For example, if the error

¹⁰⁰⁷ See paragraph (a)(4)(i) of Rule 17g-8.

¹⁰⁰⁸ See paragraph (a)(4)(ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33454.

¹⁰⁰⁹ See 15 U.S.C. 78o-7(r)(3)(C).

¹⁰¹⁰ See paragraph (a)(4)(ii) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁰¹¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33453.

was in the code of a quantitative model, the disclosure of the code containing the error without identifying that it contained an error likely would not inform users of the NRSRO's credit ratings that there was an error. Consequently, the final rule is modified to provide for the prompt publication of notice of the existence of a significant error. More specifically, the final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that the NRSRO promptly publishes on an easily accessible portion of its corporate Internet website notice of the existence of a significant error identified in a procedure or methodology, including a qualitative or quantitative model, the NRSRO uses to determine credit ratings that may result in a change to current credit ratings.¹⁰¹²

A number of commenters addressed paragraph (a)(4) of Rule 17g-8, as proposed.¹⁰¹³ Some commenters stated that Internet website publication would help ensure that NRSROs communicate information pertaining to material changes in procedures and methodologies, as well as significant errors in the procedures and methodologies, to investors and other users of credit ratings in a timely manner.¹⁰¹⁴ One commenter opposed the provision in paragraph (a)(4) of Rule 17g-8 requiring NRSROs to publish material changes and significant errors on an easily accessible portion of the NRSRO's corporate Internet website.¹⁰¹⁵ The commenter argued that the statute requires more direct notification than Internet website publication, which could include allowing users to sign up for alerts.¹⁰¹⁶ The Commission believes that specifying publication on an easily accessible portion of the NRSRO's Internet website is the most direct

¹⁰¹² See paragraph (a)(4)(ii) of Rule 17g-8 (emphasis added to highlight the modification).

¹⁰¹³ See Barnard Letter; CFA/AFR Letter; DBRS Letter; Gardner Letter; Harrington Letter; ICI Letter; Levin Letter; S&P Letter.

¹⁰¹⁴ See DBRS Letter; Harrington Letter; ICI Letter; S&P Letter.

¹⁰¹⁵ See CFA/AFR Letter.

¹⁰¹⁶ See id.

and cost effective way to provide an opportunity for all potentially interested parties to have access to the required disclosures.¹⁰¹⁷ This does not preclude an NRSRO from offering additional disclosure services such as alerts or third parties from offering alert services based on the disclosures an NRSRO publishes.

One NRSRO stated that it would be helpful for the Commission to provide guidance as to when either a material change or significant error would trigger the disclosures.¹⁰¹⁸ This commenter stated that significant errors should be disclosed if there is a reasonable likelihood that correction of the error will result in a change to current credit ratings. In contrast, another commenter stated that the Commission should not attempt to define the phrase significant error as any imposition of an arbitrary definition could result in situations where an NRSRO must identify errors that are minor and a correction does not result in a rating action.¹⁰¹⁹

The question of whether a change is material or an error is significant will depend on the facts and circumstances and, most importantly, on the impacted rating procedure or methodology (which vary across NRSROs). In general, the Commission believes that a change to a rating procedure or methodology would be material if there is a substantial likelihood that reasonable users of the NRSRO's credit ratings would find notice of the change important information in terms of assessing the rating procedure or methodology.¹⁰²⁰ The Commission believes that an error in a rating procedure or methodology would be significant if there is a substantial likelihood that reasonable users of the NRSRO's credit ratings would find notice of the error

¹⁰¹⁷ See DBRS Letter (supporting website-based disclosure); Harrington Letter (same); ICI Letter (same).

¹⁰¹⁸ See DBRS Letter.

¹⁰¹⁹ See S&P Letter.

¹⁰²⁰ See DBRS Letter (suggested that a change to a rating methodology should be considered material if there is a substantial likelihood that a reasonable investor or other user of the credit ratings would consider the change to be important in evaluating the affected credit ratings).

important information in terms of assessing the impact the error had on credit ratings determined using the rating procedure or methodology that contained the error.¹⁰²¹

Finally, paragraph (a)(5) of Rule 17g-8, as proposed, would implement section 15E(r)(3)(A) of the Exchange Act.¹⁰²² This section provides that the Commission's rules shall require an NRSRO to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.¹⁰²³ As proposed, paragraph (a)(5) would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that the NRSRO discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.¹⁰²⁴

The Commission is adopting paragraph (a)(5) of Rule 17g-8 as proposed.¹⁰²⁵ Specifically, the final rule requires an NRSRO to have policies and procedures that are reasonably designed to ensure that it discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.¹⁰²⁶

¹⁰²¹ See *id.* (stating an error should be disclosed if there is a reasonable likelihood that correction of the error will result in a change to current credit ratings).

¹⁰²² See paragraph (a)(5) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33454-33455.

¹⁰²³ See 15 U.S.C. 78o-7(r)(3)(A).

¹⁰²⁴ See paragraph (a)(5) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543. In addition, because this would be a rating-by-rating disclosure, the Commission proposed, as discussed below in section II.G.3. of this release, that disclosure of the version of a credit rating procedure or methodology be part of the rule implementing section 15E(s) of the Exchange Act. See 15 U.S.C. 78o-7(s). Section 15E(s) specifies, among other things, that the Commission adopt rules requiring an NRSRO to generate a form to be included with the publication of a credit rating. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459-33460 (discussing paragraph (a)(1)(ii)(B) of Rule 17g-7, as proposed).

¹⁰²⁵ See paragraph (a)(5) of Rule 17g-8.

¹⁰²⁶ See *id.*

One commenter requested clarification that the requirement to publish the version of the criteria used for a particular credit rating applies only when there is an action on the credit rating, such as an upgrade, downgrade, or withdrawal.¹⁰²⁷ A second commenter stated that the rule should require the NRSRO to publicly provide, along with the publication of the credit rating, disclosure about the credit rating and the methodology used to determine it.¹⁰²⁸

The Commission is implementing section 15E(r)(3)(A) of the Exchange Act through paragraph (a)(5) of Rule 17g-8 and paragraph (a)(1)(ii)(B) of Rule 17g-7. Paragraph (a)(1)(ii)(B) of Rule 17g-7, as discussed below in section II.G.3. of this release, requires that the form to be included with the publication of certain rating actions include a disclosure of the version of the credit rating procedure or methodology used to determine the credit rating.¹⁰²⁹ The policies and procedures required by paragraph (a)(5) of Rule 17g-8 must address the NRSRO's compliance with the disclosure requirement in Rule 17g-7. In response to the comments about when the version of the credit rating procedure or methodology used to determine the credit rating must be disclosed, Rule 17g-7 specifies when the form containing the disclosure of the version of the credit rating procedure or methodology used to determine the credit rating must be published by the NRSRO: upon the taking of one of the rating actions identified in the rule (for example, an initial credit rating or an upgrade or a downgrade of an outstanding credit rating).¹⁰³⁰

A third commenter expressed concern that the proposal would provide NRSROs with a defense for developing poor opinions on creditworthiness.¹⁰³¹ More specifically, the commenter

¹⁰²⁷ See S&P Letter.

¹⁰²⁸ See Gardner Letter.

¹⁰²⁹ See paragraph (a)(1)(ii)(B) of Rule 17g-7.

¹⁰³⁰ See id.

¹⁰³¹ See Harrington Letter.

stated that, based on his experience, reference to published methodologies has given at least one NRSRO a defense for having formed poor opinions on CDOs and RMBS.¹⁰³² The commenter also questioned the underlying rationale of the rule insofar as NRSRO methodologies are already freely accessible and transparent.¹⁰³³ In response, the Commission notes that the statutory directive is clear: the rule must require each NRSRO to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.¹⁰³⁴ To address the commenter's concern, the Commission would need to do the opposite and prohibit an NRSRO from notifying users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating. This would be inconsistent with the statutory requirement that the rule provide for notification.

2. Amendment to Rule 17g-2

The Commission proposed adding paragraph (b)(13) to Rule 17g-2 to identify the policies and procedures an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g-8 as a record that must be retained.¹⁰³⁵ The one comment letter that addressed the proposal supported it.¹⁰³⁶ The Commission is adding paragraph (b)(13) to Rule 17g-2 as proposed.¹⁰³⁷ This will provide a means for the Commission to monitor the NRSROs' compliance with paragraph (a) of Rule 17g-8. The record must be retained until three

¹⁰³² See id.

¹⁰³³ See id.

¹⁰³⁴ See 15 U.S.C. 78o-7(r)(3)(A).

¹⁰³⁵ See paragraph (b)(13) of Rule 17g-2, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. See also section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

¹⁰³⁶ See DBRS Letter.

¹⁰³⁷ See paragraph (b)(13) of Rule 17g-2.

years after the date the record is replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g-2 discussed above in section II.A.2. of this release.¹⁰³⁸

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments and new rule relating to credit rating methodologies.¹⁰³⁹ The economic baseline that existed before today's amendments was one in which an NRSRO's board of directors must oversee the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings pursuant to Exchange Act section 15E(t)(3)(A).¹⁰⁴⁰ The baseline that existed before today's amendments and new rule also was one in which NRSROs must establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to their methodologies for determining credit ratings.¹⁰⁴¹

NRSROs – under the baseline requirements – were not explicitly required to establish, maintain, enforce, document, and retain a record of policies and procedures relating to: (1) board approval of the procedures and methodologies for determining credit ratings;¹⁰⁴² (2) the development and modification of the procedures and methodologies for determining credit ratings;¹⁰⁴³ (3) applying material changes to the procedures and methodologies for determining

¹⁰³⁸ See paragraphs (b)(13) and (c) of Rule 17g-2.

¹⁰³⁹ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁰⁴⁰ See 15 U.S.C. 78o-7(t)(3)(A).

¹⁰⁴¹ See 15 U.S.C. 78o-7(c)(3)(A).

¹⁰⁴² See paragraph (a)(1) of Rule 17g-8.

¹⁰⁴³ See paragraph (a)(2) of Rule 17g-8. As noted above, an NRSRO must establish, maintain, enforce, and document an effective internal control structure governing the implementation of their methodologies for determining credit ratings. See 15 U.S.C. 78o-7(t)(3)(A).

credit ratings;¹⁰⁴⁴ (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;¹⁰⁴⁵ and (5) disclosing the version a procedure or methodology for determining credit ratings used with respect to a particular credit rating.¹⁰⁴⁶

Relative to this baseline, the Commission believes that the amendments and new rule may result in a number of benefits. For example, implementing policies and procedures designed to ensure that the NRSRO's board of directors (or a body performing a similar function) oversees the establishment, maintenance, and enforcement of the NRSRO's policies and procedures for determining credit ratings in accordance with 15E(t)(3)(A) of the Exchange Act should promote the quality and consistency of the procedures and methodologies. Similarly, taking steps to ensure that the procedures and methodologies for determining credit ratings are developed and modified pursuant to the NRSRO's policies and procedures also should promote the quality and consistency of the procedures and methodologies.

Taking steps to ensure that material changes to the procedures and methodologies the NRSRO uses to determine credit ratings are applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply should help ensure consistent and timely application of such changes and promote the integrity of the credit rating process. This should benefit users of credit ratings. In addition, taking steps to ensure that an NRSRO promptly publishes on an easily accessible portion of its Internet website information about material changes to the procedures and methodologies the NRSRO uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any

¹⁰⁴⁴ See paragraph (a)(3) of Rule 17g-8.

¹⁰⁴⁵ See paragraph (a)(4) of Rule 17g-8.

¹⁰⁴⁶ See paragraph (a)(5) of Rule 17g-8.

current credit ratings should benefit investors and other users of credit ratings by increasing the transparency of the NRSROs' credit rating activities and providing additional information with which to assess the quality of a given NRSRO's credit rating processes. Similarly, taking steps to ensure that an NRSRO promptly publishes on an easily accessible portion of its corporate Internet website notice of the existence of a significant error identified in a procedure or methodology used to determine credit ratings also should benefit investors and other users of credit ratings by increasing the transparency of the NRSROs' credit rating activities and providing additional information with which to assess the quality of a given NRSRO's credit rating processes.

The records NRSROs must keep pursuant to Rule 17g-2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are reasonably designed and the NRSRO is complying with them. Compliance with these policies and procedures may increase the likelihood that NRSROs apply sound procedures and methodologies consistently to all applicable credit ratings and inform investors of these procedures and methodologies.

Relative to the baseline, the Commission anticipates that the final rule will result in costs. NRSROs will need to expend resources to develop, document, enforce, and periodically modify the policies and procedures they establish pursuant to paragraph (a) of Rule 17g-8.

As stated above, some commenters opposed the proposed rule on the basis of cost.¹⁰⁴⁷ One of these commenters stated that certain aspects of the proposals, including those regarding credit rating methodologies, would compound barriers to entry, and that many of the rules would

¹⁰⁴⁷

See A.M. Best Letter; Kroll Letter.

be expensive and burdensome to implement.¹⁰⁴⁸ More specifically, this commenter stated that the Commission should take into account the dominance of very large players and expand small NRSRO exemptions designed to level the competitive field.¹⁰⁴⁹

In response, the Commission acknowledges that these requirements will result in costs, which could create competitive barriers. However, the Commission reiterates that the final rule is designed to meet the rulemaking mandate in section 15E(r) of the Exchange Act in a manner that provides flexibility to NRSROs in terms of designing the required policies and procedures. Consequently, an NRSRO can tailor its policies and procedures to its business model, size, and the scope of its activities as well as to its methodologies and procedures for determining credit ratings, which, to some degree, may mitigate concerns about the costs of the final rule and its potential to create barriers to entry for small credit rating agencies. These costs would likely be higher for NRSROs with more complex operations in terms of the quantity of credit ratings they issue, the different types of credit ratings they issue, and the number of locations from which they determine and issue credit ratings. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (a) of Rule 17g-8 will result in total industry-wide one-time costs to NRSROs of approximately \$566,000 and total industry-wide annual costs to NRSROs of approximately \$142,000.¹⁰⁵⁰

Relative to the baseline, the amendments to Rule 17g-2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the

¹⁰⁴⁸ See Kroll Letter.

¹⁰⁴⁹ See Kroll Letter.

¹⁰⁵⁰ See section V.G. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

recordkeeping requirements in Rule 17g-2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(13) of Rule 17g-2 and the amendment to paragraph (c) of Rule 17g-2 will result in total industry-wide one-time costs to NRSROs of approximately \$12,000 and total industry-wide annual costs to NRSROs of approximately \$3,000.¹⁰⁵¹

The Commission believes that NRSROs will incur costs to apply material changes to ratings procedures and methodologies consistently to all current credit ratings to which the changed procedures or methodologies apply. This cost will likely vary significantly per occurrence depending on the number of credit ratings and the type of instruments affected by the change as well as the nature and extent of the change. In addition, the Commission believes that an NRSRO will incur costs when promptly publishing on an easily accessible portion of its Internet website information about material changes to procedures and methodologies, the likelihood such changes will result in changes to any current ratings, and notice of significant errors identified in a procedure or methodology in accordance with paragraphs (a)(4)(i) and (ii) of Rule 17g-8. Based on analysis for purposes of the PRA, the Commission estimates that paragraphs (a)(4)(i) and (ii) of Rule 17g-8 will result in costs to NRSROs of approximately \$5,700 per publication on their website.¹⁰⁵²

¹⁰⁵¹ See section V.G. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

¹⁰⁵² See section V.G. of this release (discussing implementation and annual compliance considerations). The cost per publication is determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.7. of this release.

A possible additional cost is that the final rule potentially could decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process could improve the quality of ratings. In order to ensure that material changes to ratings procedures and methodologies are applied consistently to all current credit ratings to which the changed procedures or methodologies apply "within a reasonable timeframe" in accordance with the new rule, an NRSRO may establish credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment, which could lengthen the rating process. As a result, the credit ratings may not benefit fully from the expertise of the analysts in the rating process, which could negatively impact the quality of the credit rating. This concern may be mitigated by the fact that the new rule does not require that the policies and procedures specify a specific timeframe to apply the changed procedure or methodology but rather requires that the change to be applied within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.¹⁰⁵³ First, these amendments could improve the quality and consistency of credit ratings as well as increasing the information available to users of credit ratings regarding rating procedures and methodologies. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency also could improve if this information is reflected in asset prices. Consequently, capital formation could improve as capital may flow to more efficient uses with the benefit of

¹⁰⁵³ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

this enhanced information. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the quality of credit ratings may decrease, which could decrease the efficiency of investment decisions made by users of credit ratings. Market efficiency and capital formation may also be adversely impacted if lower quality information is reflected in asset prices, which may impede the flow of capital to efficient uses. These amendments also will result in costs, some of which may have a component that is fixed in magnitude and does not vary with the size of the NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs. Consequently, the costs associated with these amendments may have a disproportionate impact on smaller NRSROs as suggested by commenters,¹⁰⁵⁴ creating adverse effects on competition. For example, one commenter suggested that these requirements would require an NRSRO to review credit rating methodologies, which would place an undue burden on smaller NRSROs.¹⁰⁵⁵ As a result of these amendments, the barriers to entry for credit rating agencies to register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO. As discussed earlier, these costs also will depend on the complexity of operations within the NRSRO.

Commenters have proposed a number of alternatives to the final rule. One alternative would be to require that NRSROs permit users of an NRSRO's credit ratings to sign up for alerts regarding material changes and significant errors in an NRSRO's procedures and methodologies,

¹⁰⁵⁴ See A.M. Best Letter; Kroll Letter.

¹⁰⁵⁵ See A.M. Best Letter.

which, according to the commenter, “would significantly improve communication.”¹⁰⁵⁶ As stated above, the Commission believes that publication on an easily accessible portion of the NRSRO’s Internet website is the most direct and cost effective way to ensure that all potentially interested parties have access to the required disclosures. Therefore, this alternative without a requirement to also disclose the information on the NRSRO’s Internet website could potentially have the result that fewer users of credit ratings are informed of changes and errors. For example, certain users of credit ratings may opt not to sign up for e-mail notification in order to avoid receiving unwanted communications.

Another alternative would be for the Commission to establish a firm deadline for the application of revised rating methodologies or surveillance or monitoring procedures to current credit ratings to ensure that NRSROs act promptly, as suggested by commenters.¹⁰⁵⁷ As stated above, the Commission is not persuaded that prescribing a specific timeframe in which the review must take place is feasible or appropriate. For example, some NRSROs have hundreds of thousands of credit ratings outstanding in certain classes of credit ratings, while others have fewer than one thousand.¹⁰⁵⁸ In addition, there is variation across NRSROs in the level of resources available to apply these changes. For example, the number of credit analysts employed by each NRSRO ranges from fewer than ten to more than a thousand.¹⁰⁵⁹ Consequently, mandating a timeframe that is too short could negatively impact the quality of the review of the credit ratings subject to the changed surveillance or monitoring procedures and methodologies and could result in adjustments to those credit ratings that are not the result of thorough analysis.

¹⁰⁵⁶ See CFA/AFR Letter.

¹⁰⁵⁷ See Better Markets Letter; CFA/AFR Letter.

¹⁰⁵⁸ See Table 2 in section I.B. of this release.

¹⁰⁵⁹ See Table 1 in section I.B. of this release.

In this case, this alternative could result in costs for users of credit ratings who may make credit-based decisions using incomplete or inaccurate information. In addition, an NRSRO with relatively fewer resources to make the required changes might need to incur costs such as hiring more staff to meet the deadline. If the mandated timeframe were too long, an NRSRO with relatively greater resources could take longer than necessary to apply the changed surveillance procedures and methodologies to impacted credit ratings.¹⁰⁶⁰ In this case, this alternative could result in costs for users of credit ratings as information would be updated in a less timely fashion than will be the case under the new rule.

G. FORM AND CERTIFICATIONS TO ACCOMPANY CREDIT RATINGS

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add paragraphs (q) and (s).¹⁰⁶¹ Section 15E(q)(2)(F) of the Exchange Act provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.¹⁰⁶² Sections 15E(s)(1) through (4), among other things, contain provisions requiring Commission rulemaking with respect to disclosures an NRSRO must make with the publication of a credit rating.¹⁰⁶³ The Commission

¹⁰⁶⁰ See Harrington Letter (raising this concern).

¹⁰⁶¹ See 15 U.S.C. 78o-7(q) and (s).

¹⁰⁶² See 15 U.S.C. 78o-7(q)(2)(F).

¹⁰⁶³ See Pub. L. No. 111-203, 932(a)(8); 15 U.S.C. 78o-7(s)(1) through (4). Section 15E(s)(4) of the Exchange Act also establishes requirements and mandates rulemaking with respect to issuers and underwriters of asset-backed securities, NRSROs, and providers of third-party due diligence services with respect to third-party due diligence services relating to asset-backed securities. See 15 U.S.C. 78o-7(s)(4)(A) through (D). As discussed in more detail below in section II.H. of this release, the Commission also proposed to implement section 15E(s)(4) of the Exchange Act through: (1) Rule 15Ga-2; (2) amendments to Form ABS-15G; (3) Rule 17g-10; and (4) Form ABS Due Diligence-15E. Nationally Recognized Statistical Rating Organizations, 76 FR at 33465-33476.

proposed paragraph (a) to Rule 17g-7, in large part, to implement sections 15E(q) and 15E(s) of the Exchange Act.¹⁰⁶⁴

Under the proposal, an NRSRO would be required to publish two items when taking a rating action: (1) a form containing information about the credit rating resulting from or subject to the rating action; and (2) any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.¹⁰⁶⁵ The proposal also included provisions prescribing the format of the form; the content of the form; and an attestation requirement for the form.¹⁰⁶⁶ The Commission is adopting paragraph (a) to Rule 17g-7 with modifications in response to comments.¹⁰⁶⁷

1. Paragraph (a) of Rule 17g-7 – Prefatory Text

Section 15E(s)(1) of the Exchange Act provides that the Commission shall require, by rule, an NRSRO to prescribe a form to accompany the publication of each credit rating that discloses: (1) information relating to the assumptions underlying the credit rating procedures and methodologies; the data that was relied on to determine the credit rating; and if applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating; and (2) information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the NRSRO.¹⁰⁶⁸ Section 15E(s)(2)(C) of the Exchange Act provides that the form shall be made readily available to users of credit ratings, in electronic or paper form, as the Commission may,

¹⁰⁶⁴ See paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33456-33465.

¹⁰⁶⁵ See paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33456-33465.

¹⁰⁶⁶ See paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33456-33465.

¹⁰⁶⁷ See paragraph (a) of Rule 17g-7.

¹⁰⁶⁸ See 15 U.S.C. 78o-7(s)(1)(A) and (B).

by rule, determine.¹⁰⁶⁹ Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO at the time it produces a credit rating to disclose any certifications from providers of third-party due diligence services to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by the third party.¹⁰⁷⁰

The Commission proposed to implement sections 15E(s)(1), 15E(s)(2)(C), and 15E(s)(4)(D) of the Exchange Act, in large part, through the prefatory text of proposed paragraph (a) of Rule 17g-7.¹⁰⁷¹ As proposed, the prefatory text provided that an NRSRO must publish two items when taking a rating action: (1) a form containing information about the credit rating resulting from or subject to the rating action;¹⁰⁷² and (2) any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.¹⁰⁷³ The first sentence of the prefatory text further provided that an NRSRO must publish the form and certification, as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the NRSRO is registered.¹⁰⁷⁴ The second sentence of the prefatory text defined the term rating action for purposes of the rule to mean any of the following: the publication of an expected or

¹⁰⁶⁹ See 15 U.S.C. 78o-7(s)(2)(C).

¹⁰⁷⁰ See 15 U.S.C. 78o-7(s)(4)(D).

¹⁰⁷¹ See prefatory text of paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33456-33457. As discussed below, the Commission proposed to implement section 15E(s)(1)(A)(iii) of the Exchange Act – which relates to the use of servicer or remittance reports – in paragraph (a)(1)(ii)(G) of Rule 17g-7, as proposed, because it specifies a particular item of information that would need to be disclosed in the form. See 15 U.S.C. 78o-7(a)(1)(i)(G); Nationally Recognized Statistical Rating Organizations, 76 FR at 33461.

¹⁰⁷² See paragraph (a)(1) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹⁰⁷³ See paragraph (a)(2) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541-33542.

¹⁰⁷⁴ See prefatory text to paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); a placement of an existing credit rating on credit watch or review; an affirmation of an existing credit rating; and a withdrawal of an existing credit rating.¹⁰⁷⁵ The third sentence of the prefatory text provided that the form and any applicable certifications must be published in the same medium and made available to the same persons who can receive or access the credit rating that is the result of the rating action or the subject of rating action.¹⁰⁷⁶

The Commission is adopting the first sentence of the prefatory text of paragraph (a) of Rule 17g-7 with a modification in response to comment.¹⁰⁷⁷ As adopted, this sentence provides that except as provided in paragraph (a)(3), an NRSRO must publish the items described in paragraphs (a)(1) (the form) and (a)(2) (third-party due diligence certifications), as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the NRSRO is registered.¹⁰⁷⁸

The Commission is adopting the second sentence of the prefatory text of paragraph (a) of Rule 17g-7 with modifications to narrow the definition of rating action in response to comments.¹⁰⁷⁹ Several commenters stated generally that the proposed definition is overly

¹⁰⁷⁵ See prefatory text to paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹⁰⁷⁶ See prefatory text to paragraph (a) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹⁰⁷⁷ See Fitch Letter; prefatory text of paragraph (a) of Rule 17g-7 (first sentence). The modification, as discussed below, refers to an exemption the Commission is adopting from the publication requirement for certain rating actions that relate to a non-U.S. person and transactions that occur overseas. See paragraph (a)(3) of Rule 17g-7.

¹⁰⁷⁸ See prefatory text of paragraph (a) of Rule 17g-7 (first sentence).

¹⁰⁷⁹ See prefatory text of paragraph (a) of Rule 17g-7 (second sentence).

broad.¹⁰⁸⁰ One NRSRO stated that a broad definition of rating action could limit disclosure by “creating incentives for NRSROs to publish commentary about their credit ratings less frequently.”¹⁰⁸¹ Commenters stated that the proposed definition of rating action would make it difficult for NRSROs to release their credit ratings in a timely fashion.¹⁰⁸² One commenter stated that rating actions involving transaction documents that were finalized before the effective date of the rules should not be subject to the disclosure requirements.¹⁰⁸³ An NRSRO stated that the amount of preparation time needed to comply with the rule will likely delay the issuance of ratings, “particularly with respect to preliminary ratings.”¹⁰⁸⁴ In contrast, another commenter stated that including preliminary ratings on asset-backed securities ratings will ensure that investors receive the information at a time when it is “likely to be most useful to them in making an investment decision.”¹⁰⁸⁵

As explained below, commenters urged the Commission to eliminate from the definition of rating action: preliminary credit ratings; placements of credit ratings on watch or review; affirmations and confirmations of credit ratings; and withdrawals of credit ratings.¹⁰⁸⁶

One NRSRO commented that placing a credit rating on review should not be considered a rating action because a review is simply an indication of the potential for a future rating action, and is not itself a rating action.¹⁰⁸⁷ Several commenters stated that some or all rating

¹⁰⁸⁰ See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.

¹⁰⁸¹ See Moody's Letter.

¹⁰⁸² See DBRS Letter; FSR Letter.

¹⁰⁸³ See ABA Letter.

¹⁰⁸⁴ See S&P Letter.

¹⁰⁸⁵ See CFA/AFR Letter.

¹⁰⁸⁶ See, e.g., A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.

¹⁰⁸⁷ See Moody's Letter.

affirmations should not be included in the definition of a rating action.¹⁰⁸⁸ One NRSRO stated that including rating affirmations would “significantly” increase the reporting burden on NRSROs, and would produce only a record that there was no change to the rating in question.¹⁰⁸⁹ The NRSRO also suggested that if affirmations are included, they should refer only to a published announcement or written confirmation that the rating is being maintained at its current level. Another commenter stated that affirmations should be excluded unless they represent “a comprehensive review of a transaction.”¹⁰⁹⁰ A different commenter stated that a “confirmation,” which is a type of affirmation that simply indicates that a particular action will not change a credit rating, should not constitute a rating action because disclosures associated with confirmations would only cover very minor document changes and add “little value.”¹⁰⁹¹

Two commenters stated that some or all withdrawals should not be included in the definition of a rating action.¹⁰⁹² One NRSRO stated that publishing the forms for withdrawals that are “mechanical in nature and not based on a credit assessment or analysis” could make it more difficult for market participants to locate significant information.¹⁰⁹³

The Commission is sensitive to the burdens imposed by its rules, and in considering the comments discussed above has sought to balance the need for timely and robust disclosure with concerns about the costs that would result from the proposal. As discussed below, the Commission believes it is appropriate to narrow the definition of rating action from the proposed definition to include those actions that are made at a time when there is limited information about

¹⁰⁸⁸ See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.

¹⁰⁸⁹ See S&P Letter.

¹⁰⁹⁰ See ASF Letter.

¹⁰⁹¹ See FSR Letter.

¹⁰⁹² See Deloitte Letter; Moody's Letter.

¹⁰⁹³ See Moody's Letter.

the rated obligor, security, or money market instrument and to other rating actions if they are linked to the performance of credit analysis. This will reduce the burden of complying with the rule. Nonetheless, the Commission recognizes that preparing the form in response to those rating actions that trigger the disclosure requirement will take time and that this could impact how quickly an NRSRO is able to publish the credit rating that results from or is the subject of the rating action. However, the Commission has balanced this concern with the directive of the statute (that the Commission adopt a rule requiring the form to be published with a credit rating) and the benefits of the increased transparency the disclosures in the form will provide to users of the NRSRO's credit ratings.¹⁰⁹⁴ Moreover, an NRSRO should be able to draft significant portions of the form largely in tandem with the credit rating process and, therefore, the form and the final decision on the rating action generally should be completed simultaneously.

In response to the comment to eliminate preliminary credit ratings from the definition of rating action, the Commission notes that this type of rating action and certain initial credit ratings (that is, those assigned to a newly formed obligor or newly issued security or money market instrument) are made at a time when there is little information available about the rated obligor, security, or money market instrument. Given the timing of these rating actions, the Commission agrees with comments that it is critical that investors and other users of credit ratings have access to the information that is required to be disclosed in the form and any applicable certifications on Form ABS Due Diligence-15E.¹⁰⁹⁵ Consequently, the Commission is adopting the requirement

¹⁰⁹⁴ See, e.g., CFA/AFR Letter ("One reason rating agencies were able to play fast and loose with their own rating methodologies is that the ratings were a sort of 'black box,' with little information made available to the users of those ratings about the assumptions that lay behind them or the data on which they were based. Dodd-Frank includes provisions to address this problem by requiring new disclosures to accompany the publication of a rating.").

¹⁰⁹⁵ See CFA/AFR Letter ("Importantly, the Commission proposes to include preliminary ratings among the actions that would trigger the required disclosures. We strongly support this approach, which is essential to ensure that investors in ABS get the information at time [sic] when it is likely to be most useful to them in making an investment decision."). As the Commission explained when adopting Rule 17g-7, the definition

that the form and certifications be published when the NRSRO publishes a preliminary or expected credit rating or an initial credit rating.¹⁰⁹⁶

Some of the types of rating actions included in the proposed definition are not necessarily linked to the performance of credit analysis. In particular, placements of credit ratings on watch or review, certain types of affirmations of credit ratings, and certain types of withdrawals of credit ratings are not based on the NRSRO applying its rating procedures or methodologies and making a credit rating determination. In the case of a watch or review, the rating action precedes the application of the rating procedure or methodology, which, once completed, may result in an affirmation or an adjustment (upgrade or downgrade) to the credit rating. However, not all credit rating affirmations are based on the NRSRO applying its rating procedures and methodologies.¹⁰⁹⁷ Similarly, NRSROs withdraw credit ratings for a number of reasons that are

of credit rating in the note to the rule was designed to address pre-sale reports, which are typically issued by an NRSRO with respect to an asset-backed security at the time the issuer commences the offering and typically include an expected or preliminary rating and a summary of the important features of a transaction. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4503-4505 (Jan. 26, 2011). Consequently, disclosure at the time of issuance of a pre-sale report is particularly important to investors, since such reports provide them with important information prior to the point at which they make an investment decision. See id.

¹⁰⁹⁶ See prefatory text of paragraph (a) of Rule 17g-7 (second sentence). The Commission requested comment in the proposing release as to whether the disclosures required by the proposed rule in the context of a new offering should be provided no later than at least five business days in advance of the first sale of securities in the offering. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33457. In response, an NRSRO stated that requiring disclosures in a fixed timeframe is “unrealistic” because NRSROs often receive their information after the prospectus is filed and frequently assign ratings well after the actual closing and first sale of a transaction. S&P Letter. Another NRSRO and a commenter stated that the five business day requirement could potentially delay many issuances. See DBRS Letter; FSR Letter. In contrast, one commenter recommended that the Commission adopt the five business day requirement. See CFA/AFR Letter. The Commission believes at this time that the five business day requirement could raise practical issues and, therefore, is not adopting such a requirement. Consequently, the NRSRO must publish the form and any certifications at the same time the NRSRO publishes the result of the rating action.

¹⁰⁹⁷ See ASF Letter (stating that a “rating agency consent” or “rating agency confirmation” simply confirms that a specific contractual change will not result in adverse effect on an existing rating and arguing that these “statements do not reflect a comprehensive review of a transaction, unlike the type of review that would be undertaken in connection with an affirmation of a rating following on the placement of a rating on watch or review.”).

unrelated to the performance of credit analysis, including that the obligation was paid off or the obligor stopped paying to be rated.¹⁰⁹⁸

In balancing the concerns of commenters about the burden of the rule against the need for timely and robust disclosure, the Commission, as stated above, believes it is appropriate to focus the disclosure requirement on rating actions that are based on the application of the NRSRO's procedures and methodologies for determining credit ratings. In this regard, much of the information required to be disclosed in the form under section 15E(s)(3) of the Exchange Act relates to the procedures, methodologies, and information used to determine the credit rating.¹⁰⁹⁹ For these reasons, placements of credit ratings on watch or review have been removed from the definition of rating action.¹¹⁰⁰ In addition, the definition provides that an affirmation or withdrawal is a rating action if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using its procedures and methodologies for determining credit ratings.¹¹⁰¹

For the foregoing reasons, the amendments have been modified from the proposal to eliminate placements of credit ratings on watch or review from the definition of rating action and to eliminate from the definition affirmations and withdrawals that are not based on the NRSRO

¹⁰⁹⁸ See Moody's Letter (stating that the requirement to publish a form should not apply in connection with the withdrawals of credit ratings that are mechanical in nature and not based on a credit assessment or analysis).

¹⁰⁹⁹ See 15 U.S.C. 78o-7(s)(3). For example, the required disclosures include: (1) the version of the methodology used to determine the credit rating; and (2) the main assumptions and principles used in constructing the applicable rating procedures and methodologies.

¹¹⁰⁰ See prefatory text of paragraph (a) of Rule 17g-7 (second sentence).

¹¹⁰¹ See id. An affirmation that results from a look-back review under paragraph (c) of Rule 17g-8 would be an affirmation that is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using its procedures and methodologies for determining credit ratings. In particular, the NRSRO would be applying the procedures required by paragraph (c)(1) of Rule 17g-8 to promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the NRSRO uses to determine credit ratings.

applying its procedures and methodologies for determining credit ratings. Consequently, the second sentence – as adopted – provides that the term rating action “means any of the following: the publication of an expected or preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); and an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using applicable procedures and methodologies for determining credit ratings.”¹¹⁰²

The Commission is making another modification to the proposed amendments that will reduce the burden of the adopted rule. Specifically, one NRSRO recommended that the temporary conditional exemption for foreign transactions from the requirements in paragraph (a)(3) of Rule 17g-5 be applied to the disclosure requirements in paragraph (a) of Rule 17g-7, as proposed.¹¹⁰³ The commenter stated that many foreign issuers lack the infrastructure to comply with the level of disclosure required by paragraphs (a)(1) and (a)(2) of Rule 17g-7, as proposed.¹¹⁰⁴ The commenter stated further that, without an exemption, “NRSROs either might be unable to issue a credit rating on non-U.S. securities or must withdraw as an NRSRO in order to continue rating certain non-U.S. securities.”¹¹⁰⁵

¹¹⁰² See prefatory text of paragraph (a) of Rule 17g-7 (second sentence).

¹¹⁰³ See Fitch Letter. See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 62120 (May 19, 2010). See also Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 70919 (Nov. 22, 2013) (most recent extension of the exemption).

¹¹⁰⁴ See Fitch Letter.

¹¹⁰⁵ See id.

The Commission is persuaded that at this time the disclosure requirement should not apply to rating actions involving credit ratings of obligors or issuers whose securities or money market instruments will be offered or sold in transactions that occur exclusively outside the United States. As noted above, one commenter suggested that local laws could impede the ability of the NRSRO to obtain or disclose information about the issuer in accordance with the requirements of the proposed amendments. To address these types of concerns, the Commission is adding paragraph (a)(3) to Rule 17g-7 to provide an exemption from the requirements of paragraphs (a)(1) and (a)(2) for rating actions in which: (1) the rated obligor or issuer of the rated security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902(k));¹¹⁰⁶ and (2) the NRSRO has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument after issuance, only in transactions that occur outside the United States.¹¹⁰⁷ The wording of the exemption is modeled closely on the temporary conditional exemption from the requirements in paragraph (a)(3) of Rule 17g-5 the Commission has granted by order.¹¹⁰⁸ As stated above, the Commission is

¹¹⁰⁶ 17 CFR 230.902(k).

¹¹⁰⁷ See paragraph (a)(3) of Rule 17g-7. If the rating action involves a credit rating of an obligor as an entity, the NRSRO must have a reasonable basis to conclude that any security or money market instrument of the obligor will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions of the security or money market instrument after issuance, only in transactions that occur outside the United States. For example, if some securities or money market instruments issued by the obligor are sold in transactions that occur in the United States, the exemption does not apply to rating actions involving the credit rating assigned to the obligor as an entity. In contrast, if the rating action involves a security or money market instrument, the NRSRO need only make the required conclusion with respect to the specific issuance.

¹¹⁰⁸ See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 62120 (May 19, 2010). See also Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release

making a corresponding modification to the first sentence of the prefatory text of paragraph (a) of Rule 17g-7, to add that an NRSRO must publish the items described in paragraphs (a)(1) and (a)(2) of Rule 17g-7 “except as provided in paragraph (a)(3)” of Rule 17g-7.¹¹⁰⁹

The Commission is adopting the third sentence of the prefatory text of paragraph (a) of Rule 17g-7 with technical modifications to improve its clarity.¹¹¹⁰ This sentence provides that the items described in paragraphs (a)(1) and (a)(2) must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.¹¹¹¹ In response to comments, the Commission agrees that an NRSRO may satisfy this requirement by publishing the form and any applicable certifications on its public Internet website if the credit rating is disseminated through the website as well.¹¹¹² In addition, if the NRSRO publishes the credit rating in a press release announcing the relevant rating action in

No. 70919 (Nov. 22, 2013) (most recent extension of the exemption). In the original order, the Commission provided guidance on how an NRSRO may have a “reasonable basis” for the purpose of the second prong of the conditional exemption. See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 62120 (May 19, 2010) (“The question of whether an NRSRO has a ‘reasonable basis’ to conclude that the structured finance product will be offered and sold upon issuance, and [that] any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, in transactions that occur outside the United States will depend on the facts and circumstances of a given situation. In order to have a reasonable basis to make these conclusions, the NRSRO should discuss with any arranger linked to the structured finance product (i.e., the sponsor, underwriter, and issuer) how they intend to market and sell the structured finance product and how they intend to engage in any secondary market activities (i.e., re-sales) of the structured finance product. An NRSRO may choose to obtain from the arranger a representation upon which the NRSRO can reasonably rely that sales of the structured finance product will meet this condition. Factors relevant to the analysis of whether such reliance would be reasonable would include, but not be limited to: (1) ongoing or prior failures by the arranger to adhere to its representations; or (2) a pattern of conduct by the arranger where it fails to promptly correct breaches of its representations.”).

¹¹⁰⁹ See prefatory text of paragraph (a) of Rule 17g-7 (first sentence).

¹¹¹⁰ See prefatory text of paragraph (a) of Rule 17g-7 (third sentence).

¹¹¹¹ See id. As proposed, the sentence provided: “[t]he items described in paragraphs (a)(1) and (a)(2) of this section must be published in the same medium and made available to the same persons who can receive or access the credit rating that is the result of the rating action or that is the subject of the rating action.” See Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹¹¹² See S&P Letter.

addition to publishing the credit rating on its corporate Internet website, the NRSRO may make the form available through a clearly and prominently labeled hyperlink on the press release to the page on its corporate Internet website that contains the form and any applicable certifications.¹¹¹³

In addition, the final amendments, as proposed, require that the form and any applicable certifications on Form ABS Due Diligence-15E must be made available to the same persons who can receive or access the credit rating that is the result of the rating action.¹¹¹⁴ Consequently, if the NRSRO publishes credit ratings for free on its corporate Internet website, it must make the form and certifications similarly available.¹¹¹⁵ Alternatively, if the NRSRO operates under the subscriber-pay business model, it must make the form and certifications available to its subscribers.¹¹¹⁶

Finally, one commenter suggested the assessment of financial penalties for each day that NRSROs do not post the form when taking a rating action.¹¹¹⁷ The Commission has authority to take appropriate action against an NRSRO that fails to comply with the requirements of paragraph (a) of Rule 17g-7. Further, as discussed above in section II.D.1. of this release, the Exchange Act provides a wide range of fines, penalties, and other sanctions applicable to NRSROs for violations of any section of the Exchange Act (including section 15E) and the rules under the Exchange Act (including the rules under section 15E).¹¹¹⁸ The Commission therefore does not believe that providing for additional penalties is necessary.

¹¹¹³ See DBRS Letter ("DBRS supports this part of the proposal, but asks the Commission to confirm that an NRSRO that publishes its credit ratings via an electronically disseminated press release can satisfy the disclosure requirement by hyperlinking the disclosure form and any applicable due diligence certifications to that press release.").

¹¹¹⁴ See prefatory text of paragraph (a) of Rule 17g-7 (third sentence).

¹¹¹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33457.

¹¹¹⁶ See id. at 33457.

¹¹¹⁷ See Gardner Letter.

¹¹¹⁸ See 15 U.S.C. 78o-7(d); 15 U.S.C. 78u; 15 U.S.C. 78u; 15 U.S.C. 78u-2; 15 U.S.C. 78u-3; 15 U.S.C. 78ff.

2. Paragraph (a)(1)(i) of Rule 17g-7 – Format of the Form

To implement sections 15E(s)(2)(A) and (B) of the Exchange Act, the Commission proposed paragraph (a)(1)(i) of Rule 17g-7, which would describe the required format of the form to accompany the publication of a rating action.¹¹¹⁹ In particular, section 15E(s)(2)(A) of the Exchange Act provides that the form developed by the NRSRO shall be easy to use and helpful for users of credit ratings to understand the information contained in the report.¹¹²⁰ The Commission proposed paragraph (a)(1)(i)(A) of Rule 17g-7 to implement this section of the statute.¹¹²¹ This paragraph – as proposed – mirrored the statutory text by providing that the form generated by the NRSRO would need to be easy to use and helpful for users of credit ratings to understand the information contained in the form.¹¹²²

Section 15E(s)(2)(B) of the Exchange Act provides that the quantitative content required to be disclosed in the form and identified in section 15E(s)(3)(B) must be directly comparable across types of securities.¹¹²³ As discussed below, section 15E(s)(3) of the Exchange Act identifies qualitative and quantitative information that must be included in the form.¹¹²⁴ The Commission proposed that the quantitative content specified in section 15E(s)(3)(B) of the Exchange Act must be disclosed in the form pursuant to paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g-7, as proposed.¹¹²⁵ Consequently, paragraph (a)(1)(i)(B) of Rule 17g-7, as proposed,

¹¹¹⁹ See paragraph (a)(1) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33458.

¹¹²⁰ See 15 U.S.C. 78o-7(s)(2)(A).

¹¹²¹ See paragraph (a)(1) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33458.

¹¹²² See paragraph (a)(1)(i)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹¹²³ See 15 U.S.C. 78o-7(s)(3)(B).

¹¹²⁴ See 15 U.S.C. 78o-7(s)(3).

¹¹²⁵ See paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33458-33646.

required the form generated by the NRSRO to be in a format that provides the content described in paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g-7 in a manner that is directly comparable across types of obligors, securities, and money market instruments.¹¹²⁶

The Commission is adopting the proposal with modifications in response to comments.¹¹²⁷ The modifications are designed to respond to comments recommending that the rule prescribe a standard format for presenting the information in the form.¹¹²⁸

In particular, as proposed, the rule would require that the form, among other things, must be in a format that is easy to use and helpful for users of credit ratings to understand.¹¹²⁹ However, the proposal did not prescribe a form into which NRSROs would input information or provide more specificity as to how the information in the form must be presented. Two commenters recommended that the format of the form should be more standardized.¹¹³⁰ One commenter stated that standardization would simplify oversight and make the information in the form easier for investors to analyze.¹¹³¹ The other commenter suggested standard headings and prescribing an order for the presentation of the information in the form.¹¹³² The Commission agrees with the commenters that requiring the NRSROs to adhere to a more standardized format

¹¹²⁶ See paragraph (a)(1)(i)(B) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540. While the statutory text refers only to “securities,” section 3(a)(60) of the Exchange Act defines the term credit rating to mean an “assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.” See 15 U.S.C. 78c(a)(60). Consequently, proposed paragraph (a)(1)(i)(B) of Rule 17g-7 also referred to “obligors” and “money market instruments” to ensure that it applies to all types of credit ratings and to be consistent with the Commission’s rules for NRSROs, which commonly apply to credit ratings of “obligors, securities, and money market instruments.” Nationally Recognized Statistical Rating Organizations, 76 FR at 33458, n.411.

¹¹²⁷ See paragraph (a)(1)(i) of Rule 17g-7.

¹¹²⁸ See id.

¹¹²⁹ See paragraph (a)(1)(i)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹¹³⁰ See CFA/AFR Letter; Levin Letter.

¹¹³¹ See Levin Letter.

¹¹³² See CFA/AFR Letter.

will assist users of the form in locating and analyzing items of information disclosed in the form. It also will facilitate the Commission's oversight of the disclosure requirements, as noted by the commenter. Consequently, paragraph (a)(1)(i) of Rule 17g-7 provides that the form must be in a format that organizes the information required to be disclosed into numbered items that are identified by the type of information being disclosed and by a reference to the paragraph in Rule 17g-7 that specifies the information required to be disclosed, and are in the order that the paragraphs specifying the information to be disclosed are codified in Rule 17g-7.¹¹³³ In addition, as adopted, paragraph (a)(1)(i) of Rule 17g-7 contains a note providing details about this requirement—in particular, stating that a given item in the form should be identified by a title that identifies the type of information and references paragraph (a)(1)(ii)(A), (B), (C), (D), (E), (F), (G), (H), (I), (J), (K), (L), (M), (N), or (a)(2) of Rule 17g-7, based on the information being disclosed in the item.¹¹³⁴ The note provides the example that the item on the form containing the information specified in paragraph (a)(1)(ii)(C) of Rule 17g-7 should be captioned: "Main Assumptions and Principles Used to Construct the Rating Methodology used to Determine the Credit Rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7."¹¹³⁵ The note also explains that the form must organize the items of information in the following order: items 1 through 14 must contain the information specified in paragraphs (a)(1)(ii)(A) through (N) of Rule 17g-7,

¹¹³³ See paragraph (a)(1)(i)(A) of Rule 17g-7, and the accompanying note to the paragraph. This approach, specifying the order in which the information must be presented, is consistent with the amendments to the instructions for Exhibit 1 to Form NRSRO being adopted today, which specify the order in which the Transition/Default Matrices must be presented in the Exhibit. See paragraph (2) of the instructions for Exhibit 1 to Form NRSRO. See also section II.E.1.c. of this release discussing the amendments to the instructions for Exhibit 1 to Form NRSRO.

¹¹³⁴ See note to paragraph (a)(1)(i)(A) of Rule 17g-7. See also paragraphs (a)(1)(ii)(A) through (N) and (a)(2) of Rule 17g-7. As discussed below in section II.G.3. of this release, paragraphs (a)(1)(ii)(A) through (N) and (a)(2) of Rule 17g-7 specify the types of information that must be disclosed in the form.

¹¹³⁵ See note to paragraph (a)(1)(i)(A) of Rule 17g-7.

respectively, and item 15 must contain the certifications specified in paragraph (a)(2) of Rule 17g-7.¹¹³⁶

Several NRSROs stated that a standardized form may discourage NRSROs from providing more transparency.¹¹³⁷ Another NRSRO stated that if formatted disclosure is ultimately required, “the Commission should provide sufficient flexibility to allow for disclosure that is meaningful in the context provided.”¹¹³⁸ The Commission believes the approach it has taken in prescribing a standardized format for presenting the information in the form without, for example, requiring that a prescribed form be filled out, strikes an appropriate balance in implementing section 15E(s)(2) of the Exchange Act between the comparability of the information provided across NRSROs and the flexibility to allow for meaningful disclosure. For example, the final amendments – while prescribing certain formatting requirements – generally permit an NRSRO to design the form that will be used to make the disclosure. Thus, an NRSRO can tailor the form to specific classes or subclasses of credit ratings to provide more targeted information.

The proposed amendments required that the form must be in a format that is easy to use and helpful for users of credit ratings to understand the information contained in the form.¹¹³⁹ The proposed rule text closely mirrored section 15E(s)(2)(A) of the Exchange Act.¹¹⁴⁰ The modifications discussed above prescribing a standard for presenting the information in the form are specifically designed to achieve the objective set forth in section 15E(s)(2)(A) and the

¹¹³⁶ See id.

¹¹³⁷ See DBRS Letter; Morningstar Letter; S&P Letter.

¹¹³⁸ See Kroll Letter.

¹¹³⁹ See paragraph (a)(1)(i)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR 33540.

¹¹⁴⁰ See 15 U.S.C. 78o-7(s)(2)(A).

proposed rule. However, the final amendments, as proposed, include the more general requirement that the form must be in a format that is “easy to use and helpful for users of credit ratings to understand the information contained in the form.”¹¹⁴¹ Because the presentation of the information has been prescribed, this format-related requirement will be more relevant to the narrative disclosures that are made in the items of the form. In particular, NRSROs must provide narrative disclosures that help users of credit ratings to understand the information. Several commenters stated that the form will result in boilerplate disclosure rather than more transparency.¹¹⁴² Pursuant to the final amendments, NRSROs will need to make the disclosures as specific to the particular rating action, and as relevant to investors, as possible, and strike a reasonable balance between standardizing the disclosures and tailoring them to specific rating actions. While the Commission recognizes that some of the information to be disclosed in the form may be standardized for classes or subclasses of credit ratings, NRSROs must disclose information in the form in a manner that promotes greater understanding of how a credit rating was determined. Accordingly, the form must contain plainly worded and succinct disclosures that are easy to understand and not lengthy boilerplate disclaimers.

Finally, paragraph (a)(1)(i)(C) of Rule 17g-7, as proposed, provides that the form must be in a format that provides the content described in paragraphs (a)(1)(ii)(K), (L), and (M) of Rule 17g-7 in a manner that is directly comparable across types of obligors, securities, and money market instruments.¹¹⁴³ As discussed below in section II.G.3. of this release, these paragraphs of Rule 17g-7 require the disclosure of certain types of quantitative information as mandated by

¹¹⁴¹ See paragraph (a)(1)(i)(B) of Rule 17g-7.

¹¹⁴² See DBRS Letter; Morningstar Letter; S&P Letter.

¹¹⁴³ See paragraph (a)(1)(i)(C) of Rule 17g-7.

section 15E(s)(3)(B) of the Exchange Act.¹¹⁴⁴ One commenter stated that it would be difficult, if not impossible, to make this information “directly comparable” across all NRSROs.¹¹⁴⁵ In response, the Commission notes that the final amendments require certain types of quantitative information to be comparable across types of obligors, securities, and money market instruments rated by the NRSRO (rather than across NRSROs).¹¹⁴⁶

3. Paragraph (a)(1)(ii) of Rule 17g-7 – Content of the Form

Section 15E(s)(3) of the Exchange Act provides that the Commission shall require, by rule, that the form accompanying the publication of a credit rating contain specifically identified items of information.¹¹⁴⁷ In particular, section 15E(s)(3)(A) identifies eight items of “qualitative content,”¹¹⁴⁸ and section 15E(s)(3)(B) identifies four items of “quantitative content.”¹¹⁴⁹ Because the statute specified the type of information to be included in the form, the Commission proposed rule text prescribing the required contents of the form that largely mirrored the statutory text.¹¹⁵⁰ In particular, the prefatory text of paragraph (a)(1)(ii) of Rule 17g-7, as proposed, provided that the form generated by the NRSRO must contain the information about the credit rating that is identified in paragraphs (a)(1)(ii)(A) through (N) of the rule.¹¹⁵¹ The order of, and information

¹¹⁴⁴ See paragraphs (a)(1)(ii)(K) through (M) of Rule 17g-7; 15 U.S.C. 78o-7(s)(3)(B).

¹¹⁴⁵ See S&P Letter.

¹¹⁴⁶ See paragraph (a)(1)(i)(C) of Rule 17g-7.

¹¹⁴⁷ See 15 U.S.C. 78o-7(s)(3).

¹¹⁴⁸ See 15 U.S.C. 78o-7(s)(3)(A)(i) through (vii). Section (s)(3)(A)(ix) includes a ninth catchall item: such additional information as the Commission may require. 15 U.S.C. 78o-7(s)(3)(A)(ix).

¹¹⁴⁹ See 15 U.S.C. 78o-7(s)(3)(B)(i) through (iv).

¹¹⁵⁰ See paragraph (a)(1)(ii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33458-33463.

¹¹⁵¹ See paragraph (a)(1)(ii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

required in, these paragraphs largely mirrored the provisions of section 15E(s)(3) of the Exchange Act.¹¹⁵²

The Commission is adopting the prefatory text of paragraph (a)(1)(ii) of Rule 17g-7 without modification.¹¹⁵³ The paragraph provides that the form generated by the NRSRO must contain information about the credit rating identified in paragraphs (a)(1)(ii)(A) through (N).¹¹⁵⁴ Consequently, NRSROs are required to generate a form containing the prescribed information and publish it when taking a rating action (as defined in the prefatory text of paragraph (a) of Rule 17g-7).

Several commenters raised concerns that the proposed rule could require the disclosure of confidential or proprietary information regarding the NRSRO or an issuer.¹¹⁵⁵ The Commission does not intend that the rule require an NRSRO to disclose confidential or proprietary information in the form. As discussed above, the format of the form must be easy to use and helpful for users of credit ratings to understand the information contained in the form about the rating action.¹¹⁵⁶ NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. An NRSRO must meet this standard through disclosures that are informative but at the same time the Commission does not expect an NRSRO to disclose confidential or proprietary information.

¹¹⁵² See paragraphs (a)(1)(ii)(A) through (M) of Rule 17g-7; 15 U.S.C. 78o-7(s)(3)(A)(i) through (vii) and (B)(i) through (iv).

¹¹⁵³ See paragraph (a)(1)(ii) of Rule 17g-7. One NRSRO suggested that the prefatory text be modified to add the phrase "to the extent applicable". See Moody's Letter. The Commission is not making this modification because the specific disclosure provisions contain such limiters when the information to be disclosed may not be applicable in all cases. See, e.g., paragraphs (a)(1)(ii)(D), (G), (J), (L), (M), (N) of Rule 17g-7.

¹¹⁵⁴ See paragraph (a)(1)(ii) of Rule 17g-7.

¹¹⁵⁵ See, e.g., Barnard Letter; FSR Letter; Moody's Letter; Siff Letter; S&P Letter.

¹¹⁵⁶ See paragraph (a)(1)(i)(B) of Rule 17g-7.

As noted above, commenters suggested expanding the information required to be disclosed in the form. In particular, one commenter stated that the Commission should encourage NRSROs to provide additional information if they deem it appropriate,¹¹⁵⁷ another stated that NRSROs should provide further information that would enable investors to understand the significance of the disclosures,¹¹⁵⁸ and a third stated that NRSROs should be required to indicate the “projected time period during which the given rating was expected to be valid.”¹¹⁵⁹ One commenter stated that some disclosure requirements should be expanded to provide in greater detail information that can be used by investors and other users of credit ratings.¹¹⁶⁰ Another commenter suggested further rulemaking to require NRSROs to disclose and explain the rationale behind proposed credit ratings to the rated entity prior to publication, provide a rated entity with the right to appeal a proposed credit rating, and give reasonable consideration to an appeal.¹¹⁶¹

In contrast, other commenters raised burden concerns with respect to the breadth of the information that the proposed rule required to be included in the form. One NRSRO urged the Commission not to extend the rule beyond what the statute requires.¹¹⁶² Another NRSRO stated that although the form may be useful to investors, it must not be “so lengthy and overburdened with detail that it loses its utility,” and expressed a concern that the level of detail “far surpasses what most users of credit ratings would find of practical use, while imposing unnecessary

¹¹⁵⁷ See ICI Letter.

¹¹⁵⁸ See Better Markets Letter.

¹¹⁵⁹ See Levin Letter.

¹¹⁶⁰ See Better Markets Letter.

¹¹⁶¹ See Andrews Letter.

¹¹⁶² See DBRS Letter.

burdens on NRSROs.”¹¹⁶³ A third NRSRO stated that disclosure should be limited to asset-backed securities ratings, indicating that expanding requirements to other ratings is “extremely overburdensome” and provides little information that is not already publicly available.¹¹⁶⁴

The Commission acknowledges that section 15E(s)(3) of the Exchange Act identifies a significant amount of information that the Commission’s rule must require to be disclosed in the form.¹¹⁶⁵ This information will be helpful in providing transparency as to how an NRSRO determines credit ratings across all classes of credit ratings. This transparency should benefit users of credit ratings and could mitigate the risk of undue reliance on credit ratings by providing information about the limits of credit ratings. Further, because the statute was very specific regarding the information to be disclosed, the Commission has sought to model its rule closely on the statutory text. Accordingly, the Commission does not believe it would be appropriate to limit the disclosure requirements to rating actions involving asset-backed securities. Moreover, given the significant amount of information required to be disclosed, the Commission also does not believe it to be necessary at this time to expand the disclosure requirements as suggested by some commenters.

The Commission also wants to emphasize that the information that must be disclosed in the form must relate to the rating action that is being taken. The NRSRO need not include in the disclosure information about the credit rating that is no longer up-to-date. For example, consistent with the statutory text, the rule text sometimes uses the phrase “to determine the credit rating.” The Commission intended this to relate to the credit rating that is determined as a consequence of the rating action that triggers the disclosure requirement (a preliminary credit

¹¹⁶³ See S&P Letter.

¹¹⁶⁴ See A.M. Best Letter.

¹¹⁶⁵ See 15 U.S.C. 78o-7(s)(3).

rating, an initial credit rating, an upgrade or downgrade of the credit rating, or certain affirmations or withdrawals of the credit rating). The objective is to provide investors and other users of credit ratings with helpful information about the rating action being taken with respect to the credit rating of the obligor, security, or money market instrument.

Paragraph (a)(1)(ii)(A). Section 15E(s)(3)(A)(i) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the credit ratings produced by the NRSRO.¹¹⁶⁶ The Commission proposed to implement this section in paragraph (a)(1)(ii)(A) of Rule 17g-7.¹¹⁶⁷ This paragraph, as proposed, would require the NRSRO to include in the form the symbol, number, or score in the rating scale used by the NRSRO to denote the credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and the identity of the obligor, security, or money market instrument.¹¹⁶⁸

The Commission is adopting paragraph (a)(1)(ii)(A) of Rule 17g-7 with one modification from the proposal.¹¹⁶⁹ The paragraph provides that the form must contain the symbol, number, or score in the rating scale used by the NRSRO to denote credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and, as applicable, the identity of the obligor or the identity of the security or money market instrument and, in a modification from the proposal, must also contain, a description of the security or money market instrument.¹¹⁷⁰

¹¹⁶⁶ See 15 U.S.C. 78o-7(s)(3)(A)(i).

¹¹⁶⁷ See paragraph (a)(1)(ii)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33459.

¹¹⁶⁸ See paragraph (a)(1)(ii)(A) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR 33540.

¹¹⁶⁹ See paragraph (a)(1)(ii)(A) of Rule 17g-7.

¹¹⁷⁰ Id.

The Commission stated in the proposing release that the identity of a security or money market instrument must be the name of the security or money market instrument, if applicable, and a description of the security or money market instrument.¹¹⁷¹ In the proposing release, the Commission provided an example of how an NRSRO could identify a bond: “senior unsecured debt issued by Company XYZ maturing in 2015.”¹¹⁷² Consistent with the discussion in the proposing release, the Commission has modified the rule text from the proposal to add that, in the case of a credit rating of a security or money market instrument, the NRSRO must include in the form “the identity and a description of the security or money market instrument.”¹¹⁷³

Two NRSROs commented on the requirement to identify the relevant obligor.¹¹⁷⁴ In the proposing release, the Commission stated its preliminary belief that the obligor’s identity would be its legal name and any other name used in its business.¹¹⁷⁵ One NRSRO stated that it could be “enormously burdensome” for an NRSRO to learn and disclose all the business names that an obligor may use, and the additional information would add “little benefit” to those who use the form.”¹¹⁷⁶ The other NRSRO stated that entry of legal names in its database has been problematic due to the inconsistent use of abbreviations.¹¹⁷⁷ Both NRSROs suggested that NRSROs should be permitted to determine the clearest way to identify obligors.¹¹⁷⁸ The Commission agrees with the commenters that an NRSRO should be permitted to determine the

¹¹⁷¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459.

¹¹⁷² Id.

¹¹⁷³ See paragraph (a)(1)(ii)(A) of Rule 17g-7.

¹¹⁷⁴ See DBRS Letter; S&P Letter.

¹¹⁷⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459.

¹¹⁷⁶ See DBRS Letter.

¹¹⁷⁷ See S&P Letter.

¹¹⁷⁸ See DBRS Letter; S&P Letter.

clearest way to identify an obligor. An NRSRO must disclose a name that clearly identifies the obligor.¹¹⁷⁹

Paragraph (a)(1)(ii)(B). Section 15E(r)(3)(A) of the Exchange Act provides that the Commission shall prescribe rules with respect to the procedures and methodologies used by NRSROs that require NRSROs to notify users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.¹¹⁸⁰ As discussed above in section II.F.1. of this release, the Commission proposed to implement this provision in Rules 17g-8 and 17g-7.¹¹⁸¹ With respect to Rule 17g-7, proposed paragraph (a)(1)(ii)(B) would require an NRSRO to disclose on the form the version of the procedure or methodology used to determine the credit rating.¹¹⁸²

The Commission is adopting paragraph (a)(1)(ii)(B) of Rule 17g-7 as proposed.¹¹⁸³ The paragraph provides that the NRSRO must include in the form the version of the procedure or methodology used to determine the credit rating.¹¹⁸⁴

Two NRSROs commented on paragraph (a)(1)(ii)(B) of Rule 17g-7, as proposed.¹¹⁸⁵ One NRSRO stated that disclosing the version of the procedure or methodology used to determine a credit rating could be accomplished by identifying the name of the procedure or

¹¹⁷⁹ As discussed above in section II.G.2. of this release, the format of the form must be easy to use and helpful for users of credit ratings to understand the information contained in the form. See paragraph (a)(1)(i) of Rule 17g-7.

¹¹⁸⁰ See 15 U.S.C. 78o-7(r)(3)(A).

¹¹⁸¹ See Nationally Recognized Statistical Rating Organizations, 76 FR 33454-33455, 33459.

¹¹⁸² See paragraph (a)(1)(ii)(B) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33540.

¹¹⁸³ See paragraph (a)(1)(ii)(B) of Rule 17g-7.

¹¹⁸⁴ Id.

¹¹⁸⁵ See DBRS Letter; S&P Letter.

methodology, the date the procedure was implemented, and a hyperlink to further information about the procedure or methodology.¹¹⁸⁶ The Commission agrees.¹¹⁸⁷

A second NRSRO stated that the actual benefit to investors is slight because the required content can be accessed through the NRSRO's public Internet website.¹¹⁸⁸ As the Commission stated in the proposing release, section 15E(s)(1)(B) of the Exchange Act provides that the Commission shall require, by rule, each NRSRO to prescribe a form to accompany the publication of a credit rating that discloses information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the NRSRO.¹¹⁸⁹ Disclosing in the form the version of the procedure or methodology used to determine the credit rating will promote this goal. For example, credit rating methodologies that are predominantly quantitative may rely on models to produce credit ratings. These models are periodically updated and released as newer or different versions of the previous model. Disclosing in the form the version of a model used to produce a credit rating with the credit rating is expected to help investors and other users of credit ratings better understand the credit rating and how the determination of the credit rating may differ from the determination of credit ratings of similar products using an earlier version of the model.

Paragraph (a)(1)(ii)(C). Section 15E(s)(3)(A)(ii) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the main assumptions and

¹¹⁸⁶ See DBRS Letter.

¹¹⁸⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459 ("The Commission preliminarily believes that this disclosure could be made by identifying the name of the procedure or methodology (including any number used to denote the version), the date the procedure was implemented, and an Internet URL where further information about the procedure or methodology can be obtained."). In the proposing release, the Commission provided an example of the disclosure. Id. at 33459 ("For example, a disclosure could resemble: 'RMBS Rating Methodology 3.0, implemented February 12, 2011. For further information go to [insert website address].'"). The Commission continues to believe this provides a useful example that NRSROs could use in making the required disclosure.

¹¹⁸⁸ See S&P Letter.

¹¹⁸⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33459; 15 U.S.C. 78o-7(s)(1)(B).

principles used in constructing procedures and methodologies, including qualitative methodologies and quantitative inputs and assumptions about the correlation of defaults across underlying assets used in rating structured products.¹¹⁹⁰ The Commission proposed to implement this section through paragraph (a)(1)(ii)(C) of Rule 17g-7, which mirrored the statutory text.¹¹⁹¹ The Commission is adopting paragraph (a)(1)(ii)(C) of Rule 17g-7 as proposed.¹¹⁹² The paragraph provides that the NRSRO must include in the form the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets.¹¹⁹³

Three commenters addressed paragraph (a)(1)(ii)(C) of Rule 17g-7, as proposed.¹¹⁹⁴ One NRSRO stated that the Commission should harmonize this requirement with those of similar disclosures required in other jurisdictions, including the European Union.¹¹⁹⁵ The commenter, however, did not provide explicit suggestions as to how the rule text could be modified to provide for such harmonization. Consequently, the Commission is not modifying the text on this basis. Two commenters stated that the Commission should not require the disclosure of confidential or proprietary information belonging to either the NRSRO or the issuer, such as

¹¹⁹⁰ See 15 U.S.C. 78o-7(s)(3)(A)(ii).

¹¹⁹¹ See paragraph (a)(1)(ii)(C) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33460, 33540. This paragraph, as proposed, would require the NRSRO to include in the form the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets.

¹¹⁹² See paragraph (a)(1)(ii)(C) of Rule 17g-7.

¹¹⁹³ Id.

¹¹⁹⁴ See Barnard Letter; S&P Letter; Siff Letter.

¹¹⁹⁵ See S&P Letter.

non-public financial information of an issuer.¹¹⁹⁶ The Commission does not intend that NRSROs will be required to disclose confidential or proprietary information to meet the requirements of paragraph (a)(1)(ii)(C) of Rule 17g-7. As discussed earlier with respect to the format of the form, NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information. Accordingly, the form must contain plainly worded and succinct disclosures. However, the Commission does not expect the disclosures to include confidential or proprietary information.

Paragraph (a)(1)(ii)(D). Section 15E(s)(3)(A)(iii) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form the potential limitations of the credit ratings and the types of risks excluded from the credit ratings that the NRSRO does not comment on, including liquidity, market, and other risks.¹¹⁹⁷ The Commission proposed to implement this section through paragraph (a)(1)(ii)(D) of Rule 17g-7, which mirrored the statutory text.¹¹⁹⁸

The Commission is adopting paragraph (a)(1)(ii)(D) of Rule 17g-7 as proposed.¹¹⁹⁹ The paragraph provides that the NRSRO must include in the form the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks.¹²⁰⁰

¹¹⁹⁶ See Barnard Letter; Siff Letter.

¹¹⁹⁷ See 15 U.S.C. 78o-7(s)(3)(A)(iii).

¹¹⁹⁸ See paragraph (a)(1)(ii)(D) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33460, 33540. This paragraph, as proposed, would require the NRSRO to include in the form the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks.

¹¹⁹⁹ See paragraph (a)(1)(ii)(D) of Rule 17g-7.

¹²⁰⁰ Id.

Two commenters addressed paragraph (a)(1)(ii)(D) of Rule 17g-7, as proposed.¹²⁰¹ One NRSRO supported the rule text as proposed,¹²⁰² and another commenter stated that the disclosure should include more than a listing of the risks that are not assessed as part of the rating.¹²⁰³ The Commission agrees with both commenters and notes that the rule as proposed and adopted requires the NRSRO to disclose the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks. Consequently, the risks excluded from the credit rating are only a part of the required disclosure. For example, the NRSRO also must disclose the limitations of the credit rating with respect to the risks the NRSRO does comment on, including credit risk.

Paragraph (a)(1)(ii)(E). Section 15E(s)(3)(A)(iv) of the Exchange provides that, as required by Commission rule, an NRSRO shall disclose on the form information on the uncertainty of the credit rating, including: (1) information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and (2) a statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including any limits on the scope of historical data and any limits in accessibility to certain documents or other types of information that would have better informed the credit rating.¹²⁰⁴ The Commission proposed to implement this section through paragraph (a)(1)(ii)(E) of Rule 17g-7, which mirrored the statutory text.¹²⁰⁵

¹²⁰¹ See CFA/AFR Letter; S&P Letter.

¹²⁰² See S&P Letter.

¹²⁰³ See CFA/AFR Letter.

¹²⁰⁴ See 15 U.S.C. 78o-7(s)(3)(A)(iv).

¹²⁰⁵ See paragraph (a)(1)(ii)(E) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33460, 33540.

The Commission is adopting paragraph (a)(1)(ii)(E) of Rule 17g-7 as proposed.¹²⁰⁶ The paragraph provides that the form must contain information on the uncertainty of the credit rating, including: (1) information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and (2) a statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including any limits on the scope of historical data and any limits on accessibility to certain documents or other types of information that would have better informed the credit rating.¹²⁰⁷

Two commenters addressed paragraph (a)(1)(ii)(E) of Rule 17g-7, as proposed.¹²⁰⁸ One commenter stated that the Commission should require an NRSRO to address specifically the heightened uncertainty associated with ratings of offerings that do not have an extensive track record, complex or customized securities, or areas where the credit rating agency has limited data on which to base a rating.¹²⁰⁹ The Commission agrees and believes the rule as proposed and adopted requires disclosure on the matters identified by the commenter in that it requires disclosures regarding limits on the scope of historical data and limits on the accessibility to certain documents or other types of information that would have better informed the credit rating.

One NRSRO stated that requiring NRSROs to provide overly detailed information regarding “‘reliability,’ ‘accuracy’ and ‘quality’” of data, could result in extremely lengthy disclosures due to the number of types of data.¹²¹⁰ The NRSRO further stated that the Commission should harmonize this requirement with other jurisdictions’ requirements by

¹²⁰⁶ See paragraph (a)(1)(ii)(E) of Rule 17g-7.

¹²⁰⁷ Id.

¹²⁰⁸ See CFA/AFR Letter; S&P Letter.

¹²⁰⁹ See CFA/AFR Letter.

¹²¹⁰ See S&P Letter.

requiring only a statement about “(i) whether essential data was available; (ii) whether such data was believed to be reliable; and (iii) any limitations on access to data for that transaction that differed from typical circumstances.”¹²¹¹ As discussed above, NRSROs must provide narrative disclosures that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not unnecessarily detailed. As for the suggestion to harmonize the rule with other jurisdictions’ requirements, the text suggested by the commenter generally seems consistent with the proposed rule. Consequently, the Commission is not persuaded that it is necessary to modify the proposed rule in response to this comment.¹²¹²

Paragraph (a)(1)(ii)(F). Section 15E(s)(3)(A)(v) of the Exchange Act provides that, as required by Commission rule, an NRSRO shall disclose on the form whether and to what extent third-party due diligence services have been used by the NRSRO, a description of the information that such third party reviewed in conducting due diligence services, and a description of the findings or conclusions of such third party.¹²¹³ The Commission proposed to implement this section through paragraph (a)(1)(ii)(F), which largely mirrored the statutory text.¹²¹⁴

¹²¹¹ See *id.*

¹²¹² See 15 U.S.C. 78o-7(s)(3)(A)(iv).

¹²¹³ See 15 U.S.C. 78o-7(s)(3)(A)(v).

¹²¹⁴ See paragraph (a)(1)(ii)(F) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33460-33461, 33540. This paragraph, as proposed, would require the NRSRO to include in the form whether and to what extent third-party due diligence services were used by the nationally recognized statistical rating organization, a description of the information that such third party reviewed in conducting due diligence services, and a description of the findings or conclusions of such third party.

Several commenters addressed paragraph (a)(1)(ii)(F) of Rule 17g-7, as proposed.¹²¹⁵ The Commission is adopting paragraph (a)(1)(ii)(F) of Rule 17g-7 with modifications in response to comments.¹²¹⁶

Two commenters stated that the rule should be confined in scope to credit ratings on asset-backed securities.¹²¹⁷ Two NRSROs stated that unless the person providing third-party due diligence services was engaged by the NRSRO, disclosure would be more appropriately made by the party that hired the due diligence provider.¹²¹⁸ One NRSRO stated that “[i]ssuers and underwriters, not NRSROs, should pass through the third party’s description of the information reviewed and the third party’s findings and conclusions,” but, if the NRSROs must disclose the information, the Commission should clarify that the disclosure requirement can be met by the NRSRO “passing through the certification that the third party provides to the NRSRO.”¹²¹⁹ In addition, one commenter stated that the final amendments should require that NRSROs “expressly restate” specific findings and conclusions from third-party due diligence reports to prevent them from being “mischaracterized or taken out of context.”¹²²⁰ Another commenter suggested that the words “a description of the findings or conclusions” should be revised to “a summary of the findings and conclusions,” because a “summary” better aligns with the requirement in proposed Form ABS Due Diligence-15E.¹²²¹ The commenter further stated that what should be provided is a summary of the findings and conclusions, not the findings and conclusions themselves, and “there is no reason why the summary would not be substantially

¹²¹⁵ See ASF Letter; DBRS Letter; Deloitte Letter; Moody’s Letter; PWC Letter; S&P Letter.

¹²¹⁶ See paragraph (a)(1)(ii)(F) of Rule 17g-7.

¹²¹⁷ See Moody’s Letter; PWC Letter.

¹²¹⁸ See Moody’s Letter; S&P Letter.

¹²¹⁹ See Moody’s Letter.

¹²²⁰ See Deloitte Letter.

¹²²¹ See ASF Letter.

similar in each context.”¹²²² One NRSRO stated that publishing the certification of the third-party due diligence provider with the form as required by paragraph (a)(2) of Rule 17g-7, as proposed, makes its use by the NRSRO “self-evident.”¹²²³

The Commission is adopting the requirement that the form must contain information relating to due diligence services performed by a third party to implement section 15E(s)(3)(A)(v) of the Exchange Act.¹²²⁴ This information will help investors and other users of credit ratings to understand how the NRSRO determined the credit rating. In response to the comments that paragraph (a)(1)(ii)(F) should be limited to rating actions involving asset-backed securities, the Commission interprets the text of the rule referring to “due diligence services of a third party” as meaning the type of due diligence services that are within the scope of Rule 17g-10, as adopted, and Form ABS Due Diligence-15E (which apply to third-party due diligence services only in connection with asset-backed securities).¹²²⁵ Consequently, paragraph (a)(1)(ii)(F) is limited to rating actions involving Exchange Act-ABS.¹²²⁶

In response to comments, the Commission is modifying the rule from the proposal to permit the NRSRO to provide a cross-reference to a Form ABS Due Diligence-15E that is

¹²²² See id.

¹²²³ See DBRS Letter.

¹²²⁴ See 15 U.S.C. 78o-7(s)(3)(A)(v).

¹²²⁵ See paragraph (d)(1) of Rule 17g-10 defining the term due diligence services to mean, in pertinent part, “a review of the assets underlying an asset-backed security, as defined in section 3(a)(79) of the [Exchange] Act...” In addition, section 15E(s)(4) of the Exchange Act is titled “Due Diligence Services for Asset-Backed Securities.” See 15 U.S.C. 78o-7(s)(4). Moreover, section 15E(s)(4)(A) provides that “[t]he issuer or underwriter of any asset-backed security shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.” See 15 U.S.C. 78o-7(s)(4)(A) (emphasis added). Consequently, as proposed, paragraph (a)(1)(ii)(F) – which refers to due diligence services – was intended to address due diligence services in the context of an asset-backed security.

¹²²⁶ As stated above in section I.B.1. of this release, the term Exchange Act-ABS as used throughout this release refers to an asset-backed security as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

published with the form to meet part of the disclosure requirement in paragraph (a)(1)(ii)(F).¹²²⁷

The Commission is persuaded by commenters that if an NRSRO used due diligence services of a third party it would be redundant, and potentially confusing, for the NRSRO to provide a description of the information that the third party reviewed in conducting the due diligence services and a description of the findings or conclusions of the third party if that information is in a Form ABS Due Diligence-15E published with the form.¹²²⁸

In addition, as noted above, a commenter proposed modifying the rule to replace the phrase “a description of the findings or conclusions” to “a summary of the findings and conclusions,” because the commenter believed that a “summary” better aligns with the requirement in proposed Form ABS Due Diligence-15E and that, in each case, the rules should require a summary of the findings and conclusions (as opposed to the findings and conclusions themselves).¹²²⁹ Item 5 of Form ABS Due Diligence-15E requires the third party to provide a “summary of the findings and conclusions that resulted from the due diligence services.”¹²³⁰ The Commission agrees with the commenter and has therefore modified the proposal to replace the words “description of the findings or conclusions of such third party” with the words “summary of the findings and conclusions of the third party.”¹²³¹ However, if an NRSRO chooses to provide a summary of the findings and conclusions, the level of detail in the summary should be comparable to the level of detail a provider of third-party due diligence services provides in

¹²²⁷ See paragraph (a)(1)(ii)(F)(2) of Rule 17g-7.

¹²²⁸ As discussed below in section II.H.3.c. of this release, Item 4 of Form ABS Due Diligence-15E requires the third party to provide a description of the due diligence performed that addresses the information that was reviewed and Item 5 requires the third party to provide a summary of the findings and conclusions of the review.

¹²²⁹ See ASF Letter.

¹²³⁰ See Item 5 of Form ABS Due Diligence-15E.

¹²³¹ See paragraph (a)(1)(ii)(F)(1) of Rule 17g-7.

Form ABS Due Diligence-15E, as the summary in the form can be a substitute for the NRSRO providing a summary.¹²³²

For these reasons, the final amendments provide that the form must contain whether and to what extent the NRSRO used due diligence services of a third party in taking the rating action, and, if the NRSRO used such services, either: (1) a description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party; or (2) a cross-reference to a Form ABS Due Diligence-15E executed by the third party that is published with the form, provided the cross-referenced Form ABS Due Diligence-15E contains a description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party.¹²³³

The Commission is not persuaded by the comment that publishing the certification of the third-party due diligence provider with the form as required by paragraph (a)(2) of Rule 17g-7, as proposed, makes its use by the NRSRO “self-evident.”¹²³⁴ As discussed below in section II.G.5. of this release, section 15E(s)(4)(B) of the Exchange Act requires a third party providing due diligence services to an NRSRO, issuer, or underwriter with respect to an asset-backed security to provide a written certification to any NRSRO that produces a credit rating to which the due diligence services relate.¹²³⁵ Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO that receives a certification to disclose the

¹²³² The Commission, however, does not believe the rule as proposed (which required “a description of the findings or conclusions”) and the rule as adopted (which requires a “summary of the findings and conclusions”) contain standards that differ in any significant way. Under either standard, the NRSRO need not repeat the actual findings and conclusions but rather must provide a higher level disclosure about them.

¹²³³ See paragraph (a)(1)(ii)(F) of Rule 17g-7.

¹²³⁴ See DBRS Letter.

¹²³⁵ See 15 U.S.C. 78o-7(s)(4)(B).

certification to the public at the time at which the NRSRO produces a rating.¹²³⁶ Paragraph (a)(2) of Rule 17g-7, as amended, implements section 15E(s)(4)(D) by requiring the NRSRO to publish with the form any certifications it receives. However, the NRSRO's receipt of the certification pursuant to section 15E(s)(4)(B) and publication of the certification pursuant to paragraph (a)(2) of Rule 17g-7, as amended, is not predicated on the NRSRO having used the due diligence services in determining the credit rating. Consequently, the final amendments retain the requirement for the NRSRO to include in the form whether and to what extent the NRSRO used due diligence services of a third party in taking the rating action.¹²³⁷

Paragraph (a)(1)(ii)(G). Section 15E(s)(1)(A)(iii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information relating to, if applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating.¹²³⁸ The Commission proposed to implement this section through paragraph (a)(1)(ii)(G) of Rule 17g-7, which mirrored the statutory text.¹²³⁹

One commenter addressed paragraph (a)(1)(ii)(G) of Rule 17g-7, as proposed, by noting its support of the rule text as proposed.¹²⁴⁰ The Commission is adopting paragraph (a)(1)(ii)(E) of Rule 17g-7 as proposed.¹²⁴¹ The paragraph provides that the NRSRO must include in the

¹²³⁶ See 15 U.S.C. 78o-7(s)(4)(D).

¹²³⁷ See paragraph (a)(1)(ii)(F) of Rule 17g-7.

¹²³⁸ See 15 U.S.C. 78o-7(s)(1)(A)(iii).

¹²³⁹ See paragraph (a)(1)(ii)(G) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33461, 33540. This paragraph, as proposed, would require the NRSRO to include in the form, if applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating.

¹²⁴⁰ See S&P Letter.

¹²⁴¹ See paragraph (a)(1)(ii)(G) of Rule 17g-7. One commenter addressed this proposal and supported it. See S&P Letter.

form, if applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating.¹²⁴²

Paragraph (a)(1)(ii)(H). Section 15E(s)(3)(A)(vi) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.¹²⁴³ The Commission proposed to implement this section through paragraph (a)(1)(ii)(H) of Rule 17g-7, which mirrored the statutory text.¹²⁴⁴ The Commission is adopting paragraph (a)(1)(ii)(H) of Rule 17g-7 with a modification in response to comments.¹²⁴⁵

One NRSRO stated that the requirement may result in “effectively overloading” investors with information and essentially “reducing rather than enhancing” the disclosure’s value.¹²⁴⁶ This commenter and another commenter expressed concerns that some data may be confidential or provided to the NRSRO under terms restricting public disclosure.¹²⁴⁷ One commenter suggested that the Commission clarify that the requirement for a “description of the data relied upon” requires only a description of the general type of data and not of specific data, since specific data can be obtained from the relevant offering documents.¹²⁴⁸

¹²⁴² See paragraph (a)(1)(ii)(G) of Rule 17g-7.

¹²⁴³ See 15 U.S.C. 78o-7(s)(3)(A)(vi).

¹²⁴⁴ See paragraph (a)(1)(ii)(H) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33461, 33540-33541. This paragraph, as proposed, would require the NRSRO to include in the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.

¹²⁴⁵ See paragraph (a)(1)(ii)(H) of Rule 17g-7.

¹²⁴⁶ See S&P Letter.

¹²⁴⁷ See FSR Letter; S&P Letter.

¹²⁴⁸ See FSR Letter.

In response to these comments, the Commission notes, as stated above, that section 15E(s)(3)(A)(vi) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.¹²⁴⁹ Paragraph (a)(1)(ii)(H) of Rule 17g-7, as proposed, was designed to implement the statute. Moreover, as discussed above, the form must disclose information that can be used by investors and other users of credit ratings to better understand credit ratings¹²⁵⁰ and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. In this regard, the Commission did not intend to require that the form repeat verbatim all the data that were relied upon to determine the credit rating. Instead, it intended the form to include a “description” to help users of the credit rating to understand the types of data the NRSRO relied on. To make this more clear and address the commenter’s concern, the Commission has modified the final amendments to require the NRSRO to include in the form a description of the types of data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating.¹²⁵¹

Paragraph (a)(1)(ii)(I). Section 15E(s)(3)(A)(vii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form a statement containing an overall assessment of the quality of information available and considered in producing a rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar issuances.¹²⁵² The Commission proposed

¹²⁴⁹ See 15 U.S.C. 78o-7(s)(3)(A)(vi).

¹²⁵⁰ See 15 U.S.C. 78o-7(s)(1)(B).

¹²⁵¹ See paragraph (a)(1)(ii)(H) of Rule 17g-7 (emphasis added to highlight the modification).

¹²⁵² See 15 U.S.C. 78o-7(s)(3)(A)(vii).

to implement this section through paragraph (a)(1)(ii)(I) of Rule 17g-7, which largely mirrored the statutory text.¹²⁵³

The Commission is adopting paragraph (a)(1)(ii)(I) of Rule 17g-7 as proposed.¹²⁵⁴ The paragraph provides that the NRSRO must include in the form a statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments.¹²⁵⁵

One NRSRO stated that the requirement to disclose an overall assessment of the quality of information used in its rating “would present practical, and possibly contractual difficulties,” and that the Commission should harmonize this requirement with other jurisdictions’ requirements by requiring a statement about “(i) whether essential data was available; (ii) whether such data was believed to be reliable; and (iii) any limitations on access to data for that transaction that differed from typical circumstances.”¹²⁵⁶ The commenter did not explain how the proposed requirement would present contractual difficulties but, as discussed above, the Commission does not intend the disclosure provisions in the rule to require NRSROs to disclose confidential or proprietary information. In terms of practical issues, as discussed above, the

¹²⁵³ See paragraph (a)(1)(ii)(I) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33461, 33541. This paragraph, as proposed, would require the NRSRO to include in the form a statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments. The statute refers to ratings of “similar issuances.” However, a credit rating of an obligor commonly means the rating of the obligor as an entity rather than a rating of securities or money market instruments issued by the obligor. Consequently, the rating of an obligor may not relate to an “issuance” of a particular security or money market instrument. Therefore, paragraph (a)(1)(ii)(I) of Rule 17g-7, as proposed, substituted the phrase “similar obligors, securities, or money market instruments” for the phrase “similar issuances” in the statutory text.

¹²⁵⁴ See paragraph (a)(1)(ii)(I) of Rule 17g-7.

¹²⁵⁵ Id.

¹²⁵⁶ See S&P Letter.

NRSROs must provide narrative disclosures in the form that are helpful for users of credit ratings to understand the information and, therefore, the form must contain plainly worded and succinct disclosures that are not overly detailed. Thus, the practical issue of having to make highly detailed disclosures is not implicated by the rule as proposed and adopted. As for the suggestion to harmonize the rule with other jurisdictions, the text suggested by the commenter generally seems aimed at requiring relatively similar disclosures though it does not explicitly require an assessment of the overall quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments. Consequently, the Commission is not persuaded that it is necessary to implement the statute in a manner that deviates from the proposed rule.¹²⁵⁷

Paragraph (a)(1)(ii)(J). Proposed paragraph (a)(1)(ii)(J) of Rule 17g-7¹²⁵⁸ would implement, in part, section 15E(s)(3)(A)(viii) of the Exchange Act, which provides that the Commission shall require, by rule, that the NRSRO disclose on the form information relating to conflicts of interest of the NRSRO.¹²⁵⁹ The Commission proposed to identify three specific items of information that, at a minimum, an NRSRO would need to disclose in the form relating to conflicts of interest.¹²⁶⁰

First, proposed paragraph (a)(1)(ii)(J)(1) would require the NRSRO to include a classification of the credit rating as either solicited sell-side, solicited buy-side, or unsolicited.¹²⁶¹ The proposal defined solicited sell-side to mean that the credit rating was paid for by the obligor

¹²⁵⁷ See 15 U.S.C. 78o-7(s)(3)(A)(vii).

¹²⁵⁸ See paragraph (a)(1)(ii)(J) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

¹²⁵⁹ See 15 U.S.C. 78o-7(s)(3)(A)(viii).

¹²⁶⁰ See paragraph (a)(1)(ii)(J) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33461-33462, 33541.

¹²⁶¹ See paragraph (a)(1)(ii)(J)(1) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated.¹²⁶² The proposal defined solicited buy-side to mean that the credit rating was paid for by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated.¹²⁶³ The proposal defined an unsolicited credit rating to mean the NRSRO was not paid to determine the credit rating.¹²⁶⁴ The Commission is adopting paragraph (a)(1)(ii)(J)(1) of Rule 17g-7 with modifications in response to comments about these definitions.¹²⁶⁵

One NRSRO stated that equating the concept of solicitation with payment would result in confusion in the market, and that the definition should be harmonized with that of other jurisdictions, where an unsolicited credit rating is defined as one that is initiated by the credit rating agency and not requested by the issuer.¹²⁶⁶ The Commission is persuaded that requiring the NRSRO to classify the credit rating using one of these terms could be confusing given other views as to what constitutes a solicited or unsolicited credit rating. Further, disclosing the conflict through a classification may not be as helpful as simply having the NRSRO include a statement in the form as to whether another person paid for the credit rating. For these reasons, the final amendments have been modified to exclude the specific terms proposed and instead

¹²⁶² See paragraph (a)(1)(ii)(J)(1)(i) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

¹²⁶³ See paragraph (a)(1)(ii)(J)(1)(ii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

¹²⁶⁴ See paragraph (a)(1)(ii)(J)(1)(iii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541. The Commission further explained in the proposing release that the intent was to include credit ratings funded by selling subscriptions to access the credit ratings (so-called "subscriber-paid credit ratings"). See Nationally Recognized Statistical Rating Organizations, 76 FR at 33461-33462. However, if a subscriber paid the NRSRO to determine a credit rating for a specific obligor, security, or money market instrument, the credit rating would need to be classified as either solicited sell-side, if the subscriber also was the obligor, issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, or solicited buy-side if the subscriber was not the obligor, issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated. Id.

¹²⁶⁵ See paragraph (a)(1)(ii)(J)(1) of Rule 17g-7.

¹²⁶⁶ See Moody's Letter.

require the NRSRO to include in the form, as applicable, a statement that the NRSRO was: (1) paid to determine the credit rating by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; (2) paid to determine the credit rating by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; or (3) not paid to determine the credit rating.¹²⁶⁷

The second type of conflict disclosure was specified in proposed paragraph (a)(1)(ii)(J)(2) of Rule 17g-7.¹²⁶⁸ Pursuant to this paragraph, if the credit rating was classified as either solicited sell-side or solicited buy-side, the NRSRO would be required to disclose whether the NRSRO provided services other than determining credit ratings to the person that paid for the credit rating during the most recently ended fiscal year.¹²⁶⁹ The Commission is adopting paragraph (a)(1)(ii)(J)(2) of Rule 17g-7 with modifications in response to comments.¹²⁷⁰

A commenter stated that the disclosure about other services provided by an NRSRO does not provide any basis to conclude that a rating may be compromised.¹²⁷¹ Another commenter strongly opposed the requirement due to the difficulty of shielding analysts from such information so as to promote independence in the credit rating process.¹²⁷² A third commenter

¹²⁶⁷ See paragraph (a)(1)(ii)(J)(1) of Rule 17g-7. For the purpose of these disclosures, the Commission does not consider a subscriber to an NRSRO's credit ratings to be a person who paid for the credit rating simply because the subscriber paid a fee to access the credit ratings of the NRSRO. However, the NRSRO would need to state that it was paid to determine the credit rating if, for example, the subscriber paid for the credit rating because it was the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, or the subscriber paid for determination of the credit rating because the subscriber was an investor or potential investor in the security or money market instrument and hired the NRSRO to rate the security or money market instrument.

¹²⁶⁸ See paragraph (a)(1)(ii)(J)(2) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

¹²⁶⁹ See paragraph (a)(1)(ii)(J)(2) of Rule 17g-7, as proposed.

¹²⁷⁰ See paragraph (a)(1)(ii)(J)(2) of Rule 17g-7.

¹²⁷¹ See S&P Letter.

¹²⁷² See Moody's Letter.

supported the proposed requirement and added that the Commission should also require NRSROs to disclose the revenue they received from a particular issuer.¹²⁷³

The Commission does not agree with the commenter that being paid for other services does not present a potential conflict. As the Commission stated in the proposing release, clients paying an NRSRO for services in addition to determining credit ratings may pose an increased risk of exerting undue influence on the NRSRO with respect to its determination of credit ratings.¹²⁷⁴ The Commission has adopted rules that address this conflict.¹²⁷⁵ The proposed disclosure requirement about paying for other services was intended to complement these requirements.¹²⁷⁶

The Commission acknowledges the concern raised by the commenter about the objective of shielding analysts from information that could compromise their independence.¹²⁷⁷ Nonetheless, the Commission believes that the proposed disclosure that the NRSRO was paid for other services is appropriate because it will provide users of credit ratings with relevant information about this conflict even when balanced against the concern that an analyst reading the report will learn that the NRSRO was paid for other services. If the NRSRO was required to

¹²⁷³ See CFR/AFR Letter.

¹²⁷⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33461-33462. In this regard, the Commission notes that section 939H of the Dodd-Frank Act contains a sense of Congress that the Commission should exercise rulemaking authority under section 15E(h)(2)(B) of the Exchange Act to prevent improper conflicts of interest arising from employees of NRSROs providing services to issuers of securities that are unrelated to the issuance of credit ratings, including consulting, advisory, and other services. See Pub. L. No. 111-203, 939H. See also 2013 Staff Report on Credit Rating Agency Independence (a report on the potential conflict of interest that arises from a credit rating agency providing other services).

¹²⁷⁵ See 2013 Staff Report on Credit Rating Agency Independence, pp. 9-13 (summarizing and describing the relevant rules).

¹²⁷⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33461-33462.

¹²⁷⁷ See Moody's Letter.

disclose the amount of revenue received (as suggested by the third commenter), this concern that the analyst might be influenced by the disclosure would be increased.¹²⁷⁸

For all of these reasons, the Commission is adopting the requirement that the NRSRO must include a disclosure in the form if it was paid for other services.¹²⁷⁹ The Commission modified the final amendments to correspond to the modifications discussed above with respect to eliminating the proposed classification of the credit rating as either solicited or unsolicited. Specifically, the final amendments require the NRSRO, if applicable, to include in the form a statement that the NRSRO also was paid for services other than determining credit ratings during the most recently ended fiscal year by the person that paid the NRSRO to determine the credit rating.¹²⁸⁰

The third type of conflict disclosure was specified in (a)(1)(ii)(J)(3) and related to rating actions resulting from look-back reviews.¹²⁸¹ As discussed above in section II.C.1. of this release, the proposal would require the disclosure of information about a conflict of interest influencing a credit rating action discovered as a result of a look-back review conducted pursuant to section 15E(h)(4)(A) of the Exchange Act and proposed paragraph (c) of Rule 17g-8. Also, as discussed above in section II.C.1. of this release, the Commission is adopting paragraph (a)(1)(ii)(J)(3) of Rule 17g-7 with modifications in response to comments that eliminate the required disclosure that would have accompanied the placement of the credit rating on credit

¹²⁷⁸ See CFR/AFR Letter.

¹²⁷⁹ See paragraph (a)(1)(ii)(J)(2) of Rule 17g-7.

¹²⁸⁰ Id.

¹²⁸¹ See paragraph (a)(1)(ii)(J)(3) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

watch, modify the required disclosure with respect to estimating the impact of the conflict, and make certain related and technical modifications.¹²⁸²

Paragraph (a)(1)(ii)(K). Section 15E(s)(3)(B)(i) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form an explanation or measure of the potential volatility of the credit rating, including: (1) any factors that might lead to a change in the credit rating; and (2) the magnitude of the change that a user can expect under different market conditions.¹²⁸³ The Commission proposed to implement this section through paragraph (a)(1)(ii)(K) of Rule 17g-7, which largely mirrored the statutory text.¹²⁸⁴ The Commission is adopting paragraph (a)(1)(ii)(K) of Rule 17g-7 with modifications in response to comment.¹²⁸⁵

Three commenters addressed paragraph (a)(1)(ii)(K) of Rule 17g-7, as proposed.¹²⁸⁶ An NRSRO suggested that the Commission modify the rule to require the disclosure of any factors that are “reasonably likely to” (rather than “might”) lead to a change in the credit rating.¹²⁸⁷ A second NRSRO stated that “each NRSRO should decide for itself what conditions merit discussion in light of the characteristics of the rated instrument and whatever other information the NRSRO believes it is appropriate to take into account.”¹²⁸⁸ A third commenter stated that the Commission should require the NRSROs to be very specific about the events and the magnitude

¹²⁸² See paragraph (a)(1)(ii)(J)(3) of Rule 17g-7.

¹²⁸³ See 15 U.S.C. 78o-7(s)(3)(B)(i).

¹²⁸⁴ See paragraph (a)(1)(ii)(K) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33462, 33541. This paragraph, as proposed, would require the NRSRO to include in the form an explanation or measure of the potential volatility of the credit rating, including: (1) any factors that might lead to a change in the credit rating; and (2) the magnitude of the change that could occur under different market conditions.

¹²⁸⁵ See paragraph (a)(1)(ii)(K) of Rule 17g-7.

¹²⁸⁶ See CFR/AFR Letter; DBRS Letter; S&P Letter.

¹²⁸⁷ See DBRS Letter.

¹²⁸⁸ See S&P Letter.

of those events that would cause ratings to be in “error” and provided a five percent drop in housing prices as an example.¹²⁸⁹

The Commission agrees with the modifications suggested by the first commenter. The word “might” as used in the proposed rule text is imprecise and could lead to disclosures that seek to identify any conceivable factor that could lead to the change in the credit rating no matter how remote the possibility. This could diminish the usefulness of the disclosure by including information that is not highly relevant to understanding the credit rating and generally making the disclosure too long.

Regarding the second comment, the magnitude of the change that could occur under different market conditions will depend on an NRSRO’s procedures and methodologies for determining credit ratings that apply to the credit rating that is subject to the rating action.¹²⁹⁰ Consequently, the required disclosure – as proposed and adopted – will be based on those procedures and methodologies and how they account for different market conditions. In other words, the NRSRO will need to “decide for itself” the potential market conditions that could cause a change in the credit rating given its rating procedures and methodologies. However, to make this clear, the Commission is modifying the rule to specify that the different market conditions are those that are determined by the NRSRO to be relevant to the rating.¹²⁹¹

Finally, the Commission generally agrees with the third commenter that the disclosure by the NRSRO must specify the factors (for example, market conditions) that would lead to a change in the credit rating. As discussed above, the NRSRO must disclose factors that might lead to a change in the credit rating. In doing so, the NRSRO must explain the factors.

¹²⁸⁹ CFR/AFR Letter.

¹²⁹⁰ See, e.g., 2012 Staff Report on Credit Rating Standardization, pp. 25-29 (discussing the feasibility and desirability of standardizing the market stress conditions under which ratings are evaluated).

¹²⁹¹ See paragraph (a)(1)(ii)(K)(2) of Rule 17g-7.

For these reasons, the final amendments require the NRSRO to include in the form an explanation or measure of the potential volatility of the credit rating, including: (1) any factors that are reasonably likely to lead to a change in the credit rating; and (2) the magnitude of the change that could occur under different market conditions determined by the NRSRO to be relevant to the rating.¹²⁹²

Paragraph (a)(1)(ii)(L). Section 15E(s)(3)(B)(ii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information on the content of the credit rating, including: (1) the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.¹²⁹³ The Commission proposed to implement this section through paragraph (a)(1)(ii)(L) of Rule 17g-7, which mirrored the statutory text.¹²⁹⁴

The Commission is adopting paragraph (a)(1)(ii)(L) of Rule 17g-7 as proposed.¹²⁹⁵ The paragraph provides that the NRSRO must include in the form information on the content of the credit rating, including: (1) if applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.¹²⁹⁶

Two NRSROs addressed paragraph (a)(1)(ii)(L) of Rule 17g-7, as proposed.¹²⁹⁷ One stated that it supports the disclosure elements specified in this paragraph.¹²⁹⁸ The other

¹²⁹² Id.

¹²⁹³ See 15 U.S.C. 78o-7(s)(3)(B)(ii).

¹²⁹⁴ See paragraph (a)(1)(ii)(L) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33462, 33541. This paragraph, as proposed, would require the NRSRO to include in the form information on the content of the credit rating, including: (1) if applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default.

¹²⁹⁵ See paragraph (a)(1)(ii)(L) of Rule 17g-7.

¹²⁹⁶ Id.

¹²⁹⁷ See Kroll Letter; S&P Letter.

¹²⁹⁸ See Kroll Letter.

commenter stated that the proposal is sufficiently explicit, but indicated that its credit ratings do not connote a “particular” expectation of the probability of default.¹²⁹⁹ The Commission recognizes that credit ratings generally are intended to indicate the relative degree of credit risk of an obligor or debt instrument rather than reflect a measure of a specific default probability or loss expectation.¹³⁰⁰ The Commission does not expect NRSROs to alter the meanings of their credit ratings or rating procedures and methodologies to conform to the disclosure requirement. Rather, the Commission expects NRSROs to provide “information” to the extent it is consistent with their procedures and methodologies for determining credit ratings, on the expected probability of default and expected loss in the event of default. This information could consist of, for example, historical default and loss statistics, respectively, for the class or subclass of the credit rating.

Paragraph (a)(1)(ii)(M). Section 15E(s)(3)(B)(iii) of the Exchange Act provides that the Commission shall require, by rule, that the NRSRO disclose on the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on a rating if the assumptions were proven false or inaccurate; and (2) an analysis, using specific examples, of how each of the five assumptions identified impacts a credit rating.¹³⁰¹ The Commission proposed to implement this section through paragraph

¹²⁹⁹ See S&P Letter.

¹³⁰⁰ See 2012 Staff Report on Credit Rating Standardization, pp. 29-34 (discussing the feasibility and desirability of requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress).

¹³⁰¹ See 15 U.S.C. 78o-7(s)(3)(B)(iii).

(a)(1)(ii)(M) of Rule 17g-7, which mirrored the statutory text.¹³⁰² The Commission is adopting paragraph (a)(1)(ii)(M) of Rule 17g-7 with modifications in response to comments.¹³⁰³

Several commenters addressed paragraph (a)(1)(ii)(M) of Rule 17g-7, as proposed.¹³⁰⁴ An NRSRO stated that the disclosure of assumptions will tend to become a “mechanical exercise” where disclosure is “sufficiently vague so as to be unimpeachable,” but will not be useful.¹³⁰⁵ Another NRSRO stated that it should be permissible to disclose fewer than five assumptions if fewer than five significant assumptions exist.¹³⁰⁶ Two other NRSROs stated that it may be difficult to identify five single assumptions¹³⁰⁷ because, according to one NRSRO, many assumptions are “cross-dependent,” and different assumptions may “play out differently in various economic scenarios.”¹³⁰⁸ Another commenter stated that the Commission should also require NRSROs to disclose the sensitivity of the credit rating to several assumptions changing at the same time and the dependencies assumed between the assumptions.¹³⁰⁹

The Commission agrees with the commenter that an NRSRO should not disclose five assumptions if there are fewer than five assumptions that would have an impact on the credit rating if proven false or inaccurate. Otherwise, the disclosure could contain information that is

¹³⁰² See paragraph (a)(1)(ii)(M) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541. This paragraph, as proposed, would require the NRSRO to include in the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on a credit rating if the assumptions were proven false or inaccurate; and (2) an analysis, using specific examples, of how each of the five assumptions impacts a rating.

¹³⁰³ See paragraph (a)(1)(ii)(M) of Rule 17g-7.

¹³⁰⁴ See Barnard Letter; CFA/AFR Letter; DBRS Letter; Kroll Letter; Moody's Letter; Morningstar Letter; S&P Letter.

¹³⁰⁵ See Kroll Letter.

¹³⁰⁶ See Moody's Letter.

¹³⁰⁷ See Morningstar Letter; S&P Letter.

¹³⁰⁸ See S&P Letter.

¹³⁰⁹ See Barnard Letter.

potentially misleading by, for example, creating the impression the assumption is important when it is not. Consequently, the final amendments are modified to include a provision that the NRSRO need only disclose information on the assumptions that would have an impact on the credit rating if there are fewer than five such assumptions.¹³¹⁰ Specifically, the final amendments require the NRSRO to include in the form information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: (1) five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if the assumptions were proven false or inaccurate, provided that, if the NRSRO has made fewer than five such assumptions, it need only disclose information on the assumptions that would have an impact on the credit rating; and (2) an analysis, using specific examples, of how each of the assumptions impacts the credit rating.¹³¹¹

In response to the comment that this disclosure will become “mechanical” and not useful, the Commission – as stated above – expects NRSROs to make the disclosures as specific to the particular rating action, and as relevant to investors, as possible, and to strike a reasonable balance between standardizing the disclosures and tailoring them to specific rating actions. With respect to the comments on isolating the assumptions and the co-dependencies between assumptions, the Commission understands that certain assumptions may be co-dependent. The NRSRO should provide an explanation of this co-dependency in the disclosure of the assumptions to the extent it is relevant to understanding how they would impact the credit rating.

Paragraph (a)(1)(ii)(N). Paragraph (a)(1)(ii)(N) of Rule 17g-7, as proposed, would contain the disclosure requirements in paragraphs (a) and (b) of Rule 17g-7 before today’s

¹³¹⁰ See paragraph (a)(1)(ii)(M)(1) of Rule 17g-7. For the reasons stated above, the Commission believes this modification is necessary or appropriate in the public interest, and is consistent with the protection of investors. See 15 U.S.C. 78mm (providing the Commission with general exemptive authority).

¹³¹¹ See paragraph (a)(1)(ii)(M) of Rule 17g-7.

amendments.¹³¹² Specifically, this paragraph would provide that if the credit rating is issued with respect to an asset-backed security, as that term is defined in section 3(a)(79) of the Exchange Act, the NRSRO must include in the form a description of: (1) the representations, warranties, and enforcement mechanisms available to investors; and (2) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, each time there was a rating action with respect to an asset-backed security.¹³¹³ The Commission is adopting paragraph (a)(1)(ii)(N) of Rule 17g-7 with modifications in response to comments.¹³¹⁴

Several commenters addressed paragraph (a)(1)(ii)(N) of Rule 17g-7, as proposed.¹³¹⁵ Two NRSROs objected to the frequency of the required disclosures under the proposed paragraph.¹³¹⁶ One NRSRO stated that, while the disclosures are relevant at the time an initial credit rating is published, the disclosures may not be relevant at later times because the representations, warranties, and enforcement mechanisms likely will not change in the course of a rated security's existence.¹³¹⁷ Another NRSRO stated that requiring the disclosures with each rating action "unacceptably" expands the disclosure requirement in Rule 17g-7 before today's amendments, which required the disclosures when a rating report is published, noting that some rating actions "would not necessarily be accompanied by the issuance of a credit rating report."¹³¹⁸

¹³¹² See paragraph (a)(1)(ii)(N) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33463, 33541; 17 CFR 240.17g-7.

¹³¹³ See paragraph (a)(1)(ii)(N) of Rule 17g-7, as proposed.

¹³¹⁴ See paragraph (a)(1)(ii)(N) of Rule 17g-7.

¹³¹⁵ See Mills Letter; DBRS II Letter; Kroll Letter; S&P Letter.

¹³¹⁶ See Kroll Letter; S&P Letter.

¹³¹⁷ See Kroll Letter.

¹³¹⁸ See S&P Letter.

One NRSRO stated that the disclosures required by Rule 17g-7 before today's amendments are "enormously costly to the NRSROs" and are "of very little value to investors" according to feedback from institutional clients and an analysis of the NRSRO's Internet website usage data.¹³¹⁹ This NRSRO suggested that the rule be modified to require disclosures that "relate to the asset pool underlying the ABS transaction" and which "the issuer has disclosed in the prospectus, private placement memorandum or other offering document for that transaction."¹³²⁰ Similarly, one commenter stated that the required disclosures should be limited to representations, warranties, and enforcement mechanisms that "appear in the prospectus or other offering document for [the applicable] security" because otherwise the information would not be material to an investor's ability to make an informed decision.¹³²¹ Finally, an NRSRO suggested that the benchmarks for the representations, warranties, and enforcement mechanisms should be displayed in "a dedicated area of the NRSROs' websites" instead of in the form.¹³²²

The Commission has modified the final amendments in response to some of these comments and consistent with the Commission's objective of making the information in the form disclosed with a credit rating helpful to investors and other users of credit ratings in understanding how the credit rating was determined. The first significant modification is to narrow the disclosure requirement so that it addresses the representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private

¹³¹⁹ See DBRS II Letter. See also DBRS PRA Letter; Kroll PRA Letter; Moody's PRA Letter.

¹³²⁰ See DBRS II Letter. In support of its suggestion, the NRSRO cited the Senate Committee on Banking, Housing, and Urban Affairs, Committee Report No. 111-176, April 30, 2010 ("Senate Banking Committee Report"), stating that the deficiencies in the securitization process that the applicable provision of the Dodd-Frank Act was designed to address "included the fact that 'investors in asset-backed securities could not assess the risks of the underlying assets, particularly when those assets were res securitized into complex instruments like collateralized debt obligations.'" DBRS II Letter (quoting Senate Banking Committee Report at 35-37).

¹³²¹ See Mills Letter.

¹³²² See DBRS II Letter.

placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security. The Commission agrees with commenters that this is highly relevant information for investors. Therefore, focusing the disclosure requirement in this way may make the required disclosure more relevant and useful to investors and other users of credit ratings than the disclosures required under Rule 17g-7 before today's amendments. Specifically, paragraph (a)(1)(ii)(N) of Rule 17g-7 requires an NRSRO, if the credit rating is assigned to an asset-backed security as defined in section 3(a)(79) of the Exchange Act, to disclose in the form information on: (1) the representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security; and (2) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities.¹³²³

The second significant modification is to reduce the frequency of the disclosure. As commenters stated, the proposal – by incorporating the requirements of Rule 17g-7 before today's amendments into the new form disclosure requirements – would increase the number of times an NRSRO would need to disclose the information about representations, warranties, and enforcement mechanisms. The Commission believes that the critical time for disclosing this information is when investors are making investment decisions about a new issuance, which

¹³²³

See paragraph (a)(1)(ii)(N)(1) of Rule 17g-7. As noted above, one NRSRO suggested that the benchmarks for the representations, warranties, and enforcement mechanisms should be displayed in "a dedicated area of the NRSROs' websites" instead of in the form. See DBRS II Letter. In response, the Commission notes that the final amendments require the NRSRO disclose in the form information on the representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum, or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security, and how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities. The Commission does not intend the rule to preclude including an Internet address where the benchmarks can be found on the NRSRO's website, provided the disclosure in the form meets the requirement in the rule. Moreover, to the extent the benchmarks are lengthy, this approach could make the form easier to use.

would have no performance history. The Commission also believes the disclosure would be useful if there is a material change in the representations, warranties, or enforcement mechanisms after issuance because the change could be relevant to investment decisions made in the secondary market for the security. Finally, because Rule 17g-7 became effective on September 26, 2011, the final amendments provide that the requirement to make the disclosure after a material change is triggered only if the rating action involves an asset-backed security that was initially rated by the NRSRO on or after September 26, 2011. This will further limit the burden associated with the rule. It also will address the practical issue of an NRSRO having to make a disclosure involving historical information that it may not have collected and retained because it was not required to make the disclosure about the representations, warranties, or enforcement mechanisms when it initially rated the asset-backed security. For these reasons, the final amendments require the information to be disclosed if the rating action is a preliminary credit rating or an initial credit rating or if the rating action is the first one taken after a material change in the representations, warranties, or enforcement mechanisms and the rating action involves an asset-backed security that was initially rated by the NRSRO on or after September 26, 2011.¹³²⁴

4. Paragraph (a)(1)(iii) of Rule 17g-7 – Attestation

Section 15E(q)(2)(F) of the Exchange Act provides that the Commission's rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.¹³²⁵ While section 15E(q) relates to the disclosure of

¹³²⁴ See paragraph (a)(1)(ii)(N)(2) of Rule 17g-7.

¹³²⁵ See 15 U.S.C. 78o-7(q)(2)(F).

information about the performance of credit ratings, the Commission proposed that this attestation provision would more appropriately be implemented with respect to all disclosures that must be made when a specific rating action is published.¹³²⁶ Accordingly, the Commission proposed that the attestation be included in the form accompanying a credit rating.¹³²⁷

As proposed, an NRSRO would be required to attach to the form with each rating action a signed statement by a person within the NRSRO stating that the person has responsibility for the credit rating and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the risks and merits of the obligor, security, or money market instrument.¹³²⁸ Thus, the proposed rule text mirrored the statutory text in terms of the representations that would be included in the attestation.¹³²⁹

The Commission received several comments that addressed the proposal.¹³³⁰ One commenter stated that the “strong” attestation requirement is a “valuable enhancement” because it promotes increased accountability and “more meaningful disclosures.”¹³³¹ One NRSRO endorsed the attestation requirement substantially as proposed.¹³³² Two NRSROs were concerned that the attestation requirement would result in an employee or officer being

¹³²⁶ See paragraph (a)(1)(iii) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR 33464-33465, 33541.

¹³²⁷ See 15 U.S.C. 78o-7(s); 15 U.S.C. 78o-7(q).

¹³²⁸ See paragraphs (a)(1)(iii)(A) through (C) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33541.

¹³²⁹ See 15 U.S.C. 78o-7(q)(2)(F).

¹³³⁰ See A.M. Best Letter; Better Markets Letter; DBRS Letter; Moody's Letter; Morningstar Letter; S&P Letter.

¹³³¹ See Better Markets Letter.

¹³³² See DBRS Letter.

personally liable for a rating action.¹³³³ One NRSRO stated that a ratings committee already attests to the rating's independence by signing its internal rating forms and stated "[t]hus, such an attestation is already part and parcel of the ratings package that is...available to Commission staff during their annual exams, or at any other time."¹³³⁴ One NRSRO suggested that rather than an attestation, the NRSRO should be required to disclose the name of the chair of the rating committee because doing so is an implicit attestation that the credit rating was determined in accordance with the NRSRO's rating procedures and methodologies.¹³³⁵

The Commission is adopting paragraph (a)(1)(iii) of Rule 17g-7 with one modification in response to comments. Specifically, one NRSRO suggested that the wording of the proposed attestation – because it used the phrase “risks and merits” – could inadvertently lead users of credit ratings to believe that credit ratings address other types of risk, such as liquidity risk, market value risk, or price volatility.¹³³⁶ The commenter suggested the phrase “credit risk” be used instead.

The Commission agrees. Credit ratings are assessments of creditworthiness.¹³³⁷ Consequently, the attestation should reference credit risk so as not to be misleading. In addition, the NRSRO should have the flexibility to designate the individual who will execute the

¹³³³ See A.M. Best Letter; Morningstar Letter. While the Commission understands the commenters' concerns about potential liability, the Commission believes the attestation requirement is an important provision that will promote analytic independence. The Commission does not believe it would be necessary or appropriate in the public interest, or consistent with the protection of investors, to refrain from implementing section 15E(q)(2)(F) of the Exchange Act, which, as discussed above, requires rulemaking establishing an attestation requirement. See 15 U.S.C. 78mm. Further, the Commission notes that, consistent with all other provisions of the Exchange Act and rules that impose an obligation on an entity, there is a potential for secondary liability for an individual that aids and abets, or causes, a violation.

¹³³⁴ See A.M. Best Letter.

¹³³⁵ See S&P Letter.

¹³³⁶ See Moody's Letter.

¹³³⁷ See 15 U.S.C. 78o-7(c)(60) (defining a credit rating to mean “an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments”).

certification, as more than one individual within the NRSRO may have responsibility for the rating action.¹³³⁸ For these reasons, the final amendments provide that the NRSRO must attach to the form a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.¹³³⁹

The Commission does not believe the alternatives suggested by commenters – relying on internal records or disclosure of the identity of the rating committee chair – would adequately implement the statute. As discussed above, section 15E(q)(2)(F) of the Exchange Act provides that the Commission’s rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.¹³⁴⁰ Consequently, the attestation must be included with the credit rating the NRSRO issues rather than being documented in an internal record. Further, the Commission believes that having an individual attest to the information disclosed in the form will promote analytical independence. In particular, the individual executing the attestation will want to ensure that it contains no untrue or inaccurate statements. Consequently, the individual will have an incentive to take steps to verify that the credit rating was not influenced by any other business activities, was based solely

¹³³⁸ For example, if the rating action was determined through a rating committee, each of the individuals on the committee could be designated by the NRSRO as having responsibility for the rating action.

¹³³⁹ See paragraph (a)(1)(iii) of Rule 17g-7 (emphasis added to highlight the modification).

¹³⁴⁰ See 15 U.S.C. 78o-7(q)(2)(F).

on the merits of the instruments being rated, and was an independent evaluation of the risks and merits of the instrument. Moreover, if the individual does not believe such an attestation can be truthfully made, the individual will have a reason to refuse to make the attestation. This could prevent the NRSRO from taking a rating action that, for example, was inappropriately influenced by conflicts of interest arising from business considerations.

The Commission is not persuaded that disclosing the name of the rating chair would provide an implicit attestation that that no part of the credit rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument. Moreover, as discussed above, having an individual execute the attestation will promote analytical independence. Accordingly, the final amendments (as was proposed) require that the form include an attestation executed by an individual responsible for the rating action.

Finally, one NRSRO stated that every NRSRO should be able to determine who within the NRSRO should be responsible for making the proposed attestation.¹³⁴¹ The Commission agrees with the commenter that the NRSRO has flexibility to select the appropriate person within the NRSRO to execute the attestation, provided the person has responsibility for the credit rating. For example, the analyst or another member of the rating committee could execute the attestation.

5. Paragraph (a)(2) of Rule 17g-7 – Third-Party Due Diligence Certification

As discussed in more detail below in section II.H. of this release, section 15E(s)(4)(B) of the Exchange Act requires a third party providing due diligence services to an NRSRO, issuer, or underwriter with respect to an Exchange Act-ABS to provide a written certification to any

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See DBRS Letter.

NRSRO that produces a credit rating to which the due diligence services relate.¹³⁴² Section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt a rule requiring an NRSRO that receives a certification from a provider of third-party due diligence services to disclose the certification to the public in a manner that allows the public to determine the adequacy and level of the due diligence services provided by the third party.¹³⁴³ The Commission proposed to implement section 15E(s)(4)(D) through paragraph (a)(2) of Rule 17g-7, as proposed.¹³⁴⁴ As proposed, paragraph (a)(2) identified the second item of information an NRSRO would need to publish with a credit rating when taking a rating action: any written certification related to the credit rating received from a third-party provider of due diligence services pursuant to section 15E(s)(4)(B) of the Exchange Act.¹³⁴⁵ The proposed approach was intended to provide disclosure of the certification to the public in a manner that allows the public to determine the adequacy and level of the due diligence services provided.¹³⁴⁶

The Commission received a number of comment letters regarding proposed paragraph (a)(2) of Rule 17g-7.¹³⁴⁷ An NRSRO stated that requiring the NRSRO to deliver “information and commentary generated by other market participants” may lead to confusion about “the appropriate role of NRSROs,”¹³⁴⁸ and another NRSRO stated that the proposed requirements may cause NRSROs to “include in their rating disclosure form information that they believe is

¹³⁴² See 15 U.S.C. 78o-7(s)(4)(B). As stated above in section I.B.1. of this release, the term Exchange Act-ABS as used throughout this release refers to an asset-backed security as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

¹³⁴³ See 15 U.S.C. 78o-7(s)(4)(D).

¹³⁴⁴ See paragraph (a)(2) of Rule 17g-7, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33465, 33541.

¹³⁴⁵ See paragraph (a)(2) of Rule 17g-7, as proposed.

¹³⁴⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33465.

¹³⁴⁷ See ASF Letter; CII Letter; Clayton Letter; Levin Letter; Moody's Letter; Morningstar Letter; S&P Letter.

¹³⁴⁸ See Moody's Letter.

not from a reliable source and that they did not use in their rating analysis.”¹³⁴⁹ The second NRSRO also stated that “NRSROs do not typically engage third-party due diligence providers” and “obtaining and disclosing this certification should be the obligation of the issuer.”¹³⁵⁰ On the other hand, two commenters expressed their support for requiring NRSROs to disclose information related to third-party due diligence reviews.¹³⁵¹ Another commenter stated that only the NRSRO is in a position to know which reports it used in issuing a credit rating.¹³⁵² A fourth commenter stated that the due diligence providers have a “limited role” in the transaction and that “the onus for making the certification publicly available should rest solely with the NRSRO.”¹³⁵³

The Commission is adopting paragraph (a)(2) of Rule 17g-7 with modifications designed to address comments made in the context of proposed Rule 17g-10.¹³⁵⁴ Specifically, the final amendments are modified to explicitly reference Form ABS Due Diligence-15E.¹³⁵⁵ In addition, the final amendments are modified to correspond to modifications to Rule 17g-10 (discussed below) to provide that an NRSRO must publish with a rating action any executed Form ABS Due Diligence-15E containing information about the security or money market instrument subject to the rating action that is received by the NRSRO or obtained by the NRSRO through an Internet website maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to paragraph (a)(3) of Rule 17g-5. As discussed below in section

¹³⁴⁹ See S&P Letter.

¹³⁵⁰ Id.

¹³⁵¹ See CII Letter; Levin Letter.

¹³⁵² See ASF Letter.

¹³⁵³ See Clayton Letter.

¹³⁵⁴ See paragraph (a)(2) of Rule 17g-7. See also section II.H.2. of this release (discussing the “safe harbor” provision that incorporates the use of the Internet website maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to paragraph (a)(3) of Rule 17g-5).

¹³⁵⁵ See paragraph (a)(2) of Rule 17g-7. As proposed, the paragraph referred to “any certification.”

II.H.2.c. of this release, the Commission is modifying Rule 17g-10 from the proposal to provide that a person employed to provide third-party due diligence services can meet its statutory obligation to provide the written certification relating to those services to any NRSRO that produces a credit rating to which such services relate by promptly responding to a written request from an NRSRO for the executed Form ABS Due Diligence-15E and promptly delivering the Form ABS Due Diligence-15E to the issuer, sponsor, or underwriter of the security or money market instrument that maintains the relevant Internet website pursuant to Rule 17g-5.¹³⁵⁶ Further, the Commission is amending Rule 17g-5 to provide for the issuer, sponsor, or underwriter to represent that it will promptly post the Form ABS Due Diligence-15E to the Internet website it maintains under paragraph (a)(3) of Rule 17g-5.¹³⁵⁷

As discussed above, two NRSROs raised concerns about requiring the NRSRO to disclose the due diligence certifications.¹³⁵⁸ The Commission notes that section 15E(s)(4)(D) of the Exchange Act provides that the Commission shall adopt a rule requiring an NRSRO that receives a certification from a provider of third-party due diligence services to disclose the certification to the public in a manner that allows the public to determine the adequacy and level of the due diligence services provided by the third party.¹³⁵⁹ Moreover, the Commission believes that the information contained in Form ABS Due Diligence-15E will be useful to investors and to other users of the NRSRO's credit ratings. Therefore, disclosing the information in the form that will accompany the credit rating will associate the information with the credit rating. This will make it easier for investors and other users of credit ratings to locate the information and it

¹³⁵⁶ See paragraph (c) of Rule 17g-10.

¹³⁵⁷ See paragraph (a)(3)(iii)(E) of Rule 17g-5.

¹³⁵⁸ See Moody's Letter; S&P Letter.

¹³⁵⁹ 15 U.S.C. 15E(s)(4)(D).

will promote their use of the information in evaluating the credit rating and asset-backed security that is the subject of the rating action. For these reasons, the Commission does not believe it would be necessary or appropriate in the public interest, or consistent with the protection of investors to exempt NRSROs from the requirement to include the due diligence certifications with their forms.¹³⁶⁰

6. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments relating to the forms and certifications that an NRSRO must publish when taking certain rating actions.¹³⁶¹ The baseline that existed before today's amendments was one in which NRSROs were not required by Commission rules to publish specified information when taking a rating action. However, today's amendments contain requirements for the disclosure of certain types of information with the publication of certain rating actions that an applicant or NRSRO was required, before these amendments, to report generally with respect to all of its credit ratings on Form NRSRO. For example, before today's amendments, the instructions for Exhibit 2 to Form NRSRO required the disclosure of a general description of the procedures and methodologies used by the NRSRO to determine credit ratings. This description must address, among other items, the quantitative and qualitative models and metrics and the public and non-public sources of information, including data and analysis provided by third-party vendors, used to determine credit ratings. This information was not, however, required to be disclosed at the level of individual rating actions, so users of credit ratings interested in a particular rating action may not

¹³⁶⁰ See 15 U.S.C. 78mm (providing the Commission with exemptive authority).

¹³⁶¹ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today. The economic effects related to the certification of third-party due diligence providers are discussed below in more detail in section II.H.4. of this release.

have known, for example, the “version of the procedure or methodology used” or the “types of data...that were relied on” to determine the credit rating in question, as required to be disclosed with the publication of certain credit rating actions under the amendments.

Before today’s amendments, some NRSROs provided, but were not required by the Commission to provide, additional disclosures on their public websites with respect to all of their credit ratings, such as a description of the intended informational content of their credit ratings and a general discussion of the uncertainty and risk factors to which their credit ratings are subject. Also, in some public press releases and reports to subscribers issued in connection with rating actions, NRSROs have discussed certain risk factors specific to a given rating action or provided information or web addresses directing interested persons to the descriptions of methodologies that are relevant for that particular rating action, though such disclosures were not required.

Relative to this baseline, the amendments being adopted today may benefit users of credit ratings because the forms may provide new information specific to a given rating action or may clearly direct users of credit ratings to information that may already have been available. Specifically, as discussed above, the information provided in the forms will include, among other things: (1) information about the content of the credit rating; (2) the main assumptions and principles and the version of the methodology used to determine the credit rating; (3) a description of the types of data that were relied on and whether due diligence services and servicer or remittance reports were used for the purpose of determining the credit rating; (4) information relating to potential conflicts of interest; and (5) information about the potential limitations, uncertainty, sensitivity to assumptions, and potential volatility of the credit rating.¹³⁶²

¹³⁶²

See paragraph (a)(1)(ii) of Rule 17g-7 (prescribing the information that must be disclosed in the form).

The disclosure of this information and the other required content of the forms may benefit users of credit ratings by allowing them to better understand how credit ratings are produced and the information content of credit ratings, including how these factors vary across NRSROs. Also, the information disclosed in the form – particularly information about the potential limitations, uncertainty and potential volatility of the credit rating, the sensitivity of the credit rating to assumptions made by the NRSRO, and information regarding the due diligence services used in rating Exchange Act-ABS – may discourage undue reliance on credit ratings by investors and other users of credit ratings in making investment and other credit-based decisions. The disclosures, and particularly the attestation requirement, also may encourage enhanced integrity in the production of credit ratings.

If the forms increase the ability of users of credit ratings to compare the assumptions, data, and due diligence relied on by different NRSROs, the adopted rules and amendments may have beneficial competitive effects by enhancing the reputation of NRSROs that users of credit ratings view as being more thorough or as providing more informative credit ratings on the basis of these reviews. Also, to the extent that the forms allow investors to more accurately interpret the information conveyed by credit ratings, they may result in more efficient investment decisions and higher overall market efficiency.¹³⁶³ However, the benefits of the forms may be limited to the extent that standardized language and a high level of narrative in the forms limit the amount of useful information that can readily be acquired from the disclosures or the extent to which the information may be easily compared across NRSROs.

The amendments will result in compliance costs to NRSROs. The Commission believes that NRSROs will be able to develop disclosures that are standardized to some degree for

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See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

particular types of credit ratings and, when they publish individual rating actions, to tailor those disclosures appropriately to each such rating action. NRSROs will therefore bear one-time costs to develop a template for the form and to produce any disclosures that can be standardized across and within various credit rating classes, asset classes, and types of rating actions. As part of this process, NRSROs will likely identify the required disclosure items that, based on their individual credit rating methodologies and procedures, may share common elements across these various subgroups. For example, some or all of the disclosure required by paragraph (a)(1)(ii)(C) of Rule 17g-7 (with respect to the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating) can likely be standardized across credit ratings generated using the same procedures and methodologies. NRSROs may then have to draft, review, and finalize any such common components of these disclosures.

NRSROs will bear additional one-time costs to establish systems, protocols, and procedures for generating and publishing the form, attestation, and certifications when required. These systems, protocols, and procedures may include processes by which the latest versions of any standardized components of the disclosures will be stored, retrieved, and input into the form when required. NRSROs may also have to consider how the other newly required information will be generated, including how analyses constructed in the process of applying their credit rating procedures and methodologies can be translated into some of the required disclosure and whether additional analyses may be required, as well as at what stage and by which staff the generation of this information will be undertaken. NRSROs also will need to establish systems, protocols, and procedures to ensure that the form is populated with the required information (including that any certifications received from a provider of third-party due diligence services

are attached to the form) and that the form, attestation, and certifications are published with the associated credit rating.

The amendments also will result in ongoing costs to NRSROs. At the time of any rating action that triggers the requirement, an NRSRO must produce disclosures for the particular rating action and compile these into the form. This process may include retrieving any applicable standardized components of the disclosure, revising this content if necessary to tailor it to the particular rating action, and generating and including any additional tailored content that is specific to the particular rating action. Some of the tailored components of the disclosure may be relatively straightforward because they are primarily factual in nature, such as the assigned credit rating, the identity of the obligor, security, or instrument, the version of the procedure or methodology used to determine the credit rating, and the required information relating to conflicts of interest. Other tailored components of the disclosure may require more consideration and the application of analysis that was produced in the course of producing the credit rating or the completion of additional analysis. Examples of required disclosure items that may require more consideration or analysis include the explanation or measure of the potential volatility of the credit rating and the information on the sensitivity of the credit rating to assumptions made by the NRSRO required by paragraphs (a)(1)(ii)(K) and (a)(1)(ii)(M) of Rule 17g-7.

NRSROs also will bear ongoing costs to review the form, include any relevant hyperlinks, attach applicable attestations and certifications to the form, and to publish the form as required. Also, NRSROs will periodically need to update the standardized components of the disclosures (for example, when methodologies are revised). The Commission's estimates of the total costs of these compliance efforts – which are based on analyses for purposes of the PRA – are provided below.

The Commission received comments identifying costs and burdens, including significant administrative, recordkeeping, technological, and compliance costs, including costs associated with time spent by rating analysts and other NRSRO employees in complying with the proposed amendments.¹³⁶⁴ Commenters also expressed concerns about the potential for the publication of confidential or proprietary information.¹³⁶⁵ As stated above, the Commission is sensitive to the costs resulting from its rules. In this regard, the Commission has modified the amendments from the proposal in a number of ways to mitigate burdens. The Commission narrowed the scope of rating actions that will trigger the disclosure requirement and provided an exemption for certain rating actions involving foreign obligors or foreign-issued securities or money market instruments. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. All of these modifications were made in response to concerns about burdens raised by commenters. The Commission also has clarified the type of information that is required to be included in the form, which may address concerns about burdens as well as concerns about the disclosure of confidential information raised by commenters.

One NRSRO commented that the Commission, in the proposing release, had underestimated the burden associated with the form because the proposed disclosure items would not be able to be standardized across rating actions or asset class types and would require an individual analysis of the rated transaction.¹³⁶⁶ While the Commission encourages NRSROs to make the disclosures as specific to the particular rating action and as relevant to investors as possible, it also believes, as discussed above, that NRSROs will be able to develop disclosures

¹³⁶⁴ See Kroll Letter; Morningstar Letter; S&P Letter.

¹³⁶⁵ See Barnard Letter; Siff Letter.

¹³⁶⁶ See Morningstar Letter.

that are standardized to some degree for particular types of credit ratings and, when they publish individual rating actions, to tailor those disclosures appropriately to each such rating action.

Compliance costs should vary across NRSROs due to differences in the number of sectors (such as asset classes, industries, and geographies) rated – which may affect the number of standardized disclosures that will be created – and the number of rating actions each year subject to the requirements, as well as the frequency with which the NRSROs change their approaches to producing credit ratings or the sectors for which they produce credit ratings, and any differences in the complexity of rating procedures and methodologies that may impact the complexity of the forms. However, based on analysis for purposes of the PRA, the Commission estimates that the amendments to paragraph (a) of Rule 17g-7 will result in total industry-wide one-time costs to NRSROs of approximately \$15,613,000 and total industry-wide annual costs to NRSROs of approximately \$196,783,000.¹³⁶⁷

Given that some of the compliance costs associated with creating and revising standardized disclosures may not scale proportionately with size, and that costs should also vary across NRSROs for the other reasons listed above, these amendments may negatively affect competition through the disproportionate burden on small NRSROs and, for example, NRSROs with procedures and methodologies that would result in more complex disclosure.¹³⁶⁸ The amendments also may result in other costs. The Commission received comments from NRSROs expressing concerns about potential delays in the issuance of ratings.¹³⁶⁹ The Commission is

¹³⁶⁷ See section V.H. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.6. of this release.

¹³⁶⁸ See section IV.D.6. of this release for the Commission's estimates of the different components of the compliance burden and a further discussion of how they may vary across NRSROs. See also section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

¹³⁶⁹ See S&P Letter; DBRS Letter.

sensitive to concerns that, in some instances, the need to draft and review these additional disclosures may delay NRSROs in publishing preliminary and initial credit ratings, may result in NRSROs taking fewer rating actions, may result in NRSROs taking more time to take rating actions in response to changing conditions, and may particularly extend the amount of time required for NRSROs to take steps which would require the NRSRO to revise the standardized language prepared for the disclosures for certain asset classes or other sectors, such as making appropriate changes to credit rating methodologies. Commenters also predicted a decline in the transparency of credit ratings over time due to the increased standardization of disclosure, and raised concerns that very extensive disclosures could overwhelm users of credit ratings or obfuscate key points.¹³⁷⁰ As mentioned above, though section 15E(s)(3) identifies specific qualitative and quantitative information that must be included in the form, the Commission has modified the amendments from the proposals in a number of ways to mitigate burdens, which may reduce the likelihood or extent of such impacts. However, any such effects may reduce the information readily available to users of credit ratings and thus reduce the efficiency of their investment decisions and potentially the efficiency of the overall market.¹³⁷¹

The Commission considered the costs and benefits of reasonable alternatives to the amendments. Section 15E(s)(3) of the Exchange Act identifies a significant amount of information that the Commission's rule must require to be disclosed in the form. Because the statute is specific about the type of information to be included in the form, and the information thus detailed by the statute is quite comprehensive, the rule text prescribing the required contents of the form largely mirrors the statutory text. However, the Commission has applied some

¹³⁷⁰ See A.M. Best Letter; DBRS Letter; Kroll Letter; Morningstar Letter.

¹³⁷¹ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

discretion with respect to the format of the form and which rating actions must be accompanied by the forms and certifications. One alternative to the approach in the amendments would be to prescribe a specific form in which NRSROs would input the information required by the amendments. Requiring NRSROs to use a standardized form could assist users of the form in locating and analyzing items of information disclosed. On the other hand, a standardized form with line items and fields to input information could cause NRSROs to provide disclosures that are less thorough or tailored to their individual approaches, which could reduce transparency. The Commission believes the approach it has taken in requiring that the content of the forms be disclosed in numbered items that are presented in a consistent order across NRSROs, without, for example, requiring that a prescribed form be filled out, strikes an appropriate balance in implementing section 15E(s)(2) of the Exchange Act between the comparability of the information provided and the flexibility to allow for meaningful disclosure.

Other alternatives would be, as the Commission proposed, to require the forms to be disclosed even with affirmations or withdrawals that are not based on the NRSRO applying its procedures and methodologies for determining credit ratings or, as the Commission proposed, to require broader disclosures of representations, warranties, and enforcement mechanisms. However, the additional information that these alternatives would make available to users of credit ratings would likely not be significant, while, as raised by several commenters,¹³⁷² the burden to create these additional disclosures could be substantial.

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As discussed above, commenters raised concerns regarding the rating actions that would trigger the disclosure requirement. See A.M. Best Letter; ASF Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter. Commenters also raised concerns regarding the disclosures of representations, warranties and enforcement mechanisms. See DBRS II Letter. See also DBRS PRA Letter; Kroll PRA Letter; Moody's PRA Letter.

H. THIRD-PARTY DUE DILIGENCE FOR ASSET-BACKED SECURITIES

Section 932(a)(8) of the Dodd-Frank Act amended section 15E of the Exchange Act to add paragraph (s)(4), "Due diligence services for asset-backed securities," which contains four provisions regarding due diligence services relating to an Exchange Act-ABS.¹³⁷³ Specifically, section 15E(s)(4)(A) requires the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.¹³⁷⁴ Section 15E(s)(4)(B) requires that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide written certification in a format provided in section 15E(s)(4)(C) to any NRSRO that produces a rating to which such services relate.¹³⁷⁵ Section 15E(s)(4)(C) requires the Commission to establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B) to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate credit rating.¹³⁷⁶ Finally, as discussed above in section II.G.5. of this release, section 15E(s)(4)(D) of the Exchange Act directs the Commission to adopt rules requiring an NRSRO, at the time at which it produces a credit rating, to disclose the certification required by section 15E(s)(4)(B) to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by a third party.¹³⁷⁷

¹³⁷³ See Pub. L. No. 111-203, 932(a)(8); 15 U.S.C. 78o-7(s)(4). As stated above in section I.B.1. of this release, the term Exchange Act-ABS as used throughout this release refers to an asset-backed security as defined in section 3(a)(79) of the Exchange Act. 15 U.S.C. 78c(a)(79).

¹³⁷⁴ See 15 U.S.C. 78o-7(s)(4)(A).

¹³⁷⁵ See 15 U.S.C. 78o-7(s)(4)(B).

¹³⁷⁶ See 15 U.S.C. 78o-7(s)(4)(C).

¹³⁷⁷ See 15 U.S.C. 78o-7(s)(4)(D).

The Commission proposed amendments to Rule 314 of Regulation S-T and Form ABS-15G, and proposed Rule 15Ga-2 to implement section 15E(s)(4)(A) of the Exchange Act.¹³⁷⁸

The Commission proposed amendments to Rule 17g-7 and proposed Rule 17g-10 and related Form ABS Due Diligence-15E to implement sections 15E(s)(4)(B), (C), and (D) of the Exchange Act.¹³⁷⁹ The proposals, comments received on the proposals, and final rules are discussed below.

1. New Rule 15Ga-2 and Amendments to Form ABS-15G

The Commission re-proposed rules to implement section 15E(s)(4)(A) of the Exchange Act, which requires that an issuer or underwriter of any Exchange Act-ABS make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.¹³⁸⁰ In October 2010, the Commission proposed to implement section 15E(s)(4)(A) of the Exchange Act as part of a set of rules proposed to implement section 945 of the Dodd-Frank Act.¹³⁸¹ After reviewing the comments to that proposal regarding issuer review of assets in offerings of asset-backed securities,¹³⁸² the Commission was persuaded that section 15E(s)(4)(A) of the Exchange Act, when considered in the context of sections 15E(s)(4)(B), (C), and (D),¹³⁸³ should be interpreted more narrowly than in the proposal.¹³⁸⁴ Therefore, the

¹³⁷⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466-33471.

¹³⁷⁹ See id. at 33465, 33471-33476.

¹³⁸⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466-33471.

¹³⁸¹ See Issuer Review of Assets in Offerings of Asset-Backed Securities, Securities Act Release No. 9150 (Oct. 13, 2010), 75 FR 64182 (Oct. 19, 2010).

¹³⁸² See, e.g., comment letters from the American Bar Association (stating that “[section] 15E(s)(4)(A) was not intended to be applied to all manner of third-party due diligence reports that may be obtained by an issuer or underwriter, but instead was intended to be applied more narrowly, to any third-party due diligence report prepared for an ABS issuer or underwriter specifically for the purpose of sharing it with a given NRSRO”) and the National Association of Bond Lawyers. The comment letters are available at <http://www.sec.gov/comments/s7-26-10/s72610.shtml>.

¹³⁸³ See 15 U.S.C 78o-7(s)(4)(A) through (D), which relate to due diligence performed by third parties with respect to Exchange Act-ABS.

Commission re-proposed Rule 15Ga-2 to require an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS-15G¹³⁸⁵ containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.¹³⁸⁶ The Commission also proposed that if Form ABS-15G was furnished by the issuer, it must be signed by the senior officer of the depositor in charge of securitization, and if Form ABS-15G was furnished by the underwriter, then it must be signed by a duly authorized officer of the underwriter.¹³⁸⁷

In addition, the Commission proposed that an issuer or underwriter would not need to furnish Form ABS-15G if it obtains a representation from an NRSRO engaged to produce a credit rating for the Exchange Act-ABS that the NRSRO will publicly disclose the findings and conclusions of the third-party due diligence report obtained by the issuer or underwriter.¹³⁸⁸ As proposed, the NRSRO's representation must state that it will make the disclosure with the publication of the credit rating five business days prior to the first sale in the offering in the form generated pursuant to proposed paragraph (a)(1) of Rule 17g-7.¹³⁸⁹ In this context, the Commission stated in the proposing release that the term publicly disclose means to make the

¹³⁸⁴ See Issuer Review of Assets in Offerings of Asset-Backed Securities, Securities Act Release No. 9176 (Jan. 20, 2011), 76 FR 4231 (Jan. 25, 2011).

¹³⁸⁵ As discussed below, Form ABS-15G is being amended today to incorporate Rule 15Ga-2. Form ABS-15G was originally adopted for the purpose of providing disclosures required by the new disclosure requirements of Rule 15Ga-1 (17 CFR 240.15Ga-1). See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4499-4501.

¹³⁸⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466-33470, 33538. The Commission stated in the proposing release that the term issuer would mean the depositor or sponsor that participates in the issuance of Exchange Act-ABS, which was consistent with proposed Rule 17g-10, but did not include a definition of issuer within proposed Rule 15Ga-2. The Commission proposed to define the term third-party due diligence report to mean any report containing findings and conclusions relating to due diligence services as defined in paragraph (c)(1) of Rule 17g-10, as proposed. See *id.* at 33467, n.532.

¹³⁸⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466-33470.

¹³⁸⁸ See *id.* at 33466-33470, 33538.

¹³⁸⁹ See *id.*

findings and conclusions readily available to any users of credit ratings.¹³⁹⁰ Consequently, an NRSRO that agreed to make the findings and conclusions available only to its subscribers or prospective investors in the Exchange Act-ABS would not satisfy this proposed requirement. The Commission recognized, however, that there may be instances where, notwithstanding an issuer's or underwriter's reasonable reliance on a representation by an NRSRO, the NRSRO fails to make the required information publicly available in the form pursuant to proposed paragraph (a)(1) of Rule 17g-7 five business days prior to the first sale in the offering.¹³⁹¹ Therefore, the Commission proposed to require that if the NRSRO failed to make the information publicly available, an issuer or underwriter must furnish, two business days prior to the first sale in the offering, Form ABS-15G with the information required by proposed Rule 15Ga-2.¹³⁹²

The Commission did not propose to require that disclosure about a third-party due diligence report for registered Exchange Act-ABS transactions required by proposed Rule 15Ga-2 be provided in the prospectus because such information only pertains to the findings and conclusions of a third-party due diligence report relevant to the determination of a credit rating.¹³⁹³ Under Rule 193,¹³⁹⁴ on the other hand, if an issuer were to use the third-party due diligence report in connection with its review of disclosure in the prospectus about the pool assets as required under Rule 193, it would be required to include the findings and conclusions in the prospectus¹³⁹⁵ and, if the issuer attributed the findings and conclusions to the third party, that

¹³⁹⁰ See *id.* at 33468, n.534.

¹³⁹¹ See *id.* at 33468. Under the proposal, an NRSRO's failure to disclose the certification would be a violation of the requirement in proposed paragraph (a)(2) of Rule 17g-7. See *id.* at 33540-33541.

¹³⁹² See *id.* at 33468, 33538.

¹³⁹³ See *id.* at 33469.

¹³⁹⁴ See 17 CFR 230.193. Rule 193 implemented section 945 of the Dodd-Frank Act by requiring that any issuer registering the offer and sale of an Exchange Act-ABS perform a review of the assets underlying the asset-backed security.

¹³⁹⁵ See 17 CFR 229.1111.

third party's consent to be named as an expert in the registration statement would need to be obtained.¹³⁹⁶

The Commission also proposed that Rule 15Ga-2 would apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS.¹³⁹⁷ Accordingly, if a municipal entity that sponsors or issues Exchange Act-ABS ("municipal Exchange Act-ABS") or an underwriter of municipal Exchange Act-ABS obtained a third-party due diligence report, as defined by the proposed rule, and the municipal Exchange Act-ABS is to be rated by an NRSRO, the proposal noted that Rule 15Ga-2 would apply.¹³⁹⁸ The Commission proposed to permit municipal securitizers of Exchange Act-ABS, or underwriters in the offering, to provide the information required by Form ABS-15G on the Electronic Municipal Market Access system ("EMMA").¹³⁹⁹

Commenters generally supported the overarching principle of proposed Rule 15Ga-2 but were mixed about the specifics of how the rule should be implemented.¹⁴⁰⁰ As a result, the Commission is adopting Rule 15Ga-2 and revised Form ABS-15G with some revisions to address comments and to make clarifying changes.¹⁴⁰¹ Commenters generally agreed that Rule

¹³⁹⁶ See Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 FR 4238.

¹³⁹⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33469.

¹³⁹⁸ See id. at 33469.

¹³⁹⁹ See id. at 33469, 33538.

¹⁴⁰⁰ See, e.g., CRE Letter (stating that it "does not oppose the concept of third-party asset review and disclosure" but stated that the proposed rule and form needed "certain clarifications and modifications regarding disclosure requirements and logistics"); Deloitte Letter (stating that it "support[s] the goals of transparency and accountability underlying Section 932, but [believes] it is essential that the Commission clarify certain aspects of the proposed rule").

¹⁴⁰¹ The modifications to proposed Form ABS-15G are technical rather than substantive and include: (1) re-ordering the information supplied on the cover page to reflect the differences between Rule 15Ga-1 filings and Rule 15Ga-2 furnishings; (2) changing "file" to "furnish" wherever it relates to Rule 15Ga-2 requirements; (3) removing references to the proposed NRSRO representation allowance that is not being adopted; (4) revising the language in Item 2.02 to reflect that Rule 15Ga-2 refers to third-party due diligence reports obtained by the underwriter rather than third parties managed by the underwriter; and (5) adding "Depositor" as an option to the signature block. See Form ABS-15G.

15Ga-2 should only apply to an Exchange Act-ABS that is to be rated by an NRSRO.¹⁴⁰² The Commission continues to believe for the reasons stated in the proposing release that section 15E(s)(4)(A) of the Exchange Act should be interpreted to relate only to Exchange Act-ABS that are rated.¹⁴⁰³ Therefore, the Commission is adopting, generally as proposed, the requirement that an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO must furnish a Form ABS-15G containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, with modifications to provide limited exclusions for issuers and underwriters of Exchange Act-ABS in certain offshore transactions and municipal issuer offerings, as discussed further below.¹⁴⁰⁴ Rule 15Ga-2 applies to Exchange Act-ABS transactions that are rated by an NRSRO regardless of who pays for the credit rating, and regardless of whether the Exchange Act-ABS is sold in a registered or unregistered transaction, as described in more detail below. Several commenters suggested that the issuer's or underwriter's requirement under Rule 15Ga-2 should apply only to third-party due diligence reports that were provided to an NRSRO.¹⁴⁰⁵ The Commission is not, however, limiting the applicability of Rule 15Ga-2 as these commenters suggest. The Commission does not believe it

¹⁴⁰² See, e.g., ABA Letter; ASF Letter; CRE Letter; DBRS Letter; Deloitte Letter.

¹⁴⁰³ As explained in the proposing release, the Commission continues to believe that section 15E(s)(4)(A) should be interpreted in the context of the accompanying provisions of section 15E(s)(4) to relate to a particular type of report that is relevant to the determination of a credit rating by an NRSRO. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33467-33469. This is in contrast with the October 2010 proposal, where Rule 15Ga-2 was not limited to transactions rated by NRSROs. See Issuer Review of Assets in Offerings of Asset-Backed Securities, 75 FR at 64183.

¹⁴⁰⁴ As discussed below in section II.H.2. of this release, the term issuer as defined for purposes of Rule 17g-10, includes the sponsor or depositor that participates in the issuance of Exchange Act-ABS. See paragraph (d)(2) of Rule 17g-10.

¹⁴⁰⁵ See, e.g., Deloitte Letter; DBRS Letter. Some commenters further suggested that Rule 15Ga-2 should only apply if the third-party due diligence report is actually used by the NRSRO. See ABA Letter (suggesting an additional recommendation that "Rule 15Ga-2 should not apply to an Exchange Act-ABS transaction in which the only rating that is issued is a rating that is paid for by a party other than the issuer, sponsor or underwriter"); ASF Letter; CRE Letter (stating that the third-party due diligence report should be material to the credit rating of the ABS in order for Rule 15Ga-2 to apply).

is appropriate to limit the applicability of Rule 15Ga-2 in this manner because most, if not all, third-party due diligence reports will be made available to NRSROs pursuant to Rule 17g-10.¹⁴⁰⁶ In the instance a third-party due diligence report that is obtained by the issuer or underwriter is not provided to an NRSRO under Rule 17g-10, the Commission believes it is important for these reports to be made publicly available by the issuer or underwriter in accordance with Rule 15Ga-2 in order for users of credit ratings to evaluate the level of due diligence obtained by the issuer or underwriter as compared to the due diligence services used by an NRSRO rating the securities. Similarly, the Commission is not persuaded to adopt the more restrictive interpretation suggested by some commenters that Rule 15Ga-2 should only apply when a third-party due diligence report is both provided to an NRSRO and used by that NRSRO in its credit rating determination. The Commission understands there may be instances when the NRSRO may not actually use that third-party due diligence report in determining a credit rating; however, it is not clear that an issuer or underwriter would be able to determine whether a third-party due diligence report was actually used by the NRSRO.¹⁴⁰⁷ Moreover, by not limiting Rule 15Ga-2 in this way, users of credit ratings will be able to determine if there are differences between the information provided to NRSROs, as disclosed under Rules 17g-7 and 17g-10, and the information obtained by the issuer or underwriter, as disclosed in accordance with Rule 15Ga-2, and evaluate the significance, if any, of those differences.

¹⁴⁰⁶ As discussed below in sections II.H.2. and II.H.3. of this release, Rule 17g-10 (which defines terms such as due diligence services) requires third-party due diligence providers to use new Form ABS Due Diligence-15E to make the written certification to be provided to the NRSRO under section 15E(s)(4)(B) of the Exchange Act. The form elicits information about the due diligence performed including a description of the work performed, a summary of the findings and conclusions of the third party, and the identification of any relevant NRSRO due diligence criteria that the third party intended to meet in performing the due diligence.

¹⁴⁰⁷ See, e.g., ASF Letter (stating that the "issuer or underwriter would not or may not know whether: a) an engaged NRSRO elected to disregard a report provided to it, b) an engaged NRSRO accessed and considered a report provided to a different engaged NRSRO via its Rule 17g-5 website, c) an engaged NRSRO directly retained a [third-party due diligence services] [p]rovider, or d) a non-engaged NRSRO accessed and considered a report provided to an engaged NRSRO via its Rule 17g-5 website.").

A few commenters suggested that section 15E(s)(4)(A) should not apply to privately offered, unregistered Exchange Act-ABS,¹⁴⁰⁸ while one commenter suggested that the findings and conclusions of third-party due diligence providers should not be made publicly available on EDGAR for private or confidential transactions.¹⁴⁰⁹ After considering these comments, the Commission continues to believe that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS. The Commission is not persuaded that Congress' use of the term underwriters was meant to limit the applicability of section 15E(s)(4)(A) to registered offerings, as the definition of underwriter in the Exchange Act is not explicitly limited to registered offerings.¹⁴¹⁰ Moreover, section 15E(s)(4)(A) uses the Exchange Act definition of asset-backed securities, which is much broader than the definition of asset-backed security in Regulation AB.¹⁴¹¹ The definition of asset-backed security in section 3(a)(79) of the Exchange Act expressly includes securities that are almost exclusively offered in unregistered offerings, such as CDOs.¹⁴¹² In other contexts where the Commission has adopted or proposed rules that apply to Exchange Act-ABS, those rules have been applied to both registered and unregistered offerings of asset-backed securities.¹⁴¹³ Moreover, the Commission believes there are sound policy

¹⁴⁰⁸ See ABA Letter (commenting that the use of the terms underwriter and publicly available in section 932 of the Dodd-Frank Act makes the requirement fundamentally inconsistent with private placements). See also ASF Letter (suggesting that (1) Congress may have intended to exclude unregistered offerings by the use of the term underwriter and (2) "[i]n the unregistered context, the timing related rationale for the issuer and underwriter's disclosure duty under Rule 15Ga-2 is entirely inapplicable").

¹⁴⁰⁹ See S&P Letter. This commenter does not indicate if "private or confidential transactions" means something other than unregistered offerings.

¹⁴¹⁰ See section 3(c)(20) of the Exchange Act (15 USC 78c(a)(20)) which refers to the definition of underwriter set forth in the Investment Advisers Act of 1940. See also section 202(a)(20) of the Investment Advisers Act of 1940 (15 USC 80b-2(a)(20)).

¹⁴¹¹ See Item 1101(c) of Regulation AB.

¹⁴¹² See 15 U.S.C. 78c(a)(79).

¹⁴¹³ See, e.g., Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 4489.

reasons why both registered and unregistered Exchange Act-ABS offerings should be covered by section 15(E)(s)(4)(A) of the Exchange Act. The Commission believes that the benefits of making the findings and conclusions of third-party due diligence reports publicly available, which would include providing more information about the contents of these reports,¹⁴¹⁴ equally apply to registered or unregistered offerings since both types of offerings can be the subject of a credit rating.¹⁴¹⁵ The Commission continues to believe that, since section 15E(s)(4) relates to oversight of NRSROs and the ratings process and such oversight is not limited to registered offerings, it is not appropriate to exempt any particular issuers or underwriters who offer securities to U.S. investors if they receive a credit rating for the securities.¹⁴¹⁶

Commenters were also concerned that requiring issuers and underwriters to make information available for private placements would violate rules prohibiting general solicitation.¹⁴¹⁷ The Commission continues to believe, as explained in the proposing release,¹⁴¹⁸ that issuers and underwriters can disclose information required by Rule 15Ga-2 without jeopardizing their reliance on private offering exemptions and safe harbors under the Securities Act, provided the only information made publicly available on Form ABS-15G is required by the rule, and the issuer does not otherwise use Form ABS-15G to offer or sell securities in a manner

¹⁴¹⁴ As discussed below, the Commission believes this information would necessarily include the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those criteria. See instruction to paragraph (a) of Rule 15Ga-2.

¹⁴¹⁵ As noted above, one commenter suggested the rule should not apply to "private or confidential transactions." To the extent such transactions are rated, the Commission believes the disclosures required by Rule 15Ga-2 would be equally beneficial to an assessment of the resulting credit ratings.

¹⁴¹⁶ As discussed below, issuers and underwriters of municipal Exchange Act-ABS are being excluded from the requirements of Rule 15Ga-2 but will continue to be subject to the statutory obligation under section 15E(s)(4)(A) to make the findings and conclusions of any third-party due diligence reports they obtain publicly available.

¹⁴¹⁷ See, e.g., ABA Letter.

¹⁴¹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33469.

that conditions the market for offers or sales of its securities. Moreover, issuers are now permitted to engage in general solicitation or general advertising if they are offering and selling securities pursuant to Rule 506(c) or Rule 144A under the Securities Act, provided that all purchasers of the securities are accredited investors and the issuer has taken reasonable steps to verify that such purchasers are accredited investors, for Rule 506(c) offerings, or qualified institutional buyers, for Rule 144A offerings.¹⁴¹⁹

Commenters suggested that Rule 15Ga-2 should exclude offshore transactions.¹⁴²⁰ The Commission agrees that, in light of the practical and legal considerations raised by commenters, certain offshore transactions should be exempted and is adopting revisions to provide that Rule 15Ga-2 as well as section 15E(s)(4)(A) will not apply to certain offshore offerings of Exchange Act-ABS,¹⁴²¹ consistent with revisions being adopted in Rule 17g-7.¹⁴²² Under this exemption, the requirements of Rule 15Ga-2 and section 15E(s)(4)(A) will not apply to an offering of Exchange Act-ABS if: (1) the offering is not required to be, and is not, registered under the Securities Act; (2) the issuer of the rated security is not a U.S. person (as defined under

¹⁴¹⁹ See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 9415 (July 10, 2013), 78 FR 44771 (July 24, 2013).

¹⁴²⁰ See ABA Letter (indicating that the application of Rule 15Ga-2 to offshore transactions invokes the same issues identified in connection with the extra-territorial application of paragraph (a)(3) of Rule 17g-5 and may conflict with foreign securities laws, stock exchange rules, and other applicable laws, rules, and regulations); DBRS Letter.

¹⁴²¹ See paragraph (e) of Rule 15Ga-2.

¹⁴²² As discussed above in section II.G.1. of this release, paragraph (a)(3) of Rule 17g-7 provides an exemption from the requirement that NRSROs publish a form and any required third-party due diligence certifications when taking a rating action if the rated obligor or issuer of the rated security is not a U.S. person and if the NRSRO has a reasonable basis to conclude that the security will be offered and sold upon issuance and that any underwriter or arranger linked to the security will effect transactions in the security after issuance only in transactions outside the United States. See paragraph (a)(3) of Rule 17g-7. While one commenter requested that the Commission adopt an exemption for foreign transactions in Rule 15Ga-2 similar to that proposed in the credit risk retention rules, the Commission believes it is more appropriate for this exemption to be aligned with the exemption in Rule 17g-7 so that there is a consistent approach to determining when the Commission's NRSRO rules apply to offshore transactions. See ABA Letter.

Securities Act Rule 902(k));¹⁴²³ and (3) the security issued by the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States.¹⁴²⁴

Several commenters provided views on the proposed timeframe for furnishing Form ABS-15G. One commenter noted that the proposed five business day timeframe parallels a requirement in the proposed revisions to asset-backed securities regulations (“Regulation AB II”)¹⁴²⁵ and suggested that, in the event the timeframe is shortened in the adopted Regulation AB II rules, then a corresponding change under Rule 15Ga-2 should be made.¹⁴²⁶ This commenter also suggested that Rule 15Ga-2 should not impose a deadline for furnishing Form ABS-15G in an unregistered offering that differs from the time an NRSRO is required to publish its report under Rule 17g-7.¹⁴²⁷ Another commenter stated that the proposed five business day delay prior to the first sale in an offering under Regulation AB II would be unnecessarily long in many circumstances.¹⁴²⁸ Another commenter, however, stated that the proposed five business day timeframe prior to a first sale would not be sufficient time for an NRSRO to review most issuances of asset-backed securities,¹⁴²⁹ while one commenter supported the proposed five

¹⁴²³ 17 CFR 230.902(k).

¹⁴²⁴ See paragraph (a)(3) of Rule 17g-7.

¹⁴²⁵ See Asset-Backed Securities, Securities Act Release No. 9117 (Apr. 7, 2010), 75 FR 23328 (May 3, 2010) (proposing release); Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities, Securities Act Release No. 9244 (July 26, 2011), 76 FR 47948 (Aug. 5, 2011).

¹⁴²⁶ See ASF Letter (noting that the timeframes for Rule 15Ga-2 and Regulation AB II should match because they both directly relate to the timing of finalizing the composition of the asset pool).

¹⁴²⁷ See id. As noted above, this commenter also suggested that Rule 15Ga-2 should not apply to unregistered offerings.

¹⁴²⁸ See FSR Letter (also stating that tying the disclosure of third-party due diligence information in the forms to accompany a credit rating prior to the first sale in an offering may not be practical and may create an impediment to prompt market access for many issuers).

¹⁴²⁹ See S&P Letter.

business day timeframe.¹⁴³⁰ After considering the comments, the Commission has decided to adopt, as proposed, the requirement that an issuer or underwriter must furnish Form ABS-15G at least five business days prior to the first sale in the offering.¹⁴³¹ The Commission believes that the proposed five business day time period strikes an appropriate balance between issuers' and underwriters' timing concerns and allows users of credit ratings, including investors, NRSROs, and other market participants, in combination with the disclosure mandated by Rules 17g-7 and 17g-10, adequate time to evaluate the extent to which the rating process has incorporated the findings and conclusions of third-party due diligence reports obtained and disclosed by the issuer and underwriter.¹⁴³² The Commission believes that adopting a deadline to furnish Form ABS-15G that matches the deadlines for an NRSRO to publish its reports under Rule 17g-7 or Rule 17g-10 would not provide enough certainty about how far in advance of sale a user of a credit rating could expect the information, because NRSROs are required to make this information available when they take a rating action, which could vary among NRSROs and Exchange Act-ABS issuances. The Commission also believes that the timeframe for Rule 15Ga-2 should not be tied to the timeframe under Regulation AB II, as they serve different purposes.¹⁴³³ Finally, for

¹⁴³⁰ See CFA/AFR Letter.

¹⁴³¹ See paragraph (a) of Rule 15Ga-2. One commenter requested that the meaning of the term first sale in the offering be clarified in the final rule. See ABA Letter. As with other regulations adopted by the Commission, the date of first sale in the offering is the date at which the purchaser makes an investment decision and commits to purchase the securities offered. See, e.g., Electronic Filing and Revision of Form D, Securities Act Release No. 8891 (Feb. 6, 2008), 73 FR 10599 (Feb. 27, 2008). See also instruction to paragraph (a) of Rule 15Ga-2.

¹⁴³² As stated above, the findings and conclusions that are made public under Rule 15Ga-2 include all third-party due diligence reports that are obtained by the issuer or underwriter, which is more than what an NRSRO may receive under Rule 17g-10 or may use and disclose under Rule 17g-7. Users of credit ratings would have five business days before the first sale to compare the totality of third-party due diligence information with what was provided to, and used by, an NRSRO, as disclosed under Rules 17g-7 and 17g-10.

¹⁴³³ As discussed in this section, the disclosure made under Rule 15Ga-2 is for the benefit of the users of credit ratings including investors looking to make an investment decision. Accordingly, the timing of the publication of third-party due diligence report findings and conclusions, which may be available far in advance of the first sale in the offering, serves a different purpose than delivery of preliminary offering

the same reasons noted above, the Commission does not believe it is appropriate to differentiate between registered and unregistered offerings under this rule, so the Commission is adopting the five business-day requirement regardless of whether the transaction is registered or exempt.

The Commission is adopting, as proposed, the requirement that a Form ABS-15G furnished by the issuer must be signed by the senior officer of the depositor in charge of securitization, and a Form ABS-15G furnished by the underwriter must be signed by a duly authorized officer of the underwriter. The Commission agrees with the commenter that suggested¹⁴³⁴ that a single Form ABS-15G may be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report and has revised the final rule to clarify this point.¹⁴³⁵ For example, if the issuer and an underwriter obtain the same third-party due diligence report related to a particular asset-backed security and the issuer timely furnishes a Form ABS-15G for that report, the underwriter has no obligation to furnish a Form ABS-15G for the same third-party due diligence report. Similarly, if a transaction has more than one underwriter, and two or more of those underwriters obtain the same third-party due diligence report related to a particular asset-backed security, only one of those underwriters must timely furnish Form ABS-15G for that report. Commenters also requested clarification that a requirement to provide the findings and conclusions of third-party due diligence reports would apply only to the initial credit rating and not to any subsequent upgrades, downgrades, or other rating actions.¹⁴³⁶ The Commission agrees that once the information has been disclosed in connection with an initial credit rating, it does not need to be furnished again in connection with

materials under Regulation AB II.

¹⁴³⁴ See ABA Letter.

¹⁴³⁵ See paragraph (b) of Rule 15Ga-2.

¹⁴³⁶ See ABA Letter; DBRS Letter.

any subsequent rating actions. Accordingly, as clarified in the instructions to the final rule, Form ABS-15G does not need to be furnished for any subsequent updates to a credit rating issued by an NRSRO.

While one commenter supported the Commission's proposed approach of defining the third-party due diligence reports covered by the rule,¹⁴³⁷ a number of other commenters wanted the definitions of third-party due diligence report and due diligence services (defined in proposed Rule 17g-10,¹⁴³⁸ which is the basis for the term third-party due diligence report in Rule 15Ga-2) to be narrowed in a variety of ways. After considering these comments, the Commission is adopting, as proposed, the definition of third-party due diligence report to mean any report containing findings and conclusions of any due diligence services (as defined in Rule 17g-10) performed by a third party.¹⁴³⁹ One commenter suggested that, in the definition of third-party due diligence report, the phrase "final report" replace the phrase "any report."¹⁴⁴⁰ The Commission is not, however, replacing the phrase "any report" with the phrase "final report," as

¹⁴³⁷ See CFA/AFR Letter (stating that they "share the view, cited by the Commission, that the variation for reviews of different types of offerings is likely to be significant and that this area therefore is better served by principles-based standards than by prescriptive rules"). However, this commenter did object to the Commission's decision to withdraw the approach proposed in the October 2010 proposal, where issuers and underwriters of registered Exchange Act-ABS would have been required to make third-party due diligence disclosures in the prospectus. The commenter suggested that the revised approach is unnecessarily complex and should be simplified.

¹⁴³⁸ A summary of comments addressing the definition of due diligence services is provided in section II.H.2. of this release.

¹⁴³⁹ See paragraph (d) of Rule 15Ga-2; see also paragraph (d)(1) of Rule 17g-10 (defining the term due diligence services). Although the Commission is not modifying the definition of third-party due diligence report, it is making some changes to, and providing guidance on some aspects of, the definition of due diligence services in Rule 17g-10. For example, as discussed below in section II.H.2. of this release, the Commission is: (1) modifying the first prong of the definition of due diligence services by replacing the phrase "quality and integrity" of the data with the word "accuracy;" (2) providing guidance that the "catchall" provision of the definition of due diligence services relates to reviews of the assets underlying the Exchange Act-ABS (as opposed to the reviews of the Exchange Act-ABS itself); and (3) providing guidance that it would not object to the inclusion of the description of the requirements and limitations resulting from relevant professional standards generally described within the reports being included in the disclosure.

¹⁴⁴⁰ See Clayton Letter.

suggested by some commenters, in part because “any report” was specified by Congress in the Dodd-Frank Act. Moreover, the Commission believes all third-party due diligence reports obtained by the issuer or underwriter, including interim reports, related to an offering of asset-backed securities should be made publicly available in order for users of credit ratings to more thoroughly evaluate the level of due diligence obtained by the issuer or underwriter as compared to the due diligence services used by an NRSRO rating the Exchange Act-ABS. One commenter requested that the Commission revise the phrase “containing the findings and conclusions” to “containing a summary of the findings and conclusions,” noting that providing a summary is more appropriate than providing the findings and conclusions themselves, and that there is no reason why the summary would not be substantially similar in each context.¹⁴⁴¹ The Commission is not adopting this alternative for several reasons. First, the Commission notes that Congress specified in the Dodd-Frank Act that “the findings and conclusions” must be made publicly available, which the Commission believes would be most appropriately interpreted as precluding a summary. Moreover, the Commission believes it is important for the third-party due diligence provider’s findings and conclusions themselves to be made public rather than an issuer or underwriter’s summary of those findings and conclusions because a summary runs the risk of excluding information that could be important to a user of credit ratings.¹⁴⁴² Specifically, the Commission believes that disclosure of the findings and conclusions necessarily requires disclosure of the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those

¹⁴⁴¹ See ABA Letter.

¹⁴⁴² As noted above, the Commission believes users of credit ratings should be able to compare the totality of third-party due diligence information with what was provided to, and used by, an NRSRO, as disclosed under Rules 17g-7 and 17g-10.

criteria.¹⁴⁴³ The Commission is also revising the rule to clarify that the term issuer is defined in Rule 17g-10.¹⁴⁴⁴

Several commenters objected to the proposal that an issuer or underwriter would not be required to furnish Form ABS-15G if it reasonably relies upon the representation from an NRSRO rating the transaction that the NRSRO will publicly disclose the required information five business days prior to the first sale in the offering.¹⁴⁴⁵ One commenter supported this part of the proposal, noting that it could reduce duplicative disclosures.¹⁴⁴⁶ After considering these comments, the Commission is not adopting this part of the proposal. While the Commission would like to avoid duplicative disclosure wherever possible, it has determined that the representation may be difficult to implement in practice. NRSROs generally opposed this proposal,¹⁴⁴⁷ and a number of NRSROs, as well as a trade organization with NRSRO members, noted that it is unlikely that any NRSRO would make such a representation,¹⁴⁴⁸ making it unlikely that much duplicative disclosure would actually be avoided. One commenter thought

¹⁴⁴³ See instruction to paragraph (a) of Rule 15Ga-2. This is the same disclosure standard for findings and conclusions that is required under Item 1111(a)(7)(ii) of Regulation AB. See Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 FR 4238.

¹⁴⁴⁴ See paragraph (d) of Rule 15Ga-2 and paragraph (d)(2) of Rule 17g-10. As explained above, the proposing release did not include a definition of issuer in Rule 15Ga-2 but indicated that the term would be interpreted in a manner consistent with the definition in Rule 17g-10. For clarity and consistency, the Commission has revised the rule text to expressly refer to the definition in Rule 17g-10.

¹⁴⁴⁵ See CRE Letter; DBRS Letter; Moody's Letter; Morningstar Letter; S&P Letter.

¹⁴⁴⁶ See Deloitte Letter.

¹⁴⁴⁷ See, e.g., Moody's Letter (strongly opposing the exemption because the commenter believes: (1) it is contrary to the express intent of Congress to promote greater transparency and accountability among Exchange Act-ABS issuers; (2) it is contrary to the efforts of Congress, the Commission and others to clarify the limited role of credit rating agencies in the financial markets; (3) it is unlikely to reduce the potential for multiple, inconsistent disclosures about the due diligence services; and (4) it will create incentives for issuers and underwriters to select NRSROs who are willing to make these representations). See also S&P Letter (stating that issuers and underwriters should bear this obligation because NRSRO disclosure of the required information could confuse investors regarding who is providing the required information).

¹⁴⁴⁸ See CRE Letter (suggesting that the rule allow NRSROs and underwriters to rely on disclosure made by issuers); Morningstar Letter; S&P Letter.

that there could be a potential for discrepancies in the representations made by NRSROs that operate under the subscriber-pay business model and the issuer-pay model. This commenter noted that these NRSROs could be in compliance with Rule 17g-7, as proposed to be amended, without actually making the findings and conclusions of a third-party due diligence report publicly available.¹⁴⁴⁹ As explained in the proposing release, an NRSRO that operates under the subscriber-pay model (rather than the issuer-pay model) and only makes the third-party due diligence findings and conclusions available to its subscribers would not be able to make a representation to an issuer or underwriter that it is making the required information publicly available.¹⁴⁵⁰ Consequently, this may give issuer-paid NRSROs a competitive advantage over subscriber-paid NRSROs. Further, the disclosure of the findings and conclusions in the third-party due diligence report made by an NRSRO would need to be as comprehensive as what is required for issuers and underwriters under Rule 15Ga-2 in order to make such a representation. Because Rule 17g-7 only requires that an NRSRO disclose a description of the findings and conclusions, NRSROs, issuers, and underwriters would have to make judgments as to whether the disclosure made in accordance with Rule 17g-7 meets the standard for disclosure of the findings and conclusions under Rule 15Ga-2, as set forth in the instruction to paragraph (a) of Rule 15Ga-2, before an NRSRO could make, or an issuer or underwriter could rely, on such a representation. In addition, if issuers and underwriters were allowed to rely on such a representation in order to not furnish Form ABS-15G, there would be no central location where

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See ASF Letter. As discussed above in section II.G.1. of this release, Rule 17g-7, as proposed to be amended, required, in part, that NRSROs must, when taking a rating action, publish and make available to the same persons who can receive or access the credit rating that is the result or the subject of the rating action, a form and any written certification received by the NRSRO from a provider of third-party due diligence services under section 15E(s)(4)(B) of the Exchange Act. The form would include, among other things, a description of the findings or conclusions of any third-party due diligence services used by the NRSRO.

¹⁴⁵⁰

See Nationally Recognized Statistical Rating Organizations, 76 FR at 33468, n.534.

users of credit ratings could obtain the findings and conclusions of all third-party due diligence reports on Exchange Act-ABS. Finally, allowing issuers and underwriters to rely on a representation may have resulted in gaps in the information that is disclosed on Form ABS-15G.¹⁴⁵¹ These results would impair the intended benefits of the rule. Based on the totality of comments and the implications of allowing issuers and underwriters to rely on a representation from an NRSRO in lieu of furnishing Form ABS-15G, the Commission has determined that the potential benefit of eliminating redundant disclosure by allowing the representation does not justify the uncertainty and costs that it may create.

As stated above, the Commission continues to believe that there is no need to separately require that disclosure provided in connection with Rule 15Ga-2 about any third-party due diligence report be provided in the prospectus for a registered offering.¹⁴⁵² The Commission considered one commenter's suggestion that a separate database be created where all third-party due diligence report findings and conclusions could be centralized.¹⁴⁵³ The Commission, however, believes that the EDGAR system is the more appropriate place for issuers and underwriters to make this information publicly available. When information is electronically filed with the Commission on the EDGAR system, investors, market participants, and Commission staff can access the information from a single, permanent, and centralized location. Creating a new system may be duplicative and may result in additional costs for issuers and underwriters beyond those that would be incurred by using the EDGAR system without providing a significant improvement in making the information available to users of credit

¹⁴⁵¹ See, e.g., Moody's Letter; S&P Letter.

¹⁴⁵² Whether the findings and conclusions of a third-party are part of the Rule 193 review and, therefore, included in the prospectus disclosure is dictated by the requirements of Rule 193 and Item 1111 of Regulation AB. See 17 CFR 230.193; 17 CFR 229.1111.

¹⁴⁵³ See CFA/AFR Letter.

ratings. The additional costs incurred by issuers and underwriters of registered Exchange Act-ABS offerings by having to furnish Form ABS-15G on the EDGAR system should be incremental,¹⁴⁵⁴ as they are already required to file other forms and documents on EDGAR. Issuers and underwriters of unregistered Exchange Act-ABS offerings, however, may incur higher costs compared to those conducting registered offerings if they need to adjust their systems or engage outside counsel to prepare and furnish Form ABS-15G on EDGAR.¹⁴⁵⁵

Commenters noted that issuers of registered offerings may incorporate third-party reviews into their registration statement disclosure in order to comply with the review of the underlying assets required by Rule 193. One of these commenters suggested that when disclosures under both Rule 193 and Rule 15Ga-2 might otherwise be required, the Rule 193 disclosures should suffice for both purposes.¹⁴⁵⁶ Another commenter encouraged the Commission to enhance the efficiency of this new regulatory framework by including an exception that where disclosures about third-party due diligence services comply with Rule 193, those same services would not be subject to Rule 15Ga-2.¹⁴⁵⁷ After considering these comments, the Commission has revised Rule 15Ga-2 to reflect that if the disclosure required by Rule 15Ga-2 has been made in the prospectus (including an attribution to the third party that provided the due diligence report),¹⁴⁵⁸ and the prospectus is publicly available at the time Form ABS-15G is

¹⁴⁵⁴ See section IV.D.10. of this release (discussing the PRA burden resulting from this requirement).

¹⁴⁵⁵ The Commission notes, however, that issuers and underwriters of unregistered Exchange Act-ABS offerings who already file Form ABS-15G on EDGAR in accordance with Rule 15Ga-1 should not incur these additional costs.

¹⁴⁵⁶ See CRE Letter.

¹⁴⁵⁷ See Deloitte Letter (noting that when issuers hire third parties to conduct the Rule 193 due diligence review, the disclosures required under Rule 193 will be substantially similar to the disclosures made about the same findings and conclusions in the context of the rules adopted under section 932).

¹⁴⁵⁸ The Commission does not intend for all third parties from whom the issuer obtains a third-party due diligence report, as defined in Rule 15Ga-2, to be named in the registration statement and consent to being named as an expert solely because an issuer furnishes Form ABS-15G. If the issuer's prospectus disclosure attributes the findings and conclusions of the Rule 193 review to the third party from whom it obtains a

furnished by the issuer or underwriter, the issuer or underwriter may refer to that section of the prospectus in Form ABS-15G rather than providing the findings and conclusions directly in Form ABS-15G.¹⁴⁵⁹ This does not, however, exempt an issuer or underwriter from the requirements of Rule 15Ga-2, including its duty to furnish Form ABS-15G. The Commission continues to believe that, in addition to disclosures made by the NRSROs, Form ABS-15G is the most appropriate place to find information about a particular type of report that is relevant to the determination of a credit rating by an NRSRO.

Two comments submitted in response to the proposing release related to the impact on municipal issuers and underwriters. One commenter cautioned the Commission against imposing the new Exchange Act-ABS disclosure requirements on the municipal securities market until the completion of the reports on municipal securities mandated by the Dodd-Frank Act.¹⁴⁶⁰ The Commission notes that the reports required by sections 976 and 977 of the Dodd-Frank Act have been completed by the GAO and have not resulted in any legislative changes to disclosure requirements applicable to municipal issuers at this time.¹⁴⁶¹ This commenter recommended that the Commission exempt municipal securities from the proposed disclosure requirements to avoid creating confusion for investors and issuers in case different classes of municipal securities are subject to different requirements in the future.¹⁴⁶² Another commenter

third-party due diligence report, however, the third-party would be required to be named in the registration statement and consent to being named as an expert in accordance with Rule 436 under the Securities Act. See Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 FR 4231.

¹⁴⁵⁹ See paragraph (c) of Rule 15Ga-2.

¹⁴⁶⁰ See ICI Letter.

¹⁴⁶¹ See <http://www.gao.gov/assets/590/587714.pdf>. The Commission also issued a comprehensive report on the municipal securities market in July 2012. See Commission Report on the Municipal Securities Market, available at <http://www.sec.gov/news/studies/2012/munireport073112.pdf> ("2012 Report on the Municipal Securities Market").

¹⁴⁶² See ICI Letter.

supported the proposal to allow municipal securitizers or underwriters of municipal Exchange Act-ABS to provide the required information on EMMA.¹⁴⁶³

The Commission also has considered the comments objecting to requiring municipal issuers and underwriters to comply with Rule 15Ga-2, which were submitted in response to the October 2010 proposal.¹⁴⁶⁴ A number of these commenters expressed the view that sections 15B(d)(1) and 15B(d)(2) of the Exchange Act, known collectively as the “Tower Amendment,”¹⁴⁶⁵ expressly prohibit the Commission and the Municipal Securities Rulemaking Board (“MSRB”) from requiring an issuer of municipal securities to make any specific disclosure filing with the Commission or MSRB prior to the sale of these securities to investors.¹⁴⁶⁶ After considering these comments, the Commission has determined that issuers and underwriters of municipal Exchange Act-ABS should be excluded from the requirements of Rule 15Ga-2. The Commission notes that, in reaching this determination, it does not find it necessary to determine whether the Tower Amendment applies in this situation and no inference should be drawn from this determination regarding the Commission’s analysis of the Tower Amendment. In light of the fact that municipal issuers and underwriters will remain subject to the statutory requirement in section 15E(s)(4)(A) of the Exchange Act to make the findings and conclusions of any third-party due diligence reports publicly available, and given the Commission’s historical approach of not requiring municipal issuers to file disclosures with the

¹⁴⁶³ See DBRS Letter.

¹⁴⁶⁴ Issuer Review of Assets in Offerings of Asset-Backed Securities, 75 FR 64182.

¹⁴⁶⁵ 15 USC 78o-4. See also 2012 Report on the Municipal Securities Market, at 27-28.

¹⁴⁶⁶ See, e.g., letter from Group of 14 Municipal Organizations dated Nov. 15, 2010, National Association of Bond Lawyers dated Nov. 19, 2010; letter from National Association of Local Housing Finance Agencies dated Nov. 15, 2010; letter from Treasurer of the State of Connecticut dated Nov. 15, 2010; letter from National Council of State Housing Agencies dated Nov. 15, 2010; and letter from Robert W. Scott dated Nov. 19, 2010 (each letter submitted in response to the October 2010 proposal).

Commission in connection with the issuance of securities, the Commission is persuaded that, as a policy matter, it is unnecessary to apply Rule 15Ga-2 to municipal issuers and underwriters.¹⁴⁶⁷

Under the exclusion, the requirements of Rule 15Ga-2 will not apply to issuers and underwriters of an offering of Exchange Act-ABS if: (1) the issuer of the rated security is a municipal issuer; and (2) the offering is not required to be registered under the Securities Act. A municipal issuer is defined as an issuer (as that term is defined in paragraph (d)(2) of Rule 17g-10) that is any State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory, or the District of Columbia, or any public instrumentality of one or more States, Territories, or the District of Columbia. The exclusion further provides, as discussed below, that issuers and underwriters of municipal Exchange Act-ABS remain subject to the requirements of section 15E(s)(4)(A) of the Exchange Act.¹⁴⁶⁸

Although the Commission is excluding issuers and underwriters of municipal Exchange Act-ABS from the application of Rule 15Ga-2, the Commission continues to believe that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to such entities. By its terms, section 15E(s)(4)(A) applies to issuers and underwriters of “any asset-backed security,” and the Commission believes the intended benefits of greater transparency with respect to the credit rating process apply equally to credit ratings of municipal Exchange Act-ABS.¹⁴⁶⁹ The Commission also notes that section 15E(s)(4)(A) requires issuers and underwriters to make the

¹⁴⁶⁷ Municipal securitizers continue to be subject to Rule 15Ga-1. As the Commission noted at the time Rule 15Ga-1 was adopted, section 943 of the Dodd-Frank Act, pursuant to which Rule 15Ga-1 was adopted, is a stand-alone statutory provision that does not expressly provide the Commission with authority to provide exemptions for particular classes of securitizers, including municipal securitizers. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4493.

¹⁴⁶⁸ See paragraph (f) of Rule 15Ga-2.

¹⁴⁶⁹ As discussed above, the Commission believes that section 15E(s)(4)(A) of the Exchange Act should be interpreted to apply to issuers and underwriters of both registered and unregistered offerings of Exchange Act-ABS.

specified information publicly available and does not mandate filing with the Commission, which was the specific concern the Tower Amendment sought to address. Consequently, although municipal issuers and underwriters will not be required to furnish Form ABS-15G pursuant to Rule 15Ga-2, they are subject to the statutory requirement under section 15E(s)(4)(A) to make publicly available the findings and conclusions of any third-party due diligence report they obtain. Municipal issuers and underwriters may make such information available through any means reasonably accessible to the public, including, for example, by posting the information on an issuer or underwriter sponsored Internet website, by voluntarily furnishing Form ABS-15G on EDGAR, or by voluntarily submitting a Form ABS-15G on EMMA.

Since the Commission is excluding issuers and underwriters of municipal Exchange Act-ABS from the application of Rule 15Ga-2, it is not adopting the proposed revisions to Rule 314, which would have permitted municipal issuers of Exchange Act-ABS, or underwriters in the offering, to provide the information required by Form ABS-15G on EMMA, as proposed. Notwithstanding the foregoing, as noted above, an issuer or underwriter of municipal Exchange Act-ABS could choose to satisfy its obligation to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter, as required by section 15E(s)(4)(A) of the Exchange Act, by voluntarily submitting a Form ABS-15G on EMMA.¹⁴⁷⁰

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The Commission adopted Rule 314 to permit municipal securitizers to satisfy the obligation to furnish the information required by Rule 15Ga-1 by filing the information on EMMA. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 4489. Accordingly, EMMA will be prepared to accept Form ABS-15G in connection with this requirement.

2. New Rule 17g-10

As stated above, section 15E(s)(4)(A) of the Exchange Act requires the issuer or underwriter of any asset-backed security to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.¹⁴⁷¹ Section 15E(s)(4)(B) of the Exchange Act requires that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide, to any NRSRO that produces a credit rating to which such services relate, written certification, in a format as provided in section 15E(s)(4)(C).¹⁴⁷² Section 15E(s)(4)(C) of the Exchange Act provides that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B) to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating.¹⁴⁷³ The Commission proposed to implement these sections through Rule 17g-10 and Form ABS Due Diligence-15E.¹⁴⁷⁴ As proposed, Rule 17g-10 would require a provider of third-party due diligence services to provide the written certification required by section 15E(s)(4)(B) of Exchange Act on Form ABS Due Diligence-15E.

The Commission is adopting Rule 17g-10 with modifications from the proposal in response to comments.¹⁴⁷⁵ As discussed below, the modifications add a “safe harbor” for the third-party due diligence provider in order to satisfy its obligations under section 15E(s)(4)(B) of

¹⁴⁷¹ See 15 U.S.C. 78o-7(s)(4)(A).

¹⁴⁷² See 15 U.S.C. 78o-7(s)(4)(B).

¹⁴⁷³ See 15 U.S.C. 78o-7(s)(4)(C).

¹⁴⁷⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR 33471-33476. Form ABS Due Diligence-15E is discussed below in section II.H.3. of this release.

¹⁴⁷⁵ See Rule 17g-10.

the Exchange Act, clarify the proposed definition of due diligence services, and make certain technical modifications.¹⁴⁷⁶

As proposed, paragraph (a) of Rule 17g-10 provided that the written certification that a person employed to provide third-party due diligence services is required to provide to an NRSRO pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence-15E.¹⁴⁷⁷ The Commission did not receive comments on paragraph (a) as proposed and is adopting the paragraph with one technical modification.¹⁴⁷⁸ As adopted, the paragraph provides that the written certification that a person employed to provide third-party due diligence services is required to provide to an NRSRO pursuant to section 15E(s)(4)(B) must be on Form ABS Due Diligence-15E.¹⁴⁷⁹

Paragraph (b) of Rule 17g-10, as proposed, provided that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.¹⁴⁸⁰ The proposed requirement was designed to ensure that the person executing the certification on behalf of the provider of third-party due diligence services has responsibilities that will make the person aware of the basis of the

¹⁴⁷⁶ See id.

¹⁴⁷⁷ See paragraph (a) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁴⁷⁸ See paragraph (a) of Rule 17g-10. The modification corrects an incorrect reference to Form ABS Due Diligence-15E in the proposal by replacing the phrase “(§ 240b.400 of this chapter)” with the phrase “(§ 249b.500 of this chapter)”.

¹⁴⁷⁹ See paragraph (a) of Rule 17g-10. Form ABS Due Diligence-15E is discussed below in section II.H.3. of this release.

¹⁴⁸⁰ See paragraph (b) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

information being provided in the form.¹⁴⁸¹ The Commission did not receive comments on paragraph (b) and is adopting the paragraph as proposed.¹⁴⁸²

As discussed above, the Commission did not receive comments specifically addressing paragraphs (a) and (b) of Rule 17g-10, as proposed.¹⁴⁸³ However, the Commission did receive comments raising concerns about how a third-party due diligence provider can meet the requirement in section 15E(s)(4)(B) of the Exchange Act, which – as discussed above – provides that in any case in which third-party due diligence services are employed by an NRSRO, issuer, or underwriter, the person providing the due diligence services shall provide, to any NRSRO that produces a rating to which such services relate, written certification in a format as provided in section 15E(s)(4)(C) of the Exchange Act.¹⁴⁸⁴

Commenters stated that the third-party due diligence provider or NRSRO may not know the identities of the NRSROs producing credit ratings to which the due diligence services relate.¹⁴⁸⁵ One of these commenters stated that the proposed requirements “unfairly place a heavy burden on the third-party due diligence provider to determine which NRSRO is rating the transaction” because this information “lies with the issuer.”¹⁴⁸⁶

The Commission anticipated this concern and, consequently, in the proposing release the Commission asked a number of questions regarding how a third-party due diligence provider could comply with section 15E(s)(4)(B) of Exchange Act and whether the Commission should

¹⁴⁸¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471.

¹⁴⁸² See paragraph (b) of Rule 17g-10.

¹⁴⁸³ As discussed below in section II.H.3. of this release, the Commission did receive comments in response to the proposed format of the Form ABS Due Diligence-15E. Those comments and the Commission’s response to the commenters are discussed in section II.H.3. of this release.

¹⁴⁸⁴ See 15 U.S.C. 78o-7(s)(4)(B).

¹⁴⁸⁵ See Clayton Letter; Deloitte Letter; S&P Letter.

¹⁴⁸⁶ See Clayton Letter.

take steps to implement the statutory requirement.¹⁴⁸⁷ One of the potential approaches identified by the Commission in the proposing release was to use the website referred to in paragraph (a)(3)(iii) of Rule 17g-5 maintained by issuers, sponsors, or underwriters of structured finance products (“Rule 17g-5 website”), as the mechanism for providing the written certification to all NRSROs producing a credit rating to which the due diligence services relate.¹⁴⁸⁸

Commenters responded that the Rule 17g-5 website would be an appropriate mechanism to provide the certification to the NRSROs.¹⁴⁸⁹ One of these commenters stated that using the Rule 17g-5 website would be “the most efficient way” to provide the certification and that it would be a better approach than applying a “reasonableness test” in terms of assessing whether the third-party due diligence provider submitted the certification to all NRSROs that are required to receive the certification.¹⁴⁹⁰ Another commenter stated that the proposed requirements should “accommodate situations” in which an NRSRO obtains the written certification indirectly from, for example, a Rule 17g-5 website.¹⁴⁹¹ An NRSRO stated that using the Rule 17g-5 websites as a “delivery mechanism for the Rule 17g-10 certification” would ensure that “certifications are supplied to all affected NRSROs at roughly the same time.”¹⁴⁹²

¹⁴⁸⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466.

¹⁴⁸⁸ See *id.* See also 17 CFR 240.17g-5(a)(3). Among other things, paragraph (a)(3) of Rule 17g-5 requires an NRSRO, among other things, to maintain on a password-protected Internet website a list of each structured finance product for which it currently is in the process of determining an initial credit rating, and to provide free and unlimited access to any NRSRO that, among other things, certifies it will access the website solely for the purpose of determining and monitoring credit ratings. Paragraph (a)(3)(iii) of Rule 17g-5 requires an NRSRO to obtain from the issuer, sponsor, or underwriter of the structured product a written representation that can reasonably be relied upon that the arranger will, among other things, maintain on a password-protected Internet website the information it provides to the NRSRO and will provide access to the website to an NRSRO that, among other things, certifies it will access the website solely for the purpose of determining and monitoring credit ratings.

¹⁴⁸⁹ See ASF Letter; Clayton Letter; DBRS Letter.

¹⁴⁹⁰ See Clayton Letter.

¹⁴⁹¹ See ASF Letter.

¹⁴⁹² See DBRS Letter.

Another alternative suggested by the Commission was to establish a centralized database administered by the Commission (such as the Commission's EDGAR system) or by market participants to be used for the purpose of providing the written certifications in accordance with section 15E(s)(4)(B) of the Exchange Act.¹⁴⁹³ An NRSRO and another commenter stated that creating a new centralized database or similar alternative for distributing the due diligence certification would be costly.¹⁴⁹⁴

Commenters suggested other alternatives.¹⁴⁹⁵ One commenter stated that the due diligence provider should be required to deliver the certification "promptly upon receipt of a written request from an NRSRO" for use by the NRSRO "in preparing its published report under Rule 17g-7."¹⁴⁹⁶ Another commenter stated that the party engaging the due diligence provider should be required to obtain the certification from the service provider and that the service provider should "be able to rely on the engaging party to transmit the form" to the required NRSROs.¹⁴⁹⁷

In the proposing release, the Commission sought comment on how soon after it completes its review the provider of third-party due diligence services should provide the written certification to all NRSROs required to receive the certification, and the Commission provided examples of potential timeframes (within twenty-four hours, two business days, or ten business

¹⁴⁹³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466.

¹⁴⁹⁴ See Clayton Letter ("[W]e do not believe that it is cost-effective for the Commission or the ABS community to have the industry adopt a new system for distributing the Form ABS Due Diligence-15E information nor do we believe it is cost-effective for such parties to have to utilize a for-profit centralized database service for such purposes, especially in light of the amount of time and resources that have already been directed to the development of the Rule 17g-5 system of distribution. And as we described above, the Rule 17g-5 system more fairly allocates responsibility for dissemination of the information among the issuer, underwriter and NRSRO."); DBRS Letter ("Mandating the creation of a new centralized database or any other costly alternative is not warranted under the circumstances.").

¹⁴⁹⁵ See ASF Letter; Deloitte Letter.

¹⁴⁹⁶ See ASF Letter.

¹⁴⁹⁷ See Deloitte Letter.

days).¹⁴⁹⁸ One commenter stated that the due diligence provider should be required to deliver the certification “promptly upon receipt of a written request from an NRSRO.”¹⁴⁹⁹ Another commenter suggested that the certification be provided five business days after the service provider finishes reviewing the data in connection with its due diligence report.¹⁵⁰⁰ One NRSRO stated that the certification should be provided “within two business days following completion of the due diligence review” and added that “all required NRSROs should be in receipt of the certification at the same time.”¹⁵⁰¹ Another NRSRO stated that the certification should be provided “within one business day after the service provider completes its review.”¹⁵⁰²

The Commission is persuaded that the final rule should provide a means for providers of third-party due diligence services to be certain that they have met their obligation under section 15E(s)(4)(B) of the Exchange Act to provide Form ABS Due Diligence-15E to any NRSRO that produces a credit rating to which the due diligence services relate.¹⁵⁰³ The Commission also is persuaded that the most efficient means of providing certainty to the providers of third-party due diligence services that they have met their obligations under section 15E(s)(4)(B) is to require the third party to provide Form ABS Due Diligence-15E to any NRSRO that specifically requests the form and to post the form on the Rule 17g-5 website maintained by the issuer, sponsor, or underwriter of the Exchange Act-ABS.¹⁵⁰⁴

¹⁴⁹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33466.

¹⁴⁹⁹ See ASF Letter.

¹⁵⁰⁰ See Clayton Letter.

¹⁵⁰¹ See S&P Letter.

¹⁵⁰² See DBRS Letter.

¹⁵⁰³ See 15 U.S.C. 78o-7(s)(4)(B).

¹⁵⁰⁴ See, e.g., DBRS Letter (“DBRS believes that the most efficient and cost-effective approach is to utilize existing regulations as much as possible. As it stands today, issuers and underwriters who hire an NRSRO to rate a structured finance product such as an Exchange Act-ABS are required to make available to other NRSROs all information the issuer or underwriter ‘contracts with a third party to provide to’ the hired NRSRO. Thus, if the issuer or underwriter contracts with a third-party service provider to supply a hired

This will provide access to the form to an NRSRO that is producing a credit rating for the Exchange Act-ABS but is unaware that the third party is conducting the due diligence services because, for example, the NRSRO is using the Rule 17g-5 website to determine an unsolicited credit rating. In addition, the third party will not be burdened with the task of trying to identify every NRSRO that is producing a credit rating to which the due diligence services relate. For these reasons, the Commission believes it is appropriate to modify Rule 17g-10 from the proposal to add a “safe harbor” provision that incorporates the Rule 17g-5 websites.

Further, as discussed above, commenters suggested relatively short timeframes for providing the written certification to the NRSROs producing a credit rating to which the due diligence services relate. The Commission agrees that the written certification should be provided soon after the provider of third-party due diligence services completes its review. As discussed below, the certification will provide information that can be used by the NRSRO in determining a credit rating for the Exchange Act-ABS. Consequently, the Commission believes the certification should be provided to the appropriate NRSROs as soon as the third party completes the review so that NRSROs can consider it in determining a credit rating for the Exchange Act-ABS before the security is issued and purchased by investors. However, prescribing a specific timeframe (such as within twenty-four hours or two days) may result in situations – depending on the circumstances – where the certification could have been provided sooner than required (for example, within minutes of it being finalized) or where practical issues would prevent it from being submitted within the required timeframe. Therefore, the Commission believes the “safe harbor” for the written certification should incorporate a “promptly” standard.

NRSRO with a due diligence report, a copy of that report would already be made available to other NRSROs pursuant to Rule 17g-5(a)(3).”).

For all the foregoing reasons, the Commission is establishing a “safe harbor” provision in paragraph (c) of Rule 17g-10 pursuant to which a person employed to provide third-party due diligence services will be deemed to have satisfied its obligations under section 15E(s)(4)(B) of the Exchange Act if the person promptly delivers an executed Form ABS Due Diligence-15E after completion of the due diligence services to: (1) an NRSRO that provided a written request for the form prior to the completion of the due diligence services stating that the services relate to a credit rating the NRSRO is producing; (2) an NRSRO that provides a written request for the form after the completion of the due diligence services stating that the services relate to a credit rating the NRSRO is producing; and (3) the issuer or underwriter of the asset-backed security for which the due diligence services relate that maintains the Rule 17g-5 website with respect to the asset-backed security.¹⁵⁰⁵ Consequently, the third-party provider of due diligence services can fulfill its obligations under the statute by responding promptly to specific requests that Form ABS Due Diligence-15E be delivered to a particular NRSRO and by promptly delivering the form to the issuer or underwriter of the Exchange Act-ABS that maintains the Rule 17g-5 website. This establishes a process that can provide certainty to the third party that it has met its obligation under section 15E(s)(4)(B) of the Exchange Act.

The Commission is making a corresponding amendment to Rule 17g-5 that is designed to provide for the prompt posting of Form ABS Due Diligence-15E to the Rule 17g-5 website so that other NRSROs can have access to it contemporaneously with an NRSRO that knew the third party was performing due diligence and requested that the form be delivered upon completion of the services.¹⁵⁰⁶ Specifically, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g-5 to

¹⁵⁰⁵ See paragraphs (c)(1) through (3) of Rule 17g-10.

¹⁵⁰⁶ See, e.g., DBRS Letter (“By adding a note to paragraph (a)(3)(iii)(C) [of Rule 17g-5], the Commission could confirm that where an issuer or underwriter contracts for the delivery of a due diligence report to the hired NRSRO, the posted information must include the related Rule 17g-10 certification.”).

require that an NRSRO hired to rate a structured finance product must obtain an additional representation that can reasonably be relied upon from the issuer, sponsor, or underwriter of the product: namely, that the issuer, sponsor, or underwriter will post to the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E containing information about the security delivered by a person employed to provide third-party due diligence services with respect to the structured finance product.¹⁵⁰⁷

Paragraph (c) of Rule 17g-10, as proposed, contained definitions of due diligence services, issuer, originator, and securitizer for purposes of section 15E(s)(4)(B) of the Exchange Act and Rule 17g-10. As proposed, paragraph (c)(1) defined the term due diligence services.¹⁵⁰⁸ Under the proposed definition, an entity would be deemed to have provided due diligence services if it engaged in a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any one of the five types of activities identified in proposed paragraphs (c)(1)(i) through (v) of Rule 17g-10.¹⁵⁰⁹

Paragraph (c)(1)(i) of Rule 17g-10, as proposed, would identify the first category of due diligence services as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to the quality or integrity of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets.¹⁵¹⁰ Paragraph (c)(1)(ii), as proposed, would identify the second category of due diligence services as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect

¹⁵⁰⁷ See paragraph (a)(3)(iii)(E) of Rule 17g-5. The Commission also is amending paragraphs (a)(3)(i) and (a)(3)(iii)(A) of Rule 17g-5 to add references to new paragraph (a)(3)(iii)(E).

¹⁵⁰⁸ See paragraph (c)(1) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁵⁰⁹ See paragraphs (c)(1)(i) through (v) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33472, 33544.

¹⁵¹⁰ See paragraph (c)(1)(i) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

to whether the origination of the assets conformed to stated underwriting or credit extension guidelines, standards, criteria, or other requirements.¹⁵¹¹ Paragraph (c)(1)(iii), as proposed, would identify the third category of due diligence services as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to the value of collateral securing such assets.¹⁵¹² Paragraph (c)(1)(iv), as proposed, would identify the fourth category of due diligence services as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to whether the originator of the assets complied with federal, state, or local laws or regulations.¹⁵¹³

Paragraph (c)(1)(v) of Rule 17g-10, as proposed, would identify the fifth category of due diligence services – the catchall – as a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any other factor or characteristic of such assets that would be material to the likelihood that the issuer of the Exchange Act-ABS will pay interest and principal according to its terms and conditions.¹⁵¹⁴ The proposed catchall was intended to apply to due diligence services used for pools of other asset classes (for example, commercial loans, corporate loans, student loans, or credit card receivables) to the extent that providers of third-party due diligence services currently provide or in the future begin providing due diligence services with respect to other asset classes and those services, because of the different nature of the assets, do not fall into one of the other four categories.¹⁵¹⁵

¹⁵¹¹ See paragraph (c)(1)(ii) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁵¹² See paragraph (c)(1)(iii) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁵¹³ See paragraph (c)(1)(iv) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁵¹⁴ See paragraph (c)(1)(v) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

¹⁵¹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33472. In the proposing release, the

Paragraph (c)(2), as proposed, defined the term issuer as including a sponsor, as defined in 17 CFR 229.1011, or depositor, as defined in 17 CFR 229.1011, that participates in the issuance of an Exchange Act-ABS.¹⁵¹⁶ Paragraphs (c)(3) and (c)(4), as proposed, provided that the terms originator and securitizer, respectively, have the same meanings as in section 15G of the Exchange Act.¹⁵¹⁷ Defining these two terms was intended to provide greater clarity as to the proposed meaning of due diligence services.¹⁵¹⁸

The definitions of due diligence services, issuer, originator, and securitizer in Rule 17g-10, as adopted, are contained in paragraph (d) (rather than paragraph (c), as proposed) because of the addition of the new “safe harbor” provision in paragraph (c) as discussed above.¹⁵¹⁹ The definitions are being adopted substantially as proposed with modifications, in part, in response to comments.¹⁵²⁰

Commission stated that the first four prongs of the definition of due diligence services addressed reviews that persons commonly understood as due diligence providers conducted with respect to RMBS. Id.

¹⁵¹⁶ See paragraph (c)(2) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544. As explained in the proposing release, the Commission interprets the term issuer to refer to the depositor of an asset-backed security. See id. at 33467, n.532, 33473, n.594. This treatment is consistent with the Commission’s historical regulatory approach to that term, including the Securities Act and the rules promulgated under the Securities Act and the Exchange Act. See, e.g., 17 CFR 230.191; 17 CFR 240.3b-19.

¹⁵¹⁷ See paragraphs (c)(3) through (4) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544. Section 15G(a)(4) of the Exchange Act defines the term originator to mean “a person who—(A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (B) sells an asset directly or indirectly to a securitizer.” See 15 U.S.C. 78o-9(a)(4). Section 15G(a)(3) of the Exchange Act defines the term securitizer to mean: “(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.” See 15 U.S.C. 78o-9(a)(3).

¹⁵¹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33473.

¹⁵¹⁹ See paragraphs (d)(1) through (4) of Rule 17g-10.

¹⁵²⁰ See paragraphs (d)(1) through (4) of Rule 17g-10. In addition to the modifications discussed below, the final rule is modified from the proposal in the following ways. First, the citation to the definition of asset-backed security in the Exchange Act is corrected in the prefatory text of paragraph (d) and in paragraphs (d)(1) and (3). Second, the word “such” in third prong of the definition of due diligence services (paragraph (d)(1)(iii)) has been replaced with the word “the”. Third, references in the definition of issuer in paragraph (d)(2) have been corrected by replacing in two places the phrase “§ 229.1011” with the phrase “§ 229.1101”. These modifications are not intended to substantively change the meaning of the terms as compared to the proposed definitions.

Commenters focused on the definition of due diligence services because the requirement to provide the written certification under section 15E(s)(4)(B) of the Exchange Act is triggered when a third party is employed to provide these services with respect to an Exchange Act-ABS.¹⁵²¹ A commenter that provides due diligence services recommended modifying the first prong of the definition by replacing the phrase “quality and integrity” of the data with the word “accuracy” because that would “more accurately reflects the role of the due diligence provider and the nature of its objective review.”¹⁵²² The Commission believes that this change will more accurately describe the nature of the work undertaken by a provider of third-party due diligence services, as suggested by the commenter. Consequently, the Commission is making the modification.¹⁵²³

Commenters were concerned that the definition of due diligence services could be interpreted to include services that have not traditionally been viewed as third-party due diligence services. In this regard, several commenters focused on the fifth prong of the definition: the catchall.¹⁵²⁴ As proposed, this prong included within the definition a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to any other factor or characteristic of such assets that would be material to the likelihood that the issuer of the Exchange Act-ABS will pay interest and principal according to its terms and conditions.¹⁵²⁵ Some commenters recommended eliminating this catchall provision.¹⁵²⁶ Two

¹⁵²¹ See 15 U.S.C. 78o-7(s)(4)(B).

¹⁵²² See Clayton Letter.

¹⁵²³ See paragraph (d)(1)(i) of Rule 17g-10. The commenter also recommended this modification be made to Item 4 of Form ABS Due Diligence-15E, which used similar text to describe due diligence services. See Clayton Letter. As discussed below in section II.H.3. of this release, the Commission is making a corresponding modification to Item 4.

¹⁵²⁴ See CRE Letter; Deloitte Letter; Morningstar Letter; S&P Letter.

¹⁵²⁵ See paragraph (c)(1)(v) of Rule 17g-10, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33544.

commenters recommended it be narrowed.¹⁵²⁷ One of these commenters stated that the provision should only include “factors or characteristics that were material to determining the credit rating.”¹⁵²⁸ The other commenter stated that the provision should be limited to “factors that materially impact the likelihood that the assets themselves would pay interest and principal according to their terms and conditions.”¹⁵²⁹

The Commission is not persuaded that the catchall provision should be eliminated. As the Commission explained in the proposing release, the first four prongs of the definition were based on the Commission’s understanding of the types of reviews undertaken with respect to the pools of mortgage loans underlying issuances of RMBS because due diligence services traditionally have been performed with respect to RMBS.¹⁵³⁰ The first four prongs also may cover due diligence services performed with respect to other types of Exchange Act-ABS. However, there also may be reviews now or in the future that are more tailored to the different nature of the assets underlying these other types of Exchange Act-ABS. The proposed catchall was designed to apply to due diligence services provided with respect to the assets (for example, commercial loans, corporate loans, student loans, or credit card receivables) underlying other types of Exchange Act-ABS to the extent not covered by the first four prongs of the definition. For these reasons, the Commission believes it is appropriate to retain the catchall prong of the definition and, therefore, is adopting it as proposed.¹⁵³¹

¹⁵²⁶ See CRE Letter; Deloitte Letter; Morningstar Letter; S&P Letter.

¹⁵²⁷ See Morningstar Letter; Deloitte Letter.

¹⁵²⁸ See Morningstar Letter.

¹⁵²⁹ See Deloitte Letter.

¹⁵³⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33472.

¹⁵³¹ See paragraph (d)(1)(v) of Rule 17g-10.

One commenter stated that, if the catchall provision is not eliminated, “the final rule should limit the provision’s application to other factors that materially impact the likelihood that [the underlying] assets themselves would pay interest and principal according to their terms and conditions” so that the “focus of the diligence services will be on the assets themselves, not the issuer’s ability to pay as is set forth in the proposed definition.”¹⁵³² The Commission agrees that due diligence services typically focus on the assets underlying an Exchange Act-ABS. Indeed, the prefatory text of paragraph (d)(1) of Rule 17g-10 provides that the term due diligence services means a review of the assets underlying an Exchange Act-ABS for the purpose of making findings with respect to certain matters.¹⁵³³ Moreover, the catchall provision includes within the definition of due diligence services a review of any other factor or characteristic of the assets underlying an Exchange Act-ABS that would be material to the likelihood that the issuer will pay interest and principal in accordance with applicable terms and conditions.¹⁵³⁴ Consequently, in response to the commenter, the Commission confirms that a review must be of the assets underlying the Exchange Act-ABS in order to fall within the definition of due diligence services. However, the performance of the underlying assets (for example, their ability to pay principal and interest) ultimately will impact whether the Exchange Act-ABS itself will be able to pay interest and principal because the payments received on the underlying assets are passed through to the holders of the Exchange Act-ABS. Moreover, a review of the underlying assets that is relevant to whether the Exchange Act-ABS will pay interest and principal according to its terms is the type of information that would be useful to an NRSRO that is assessing the creditworthiness of Exchange Act-ABS. The catchall provision is designed to account for such

¹⁵³² See Deloitte Letter.

¹⁵³³ See prefatory text of paragraph (d)(1) of Rule 17g-10.

¹⁵³⁴ See paragraph (d)(1)(v) of Rule 17g-10.

reviews to the extent they are not addressed in the other prongs of the definition of due diligence services.¹⁵³⁵

While the catchall provision is not being eliminated, the definition of due diligence services in Rule 17g-10 (including the catchall prong) is not intended to bring within the definition's scope activities that are performed today in connection with the issuance of an Exchange Act-ABS that are not commonly understood as being third-party due diligence services. Rather, it is designed to cover reviews of the assets underlying an Exchange Act-ABS that are commonly understood in the securitization market to be third-party due diligences services.¹⁵³⁶ For example, it is not intended to cover every type of service that involves the performance of diligence in the offering process. The catchall provision is designed to incorporate within the definition reviews that are commonly understood in the securitization market to be third-party due diligences services or analogous services that may develop in the future but are not expressly covered by the first four prongs of the definition.

Several commenters argued that agreed-upon procedures engagements performed by accounting firms should not be considered third-party due diligence services as contemplated by

¹⁵³⁵ See id. One commenter suggested that the Commission clarify that the catchall definition of due diligence services includes only the review of the assets in connection with the issuance of the asset-backed securities as specifically requested by the issuer, underwriter, or NRSRO. See Clayton Letter. In response, the Commission notes that the certification under Rule 17g-10 must be provided by the person who is employed to provide third-party due diligence services. Accordingly, the catchall definition is not intended to cover reviews that the third-party provider itself was not employed to perform by the issuer, underwriter, or NRSRO.

¹⁵³⁶ Generally, third-party due diligence services have been performed with respect to RMBS. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471. Generally, in the RMBS context, the provider of third-party due diligence services is hired by the entity (for example, the underwriter, sponsor, or depositor) purchasing the pool of mortgage loans for the purpose of securitizing them. In conducting a review, the provider of third-party due diligence services analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) to assess the quality of the loan-by-loan data in the electronic file ("loan-tape") that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file; (2) to determine whether each loan in the sample adheres to the underwriting guidelines of the loan originator; (3) to assess the validity of the appraised value of the property indicated on the loan tape that collateralizes each loan in the sample; and (4) to determine whether the originator complied with federal, state, and local laws in making each loan in the sample. Id.

section 15E(s)(4) of the Exchange Act.¹⁵³⁷ Some of these commenters suggested that the proposed definition should apply only to reports that were prepared specifically with the intent to provide those reports to an NRSRO or otherwise in connection with obtaining a credit rating.¹⁵³⁸ Two of these commenters stated that accountants would be unlikely to perform any services that could fall within the proposed definition.¹⁵³⁹ In support of the position to exclude agreed-upon procedures engagements from the definition of due diligence services, commenters noted that these engagements generally include one or more of the following: (1) comparing the loan tape to the loan file; (2) recalculating projected future cash flows due to investors; and (3) performing procedures that address other information included in the offering document. Commenters argued that these procedures are performed primarily to assist issuers or underwriters in verifying the accuracy of disclosures in registration statements and prospectuses.

The Commission agrees that the second and third examples performed as part of an agreed-upon procedure engagement and for the purpose referenced are not commonly understood as being due diligence services and should not trigger the requirements of section 15E(s)(4) of the Exchange Act. However, comparing the information on a loan tape with the information contained on the hard-copy documents in a loan file is an activity that falls within the definition of due diligence services in Rule 17g-10 because the work undertaken involves reviewing of the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets.¹⁵⁴⁰ Consequently, the Commission is not

¹⁵³⁷ See ABA Letter; AICPA Letter; ASF Letter; CRE Letter; Deloitte Letter; Ernst & Young Letter; FSR Letter; KPMG Letter; PWC Letter.

¹⁵³⁸ See ABA Letter; AICPA Letter; Ernst & Young Letter.

¹⁵³⁹ See AICPA Letter; Ernst & Young Letter.

¹⁵⁴⁰ See paragraph (d)(1)(i) of Rule 17g-10. See also Nationally Recognized Statistical Rating Organizations, 76 FR at 33471 ("In conducting a review, the provider of third-party due diligence services analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) to assess

persuaded that it would be appropriate to exclude this type of review solely because it is being performed in the context of an agreed-upon procedures engagement. As a result, comparing information on a loan tape with information contained on the hard-copy documents in a loan file, even if performed under an agreed-upon procedure engagement, is a third-party due diligence service under Rule 17g-10.¹⁵⁴¹

The Commission understands there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession.¹⁵⁴² The requirements and limitations resulting from relevant professional standards generally are described within the reports issued and, to the extent such requirements or limitations are based upon professional standards, the Commission would not object to the inclusion of the same description in the written certifications on Form ABS Due Diligence-15E required under Rule 17g-10.

Commenters suggested that Form ABS Due Diligence-15E should be required to be provided to NRSROs only at the time the Exchange Act-ABS is initially issued or rated.¹⁵⁴³ One of these commenters stated that the due diligence provider's obligations should "come to an end" after providing the certification and suggested that for later rating actions, the NRSRO should be permitted to "disclose that it is relying on" an earlier report.¹⁵⁴⁴ Another of these commenters stated that the proposed requirements should be limited to services provided "prior to the issuance of the ABS" and suggested that the certification be prepared on a "one-time basis per

the quality of the loan-by-loan data in the electronic file ('loan-tape') that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file...").

¹⁵⁴¹ See paragraph (d)(1)(i) of Rule 17g-10.

¹⁵⁴² See, e.g., Public Company Accounting Oversight Board, Interim Attestation Standard, AT Section 201, at ¶¶ .06 and .31.

¹⁵⁴³ See Clayton Letter; DBRS Letter; Deloitte Letter; S&P Letter.

¹⁵⁴⁴ See Deloitte Letter.

report.”¹⁵⁴⁵ A third commenter stated that the certification should not “sunset” and instead should be provided “for the life of the transaction/rated security.”¹⁵⁴⁶

The Commission recognizes that third-party due diligence services commonly are performed prior to the issuance of an Exchange Act-ABS. Consequently, the Commission expects most of the forms will be executed and provided at this time. However, if an NRSRO, issuer, or underwriter employs a person to provide third-party due diligence services after the issuance, the Commission believes that NRSROs monitoring the credit rating will benefit from obtaining a Form ABS Due Diligence-15E relating to the due diligence services, as will investors in the Exchange Act-ABS. Consequently, the Commission is not persuaded that it would be appropriate to exempt post-issuance performance of due diligence services from the requirements of section 15E(s)(4) of the Exchange Act.

One commenter recommended that the obligations of the third-party due diligence provider should come to an end after the person provides the certification.¹⁵⁴⁷ As discussed above, the Commission has added a “safe harbor” to Rule 17g-10 under which a provider of third-party due diligence services can meet its obligations under section 15E(s)(4)(B) of the Exchange Act.¹⁵⁴⁸ In short, in order to be deemed to have satisfied those obligations, the provider must promptly deliver an executed Form ABS Due Diligence-15E after completion of the due diligence services to each NRSRO that previously requested or that requests the form and deliver the form to the issuer or underwriter that maintains the Rule 17g-5 website with respect to the Exchange Act-ABS. At this point, the third party will have met its obligation

¹⁵⁴⁵ See Clayton Letter.

¹⁵⁴⁶ See S&P Letter.

¹⁵⁴⁷ See Deloitte Letter.

¹⁵⁴⁸ See paragraph (c) of Rule 17g-10.

under section 15E(s)(4)(B) and Rule 17g-10. However, if the third party is employed by an NRSRO, issuer, or underwriter to perform subsequent due diligence services with respect to the Exchange Act-ABS, it will incur new obligations under section 15E(s)(4)(B) and Rule 17g-10.

Commenters also sought clarification of the application of Rule 17g-10, as proposed, to transactions or entities located outside the United States.¹⁵⁴⁹ After considering comments, as discussed above in section II.G.1. of this release, the Commission has added an exemption in paragraph (a)(3) of Rule 17g-7. The provision exempts an NRSRO from the disclosure requirements upon taking a rating action, including the requirement that the NRSRO publish any Form ABS Due Diligence-15E it receives or obtains from a Rule 17g-5 website, if the rating action involves a rated obligor or issuer of the rated security that is not a U.S. person and if the NRSRO has a reasonable basis to conclude that transactions in the securities issued by the obligor or the issuer will be effected only outside the United States.¹⁵⁵⁰ Further, the Commission has issued a temporary order exempting NRSROs from the Rule 17g-5 website requirements if similar conditions are met.¹⁵⁵¹ Consequently, if a person is employed by an NRSRO, issuer, or underwriter to perform third-party due diligence services with respect to an Exchange Act-ABS that is exempt from the Rule 17g-5 website provisions the person will not need to deliver an executed Form ABS Due Diligence-15E to the issuer or underwriter of the Exchange Act-ABS to meet the “safe harbor” requirement in paragraph (c)(3) of Rule 17g-10, as adopted.¹⁵⁵² Instead,

¹⁵⁴⁹ See ABA Letter; DBRS Letter.

¹⁵⁵⁰ See paragraph (a)(3) of rule 17g-7.

¹⁵⁵¹ See Order Extending Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 68286 (Nov. 26, 2012).

¹⁵⁵² See paragraph (c)(3) of Rule 17g-10.

the person only will need to promptly deliver an executed Form ABS Due Diligence-15E to any NRSRO that requests it under paragraphs (c)(1) or (c)(2).¹⁵⁵³

3. New Form ABS Due Diligence-15E

Section 15E(s)(4)(C) of the Exchange Act provides that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating.¹⁵⁵⁴ The Commission proposed Form ABS Due Diligence-15E to implement section 15E(s)(4)(C).¹⁵⁵⁵ As proposed, the form contained five items and a signature line with a corresponding representation.¹⁵⁵⁶

In the proposing release, the Commission sought comment on matters such as should proposed Form ABS Due Diligence-15E be more prescriptive in terms of the steps a provider of third-party due diligence services would need to take in performing the review.¹⁵⁵⁷ Commenters stated that the proposed Form ABS Due Diligence-15E should not prescribe more requirements regarding the due diligence review.¹⁵⁵⁸ Two NRSROs added that more prescriptive standards may violate section 15E(c)(2) of the Exchange Act,¹⁵⁵⁹ which prohibits the Commission from regulating the substance of credit ratings. Another NRSRO stated that the proposed form should

¹⁵⁵³ See paragraphs (c)(1) and (2) of Rule 17g-10.

¹⁵⁵⁴ See 15 U.S.C. 78o-7(s)(4)(C).

¹⁵⁵⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33474-33476, 33562-33563; Form ABS Due Diligence-15E, as proposed.

¹⁵⁵⁶ See Form ABS Due Diligence-15E, as proposed.

¹⁵⁵⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33476.

¹⁵⁵⁸ See ASF Letter; Clayton Letter; CRE Letter; DBRS Letter; Morningstar Letter.

¹⁵⁵⁹ See DBRS Letter; Morningstar Letter.

“follow a more general approach” rather than prescribe minimum requirements for the third-party due diligence reviews.¹⁵⁶⁰

The Commission believes for now that the steps to be taken by a third party-due diligence provider in reviewing the assets underlying an Exchange Act-ABS should be decided upon by the party engaging the provider (most commonly the underwriter, sponsor, or depositor). As a provider of third-party due diligence services noted in its comment letter, “[t]raditionally, our services have been used by loan purchasers to make better decisions about how they price portfolios and manage risk” and “[p]rospectively, we anticipate playing a valuable role by independently validating the information used by market participants to make decisions relating to loans being included in securitization transactions.”¹⁵⁶¹ The Commission believes that the parties engaging the services of third-party due diligence providers should have the flexibility to prescribe the steps they believe are necessary to help them evaluate the assets underlying an Exchange Act-ABS. Consequently, the form requires a provider of third-party due diligence services to disclose information about its review of the assets underlying an Exchange Act-ABS but does not prescribe how the review must be conducted. For these reasons, the Commission, as discussed below, is adopting Form ABS Due Diligence-15E substantially as proposed, with modifications to the disclosure requirements in Items 3 and 4, a modification to the representation requirement in the certification, and certain technical modifications.¹⁵⁶² The modifications do not substantively alter the form from the proposal.

¹⁵⁶⁰ See S&P Letter.

¹⁵⁶¹ See Clayton Letter.

¹⁵⁶² See Form ABS Due Diligence-15E.

As proposed, Item 1 of the form elicited the identity and address of the provider of third-party due diligence services.¹⁵⁶³ The Commission is adopting Item 1 as proposed.¹⁵⁶⁴ This Item elicits the identity and address of the provider of third-party due diligence services.

As proposed, Item 2 of the form elicited the identity and address of the issuer, underwriter, or NRSRO that employed the provider of third-party due diligence services.¹⁵⁶⁵ Those disclosures were intended to notify users of the certification of which third party conducted the review described in the certification and which person employed the third party to conduct the review, respectively.¹⁵⁶⁶

The Commission is adopting Item 2 with a technical, non-substantive modification from the proposal.¹⁵⁶⁷ Commenters asked whether the form must be addressed to a specific NRSRO.¹⁵⁶⁸ It does not. The form is a general certification. However, as discussed above in section II.H.2. of this release, the provider of third-party due diligence services must deliver the form promptly, to each NRSRO that requests it as well as to the issuer or underwriter that maintains the Rule 17g-5 website with respect to the Exchange Act-ABS that is the subject of the due diligence services, to be deemed to have met its obligation under section 15E(s)(4)(B) of the Exchange Act.

As proposed, Item 3 of the form provided that if the manner and scope of the due diligence provided by the third party satisfied the criteria for due diligence published by an

¹⁵⁶³ See Item 1 of Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33562.

¹⁵⁶⁴ See Item 1 of Form ABS Due Diligence-15E.

¹⁵⁶⁵ See Item 2 of Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33562.

¹⁵⁶⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33474.

¹⁵⁶⁷ See Item 2 of Form ABS Due Diligence-15E. The modification adds the phrase “the third-party” before the phrase “due diligence services.” As modified, Item 2 is consistent with Item 1, as proposed and adopted (which uses the phrase “third-party due diligence services”). This modification is not substantive.

¹⁵⁶⁸ See ASF Letter; Clayton Letter.

NRSRO, the third party must identify the NRSRO and the title and date of the published criteria in a table provided on the form.¹⁵⁶⁹ The proposed table and instructions would permit the identification of more than one NRSRO, which would allow the third party to reflect in a single form that it conducted due diligence services in a manner that satisfied the due diligence requirements of multiple NRSROs.¹⁵⁷⁰ The Commission is adopting Item 3 with one modification to clarify the instruction for the Item in response to comments.¹⁵⁷¹

Specifically, commenters raised concerns about what it would mean for the third party to certify that it had satisfied the criteria for due diligence published by an NRSRO.¹⁵⁷² For example, one NRSRO stated that due diligence providers are “not in a position” to opine on “whether the NRSRO’s criteria have been satisfied.”¹⁵⁷³ Another commenter stated that it should be “up to the NRSRO to determine” whether the criteria were satisfied.¹⁵⁷⁴ A third commenter stated that the disclosure should only be required where the due diligence provider is expressly engaged to “comply with a particular set of NRSRO-published criteria.”¹⁵⁷⁵ A fourth commenter – an NRSRO – stated that the disclosure requirement should be limited to criteria published by the NRSRO involved in the engagement.¹⁵⁷⁶ Another NRSRO stated that it would “continue to make its own assessment of whether its criteria are satisfied.”¹⁵⁷⁷

¹⁵⁶⁹ See Item 3 of Form ABS Due Diligence 15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33562.

¹⁵⁷⁰ See Item 3 of Form ABS Due Diligence 15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33562.

¹⁵⁷¹ See Item 3 of Form ABS Due Diligence-15E.

¹⁵⁷² See Clayton Letter; DBRS Letter; Deloitte Letter; Moody’s Letter; S&P Letter.

¹⁵⁷³ See Moody’s Letter.

¹⁵⁷⁴ See Clayton Letter.

¹⁵⁷⁵ See Deloitte Letter.

¹⁵⁷⁶ See DBRS Letter.

¹⁵⁷⁷ See S&P Letter.

In response to the comments, the Commission notes that certain NRSROs, as part of the rating criteria for RMBS, have specified the steps a person engaged to perform third-party due diligence services must take in performing the services in order for them to rate the RMBS.¹⁵⁷⁸ For example, in the RMBS context, the provider of third-party due diligence services typically is hired by the entity (for example, the underwriter, sponsor, or depositor) purchasing the pool of mortgage loans for the purpose of securitizing them. In conducting a review, the provider of third-party due diligence services typically analyzes a sample (for example, 25%) of the loans in the pool for one or more of the following purposes: (1) to assess the quality of the loan-by-loan data in the electronic file ("loan-tape") that aggregates the information for the pool by comparing the information on the loan tape for each loan in the sample with the information contained on the hard-copy documents in the loan file; (2) to determine whether each loan in the sample adheres to the underwriting guidelines of the loan originator; (3) to assess the validity of the appraised value of the property indicated on the loan tape that collateralizes each loan in the sample; and (4) to determine whether the originator complied with federal, state, and local laws in making each loan in the sample.¹⁵⁷⁹ The NRSROs most active in rating RMBS have incorporated requirements for the engagement of providers of third-party due diligence services by the entities requesting such ratings (for example, the underwriter or sponsor of the RMBS) into their procedures and methodologies for determining RMBS credit ratings.¹⁵⁸⁰ These

¹⁵⁷⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471, 33474-33475.

¹⁵⁷⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471.

¹⁵⁸⁰ See, e.g., Fitch, U.S. RMBS Originator Review and Third-Party Due Diligence Criteria (April 26, 2013) ("Fitch expects third-party loan-level reviews to be performed on all residential mortgage pools where the agency has been asked to assign ratings. The reviews should be conducted by independent due diligence companies prior to the transaction closing."); Moody's, Moody's Criteria for Evaluating Independent Third-Party Loan Level Reviews for U.S. Residential Mortgage Backed Securities (RMBS) (Sept. 22, 2009) ("Moody's will not rate a U.S. RMBS transaction unless there has been a [third-party loan level review, ('TPR')] that at least meets our minimum sample size. If the minimum sample size is met, but the sample size is still less than Moody's target sample size or if the TPR findings are poor, Moody's may

engagement requirements prescribe the minimum scope and manner of the review of the assets underlying an RMBS that the provider of third-party due diligence services must conduct in order for the NRSRO to determine a credit rating for the RMBS, including the minimum sample size of the loans to be selected from the pool.¹⁵⁸¹

Item 3 was designed to require the third party to record in the form that the third party had endeavored to perform its due diligence in accordance with the due diligence criteria an NRSRO had published. Further, by executing the form, the third party would certify that it had performed the due diligence in accordance with the NRSRO's criteria.¹⁵⁸²

The Commission acknowledges that certifying to having followed a given NRSRO's due diligence criteria does not establish that the third party in fact followed the criteria. However, the objective of sections 15E(4)(B) and (C) of the Exchange Act is to require third-party due

decide i) that more credit protection is needed to achieve a given rating level, ii) to assign a lower rating or iii) to decline to rate the transaction...Moody's will not rate a transaction unless it has received a report from the TPR firm as to the TPR scope, procedure and findings. The report must include a narrative summary of the review and an initial TPR findings report before input from the TPR sponsor."); S&P, Incorporating Third-Party Due Diligence Results into the U.S. RMBS Rating Process (Mar. 14, 2012) ("Standard & Poor's believes that using third-party due diligence results in its rating analysis will increase transparency and strengthen the rating process. Our criteria for due diligence reviews are intended to increase our insight into the quality and validity of the information used to originate the mortgage loans pooled into securities.").

¹⁵⁸¹ For example, Fitch requires, at a minimum, a randomly selected minimum sample size to be the greater of 200 loans or 10% of the pool. See Fitch, U.S. RMBS Originator Review and Third-Party Due Diligence Criteria. Moody's defines its minimum sample size through statistical techniques. Specifically, Moody's requires that the sample size must not be less than that computed using a 95% confidence level, a 5% precision level, and an assumed error rate equal to the higher of the historic error rate for the originator or a Minimum Assumed Error Rate. See Moody's, Moody's Criteria for Evaluating Independent Third-Party Loan Level Reviews for U.S. Residential Mortgage Backed Securities (RMBS). S&P requires a sample that is the greater of either the number of loans needed for a statistically valid sample, or a 10% random sample for subprime and 5% sample for prime. At a minimum, S&P states that the number of loans in the sample should be 200 for subprime, and 100 for prime. S&P defines a statistically valid sample as the number of loans based on a 5% one-tailed level of significance with a 2% level of precision. S&P expects that the number of loans in the sample also will be a function of an estimate of an error rate. See S&P, Incorporating Third-Party Due Diligence Results into the U.S. RMBS Rating Process.

¹⁵⁸² See 15 U.S.C. 78o-7(s)(4)(C) (providing that the Commission shall establish the appropriate format and content for the written certifications required under section 15E(s)(4)(B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for an NRSRO to provide an accurate rating).

diligence providers to provide a certification to NRSROs to “ensure” that the providers “have conducted a thorough review of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.”¹⁵⁸³ In the Commission’s view, if an NRSRO has published criteria for performing due diligence reviews and the third party has sought to follow the criteria, the form should provide a means for the third party to certify that it sought to follow the criteria. For these reasons, the Commission is adopting Item 3 to the form substantially as proposed. However, in response to the comments, the Commission has modified the instruction for Item 3 so that it contains the words “if the due diligence provided by the third party is intended to satisfy” the criteria of an NRSRO.¹⁵⁸⁴

As proposed, Item 4 of the form required the provider of the third-party due diligence services to describe the scope and manner of the due diligence services provided in connection with the review of assets in sufficient detail to provide an understanding of the steps taken in performing the review, including: (1) the type of assets that were reviewed; (2) the sample size of the assets reviewed; (3) how the sample size was determined and, if applicable, computed; (4) whether the quality or integrity of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; (5) whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines; (6) whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted; (7) whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and (8) any other type of review conducted with respect to the

¹⁵⁸³ See 15 U.S.C. 78o-7(s)(4)(B) and (C).

¹⁵⁸⁴ See Item 3 to Form ABS Due Diligence-15E. As proposed, the instruction read, in pertinent part, “[i]f the manner and scope of the due diligence provided by the third party satisfied” the criteria of an NRSRO. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33562 (emphasis added).

assets.¹⁵⁸⁵ The proposed disclosure was intended to allow the NRSRO and users of credit ratings to determine whether the provider of third-party due diligence services, based on its description, appeared to satisfy published criteria of the NRSRO if such a claim was made in Item 3.¹⁵⁸⁶ Alternatively, if no criteria had been published for the type of Exchange Act-ABS or no claim to satisfying criteria was made in Item 3, the proposed disclosure was intended to provide an understanding of the due diligence performed.¹⁵⁸⁷ The instructions for Items 4, as proposed, required the summary to be provided in an attachment to the Form, which would be considered part of the form.¹⁵⁸⁸

The Commission is adopting Item 4 of Form ABS Due Diligence-15E with modifications, in part, in response to comments.¹⁵⁸⁹ Consistent with the modification to Item 3 discussed above, the Commission is modifying the last sentence of the instructions for the Item to replace the phrase “satisfied the criteria for minimum due diligence” with the phrase “is intended to satisfy the criteria for due diligence.”¹⁵⁹⁰ As adopted, Item 4 requires the third party to provide a description of the scope and manner of the due diligence services provided in connection with the review of assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review and to include in the description:

- The type of assets that were reviewed;

¹⁵⁸⁵ See Item 4 of Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33563. The proposed instructions would require the third party to provide this description regardless of whether the third party represented in Item 3 of the form that its review satisfied published criteria of an NRSRO. In other words, the third party would not be able to simply rely on a cross-reference to the NRSRO’s published criteria to explain the work completed in performing the due diligence.

¹⁵⁸⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33475.

¹⁵⁸⁷ See id.

¹⁵⁸⁸ See id. at 33563.

¹⁵⁸⁹ See Item 4 to Form ABS Due Diligence-15E.

¹⁵⁹⁰ The Commission also removed the word “minimum” before the phrase “due diligence” in the last sentence because it was unnecessary.

- The sample size of the assets reviewed;
- How the sample size was determined and, if applicable, computed;
- Whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted;¹⁵⁹¹
- Whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements was reviewed and, if so, how the review was conducted;¹⁵⁹²
- Whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted;
- Whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and
- Any other type of review that was part of the due diligence services conducted by the person executing the Form.¹⁵⁹³

One commenter stated that the instruction that the description must be “sufficiently detailed” to provide an understanding of the steps taken in performing the review should be

¹⁵⁹¹ As discussed above in section II.H.2. of this release, a commenter that provides due diligence services recommended modifying this description of due diligence services by replacing the phrase “quality and integrity” of the data with the word “accuracy.” See Clayton Letter. The Commission believes that this change will more accurately describe the nature of the work undertaken by a provider of third-party due diligence services, as suggested by the commenter, and, therefore, has revised the instruction accordingly.

¹⁵⁹² As proposed, the phrase in the instruction stated “whether the origination of the assets conformed to stated underwriting or credit extension guidelines, standards, criteria or other requirements was reviewed and, if so, how the review was conducted.” See Item 4 of Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33472. The final instruction was modified to replace the phrase “origination of the assets conformed” with the phrase “conformity of the origination of the assets.” See Item 4 to Form ABS Due Diligence-15E. This modification is intended to provide a clearer description of the category without substantively changing it.

¹⁵⁹³ One commenter stated that the due diligence provider should only be required to describe “those of the eight steps that relate to the services it actually performed” and suggested that the requirement to describe “any other type of review conducted with respect to the assets” be omitted. See Deloitte Letter. The instruction requires the third-party due diligence provider to describe only the reviews that the provider conducted (that is, not reviews conducted by other service providers). The instruction has been modified to clarify this point. Specifically, it now states “any other type of review that was part of the due diligence services conducted by the person executing this Form” (emphasis added).

replaced with a standard that is not subjective.¹⁵⁹⁴ The Commission is not persuaded that this is necessary. First, this instruction is consistent with the instructions for Exhibit 2 to Form NRSRO, which has been in use since 2007.¹⁵⁹⁵ Second, by identifying the matters that must be included in the description, the instruction provides objective guidance on the topics that the description must address. Another commenter suggested that examples of each of the categories of information would be helpful.¹⁵⁹⁶ The discussion above provides some examples of the matters that providers of third-party due diligence services review in the context of RMBS issuances. As discussed above, Form ABS Due Diligence-15E is designed to account for due diligence services provided with respect to other types of Exchange Act-ABS (in addition to RMBS). Consequently, providing specific examples could create confusion if new types of reviews tailored to non-RMBS Exchange Act-ABS develop in the future. The description of the types of reviews in Item 4 provides detail on the matters that must be addressed in the form in a way that is designed to provide guidance without narrowing the matters to the RMBS context.¹⁵⁹⁷

As proposed, Item 5 of the form would require the provider of third-party due diligence services to provide a summary of the findings and conclusions that resulted from the due

¹⁵⁹⁴ See Clayton Letter.

¹⁵⁹⁵ See instructions for Exhibit 2 to Form NRSRO (instructing, in pertinent part, that an applicant for registration as an NRSRO or NRSRO submitting the form must provide in the Exhibit a general description of the procedures and methodologies used by the applicant or NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the applicant or NRSRO is seeking registration or is registered and that the description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the applicant or NRSRO in determining credit ratings, including, as applicable, descriptions of a number of matters enumerated in the instructions) (emphasis added).

¹⁵⁹⁶ See Deloitte Letter.

¹⁵⁹⁷ The descriptions in Item 4 correspond to the prongs of the definition of due diligence services in Rule 17g-10. A provider of third-party due diligence services noted in its comment letter that the definition of due diligence services in Rule 17g-10 (subject to certain modification suggested by the commenter) “captures the scope of due diligence services provided to issuers or underwriters by third-party due diligence providers in connection with the rating of an issuance of ABS...” See Clayton Letter. As discussed above and in section II.H.2. of this release, this commenter suggested, among other things, that the phrase “quality and integrity” of the data as used in the definition of due diligence services and in Item 4 should be replaced with the word “accuracy.” Id.

diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2 (that is, conveyed to the issuer, underwriter, or NRSRO that employed the third party to perform due diligence services).¹⁵⁹⁸ As with Item 4, the instructions for Items 5, as proposed, required the summary to be provided in an attachment to the form, which would be considered part of the Form.¹⁵⁹⁹

The Commission is adopting Item 5 of Form ABS Due Diligence-15E with a technical non-substantive modification in response to comment.¹⁶⁰⁰ The Item provides that the person providing due diligence services must provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person that employed the third party to perform the services. One commenter stated that the instruction regarding the summary be “sufficiently detailed to provide an understanding of the findings and conclusions” should be eliminated.¹⁶⁰¹ The Commission is adopting the “sufficiently detailed” standard in this Item as it is doing with respect to Item 4.¹⁶⁰² As stated above, the standard is consistent with the instructions for Exhibit 2 to Form NRSRO.

Finally, as proposed, the individual executing the form on behalf of a provider of third-party due diligence services would need to make two representations: (1) that he or she has executed the form on behalf of, and on the authority of, the third party; and (2) that the third

¹⁵⁹⁸ See Item 5 of Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33563.

¹⁵⁹⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33563.

¹⁶⁰⁰ See Item 5 of Form ABS Due Diligence-15E. One commenter suggested that the word “description” in the second sentence of the instruction be replaced with the word “summary.” See Clayton Letter. The Commission agrees with this suggestion because Item 5 is titled “Summary of findings and conclusions of review” and the first sentence of the instruction provides that the person executing the certification should provide a “summary” of the findings and conclusions.

¹⁶⁰¹ See Clayton Letter.

¹⁶⁰² See Item 5 of Form ABS Due Diligence-15E.

party conducted a thorough review in performing the due diligence described in Item 4 and that the information and statements contained in the form, including Items 4 and 5 attached to the form, are accurate in all significant respects.¹⁶⁰³ The proposed representation was intended to implement section 15E(s)(4)(C) of the Exchange Act, which provides that the Commission shall establish the appropriate format and content of the written certifications “to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.”¹⁶⁰⁴

The Commission is adopting the certification in Form ABS Due Diligence-15E with one modification. Commenters stated that the certification should indicate that it is as of the date signed.¹⁶⁰⁵ The Commission agrees. As adopted, the certification contains the representation that the third-party due diligence provider conducted a thorough review in performing the due diligence described in Item 4 of the form and that the information and statements contained in the form, including Items 4 and 5 attached to the form, are accurate in all significant respects on and as of the date hereof.¹⁶⁰⁶

One commenter stated that “professional standards as well as liability concerns would prevent an accountant from stating that he or she has performed a ‘thorough review’ of information because that term is undefined.”¹⁶⁰⁷ Another commenter stated that the words “thorough review” should be replaced with “due care.”¹⁶⁰⁸ This commenter stated that, “[b]y

¹⁶⁰³ See “Certification” on Form ABS Due Diligence-15E, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33563.

¹⁶⁰⁴ See 15 U.S.C. 78o-7(s)(4)(C) (emphasis added); Nationally Recognized Statistical Rating Organizations, 76 FR at 33476.

¹⁶⁰⁵ See Deloitte Letter; S&P Letter.

¹⁶⁰⁶ See “Certification” on Form ABS Due Diligence-15E (emphasis added to highlight the modification).

¹⁶⁰⁷ See AICPA Letter.

¹⁶⁰⁸ See Deloitte Letter.

their very nature, due diligence procedures often relate to a sample, rather than the entire population of assets, and in this sense the review may not be ‘thorough’ as to the scope of assets reviewed and “the procedures themselves are limited in that choices were made to perform certain procedures and not others.”¹⁶⁰⁹ This commenter also suggested that the phrase “accurate in all significant respects” be omitted from the certification.¹⁶¹⁰ Two commenters stated that the phrase “accurate in all significant respects” should be changed to a “materiality” standard.¹⁶¹¹ One of these commenters also suggested that the certification should be “based on objective standards that can be verified by the signer” and should state that the due diligence provider did not conduct any reviews in addition to those expressly requested.¹⁶¹²

In response to these comments, the Commission notes that, as stated in the proposing release, including “thorough review” in the certification was designed to implement section 15E(s)(4)(C) of the Exchange Act, which provides that the Commission shall establish the appropriate format and content of the written certifications “to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for [an NRSRO] to provide an accurate rating.”¹⁶¹³ Further, this language will provide some assurance to persons using the certification to evaluate the underlying assets (including NRSROs determining credit ratings for the Exchange Act-ABS) that the third-party due diligence provider undertook the review described in Item 4 in a thorough manner. Also, it should create an incentive for a provider of third-party due diligence services to perform these reviews in a competent manner because the third party must certify that the work was

¹⁶⁰⁹ Id.

¹⁶¹⁰ Id.

¹⁶¹¹ See Clayton Letter; DBRS Letter.

¹⁶¹² See Clayton Letter.

¹⁶¹³ See 15 U.S.C. 78o-7(s)(4)(C) (emphasis added).

thorough.¹⁶¹⁴ In response to comment, the Commission notes that the provider of third-party due diligence services must certify that it “conducted a thorough review in performing the due diligence described in Item 4 attached to [the] Form.”¹⁶¹⁵ Consequently, the third party need only certify that a “thorough review” was conducted with respect to the work actually performed as specified in Item 4 of the form (for example, reviewing a sample of the assets). This limits the scope of the certification to the matters reflected in Item 4. Consequently, in response to the comment that the third-party due diligence provider should state that it did not conduct any reviews in addition to those expressly requested, Item 4 will reflect the nature and scope of the review work performed, which will be determined by the engagement.

Further, in response to comments, the Commission notes that the part of the certification as to the accuracy of the information contained in the report is modeled on the certification NRSROs must make on Form NRSRO.¹⁶¹⁶ This has proven to be a workable attestation standard as to the accuracy of information disclosed in a form since it was implemented in 2007. It also provides an incentive for the person executing the form to take steps to verify that the information contained in the form is accurate. In response to comments that the standard should be changed to a materiality standard, the Commission notes that the “accurate in all significant respects” is a standard that is intended to incorporate materiality. For all of these reasons, the Commission is adopting the certification substantially as proposed.

¹⁶¹⁴ As discussed above in section II.H.2. of this release, the Commission understands that in making the certification there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession.

¹⁶¹⁵ See “Certification” on Form ABS Due Diligence-15E.

¹⁶¹⁶ See “Certification” on Form NRSRO.

4. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments and new rules related to disclosing information about third-party due diligence services.¹⁶¹⁷ In particular, this section addresses the potential economic effects of Rule 15Ga-2 and Rule 17g-10 and the related amendments, including effects related to amended Form ABS-15G and new Form ABS Due Diligence-15E, as well as effects of the amendments to Rule 17g-7 requiring that NRSROs publish any written certifications received from third-party due diligence providers when taking certain rating actions.¹⁶¹⁸ The baseline that existed before today's amendments and new rules was one in which, under Rule 193, the issuer of any registered Exchange Act-ABS offering was required to perform due diligence with respect to the assets underlying the security.¹⁶¹⁹ The issuer could conduct the review directly or engage one or more third-party vendors to perform the review. Under Item 1111(a)(7) of Regulation AB, the nature as well as the findings and conclusions of the review performed under Rule 193 was required to be disclosed in the prospectus.¹⁶²⁰ These requirements applied whether or not the registered Exchange Act-ABS would be rated by an NRSRO. Commission rules did not require that issuers review assets or disclose to investors the nature, findings, and conclusions of any reviews in the case of unregistered Exchange Act-ABS offerings, whether or not rated by an NRSRO.

Even in the case of registered offerings, information about the nature, findings, and conclusions of all the third-party due diligence that was undertaken might not have been

¹⁶¹⁷ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁶¹⁸ The new requirements with respect to disclosing information about due diligence services are discussed in sections II.G.5., II.H.1., II.H.2., and II.H.3. of this release.

¹⁶¹⁹ See Pub. L. No. 111-203, 945.

¹⁶²⁰ See 17 CFR 229.1111(a)(7).

disclosed under the existing rules. Rule 193 requires a review that provides reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects. The rule requires that issuers disclose the nature of their review but does not require issuers to disclose the specifics of each report where they have engaged third parties to perform multiple reviews and/or produce multiple reports, including interim reports, and does not require that the issuer disclose the identity of the third party or third parties engaged to perform a review. Any third party to which the findings and conclusions of the review disclosed in the prospectus are attributed must be named as an expert in the prospectus, though the issuer is permitted to attribute the findings and conclusions of the review to itself.

In the baseline, the issuer or underwriter of a rated Exchange Act-ABS, whether registered or unregistered, typically provided some information about third-party due diligence reports to any NRSROs they hired to rate the security. Further, some NRSROs, for certain asset classes of Exchange Act-ABS, have adopted minimum standards for due diligence that are required to be met in order for a security to be rated. For example, as discussed above, some NRSROs, as a condition to rating an RMBS, require that a non-affiliated third party perform a due diligence review of the assets underlying the RMBS. An NRSRO may also require that due diligence reviews be performed in accordance with specified criteria, and/or that due diligence be performed by one of a specified set of third-party due diligence providers that has been approved by the NRSRO. Under the baseline requirements, any information about due diligence provided by an issuer or underwriter to an NRSRO hired to rate an Exchange Act-ABS also was required to be disclosed on a password-protected Rule 17g-5 website, which could be accessed by other NRSROs that provided the required certification.¹⁶²¹ However, the information transmitted by

¹⁶²¹ See 17 CFR 240.17g-5.

issuers and underwriters to NRSROs was not subject to mandatory disclosure requirements, and any disclosure may have involved editing or filtering by issuers or underwriters.¹⁶²² In addition, issuers and underwriters who received multiple due diligence reports need not have provided information about all of the reports to NRSROs. The Commission does not believe that NRSROs typically hire third-party due diligence providers directly, but prior to the amendments and new rules, information about third-party due diligence services employed directly by NRSROs was not required to be disclosed to other NRSROs.

In addition to concerns about due diligence information potentially being withheld from NRSROs, market participants, academics, and other observers have expressed concern about decreased standards of due diligence in Exchange Act-ABS offerings.¹⁶²³ For example, it has been reported that the percentage of loans in mortgage pools subject to review dropped from 30% to 5% from the year 2000 to 2005.¹⁶²⁴ Also, litigation in the wake of the financial crisis alleged systemic abuses in due diligence practices with respect to asset-backed securities.¹⁶²⁵

Relative to the baseline, the amendments and new rules should benefit NRSROs, the users of credit ratings, and investors and other Exchange Act-ABS market participants who may or may not be users of credit ratings. NRSROs that are hired by the issuer or underwriter of any

¹⁶²² See, e.g., John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, Enhancing Investor Protection and the Regulation of Securities Markets (Mar. 10, 2009) (testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs), pp. 64-65, available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=d5da9848-ea57-475a-b6e9-93fc74b85abd (“Coffee Testimony II”) (“An offering process for structured finance that was credible would look very different than the process we have recently observed. First, a key role would be played by the due diligence firms, but their reports would not go only to the underwriter (who appears to have at times ignored them). Instead, without editing or filtering, their reports would also go directly to the credit rating agency.”).

¹⁶²³ See Coffee Testimony II, pp. 54-56 (describing “the rapid decline in due diligence after 2000” and citing market participants and journalists raising related concerns).

¹⁶²⁴ See Vikas Bajaj and Jenny Anderson, Inquiry Focuses on Withholding of Data on Loans, New York Times, January 12, 2008, at A-1.

¹⁶²⁵ See Complaint, People of the State of New York, by Eric T. Schneiderman, against J. P. Morgan Securities LLC, JPMorgan Chase Bank, EMS Mortgage LLC (Oct. 2012).

Exchange Act-ABS to provide a credit rating, and any other NRSROs that are not hired but are producing credit ratings related to the due diligence services, should benefit from receiving the information in Form ABS Due Diligence-15E. Each Form ABS Due Diligence-15E will contain important details about the third-party due diligence performed with respect to the Exchange Act-ABS to which the services relate, including a description of the scope and manner of the due diligence services provided in connection with the review of the assets underlying the Exchange Act-ABS and a summary of the findings and conclusions that resulted from the due diligence services. The form will be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification, promoting confidence in the accuracy of the content of the form. To the extent that there are any additional due diligence reports obtained by an issuer or underwriter subject to Rule 15Ga-2¹⁶²⁶ that are not related to credit ratings and therefore are not required to be disclosed to the NRSROs on Form ABS Due Diligence-15E, NRSROs will also have access to the findings and conclusions of these reports, via the Form ABS-15G required to be furnished at least five business days prior to the first sale in the offering.

NRSROs may therefore receive information derived from additional reports of third-party due diligence providers, and more detail about the third-party due diligence services, than they would have obtained under the baseline requirements. Importantly, issuers and underwriters can no longer select what part of this information to provide to NRSROs, reducing the possibility of less favorable information being withheld from NRSROs. Having access to more complete data may allow NRSROs to generate higher quality credit ratings, both in the case of solicited credit

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As discussed above, the Commission has excluded issuers and underwriters of municipal and certain offshore offerings of Exchange Act-ABS from Rule 15Ga-2. Issuers and underwriters of municipal Exchange Act-ABS remain subject to the statutory obligation under section 15E(s)(4)(A) to make publicly available the findings and conclusions of any third-party due diligence reports they obtain, and could choose to satisfy their obligation by voluntarily submitting Form ABS-15G on EMMA.

ratings and in the case of unsolicited credit ratings by NRSROs. Non-hired NRSROs that choose not to access the Rule 17g-5 websites because of the requirement to provide the annual certification under paragraph (e) of the rule may benefit less from the amendments and new rules.¹⁶²⁷ Specifically, though these non-hired NRSROs can request Form ABS Due Diligence-15E from the provider of third-party due diligence services, they will not be able to request this form until they become aware of a given offering and which third-party has provided services related to that offering, and so they may not have the required information to provide unsolicited credit ratings in as timely a manner as NRSROs that do have access to these websites. However, prior to today's amendments and new rules, non-hired NRSROs that did not have access to the Rule 17g-5 websites were already disadvantaged in providing unsolicited credit ratings given that they likely lacked timely access to other information about the Exchange Act-ABS.

Users of credit ratings, as well as investors and other market participants who may or may not be users of credit ratings, may also benefit from the Form ABS-15G and Form ABS Due Diligence-15E disclosures, particularly in cases where information that was not previously disclosed to these persons becomes available as a consequence of the amendments and new rules. As noted above, the findings and conclusions of all third-party due diligence reports obtained by issuers and underwriters of rated Exchange Act-ABS will be made public through disclosures on Form ABS-15G, except in the case of municipal Exchange Act-ABS for which the issuer or underwriter chooses to make such information publicly available through some other means and in the case of certain offshore transactions.¹⁶²⁸ In the case of registered rated

¹⁶²⁷ See 17 CFR 240.17g-5(e) (requiring, among other things, that the NRSRO certify that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to the rule, if it accesses such information for ten or more issued securities or money market instruments in the calendar year covered by the certification).

¹⁶²⁸ As discussed above, in light of the practical and legal considerations raised by commenters, the Commission adopted revisions to the proposal to provide that Rule 15Ga-2, as well as section 15E(s)(4)(A),

Exchange Act-ABS, the Form ABS-15G disclosures may include findings and conclusions of reports (for example, interim reports) other than the report(s) supporting the results reported in the prospectus under Rule 193 and Item 1111(a)(7) of Regulation AB. Consequently, information that would not have been available to the public under the baseline requirements may now be disclosed publicly. In the case of unregistered rated Exchange Act-ABS, because Rule 193 and Item 1111(a)(7) of Regulation AB do not apply to such offerings, all of the information about the findings and conclusions of third-party due diligence reports disclosed in Forms ABS-15G should be information that may not have been available to potential investors, and would not have been disclosed to the broader public, under the baseline requirements.

In addition, any disclosures on Form ABS Due Diligence-15E will be published by NRSROs with their credit ratings when taking rating actions covered by Rule 17g-7 with respect to the Exchange Act-ABS. The Forms ABS Due Diligence-15E will contain additional detailed information about third-party due diligence with respect to an Exchange Act-ABS for which the NRSRO is producing a credit rating beyond the findings and conclusions that must be disclosed by issuers and underwriters, including a description of the scope and manner of the due diligence services provided in connection with the review of the assets underlying an Exchange Act-ABS. In the case of any review that is also discussed in the prospectus pursuant to Rule 193, the description of such review disclosed in Form ABS Due Diligence-15E may include information that is not already disclosed as part of the "nature of the review" discussed in the prospectus. Also, Form ABS Due Diligence-15E information with respect to any due diligence services

will not apply to certain offshore offerings of Exchange Act-ABS. The criteria for exemption include, among other things, that the security issued will be offered and sold upon issuance, and that any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States. It is therefore possible that the rule may result in foreign issuers seeking to avoid the disclosure requirement by limiting certain offerings of Exchange Act-ABS to transactions outside the United States, thus potentially depriving U.S. investors of diversification and related investment opportunities.

employed by an NRSRO rating the security will also be published together with each NRSRO's credit rating, for credit rating actions subject to Rule 17g-7.

In particular, in the case of registered and certain unregistered Exchange Act-ABS with issuer-paid credit ratings, any disclosures on Form ABS Due Diligence-15E will be made publicly available by the issuer-paid NRSRO pursuant to Rule 17g-7, perhaps, for example, on its corporate Internet website. However, if Exchange Act-ABS, whether registered or unregistered, is rated only by subscriber-paid NRSROs, then the Form ABS Due Diligence-15E information is only required by Rule 17g-7 to be made available to subscribers of these NRSROs. Finally, a commenter indicated that in some unregistered offerings of Exchange Act-ABS, credit ratings are distributed only to potential investors in the offering.¹⁶²⁹ Because Rule 17g-7 requires that Forms ABS Due Diligence-15E are made available to the same persons who can receive or access the credit rating, the information in these forms about the scope and manner of the due diligence services provided in connection with the review of assets may then only be made available to these potential investors.

In the above cases in which, relative to the baseline, new information becomes available to users of credit ratings and investors and other market participants who may or may not be users of credit ratings, many of these persons should benefit from the information. The information on the findings and conclusions of reviews disclosed using Form ABS-15G may be of particular use in understanding the quality of the asset pool underlying the Exchange Act-ABS, and possibly may represent a more balanced view of such quality than would have been provided in the absence of the amendments and new rules, since the findings and conclusions of all reviews obtained by issuers and underwriters must be reported. The information from Form

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See DBRS Letter.

ABS Due Diligence-15E may be of particular use in determining the adequacy and the level of due diligence services provided by the third parties. The information in both forms may be of use to users of credit ratings and investors and market participants who may or may not be users of credit ratings in evaluating rated Exchange Act-ABS, both in isolation and in comparison to other rated Exchange Act-ABS. The additional information available relative to the baseline – because it provides insights into the quality of the asset pool and the due diligence procedures of the parties involved – also may help these persons in evaluating the NRSROs, issuers and underwriters of Exchange Act-ABS, third-party due diligence providers, and other parties involved in the issuance process. Consequently, the additional information may be of use in current and future investment decisions as well as other interactions among the various parties involved. The benefits of this information may be constrained, however, by the fact that Form ABS Due Diligence-15E disclosures for different securities which may be rated by different NRSROs are not consolidated in a single location, potentially increasing the effort required to collect and compare these disclosures.

Users of credit ratings and investors and other market participants who may or may not be users of credit ratings may also benefit from other effects of the adopted rules. To the extent that NRSROs obtain more complete information about Exchange Act-ABS that they rate, users of credit ratings may benefit from the higher quality credit ratings that may result. The new information available to investors and other market participants, together with these higher quality credit ratings, may result in more informed investment decisions – potentially improving individual portfolio efficiency as well as market efficiency – and may benefit capital formation by encouraging more participation in the Exchange Act-ABS market. Also, the detailed disclosures and the accompanying certification requirements may promote greater rigor and

discipline of due diligence procedures and thus benefit investors and other market participants who may or may not be users of credit ratings. In particular, the detailed disclosures and the identification of the third parties involved may enhance the ability of third-party due diligence providers to form a market reputation for providing thorough and accurate due diligence reviews, increasing the competition among these third parties on the basis of quality. In addition, the increased comparability of the quality of due diligence across transactions may enhance competition among issuers.¹⁶³⁰

Relative to the baseline, the amendments and new rules will result in compliance costs to issuers and underwriters in offerings of Exchange Act-ABS, third-party due diligence providers, and NRSROs. Rule 15Ga-2 will result in costs to issuers and underwriters in offerings of rated Exchange Act-ABS, whether registered or unregistered (other than municipal Exchange Act-ABS and certain offshore Exchange Act-ABS). Although they are excluded from Rule 15Ga-2, issuers and underwriters of municipal Exchange Act-ABS will still incur costs to comply with their statutory disclosure obligation under section 15E(s)(4)(A) of the Exchange Act, and the Commission has estimated costs to these issuers and underwriters based on the assumption that they will satisfy the disclosure obligation by furnishing Form ABS-15G on EMMA.¹⁶³¹ The Commission believes that the entities that will furnish Form ABS-15G pursuant to Rule 15Ga-2 and/or section 15E(s)(4)(A) of the Exchange Act generally will already have processes and protocols in place to file Form ABS-15G in order to disclose repurchase activity as required by

¹⁶³⁰ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

¹⁶³¹ To the extent that issuers and underwriters of municipal Exchange Act-ABS use another means to make the required information publicly available, such as through an Internet website, the compliance costs to these parties could be greater or less than the Commission's estimates, depending on the method chosen to disclose the information.

Rule 15Ga-1.¹⁶³² However, they will bear any costs of adapting their current processes and protocols to provide the information required to comply with the new disclosure requirements, including modifying their existing Form ABS-15G processes and protocols to accommodate these requirements. They also will incur ongoing costs to prepare and furnish Form ABS-15G to the Commission through EDGAR or, in the case of municipal Exchange Act-ABS, potentially through EMMA. Based on analysis for purposes of the PRA, the Commission estimates that Rule 15Ga-2 and the amendments to Form ABS-15G will result in total industry-wide one-time costs to issuers and underwriters of approximately \$9,509,000 and total industry-wide annual costs to issuers and underwriters of approximately \$202,000.¹⁶³³

Rule 17g-10 will result in one-time and recurring costs for providers of third-party due diligence services. Initially, they will need to develop processes and protocols for preparing the information required, certifying, and promptly delivering Form ABS Due Diligence-15E to NRSROs and to issuers and underwriters maintaining Rule 17g-5 websites. They also may engage outside counsel, and/or consult with in-house counsel, to advise them on how to comply with the new requirements. Providers of third-party due diligence services also will bear recurring costs. Each time they are employed by an issuer, underwriter, or NRSRO to perform due diligence services, they will need to prepare and execute the Form. Based on analysis for purposes of the PRA, the Commission estimates that Rule 17g-10 and Form ABS Due Diligence-15E will result in total industry-wide one-time costs to third-party due diligence providers of

¹⁶³² As discussed above, the Commission has revised the final rule to clarify that a single Form ABS-15G may be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report. The Commission thus expects that the securitizer responsible for filing Rule 15Ga-1 disclosures on Form ABS-15G will most likely also file the Rule 15Ga-2 disclosures.

¹⁶³³ See section V.I. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.10. of this release.

approximately \$1,405,000 and total industry-wide annual costs of approximately \$67,000.¹⁶³⁴

Third-party due diligence providers and the individuals executing the forms on behalf of the third parties may also bear the risk of future liability and associated costs due to the certification requirements in the rule.

The amendments and new rules related to Form ABS Due Diligence-15E also will result in one-time costs for NRSROs to amend their standard agreement forms with issuers and underwriters of Exchange Act-ABS to include the new representation required under Rule 17g-5. Further, the amendments and new rules will result in recurring costs for issuers and underwriters to promptly post the form on their Rule 17g-5 websites. Based on analysis for purposes of the PRA, the Commission estimates that these compliance efforts will result in total industry-wide costs of approximately \$1,902,000 in one-time costs to NRSROs and approximately \$34,000 in annual costs to issuers and underwriters.¹⁶³⁵ NRSRO compliance costs with respect to attaching Forms ABS Due Diligence-15E to the forms that they must publish when taking certain credit rating actions are addressed above in section II.G.6. of this release.

Rule 17g-10 and the associated amendments may also lead to other costs. One commenter stated that it “remains possible that certain third-party due diligence providers may refuse to provide these certifications” or “it may make it more difficult for certain relatively smaller transactions to come to market, since third-party due diligence providers may only be willing to provide these certifications for the largest of transactions, where fees are at levels high

¹⁶³⁴ See section V.J. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.9. of this release.

¹⁶³⁵ See section V.J. of this release (discussing implementation and annual compliance considerations). These costs are derived by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.5. of this release.

enough to justify the associated costs and legal risks.”¹⁶³⁶ The Commission acknowledges that the required certification by third-party due diligence providers may increase the litigation risk and liability of these providers, particularly for those third party providers that do not already bear expert liability under Rule 193. The required certification therefore may increase the fees charged by these providers – which may be borne by issuers, underwriters, or investors – and may diminish competition by reducing the number of providers who are willing to provide due diligence in these offerings. These effects could impact capital formation, in that it may be more costly or difficult to issue Exchange Act-ABS to the extent that the performance of third-party due diligence services is necessary to bring these securities to market. Also, though the Commission believes that NRSROs have not generally employed third-party due diligence services, the disclosures related to any third-party due diligence services employed by NRSROs may reduce any incentives NRSROs have to employ such services, given that the details about, and the results of, such due diligence will be disclosed to competing NRSROs.¹⁶³⁷

Together, all of the adopted rules regarding third-party due diligence services may result in additional costs. The required disclosures may be detrimental to capital formation by delaying market access by issuers.¹⁶³⁸ There also may be other costs to investors and other market participants. The disclosure requirements with respect to any third-party due diligence report obtained may incentivize issuers and underwriters to decrease the number and scope of due diligence reviews undertaken in order to decrease the likelihood that they reveal problems that would have to be disclosed to market participants. If fewer or more limited reviews are undertaken, the information available directly or indirectly (such as through credit ratings) to

¹⁶³⁶ See Morningstar Letter.

¹⁶³⁷ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

¹⁶³⁸ See id.

investors and other market participants may ultimately be reduced. Alternatively, the required disclosures with respect to third-party due diligence reports may cause issuers and underwriters to undertake their own due diligence internally or via related subsidiaries, rather than by employing third parties, in order to avoid making the required disclosure or because third-party due diligence providers increase their fees or become unwilling to provide these services. These potential changes in issuer and underwriter behavior could result in a reduced quality of due diligence undertaken with respect to Exchange Act-ABS because of the lack of independent reviews. The possibility of less comprehensive or less independent due diligence being undertaken may be mitigated by market pressures because, as noted above, some NRSROs require that due diligence be undertaken by an independent third party and that this due diligence meet certain criteria before they will produce a credit rating for certain types of Exchange Act-ABS. Also, if no Form ABS-15G disclosure is made, investors will be put on notice that the issuer or underwriter did not employ a provider of third-party due diligence services in connection with the offering of an Exchange Act-ABS, and thus these investors may be less likely to participate in the offering or may demand a lower offering price.

The Commission has considered the costs and benefits of reasonable alternatives relative to the amendments and new rules, including certain alternatives that have been raised by commenters and discussed above. As noted above, the Commission considered alternative approaches to the required timing of the disclosures, namely a greater or fewer number of days before the first sale in an offering by which Forms ABS-15G must be furnished or a more explicit requirement than the "promptly" standard governing the provision of Form ABS Due Diligence-15E.¹⁶³⁹ If Forms ABS-15G are furnished closer in time to the first sale in an offering,

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See sections II.H.1. and II.H.3. of this release.

the informational benefits of the disclosures may be reduced, because NRSROs and market participants may not have enough time to thoroughly and accurately analyze the included information before investment or credit rating decisions are made. However, the longer the delay between the required furnishing of Forms ABS-15G and the first sale in the offering, the more of an impediment the requirement may be to prompt market access by issuers and underwriters. The Commission believes it has appropriately balanced these considerations in requiring that Forms ABS-15G be furnished five business days prior to the first sale in the offering. In the case of Form ABS Due Diligence-15E, it is possible that prescribing a required timeframe for provision of the form could provide more assurance that NRSROs are able to thoroughly review the information and incorporate it into their credit ratings. However, an explicit timeframe does not seem appropriate given the variation and uncertainty in how quickly the disclosures will be able to be provided in practice.

The Commission also considered whether, as suggested by a commenter,¹⁶⁴⁰ only information about final due diligence reports should have to be disclosed on Form ABS-15G. Limiting the disclosure requirement to final reports may reduce compliance costs to issuers and underwriters. However, as discussed above, the Commission believes that NRSROs, users of credit ratings, and investors and market participants who may or may not be users of credit ratings should benefit from the information derived from interim as well as final due diligence reports.¹⁶⁴¹ In particular, requiring that all reports, including interim reports, received by issuers or underwriters be disclosed further limits the possibility that issuers and underwriters can prevent less favorable information from being revealed (for example, by requesting a change in

¹⁶⁴⁰ See Clayton Letter.

¹⁶⁴¹ See section II.H.1. of this release.

the due diligence methodology or hiring a different third party due diligence provider after viewing a less favorable interim report).

Another alternative would be to require NRSROs to publish each Form ABS Due Diligence-15E on EDGAR and allow them to incorporate the forms by reference when publishing a related credit rating. This approach would, in some cases, increase the persons that have access to the information in the form. Also, it may increase the benefits of the disclosure by including all third-party due diligence disclosures in a consolidated location, rather than a combination of EDGAR (with respect to Form ABS-15G information) and each of the various means by which each NRSRO publishes their ratings (with respect to Form ABS Due Diligence-15E information). However, this approach would increase the total compliance costs borne by NRSROs.

I. STANDARDS OF TRAINING, EXPERIENCE, AND COMPETENCE

Section 936 of the Dodd-Frank Act provides that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings: (1) meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates; and (2) is tested for knowledge of the credit rating process.¹⁶⁴² The Commission proposed new Rule 17g-9 and adding paragraph (b)(15) to Rule 17g-2 to implement section 936 of the Dodd-Frank Act.¹⁶⁴³

¹⁶⁴² Public Law 111-203, 936. A related provision, section 939E of the Dodd-Frank Act, requires the GAO to conduct a study on the feasibility and merits of creating an independent professional organization for rating analysts employed by NRSROs that would be responsible for: (1) establishing independent standards for governing the profession of rating analysts; (2) establishing a code of ethical conduct; and (3) overseeing the profession of rating analysts. A report on the results of the study must be submitted to Congress not later than one year after the publication of Commission rules pursuant to section 936 of the Dodd-Frank Act. Public Law 111-203, 939E. In this regard, a commenter stated that it “looks forward to a robust discussion on the merits and feasibility of creating an independent professional organization for ratings analysts once the [GAO] issues its report on the matter.” See AFSCME Letter.

¹⁶⁴³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33476-33480.

1. New Rule 17g-9

Rule 17g-9, as proposed, had three paragraphs: (a), (b) and (c).¹⁶⁴⁴ Paragraph (a), as proposed, contained a requirement that an NRSRO design and administer standards of training, experience, and competence.¹⁶⁴⁵ Paragraph (b), as proposed, identified factors an NRSRO would need to consider in designing the standards.¹⁶⁴⁶ Paragraph (c), as proposed, set forth two requirements – one relating to periodic testing and the other relating to minimum experience – that an NRSRO would need to incorporate into the standards.¹⁶⁴⁷ The Commission is adopting Rule 17g-9 substantially as proposed but with modifications in response to comments.¹⁶⁴⁸

As discussed below, some commenters raised concerns that the proposed rule provided too much flexibility to an NRSRO to design its standards of training, experience, and competence. The Commission intended the proposed rule to provide flexibility because, among other reasons, the NRSROs vary significantly in the size and the scope of their activities. The Commission reiterates its view, as stated in the proposing release, that the standards established by an NRSRO with more than a thousand credit analysts and that produces tens of thousands of credit ratings across a wide range of asset classes may need to be different from the standards of an NRSRO with fewer than ten credit analysts and that focuses on a particular class of credit ratings.¹⁶⁴⁹ Moreover, the rating methodologies used by NRSROs and potential NRSRO applicants to determine credit ratings may vary significantly. For these and other reasons, as discussed below, Rule 17g-9, as adopted, provides flexibility to NRSROs to customize their

¹⁶⁴⁴ See id. at 33476-33480.

¹⁶⁴⁵ See id. at 33476-33477.

¹⁶⁴⁶ See id. at 33477-33478.

¹⁶⁴⁷ See id. at 33478-33480.

¹⁶⁴⁸ See Rule 17g-9.

¹⁶⁴⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33476.

standards, provided they consider the factors in proposed paragraph (b) and incorporate the standards required under proposed paragraph (c) of Rule 17g-9.

As proposed, paragraph (a) of Rule 17g-9 provided that an NRSRO must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings that are reasonably designed to achieve the objective that such individuals produce accurate credit ratings in the classes and subclasses of credit ratings for which the NRSRO is registered.¹⁶⁵⁰ Under the proposal, an NRSRO would be permitted to design standards for its credit analysts that are customized to its size, business model, and procedures and methodologies for determining credit ratings, which vary widely across NRSROs.¹⁶⁵¹ At the same time, the proposed rule specified an objective for the standards which was consistent with section 936 of the Dodd-Frank Act.¹⁶⁵² In particular, the standards needed to be reasonably designed to achieve the objective that the individuals employed by the NRSRO to determine credit ratings produce accurate credit ratings in the classes and subclasses of credit ratings for which the NRSRO is registered.¹⁶⁵³

The Commission is adopting paragraph (a) of Rule 17g-9 substantially as proposed but with modifications in response to comments.¹⁶⁵⁴ As adopted, the paragraph provides that an NRSRO must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that

¹⁶⁵⁰ See paragraph (a) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33476-33477, 33543.

¹⁶⁵¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33476.

¹⁶⁵² See id. at 33476-33477.

¹⁶⁵³ See Public Law 111-203, 936 (providing, in pertinent part, that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates).

¹⁶⁵⁴ See paragraph (a) of Rule 17g-9.

are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.¹⁶⁵⁵

Commenters addressed paragraph (a), as proposed.¹⁶⁵⁶ Several commenters stated that in general it was not appropriate to permit NRSROs to design their own credit analyst training and testing programs and that, for example, the Commission or a private certification program should provide standards and requirements.¹⁶⁵⁷ One commenter stated that “the Commission should provide a set of minimum standards” and that the standards “should include individual sector experience, minimum education such as an MBA, and certifications such as a CFA, which includes a strong ethics standard.”¹⁶⁵⁸ A second commenter stated that “[t]he standards must include a system for periodically reviewing ratings for ‘accuracy,’ specifically for the purpose of adjusting” the standards for credit analysts based on the results of such reviews.¹⁶⁵⁹ A third commenter stated that the Commission should prescribe the minimum content for training, to include topics such as ethics, conflicts of interest, and regulations on the ratings process, as well as the proper development of methodologies.¹⁶⁶⁰

On the other hand, several NRSROs stated that it was appropriate that the rule provide flexibility to NRSROs in designing the standards required under the proposed rule.¹⁶⁶¹ One NRSRO stated that credit rating agencies “come in many shapes and sizes and they determine

¹⁶⁵⁵ Id.

¹⁶⁵⁶ See Better Markets Letter; CFA/AFR Letter; Clark Letter; COPERA Letter; Davis Letter DBRS Letter; Morningstar Letter; S&P Letter.

¹⁶⁵⁷ See Better Markets Letter; CFA/AFR Letter; Clark Letter; COPERA Letter; Davis Letter.

¹⁶⁵⁸ See COPERA Letter.

¹⁶⁵⁹ See Better Markets Letter.

¹⁶⁶⁰ See id.

¹⁶⁶¹ See DBRS Letter; Morningstar Letter; S&P Letter.

credit ratings in many different ways” and, therefore, “[i]mposing prescriptive analyst standards on such a diverse group would diminish the value of the rule.”¹⁶⁶²

In response to comments that NRSROs should not have flexibility to design their own standards and that the rule should prescribe specific requirements, the Commission believes at this time, as discussed above, that the proposed approach achieves an appropriate balance between prescribing objectives, factors that must be considered, and specific standards that must be included and allowing NRSROs to tailor the standards to their business models, size, and rating methodologies, which vary significantly across NRSROs and potential NRSRO applicants. For example, prescribing minimum education requirements (such as an MBA) and certification requirements (such as a CFA) – as suggested by one commenter – may not be appropriate for all NRSROs because, for example, it could disqualify an analyst that has substantial experience in conducting credit analysis but does not have the requisite degree or certification.¹⁶⁶³ Further, this could burden smaller NRSROs to the extent they would need to hire new analysts to meet the requirements or need to pay for their analysts to obtain the necessary degrees or certifications.

An NRSRO stated that “as forward-looking statements of opinion, ratings should not be categorized as ‘accurate’ or ‘inaccurate’” and that the Commission should instead focus on whether the ratings have been derived in a manner consistent with the NRSRO’s policies and procedures.¹⁶⁶⁴ In response, the Commission re-iterates that section 936 of the Dodd-Frank Act requires the Commission to issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience, and

¹⁶⁶² See DBRS Letter.

¹⁶⁶³ See COPERA Letter.

¹⁶⁶⁴ See S&P Letter.

competence necessary to produce “accurate” credit ratings for the categories of issuers whose securities the person rates.¹⁶⁶⁵ Paragraph (a) of Rule 17g-9, as proposed and adopted, implements this requirement by providing that the standards must be reasonably designed to achieve the objective of producing accurate credit ratings.¹⁶⁶⁶ The Commission acknowledges that there is no consensus as to whether or how credit ratings can be measured for accuracy.¹⁶⁶⁷ The Commission also recognizes that the credit rating assigned to an obligor or obligation today may need to be revised in the future if circumstances change and that even the most creditworthy obligors or obligations may default. Consequently, for the purposes of Rule 17g-9, as adopted, an “accurate” credit rating does not mean a credit rating that once issued will never need to be upgraded or downgraded or classified as a default. Instead, to be accurate under the rule, the credit rating should be a credible assessment of the relative creditworthiness of an obligor or obligation.¹⁶⁶⁸ To be a credible assessment at the time of issuance, the credit rating, among other things, should be determined in accordance with the applicable rating methodology of the NRSRO; take into account all relevant information as specified by the rating methodology; not be influenced by conflicts of interest; be based solely upon the merits of the obligor, security, or money market instrument being rated; and be an independent evaluation of the credit risk and merits of the obligor, security, or money market instrument.¹⁶⁶⁹ Historical performance statistics

¹⁶⁶⁵ See Public Law 111-203, 936(1).

¹⁶⁶⁶ See paragraph (a) of Rule 17g-9.

¹⁶⁶⁷ See, e.g., Staff 2012 Staff Report on Assigned Credit Ratings, pp. 52-53.

¹⁶⁶⁸ See *id.* at 14-21 (describing credit rating symbols and their definitions).

¹⁶⁶⁹ See, e.g., section 15E(q)(2)(F) of the Exchange Act (providing that the Commission’s rules must require an NRSRO to include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument). As discussed above in section II.G.4. of this release, the Commission is implementing section 15E(q)(2)(F) through paragraph (a)(1)(iii) of Rule 17g-7, as adopted. This paragraph, as adopted, provides that the NRSRO must attach to the form accompanying a credit rating a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the

can play a role in evaluating whether an NRSRO's credit ratings over time are providing credible assessments of the relative creditworthiness of obligors and obligations.

An NRSRO suggested that NRSROs should not be required to comply with Rule 17g-9 "to the extent the NRSRO reasonably believes it is prohibited by applicable law or binding agreements in the relevant jurisdiction from doing so."¹⁶⁷⁰ In response, the Commission notes that the rule as adopted gives NRSROs the flexibility to design their standards of training and testing for credit analysts. Consequently, an NRSRO can tailor its standards to accommodate local laws. These standards, must, however, meet the requirements of Rule 17g-9. The Commission does not believe a blanket exemption would be appropriate, but if laws or binding agreements in certain jurisdictions prohibit the NRSRO from complying with certain provisions of Rule 17g-9, the NRSRO can seek appropriate targeted relief.

Finally, one NRSRO suggested that the words "and subclasses" be removed from paragraph (a) of proposed Rule 17g-9 because "NRSROs are registered only for various credit rating classes; there is no subclass registration."¹⁶⁷¹ A second NRSRO stated that it determines "credit ratings by committee and no one individual is responsible for any credit rating."¹⁶⁷² Another commenter stated that "[i]ndividuals do not 'produce...credit ratings,' accurate or otherwise."¹⁶⁷³

person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

¹⁶⁷⁰ See Moody's Letter ("[I]n some jurisdictions it might not be possible to require an existing employee to meet new competence, experience, training, or testing requirements unless he or she agrees to such requirements in an amended employment agreement or collective bargaining agreement. If the employee, union or works council declines to sign the amended agreement, it might not be possible for the NRSRO to modify unilaterally the employment relationship.").

¹⁶⁷¹ See DBRS Letter.

¹⁶⁷² See S&P Letter.

¹⁶⁷³ See Harrington Letter.

While the use of the term “subclasses” was designed to account for the different types of obligors and obligations assigned credit ratings within a class of credit ratings, the Commission agrees with the comment that the use of the term in paragraph (a) was potentially confusing because NRSROs do not register in subclasses of credit ratings.¹⁶⁷⁴ Accordingly, the Commission has modified proposed paragraph (a) of Rule 17g-9 to remove the reference to “subclasses,” and paragraph (a) as adopted refers only to “the classes of credit ratings” for which the NRSRO is registered.¹⁶⁷⁵ In response to comments that individuals generally do not “determine” credit ratings (the language in the proposed rule),¹⁶⁷⁶ paragraph (a) of Rule 17a-9 has been modified from the proposal to refer to credit analysts as individuals an NRSRO employs “to participate in the determination of credit ratings” instead of individuals who “produce” credit ratings, and the rule as adopted refers to the NRSRO as producing credit ratings.¹⁶⁷⁷

As proposed, paragraphs (b)(1) through (4) of Rule 17g-9 identified certain factors that the NRSRO would need to consider when establishing standards of training, experience, and competence.¹⁶⁷⁸ Specifically, the NRSRO would have been required to consider:

- If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated;¹⁶⁷⁹

¹⁶⁷⁴ See DBRS Letter.

¹⁶⁷⁵ See paragraph (a) of Rule 17g-9. However, paragraphs (b) and (c) of Rule 17g-9, as adopted, refer to classes and subclasses of credit ratings. The references to “subclasses” are designed to account for the fact that rating methodologies used within a class of credit ratings (for example, structured finance) may be substantially different for certain subclasses (for example, a CDO as compared to an RMBS).

¹⁶⁷⁶ See S&P Letter; Harrington Letter.

¹⁶⁷⁷ See paragraph (a) of Rule 17g-9.

¹⁶⁷⁸ See paragraphs (b)(1) through (4) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33477-33478, 33543.

¹⁶⁷⁹ See paragraph (b)(1) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

- If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies;¹⁶⁸⁰
- The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses;¹⁶⁸¹ and
- The complexity of the obligors, securities, or money market instruments being rated by the individual.¹⁶⁸²

The proposed factors were intended to provide guidance to NRSROs about the Commission's expectations for the design of the standards of training, experience, and competence.¹⁶⁸³

The Commission is adopting paragraph (b) of Rule 17g-9 substantially as proposed but with modifications in response to comments.¹⁶⁸⁴ As adopted, paragraph (b) requires an NRSRO to consider the following factors when establishing the standards required under paragraph (a):

- If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated;¹⁶⁸⁵
- If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies;¹⁶⁸⁶

¹⁶⁸⁰ See paragraph (b)(2) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁶⁸¹ See paragraph (b)(3) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁶⁸² See paragraph (b)(4) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁶⁸³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33477.

¹⁶⁸⁴ See paragraph (b) of Rule 17g-9.

¹⁶⁸⁵ See paragraph (b)(1) of Rule 17g-9.

¹⁶⁸⁶ See paragraph (b)(2) of Rule 17g-9.

- The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses;¹⁶⁸⁷ and
- The complexity of the obligors, securities, or money market instruments for which the individual participates in determining credit ratings.¹⁶⁸⁸

Commenters addressed paragraph (b) of Rule 17g-9, as proposed.¹⁶⁸⁹ One commenter stated that “the Commission should set forth more specific expectations” and that, for example, “the Commission should provide guidance regarding what kind of technical expertise in quantitative analysis should be required, depending on how the person will be using quantitative procedures and methodologies.”¹⁶⁹⁰ Another commenter stated that the factors listed in paragraph (b) should include that certain types of securities (for example new or highly complex securities) may require more training and specialized expertise.¹⁶⁹¹ On the other hand, an NRSRO stated that the factors set forth in paragraph (b) of proposed Rule 17g-9 “sufficiently capture the general issues an NRSRO should consider in designing its analyst training program.”¹⁶⁹² Another NRSRO stated that the factors were “reasonable.”¹⁶⁹³

In response to the comment that the rule should include more specific expectations,¹⁶⁹⁴ the Commission believes the factors strike an appropriate balance in terms of identifying critical matters an NRSRO should take into consideration but with sufficient generality to have broad

¹⁶⁸⁷ See paragraph (b)(3) of Rule 17g-9.

¹⁶⁸⁸ See paragraph (b)(4) of Rule 17g-9. Consistent with the modifications to paragraph (a) discussed above, the Commission is modifying paragraph (b)(4) from the proposal by replacing the phrase “rated by the individuals” with the phrase “for which the individual participates in determining credit ratings”.

¹⁶⁸⁹ See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; COPERA Letter; DBRS Letter; S&P Letter.

¹⁶⁹⁰ See AFSCME Letter.

¹⁶⁹¹ See CFA/AFR Letter.

¹⁶⁹² See DBRS Letter.

¹⁶⁹³ See S&P Letter.

¹⁶⁹⁴ See AFSCME Letter; CFA/AFR Letter; COPERA Letter; S&P Letter.

application across NRSROs with different business models, sizes, and rating methodologies, while identifying specific factors the Commission believes are important for an NRSRO to consider when designing the standards. Further, as discussed below, the Commission is adopting, in paragraph (c) of Rule 17g-9, specific items that an NRSRO must include in its standards of training, experience, and competence.¹⁶⁹⁵

One commenter stated that the rule should recognize that certain types of securities (for example new or highly complex securities) may require more training and specialized expertise.¹⁶⁹⁶ The factor listed in paragraph (b)(4) of Rule 17g-9, as adopted, requires NRSROs to consider the complexity of the obligors or securities rated by the analyst when establishing the standards required under paragraph (a) of Rule 17g-9. The Commission believes that this requirement achieves the commenter's objective of having the standards take into account the complexity of securities being rated by the analyst.

As proposed, paragraphs (c)(1) and (2) of Rule 17g-9 provided that an NRSRO must include the following in the standards, respectively:

- A requirement for periodic testing of the individuals employed by the NRSRO to determine credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings;¹⁶⁹⁷ and
- A requirement that at least one individual with three years or more experience in performing credit analysis participates in the determination of a credit rating.¹⁶⁹⁸

The Commission is adopting paragraph (c)(1) of Rule 17g-9 substantially as proposed but with modifications in response to comments.¹⁶⁹⁹ As adopted, paragraph (c)(1) provides that an

¹⁶⁹⁵ See paragraph (c) of Rule 17g-9.

¹⁶⁹⁶ See CFA/AFR Letter.

¹⁶⁹⁷ See paragraph (c)(1) Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

¹⁶⁹⁸ See paragraph (c)(2) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

NRSRO must include in the standards required under paragraph (a) a requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings.¹⁷⁰⁰

Commenters addressed paragraph (c)(1) of Rule 17g-9, as proposed.¹⁷⁰¹ Some commenters stated that the Commission or another regulatory body or independent credentialing organization should establish and administer NRSRO testing regimes or establish minimum testing standards.¹⁷⁰² One of these commenters stated that the testing requirement should be more detailed, and should include requirements related to the “frequency of testing, basic content, consequences of failure, and eligibility for retesting.”¹⁷⁰³ In contrast, three NRSROs stated that an NRSRO should be able to design its own testing programs.¹⁷⁰⁴

In response to comments that the Commission or another independent entity should establish and administer NRSRO credit analyst testing programs or that the testing requirement should be more detailed,¹⁷⁰⁵ the Commission notes that section 936 of the Dodd-Frank Act requires that NRSRO credit analysts be “tested for knowledge of the credit rating process.”¹⁷⁰⁶

¹⁶⁹⁹ Consistent with the modifications to paragraph (a) discussed above, the Commission is modifying paragraph (c)(1) from the proposal to replace the phrase “individuals employed by [the NRSRO] to determine credit ratings” with the phrase “individuals employed by [the NRSRO] to participate in the determination of credit ratings”. See paragraph (c)(1) of Rule 17g-9.

¹⁷⁰⁰ See paragraph (c)(1) Rule 17g-9.

¹⁷⁰¹ See Better Markets Letter; CFA/AFR Letter; COPERA Letter; DBRS Letter; Fitch Letter; Harrington Letter; Moody's Letter; Morningstar Letter.

¹⁷⁰² See Better Markets Letter; CFA/AFR Letter; COPERA Letter.

¹⁷⁰³ See Better Markets Letter.

¹⁷⁰⁴ See DBRS Letter; Morningstar Letter; S&P Letter.

¹⁷⁰⁵ See Better Markets Letter; CFA/AFR Letter; COPERA Letter.

¹⁷⁰⁶ Public Law 111-203, 936(2).

As rating methodologies vary among the NRSROs, the Commission believes it is appropriate for NRSROs to design their own testing programs, subject to the requirements of paragraphs (a), (b), and (c) of Rule 17g-9. In particular, the standards for testing must be reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.¹⁷⁰⁷

An NRSRO stated that the testing program should “apply only to the credit rating procedures and methodologies that fall within the scope of the individual's primary area or areas of analytical responsibility” and that credit analysts should be tested on the “principal methodologies” used by the NRSRO to determine credit ratings.¹⁷⁰⁸ The Commission notes that the question of whether an NRSRO’s standards for testing are reasonably designed to ensure that credit analysts meet standards of training, experience, and competence necessary to produce accurate ratings for categories of issuers whose securities the person rates and that they are tested for knowledge of the credit rating process will depend on the NRSRO’s rating methodologies and how the NRSRO requires its credit analysts to apply them. An individual’s primary area or areas of responsibility certainly will be relevant to the designing testing standards that will apply to the employee. For example, an NRSRO may need to tailor its training and testing program to account for the different rating methodologies it uses to determine credit ratings across classes and subclasses of credit ratings so that a given employee is trained and tested on the particular rating methodology or methodologies the employee uses to determine credit ratings.

An NRSRO stated that analysts with certain qualifications and subject to professional examinations and continuing education requirements should be exempt from the testing

¹⁷⁰⁷ See paragraph (a) of Rule 17g-9.

¹⁷⁰⁸ See Moody’s Letter.

requirement.¹⁷⁰⁹ In response, the Commission notes that section 936 of the Dodd-Frank Act provides that the Commission shall issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings is tested for knowledge of the credit rating process.¹⁷¹⁰ Paragraph (c)(1) of Rule 17g-9, as adopted, implements this section by providing that an NRSRO must include in the standards required under paragraph (a) a requirement for periodic testing of the individuals employed by the NRSRO to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings.¹⁷¹¹ Consequently, the subject matter of the training must be the NRSRO's rating methodologies. This does not mean that the standards of training established by the NRSRO cannot take into account qualifications, professional examinations, and continuing education requirements. However, unless external professional examinations and continuing education requirements address the NRSRO's specific rating methodologies, exemptions from the required testing and continuous education requirements would not be appropriate.

One commenter stated that testing of credit analysts on their knowledge of the credit rating process could be abused by managers.¹⁷¹² The Commission believes testing credit analysts for knowledge of the credit rating process as mandated by section 936 and Rule 17g-9 will benefit the NRSRO, the analysts employed by the NRSRO, and investors and other users of credit ratings by promoting the analysts' adherence to, the proper application of, the NRSRO's

¹⁷⁰⁹ See Fitch Letter.

¹⁷¹⁰ See Public Law 111-203, 936(2) (emphasis added).

¹⁷¹¹ See paragraph (c)(1) of Rule 17g-9 (emphasis added).

¹⁷¹² See Harrington Letter.

rating methodologies. In response to the commenter's concern, the Commission notes that section 15E(j) of the Exchange Act requires the NRSRO to designate an individual responsible for, among other things, ensuring compliance with the securities laws.¹⁷¹³ This individual is responsible for, among other things, establishing procedures for the receipt, retention, and treatment of confidential anonymous complaints by employees of the NRSRO.¹⁷¹⁴ Thus, employees have the recourse of submitting confidential and anonymous complaints if managers seek to abuse the training program administered by the NRSRO. For all of these reasons, the Commission does not believe it would be appropriate or necessary to refrain from implementing the statute in response to the concern raised by the commenter.

The Commission is adopting paragraph (c)(2) of Rule 17g-9 with a modification from the proposal in response to comments.¹⁷¹⁵ In particular, a number of commenters addressed the proposed requirement that at least one individual with three or more years of experience in performing credit analysis participate in the determination of a credit rating.¹⁷¹⁶ Some commenters stated that the three-year requirement was not sufficient, for example, with respect to complex securities.¹⁷¹⁷ For example, one of these commenters stated that “[g]iven the enormous complexity of the ratings process, and the importance of ratings in our financial markets, requiring the involvement of a person with only three years of experience in each rating is woefully insufficient” and that “[s]ubstantially more seasoning is necessary to ensure that each

¹⁷¹³ See 15 U.S.C. 78o-7(j).

¹⁷¹⁴ See 15 U.S.C. 78o-7(j)(3)(B).

¹⁷¹⁵ See paragraph (c)(2) of Rule 17g-9.

¹⁷¹⁶ See AFSCME Letter; Better Markets Letter; CFA/AFR Letter; DBRS Letter; Harrington Letter; Morningstar Letter; S&P Letter.

¹⁷¹⁷ See AFSCME Letter; Better Markets Letter; CFA/AFR Letter.

rating is properly supervised.”¹⁷¹⁸ Similarly, an NRSRO stated that the proposed requirement “sets such a low bar that it is almost meaningless.”¹⁷¹⁹ Another NRSRO stated that “the Commission should not establish a minimum number of years experience for participating in the determination of a rating” and that “NRSROs should establish their own requirements.”¹⁷²⁰ In contrast, one commenter stated that requiring that at least three years of credit rating committee experience would be “sensible.”¹⁷²¹

The Commission is persuaded that the rule should not solely require three years of experience. For example, there may be types of obligors or obligations that – because of their complexity – require an individual to participate in determining the credit rating who has more than three years of experience. Consequently, as adopted, paragraph (c)(2) of Rule 17g-9 provides that an NRSRO must include in the standards required under paragraph (a) a requirement that at least one individual with an appropriate level of experience in performing credit analysis, which may in some instances be more than, but cannot be less than, three years participates in the determination of a credit rating.¹⁷²² Thus, the rule requires that the level of experience be commensurate with the type of obligor or obligation being rated and it sets a floor of a minimum of three years of experience.

As proposed, paragraph (c)(2) provided that the experience must be in performing credit analysis.¹⁷²³ In the proposing release, the Commission noted that performing credit analysis is not synonymous with determining credit ratings and that many financial institutions have credit

¹⁷¹⁸ See Better Markets Letter.

¹⁷¹⁹ See DBRS Letter.

¹⁷²⁰ See S&P Letter.

¹⁷²¹ See Harrington Letter.

¹⁷²² See paragraph (c)(2) of Rule 17g-9.

¹⁷²³ See paragraph (c)(2) of Rule 17g-9, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543.

risk departments staffed by individuals who analyze the creditworthiness of existing and future counterparties and borrowers.¹⁷²⁴ The Commission stated in the proposing release that it preliminarily intended that this type of work would qualify a credit analyst to meet the three-year requirement in paragraph (c)(2) of proposed Rule 17g-9.¹⁷²⁵

One commenter stated that the experience should be in determining credit ratings and that “other experiences in assessing credit should not serve to fulfill this requirement.”¹⁷²⁶ In contrast, an NRSRO stated that the requisite experience should not be limited to having worked for an NRSRO because such a requirement “could negatively impact smaller NRSROs and possible new entrants, given the small number of entities in the industry.”¹⁷²⁷ The Commission continues to believe that experience performing credit analysis whether in determining credit ratings or in other contexts (for example, in the credit department of a financial institution) can qualify an individual to meet the requirement in paragraph (c)(2) of Rule 17g-9, as adopted. In fact, the fresh perspective of a credit analyst who has been performing credit analysis for purposes other than determining credit ratings could promote the quality of credit ratings and innovation.

Finally, one commenter stated that that an experienced analyst also should be required to certify approval of the rating in writing.¹⁷²⁸ At this time, due to other measures in place, the Commission does not believe such a requirement is necessary. First, as discussed above, the Commission is implementing section 15E(q)(2)(F) through paragraph (a)(1)(iii) of Rule 17g-7, as adopted. This paragraph, as adopted, provides that the NRSRO must attach to the form

¹⁷²⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33479.

¹⁷²⁵ Id. at 33479.

¹⁷²⁶ See Harrington Letter.

¹⁷²⁷ See Morningstar Letter.

¹⁷²⁸ See Better Markets Letter.

accompanying a credit rating a signed statement by a person within the NRSRO stating that the person has responsibility for the rating action and, to the best knowledge of the person: (1) no part of the credit rating was influenced by any other business activities; (2) the credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and (3) the credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument. Second, paragraph (a)(2) of Rule 17g-2 requires NRSROs to make and retain records with respect to each current credit rating, including the identity of any credit analyst that participated in determining the rating and the identity of any person that approved the credit rating.

2. Amendment to Rule 17g-2

The Commission proposed adding paragraph (b)(15) to Rule 17g-2 to identify the standards of training, experience, and competence the NRSRO must establish, maintain, enforce, and document pursuant to proposed Rule 17g-9 as a record that must be retained.¹⁷²⁹ As a result, the standards would have been subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g-2.¹⁷³⁰ The Commission stated that this record, along with other records the proposal would have required NRSROs to make, should be subject to the same recordkeeping requirements applicable to other records an NRSRO is required to retain pursuant to Rule 17g-2.¹⁷³¹

One commenter stated that “we strongly support the Commission proposal to make training, testing, and experience policies subject to recordkeeping requirements” and that the

¹⁷²⁹ See section 17(a)(1) of the Exchange Act, which requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

¹⁷³⁰ See 17 CFR 240.17g-2(c) through (f).

¹⁷³¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33423.

Commission “should make clear that this includes testing results.”¹⁷³² Another commenter stated that “the documentation requirement should include documentation not only of the standards, but also of the implementation, including records showing that analysts have been tested, that ratings have been reviewed for accuracy to identify weaknesses in the training regime, and that a seasoned analyst has participated in and approved of each credit rating.”¹⁷³³ The Commission does not believe for now that it is necessary to require the documentation and/or retention of these specific types of records. The Commission notes that NRSROs may need to be able to demonstrate compliance with Rule 17g-9 and that making and retaining records showing that analysts have been tested and the experience level of persons participating in credit ratings is one way to demonstrate compliance with the rule. Further, as noted above, paragraph (a)(2) of Rule 17g-2 requires NRSROs to make and retain records with respect to each current credit rating, including the identities of any credit analyst that participated in determining the rating and the identity of any person that approved the credit rating.¹⁷³⁴ Finally, using credit rating performance statistics could be a useful input in evaluating the effectiveness of training programs.¹⁷³⁵

The Commission is adding paragraph (b)(15) to Rule 17g-2 as proposed.¹⁷³⁶ This will provide a means for the Commission to monitor the NRSROs’ compliance with Rule 17g-9. The record must be retained until three years after the date the record is replaced with an updated

¹⁷³² See CFA/AFR Letter.

¹⁷³³ See Better Markets Letter.

¹⁷³⁴ See paragraph (a)(2) of Rule 17g-2.

¹⁷³⁵ See Better Markets Letter.

¹⁷³⁶ See paragraph (b)(15) of Rule 17g-2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

record in accordance with the amendment to paragraph (c) of Rule 17g-2 discussed above in section II.A.2. of this release.¹⁷³⁷

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule relating to the standards of training, experience, and competence.¹⁷³⁸ The baseline that existed before today's adoption of Rule 17g-9 and the amendment to Rule 17g-2 was one in which an NRSRO was not required to establish, maintain, enforce, and document standards of training, experience, and competence for its credit analysts that are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which the NRSRO is registered and that include a requirement to conduct periodic testing of its credit analysts for knowledge of the NRSRO's procedures and methodologies to determine credit ratings and a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating. Further, NRSROs were not required to retain a record documenting the procedures and methodologies. However, NRSROs and applicants for registration as NRSROs were required to disclose in Exhibit 8 to Form NRSRO a general description of the minimum qualifications required of their credit analysts and credit analyst supervisors, including education level and work experience.

Relative to this baseline, Rule 17g-9 and the amendment to Rule 17g-2 will likely provide benefits. These new requirements should result in higher levels of competency among

¹⁷³⁷ See paragraphs (b)(15) and (c) of Rule 17g-2.

¹⁷³⁸ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

NRSRO credit analysts, which should result in higher quality credit ratings. The factors enumerated in paragraph (b) of Rule 17g-9 could serve an investor protection function by providing benchmarks that could be used by the Commission and the NRSRO to evaluate whether a given NRSRO's standards are reasonably designed to meet the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered. In particular, the first two factors should help the Commission and the NRSRO evaluate the degree to which knowledge and technical expertise with respect to data and models is emphasized in the standards of an NRSRO. The latter two factors should help the Commission and the NRSRO evaluate the degree to which expertise in factors relevant to credit ratings and the complexity of obligors, securities, or money market instruments are emphasized in the NRSRO's standards of training for its credit analysts.

The requirement in paragraph (c)(2) of Rule 17g-9 that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating should help achieve the objective that an NRSRO produces accurate credit ratings. The requirement in paragraph (c)(1) of Rule 17g-9 for periodic testing of an NRSRO's credit analysts on their knowledge of the NRSRO's procedures and methodologies to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings should also enhance integrity and quality of the credit ratings. Higher quality credit ratings should benefit those who use credit ratings in making investment and credit-based decisions. The requirement to document the standards will also help the NRSRO to adhere to the standards.

The record the NRSROs must retain under the amendment to Rule 17g-2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are

reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings in the classes of credit ratings for which it is registered and whether the NRSRO is complying with the policies and procedures.

Relative to the baseline, the amendments and new rule will result in costs for NRSROs. NRSROs will incur one-time costs when establishing and documenting the standards of training, experience, and competence for NRSRO credit analysts and ongoing costs to update these standards and conduct periodic testing. Based on analysis for purposes of the PRA, the Commission estimates that Rule 17g-9 will result in total industry-wide one-time costs to NRSROs of approximately \$7,834,000 and total industry-wide annual costs to NRSROs of approximately \$1,629,000.¹⁷³⁹ Further, NRSROs will incur costs in conducting periodic testing for knowledge of the credit rating process. The cost of this testing will likely vary significantly across NRSROs and depend on their size, the different types of credit ratings they issue, and the complexity of their methodologies. However, based on analysis for purposes of the PRA, the Commission estimates that Rule 17g-9 will result in additional total industry-wide annual costs for NRSROs to conduct periodic testing of their credit analysts of approximately \$5,990,000.¹⁷⁴⁰

Relative to the baseline, the amendments to Rule 17g-2 prescribing retention requirements for the documentation of the standards will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g-2 before today's amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the

¹⁷³⁹ See section V.K. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.8. of this release.

¹⁷⁴⁰ See section V.K. of this release (discussing implementation and annual compliance considerations). The annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.8. of this release.

incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(15) of Rule 17g-2 and the amendment to paragraph (c) of Rule 17g-2 will result in total industry-wide one-time costs to NRSROs of approximately \$12,000 and total industry-wide annual costs to NRSROs of approximately \$3,000.¹⁷⁴¹

A possible additional cost is that the requirements could distort the labor market for individuals with at least three years of experience in performing credit analysis. For example, NRSROs may need to pay a premium to retain such individuals, which may inhibit them from moving to productive activity in other industries. The magnitude of this cost is infeasible to estimate as the degree to which these salaries may increase is unknown.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.¹⁷⁴² First, they could improve the quality of credit ratings. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also improve if this information is reflected in asset prices. Consequently, capital formation could also improve as capital could flow to more efficient uses with the benefit of this enhanced information. These amendments also will result in costs, which may have a component that is fixed in magnitude across NRSROs and does not depend on the size of an NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs, creating adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to

¹⁷⁴¹ See section V.K. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

¹⁷⁴² See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO. These costs also will depend on the complexity of operations within the NRSRO.

There are reasonable alternatives to the requirements in the amendments and new rule. First, the Commission or an independent entity could provide standards for training and testing programs or administer these programs as suggested by commenters.¹⁷⁴³ As discussed earlier, the Commission believes at this time that allowing NRSROs the flexibility to design their own standards achieves an appropriate balance between prescribing standards and allowing NRSROs to tailor the standards to their business models, size, and rating methodologies, which vary significantly across NRSROs and potential NRSRO applicants.

Another alternative is that the Commission could make the requirements of paragraph (c)(2) of Rule 17g-9 less restrictive. For example, one commenter suggested that the Commission not require a minimum number of years of experience for individuals participating in the determination of credit ratings and that NRSROs should establish their own requirements.¹⁷⁴⁴ However, if NRSROs established a lower requirement, this alternative could decrease the quality of credit ratings by decreasing the level of expertise brought to determinations of credit ratings. However, it could also decrease costs if it eliminates the potential distortions to the labor market for analysts with at least three years of experience discussed earlier.

J. UNIVERSAL RATING SYMBOLS

Section 938(a) of the Dodd-Frank Act provides that the Commission shall require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures that: (1)

¹⁷⁴³ See Better Markets Letter; CFA/AFR Letter; COPERA Letter; Davis Letter.

¹⁷⁴⁴ See S&P Letter.

assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument;¹⁷⁴⁵ (2) clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating;¹⁷⁴⁶ and (3) apply any symbol described in item (2) in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.¹⁷⁴⁷ Section 938(b) of the Dodd-Frank Act provides that nothing in section 938 shall prohibit an NRSRO from using distinct sets of symbols to denote credit ratings for different types of securities or money market instruments.¹⁷⁴⁸

Further, section 939(h)(1) of the Dodd-Frank Act provides that the Commission shall undertake a study on the feasibility and desirability of:

- standardizing credit rating terminology, so that all credit rating agencies issue credit ratings using identical terms;
- standardizing the market stress conditions under which ratings are evaluated;
- requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and
- standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.¹⁷⁴⁹

Section 939(h)(2) of the Dodd-Frank Act provides that the Commission shall submit to Congress a report containing the findings of the study and the recommendations, if any, of the Commission

¹⁷⁴⁵ See Pub. L. No. 111-203, 938(a)(1).

¹⁷⁴⁶ See Pub. L. No. 111-203, 938(a)(2).

¹⁷⁴⁷ See Pub. L. No. 111-203, 938(a)(3).

¹⁷⁴⁸ See Pub. L. No. 111-203, 938(b).

¹⁷⁴⁹ See Pub. L. 111-203, 939(h)(1).

with respect to the study.¹⁷⁵⁰ The Commission submitted the staff report to Congress in September 2012.¹⁷⁵¹

Finally, section 15E(c)(2) of the Exchange Act provides, in pertinent part, that the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.¹⁷⁵²

The Commission proposed to implement section 938(a) of the Dodd-Frank Act by proposing paragraph (b) of Rule 17g-8 and by adding paragraph (b)(14) to Rule 17g-2.¹⁷⁵³

1. Paragraph (b) of New Rule 17g-8

Section 938(a) of the Dodd-Frank Act prescribes the policies and procedures the Commission shall require, by rule, of each NRSRO.¹⁷⁵⁴ Consequently, paragraph (b) of Rule 17g-8, as proposed, was modeled on the statutory text.¹⁷⁵⁵

As proposed, the prefatory text of paragraph (b) provided that an NRSRO must establish, maintain, enforce, and document policies and procedures that are reasonably designed to achieve three objectives identified in paragraphs (b)(1), (2), and (3).¹⁷⁵⁶ The prefatory text of paragraph (b), as proposed, mirrored the prefatory text of section 938(a) of the Dodd-Frank Act, except that the proposed rule text included the word “document” so that the rule, as proposed, would require

¹⁷⁵⁰ See Pub. L. 111-203, 939(h)(2).

¹⁷⁵¹ See 2012 Staff Report on Credit Rating Standardization.

¹⁷⁵² See 15 U.S.C. 78o-7(c)(2).

¹⁷⁵³ See paragraph (b) of Rule 17g-8, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33543. See also paragraph (b)(14) of Rule 17g-2, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33539.

¹⁷⁵⁴ See Public Law 111-203, 938(a).

¹⁷⁵⁵ See paragraph (b) of proposed Rule 17g-8; Nationally Recognized Statistical Rating Organizations, 76 FR at 33480-33481, 33543.

¹⁷⁵⁶ See prefatory text of paragraph (b) of Rule 17g-8, as proposed.

the NRSRO to document the policies and procedures it establishes, maintains, and enforces.¹⁷⁵⁷

The requirement was added so that an NRSRO would need to set forth its policies and procedures in writing.¹⁷⁵⁸ This requirement, coupled with the Commission's proposed amendment to Rule 17g-2, was designed, among other things, to make the policies and procedures more readily available to Commission examiners.¹⁷⁵⁹ Documenting the policies and procedures in writing also will promote the NRSRO's compliance with them. For all these reasons, the Commission is adopting the prefatory text as proposed.¹⁷⁶⁰

Paragraph (b)(1) of Rule 17g-8, as proposed, would require the NRSRO to have policies and procedures reasonably designed to assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.¹⁷⁶¹ The text of this provision mirrored the text of section 938(a)(1) of the Dodd-Frank Act.¹⁷⁶² One commenter stated that the paragraph, as proposed, was "sufficiently explicit."¹⁷⁶³ The Commission is adopting paragraph (b)(1) of Rule 17g-8 as proposed.¹⁷⁶⁴

The Commission noted in the proposing release that section 15E(s)(3)(B)(ii) of the Exchange Act provides that the Commission's rule requiring an NRSRO to generate a form to disclose information with the publication of a credit rating requires disclosure of information on the content of the credit rating, including: (1) the historical performance of the credit rating; and

¹⁷⁵⁷ See Pub. L. No. 111-203, 938(a).

¹⁷⁵⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33480.

¹⁷⁵⁹ See id.

¹⁷⁶⁰ See prefatory text of paragraph (b) of Rule 17g-8.

¹⁷⁶¹ See proposed paragraph (b)(1) of Rule 17g-8.

¹⁷⁶² See Pub. L. No. 111-203, 938(a)(1).

¹⁷⁶³ See S&P Letter.

¹⁷⁶⁴ See paragraph (b)(1) of Rule 17g-8.

(2) the expected probability of default and the expected loss in the event of default.¹⁷⁶⁵ As discussed above in section II.G.3. of this release, the Commission has implemented this requirement in paragraph (a)(1)(ii)(L) of Rule 17g-7, as adopted.¹⁷⁶⁶ The Commission continues to believe that paragraph (b)(1) of Rule 17g-8, as adopted, will work in conjunction with the requirement in paragraph (a)(1)(ii)(L) of Rule 17g-7, as adopted, in that the policies and procedures required under paragraph (b)(1) of Rule 17g-8 will assist the NRSRO in generating the information required to be disclosed pursuant to paragraph (a)(1)(ii)(L) of Rule 17g-7. The information produced by an NRSRO's policies and procedures under paragraph (b)(1) is expected to be relevant to the credit analyses performed by the NRSRO.

Paragraph (b)(2) of Rule 17g-8, as proposed, would require the NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings for which the NRSRO is registered and to include such definitions in Exhibit 1 to Form NRSRO.¹⁷⁶⁷ This proposed provision would implement section 938(a)(2) of the Dodd-Frank Act.¹⁷⁶⁸ One commenter stated that the paragraph, as proposed, was "sufficiently explicit."¹⁷⁶⁹

The Commission is adopting paragraph (b)(2) of Rule 17g-8 substantially as proposed.¹⁷⁷⁰ As adopted, the paragraph provides that an NRSRO must establish, maintain,

¹⁷⁶⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33480; 15 U.S.C. 78o-7(s)(3)(B)(ii).

¹⁷⁶⁶ See paragraph (a)(1)(ii)(L) of Rule 17g-7 (providing that the form to accompany a credit rating must include information on the content of the credit rating, including: (1) if applicable, the historical performance of the credit rating; and (2) the expected probability of default and the expected loss in the event of default).

¹⁷⁶⁷ See proposed paragraph (b)(2) of Rule 17g-8.

¹⁷⁶⁸ See Pub. L. No. 111-203, 938(a)(2).

¹⁷⁶⁹ See S&P Letter.

¹⁷⁷⁰ See paragraph (b)(2) of Rule 17g-8.

enforce, and document policies and procedures that are reasonably designed to clearly define each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class of credit ratings for which the NRSRO is registered (including subclasses within each class) and to include such definitions in Exhibit 1 to Form NRSRO.¹⁷⁷¹

In the proposing release, the Commission stated that paragraph (b)(2) of Rule 17g-8 would work in conjunction with the requirements to disclose definitions of symbols, numbers, or scores that denote credit rating categories and notches within categories in Exhibit 1 to Form NRSRO.¹⁷⁷² As discussed above in section II.E.1. of this release, Exhibit 1 requires, among other things, that an NRSRO clearly define, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit.¹⁷⁷³ Consequently, taken together, paragraph (b)(2) of Rule 17g-8, as adopted, and the instructions for Exhibit 1 to Form NRSRO require an NRSRO to have policies and procedures that clearly define the meaning of each symbol, number, or score used by the NRSRO to denote a credit rating and to disclose those meanings in Exhibit 1 where investors and other users of credit ratings can find them.

¹⁷⁷¹ See id. The text of paragraph (b)(2), as proposed, referred to “each class and subclass of credit ratings” for which the NRSRO is registered. As discussed above in section II.I.1. of this release, the Commission has modified paragraph (a) of Rule 17g-9 to, among other things, remove a reference to an NRSRO being registered in a subclass of credit ratings. Consistent with this modification, the Commission is modifying paragraph (b)(2) from the proposal to remove the reference to being registered in a subclass of credit ratings. However, the Commission added a parenthetical to the rule text to include a reference to “subclasses” of credit ratings.

¹⁷⁷² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33480-33481.

¹⁷⁷³ See paragraph (2) of the instructions for Exhibit 1.

Paragraph (b)(3) of Rule 17g-8, as proposed, would require the NRSRO to have policies and procedures reasonably designed to apply any symbol, number, or score defined pursuant to paragraph (b)(2) of Rule 17g-8 in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.¹⁷⁷⁴ This provision mirrored the text of section 938(a)(3) of the Dodd-Frank Act, except that the proposed rule text added the term “obligors.”¹⁷⁷⁵ The Commission proposed this addition in order to apply the provisions of paragraph (b)(3), as proposed, to credit ratings of obligors as entities in addition to credit ratings of securities and money market instruments.¹⁷⁷⁶ One commenter stated that the paragraph, as proposed, was “sufficiently explicit.”¹⁷⁷⁷ The Commission is adopting paragraph (b)(3) of Rule 17g-8 as proposed.¹⁷⁷⁸

The Commission received comments regarding paragraph (b) of proposed Rule 17g-8.¹⁷⁷⁹ One NRSRO stated that it supported the proposal and that it “is generally consistent” with what the NRSRO “does today.”¹⁷⁸⁰ Another NRSRO stated, as noted above, that the rule text was “sufficiently explicit” and also stated that it did not support the addition of further detail regarding the objectives of the rule, and that additional requirements with respect to the rule may “interfere with the analytical independence of NRSROs in violation of Section 15E(c)(2) of the Exchange Act.”¹⁷⁸¹

¹⁷⁷⁴ See paragraph (b)(3) of Rule 17g-8, as proposed.

¹⁷⁷⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33481.

¹⁷⁷⁶ See id. at 33481.

¹⁷⁷⁷ See S&P Letter.

¹⁷⁷⁸ See paragraph (b)(3) of Rule 17g-8.

¹⁷⁷⁹ See AFSCME Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter; DBRS Letter; Moody's Letter; S&P Letter.

¹⁷⁸⁰ See DBRS Letter.

¹⁷⁸¹ See S&P Letter.

Several commenters were critical of the proposal.¹⁷⁸² One commenter stated that paragraph (b) of proposed Rule 17g-8 did not achieve the objective of section 938 of the Dodd-Frank Act.¹⁷⁸³ This commenter raised concerns about how municipalities are assigned credit ratings as compared to other types of obligors and recommended that the Commission “adopt language that would clearly require NRSROs to apply symbols consistently across classes and subclasses of credit ratings.”¹⁷⁸⁴ Similarly, another commenter stated that because the proposed rule does not “require that rating symbols would have to be designed to clearly reflect the potential degree of default,” the rule will not “correct the discrepancy between what AAA means in the municipal or corporate debt context and what it means in the structured product context.”¹⁷⁸⁵ One commenter stated that the Commission should re-propose the rule and, in doing so, require NRSROs “to specify an acceptable range of default probabilities and corresponding loss expectations for each asset class and rating symbol.”¹⁷⁸⁶ The commenter also provided its analysis of NRSROs’ credit rating performance statistics as disclosed in Exhibit 1 to Form NRSRO through 2012, which the commenter stated shows that “performance across asset classes has not been comparable.”¹⁷⁸⁷

The Commission shares the concerns raised by these commenters that the historical performance of credit ratings at the same notch in a global rating scale of some NRSROs has

¹⁷⁸² See AFSCME Letter; CFA/AFR Letter; CFA II Letter; COPERA Letter.

¹⁷⁸³ See AFSCME Letter. See also Committee on Banking, Housing, and Urban Affairs, U.S. Senate, The Restoring American Financial Stability Act of 2010, Committee Report No. 111-176, at 124 (Apr. 30, 2010), available at <http://www.gpo.gov/fdsys/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf>.

¹⁷⁸⁴ See AFSCME Letter (“An AAA rating for a municipal bond should indicate the same likelihood of default or non-payment as an AAA rating for any other kind of security. Failure to do so would eviscerate Section 938 and continue to burden municipal issuers unfairly.”).

¹⁷⁸⁵ See COPERA Letter.

¹⁷⁸⁶ See CFA II Letter.

¹⁷⁸⁷ See CFA II Letter. See also CFA/AFR Letter (citing findings that the 5-year default rate prior to 2005 of one NRSRO’s ratings at the Baa notch was 0.1% for municipal bonds, 2.2% for corporate bonds, and 24% for CDOs).

been significantly different for certain classes of credit ratings, particularly the historical performance of credit ratings of structured finance products. The Commission staff noted this inconsistency of performance in its 2012 report on credit rating standardization, which was submitted to Congress as required by section 939(h)(2) of the Dodd-Frank Act.¹⁷⁸⁸

In drafting paragraph (b) of Rule 17g-8, the Commission has sought to address this concern in a manner that strikes an appropriate balance between adopting a measure designed to address inconsistencies in the performance of credit ratings in different classes to which an NRSRO applies the same rating scale and definitions with the prohibition in section 15E(c)(2) of the Exchange Act under which the Commission may not regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.¹⁷⁸⁹ In seeking to strike this balance, the Commission modeled the rule closely on the text of section 938(a) of the Dodd-Frank Act.¹⁷⁹⁰ This section provides, in pertinent part, that the Commission shall require, by rule, each NRSRO to establish, maintain, and enforce written policies and procedures to, among other things, apply any defined credit rating symbol in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.¹⁷⁹¹ The Commission also considered the fact that section 939(h)(1) of the Dodd-Frank Act required the Commission to study certain matters relating to credit rating standardization (as opposed to mandating rulemaking), including the feasibility and desirability of standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing

¹⁷⁸⁸ See 2012 Staff Report on Credit Rating Standardization, pp. 37-38. See also Pub. L. 111-203, 939(h)(2).

¹⁷⁸⁹ See 15 U.S.C. 78o-7(c)(2).

¹⁷⁹⁰ See Pub. L. No. 111-203, 938(a).

¹⁷⁹¹ See *id.*

entity.¹⁷⁹² Comments received in response to the study argued that that the Commission does not have the authority to require credit rating standardization because, by statute, the Commission may not regulate the methodologies NRSROs use to determine credit ratings.¹⁷⁹³ Moreover, as required under section 939(h)(2) of the Dodd-Frank Act, the Commission was required to report its findings to Congress upon completion of the study.¹⁷⁹⁴ The Commission submitted a staff report to Congress in 2012 and the findings in the report have not resulted in any legislative changes relating to credit rating standardization at this time.¹⁷⁹⁵

The Commission believes at this time that paragraph (b) of Rule 17g-8, as adopted, implements section 938(a) of the Dodd-Frank Act in a manner that appropriately balances relevant concerns. The rule requires NRSROs to have policies and procedures that are reasonably designed to apply the definition of any credit symbol, number, or score in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.¹⁷⁹⁶ An NRSRO – in establishing, maintaining, and enforcing these policies and procedures – will need to take into consideration how it applies its rating scales and definitions to classes of credit ratings and the rating methodologies it uses to determine credit ratings in those classes. Moreover, the prefatory text of the rule requires that the policies and procedures must be reasonably designed.¹⁷⁹⁷ Consequently, Rule 17g-8, as adopted, requires an NRSRO to have policies and procedures reasonably designed to achieve the

¹⁷⁹² See Pub. L. No. 111-203, 939(h)(1).

¹⁷⁹³ See 2012 Staff Report on Credit Rating Standardization, pp. 2, 12-14 (summarizing commenters' views).

¹⁷⁹⁴ See Pub. L. No. 111-203, 939(h)(2).

¹⁷⁹⁵ See 2012 Staff Report on Credit Rating Standardization.

¹⁷⁹⁶ See paragraphs (b)(2) and (3) of Rule 17g-8.

¹⁷⁹⁷ See prefatory text of paragraph (b) of Rule 17g-8.

objective of consistency without specifically mandating how an NRSRO's credit ratings and rating methodologies must be designed to achieve this consistency.

Commenters raised concerns about how the Commission would enforce Rule 17g-8, as proposed.¹⁷⁹⁸ One commenter stated that “the Commission fails to make clear how it will enforce the requirement that ratings be based on an assessment of the likelihood of default and applied consistently across different rating categories.”¹⁷⁹⁹ In particular, the commenter asked what standards the Commission will use to determine whether ratings are being applied consistently across categories of ratings and what steps will NRSROs be required to take if their performance statistics reveal discrepancies in the performance of ratings across different rating categories.¹⁸⁰⁰ The commenter that suggested that the Commission re-propose the rule stated that, if ratings of certain asset classes diverge significantly from the expected norms, the Commission should require the NRSRO to identify the source of the error that led to the divergence and what it is doing to remedy the problem and “where the divergence in ratings performance across asset classes persists, the Commission should require the NRSRO to adjust its methodology – which in turn could affect its outstanding and prospective ratings – to correct the problem.”¹⁸⁰¹ The commenter further stated that a different system of symbols should be used for certain asset classes “where comparability cannot be achieved.”¹⁸⁰² In addition, the commenter stated that the Commission should hold NRSROs accountable if they fail to achieve a high degree of ratings comparability between asset classes by, for example, seeking fines or the disgorgement of profits or suspending or revoking the NRSRO's registration for the affected

¹⁷⁹⁸ See CFA/AFR Letter; CFA II Letter; S&P Letter.

¹⁷⁹⁹ See CFA/AFR Letter.

¹⁸⁰⁰ See *id.*

¹⁸⁰¹ See *id.*

¹⁸⁰² See *id.*

asset class.¹⁸⁰³ In contrast, an NRSRO stated that “because credit ratings reflect forward-looking opinions, we would be concerned about any attempt to judge an NRSRO’s adherence to this proposed rule based on an analysis of its ratings performance over any defined period of time” and that “an NRSRO’s compliance with this rule should be measured by whether the NRSRO has policies and procedures in place to promote comparability of ratings across the asset classes it rates and has adhered to such policies and procedures.”¹⁸⁰⁴

In response to these comments, the Commission notes that paragraph (b) of Rule 17g-8, as adopted, sets forth an objective: that the definition of any credit rating symbol, number, or score is applied in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.¹⁸⁰⁵ Further, the rule provides that an NRSRO must establish, maintain, enforce, and document policies and procedures that are reasonably designed to achieve this objective.¹⁸⁰⁶ Consequently, in enforcing the rule, the Commission will consider whether the NRSRO is achieving the objective through the use of established procedures and methodologies that are reasonably designed. In response to the commenters, the Commission agrees that the performance of credit ratings (transition and default statistics) in each class of credit ratings for which the NRSRO applies the same rating scale and definitions will be relevant to considering whether the objective of consistency is being met.¹⁸⁰⁷ If the Commission staff believes the objective of consistency is not being met, the staff will need to consider whether the NRSRO has established, maintained, enforced, and documented policies and procedures that are reasonably designed to achieve this objective before making a

¹⁸⁰³ See CFA II Letter.

¹⁸⁰⁴ See S&P Letter.

¹⁸⁰⁵ See paragraphs (b)(2) and (3) of Rule 17g-8.

¹⁸⁰⁶ See prefatory text of paragraph (b) of Rule 17g-8.

¹⁸⁰⁷ See S&P Letter.

recommendation to the Commission that the Commission institute an enforcement action. The staff may also bring a potential violation to the attention of the NRSRO. In response to the commenters, the Commission notes that if appropriate the Commission can take enforcement action for such a violation.¹⁸⁰⁸ Finally, an NRSRO that has not complied with paragraph (b) of Rule 17g-8 may take steps to adjust its rating methodology or use different rating scales and definitions for different classes of credit ratings, as suggested by one of the commenters, to the extent doing so is necessary and appropriate to address the failure.¹⁸⁰⁹

2. Amendment to Rule 17g-2

The Commission proposed adding paragraph (b)(14) of Rule 17g-2 to identify the policies and procedures an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g-8 as a record that must be retained.¹⁸¹⁰ As a result, the policies and procedures would be subject to the record retention and production requirements in paragraphs (c) through (f) of Rule 17g-2. One NRSRO stated that it “supports” the amendment to Rule 17g-2.¹⁸¹¹ The Commission is adding paragraph (b)(14) to Rule 17g-2 as proposed.¹⁸¹² This will provide a means for the Commission to monitor the NRSROs’ compliance with paragraph (b) of Rule 17g-8 as a record. The record must be retained until three years after the date the record is

¹⁸⁰⁸ See CFA II Letter. As discussed above in section II.D. of this release, the Exchange Act provides the Commission with authority to impose a wide range of fines, penalties, and other sanctions on NRSROs for violations of any section of the Exchange Act and the rules under the Exchange Act. See 15 U.S.C. 78o-7(d); 15 U.S.C. 78u; 15 U.S.C. 78u-2; 15 U.S.C. 78u-3; 15 U.S.C. 78ff.

¹⁸⁰⁹ See CFA II Letter (suggesting the NRSRO adjust its rating methodology or use different rating scales and definitions).

¹⁸¹⁰ See paragraph (b)(14) of Rule 17g-2, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33481.

¹⁸¹¹ See DBRS Letter.

¹⁸¹² See paragraph (b)(14) of Rule 17g-2. Section 17(a)(1) of the Exchange Act requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. 15 U.S.C. 78q(a)(1).

replaced with an updated record in accordance with the amendment to paragraph (c) of Rule 17g-2 discussed above in section II.A.2. of this release.¹⁸¹³

3. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendments and new rule regarding NRSRO credit rating symbols, numbers, or scores.¹⁸¹⁴ The economic baseline that existed before today's new rules was one in which an NRSRO was not required to establish, maintain, enforce, document, and retain records of policies and procedures reasonably designed to: assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument; clearly define each symbol, number, or score in the NRSRO's rating scale for each class of credit ratings (including subclasses within each class) for which the NRSRO is registered; or to apply any such symbol, number, or score in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used. However, the instructions for Exhibit 1 to Form NRSRO required an NRSRO or a credit rating agency applying for registration as an NRSRO to "define the credit rating categories, notches, grades, and rankings used" by the NRSRO or applicant.¹⁸¹⁵

¹⁸¹³ See paragraphs (b)(14) and (c) of Rule 17g-2.

¹⁸¹⁴ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁸¹⁵ Before today's amendments, paragraph (i) of Rule 17g-1 required an NRSRO to make Form NRSRO and Exhibits 1 through 9 publicly available on its website "or through another comparable, readily accessible means."

One academic study finds that performance within comparable rating categories has been inconsistent across asset classes from 1980 until 2010.¹⁸¹⁶ In addition, it has been reported that five-year default rates for CDOs at the lowest investment-grade rating as determined by a large NRSRO were roughly ten times higher from 1993 to 2005 than for corporate bonds at the same rating for the same NRSRO from 1983 to 2005.¹⁸¹⁷ Another academic study concludes that having new structured products rated similarly to corporate bonds created the illusion of comparability with existing “single-name” securities and provided access to a large pool of potential buyers in the years prior to the financial crisis.¹⁸¹⁸ This academic study also finds evidence suggesting that differences in observed default rates between structured products and comparable corporate bonds may be explained by differences in the types of risk to which these instruments are exposed.¹⁸¹⁹

Relative to this baseline, paragraph (b) of Rule 17g-8 should provide benefits. In particular, it should promote greater consistency by NRSROs in terms of assigning credit ratings across different classes of credit ratings and, thereby, promote the information value of credit ratings as assessments of relative creditworthiness for the benefit of users of credit ratings. The requirement that an NRSRO have policies and procedures reasonably designed to assess the probability that an issuer will default, fail to make timely payments, or otherwise not make payments to investors should facilitate this outcome. Specifically, this assessment may provide additional inputs in terms of the relative creditworthiness of obligors and issuers, which may be

¹⁸¹⁶ See Jess Cornaggia, Kimberly J. Cornaggia, and John E. Hund, Credit Ratings across Asset Classes (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1909091.

¹⁸¹⁷ See Charles Calomiris and Joseph Mason, Reclaim Power from the Ratings Agencies, Financial Times (Aug. 24, 2007), p. 11.

¹⁸¹⁸ See Coval, Jurek, and Stafford, The Economics of Structured Finance.

¹⁸¹⁹ See *id.* (A “feature of the securitization process is that it substitutes risks that are largely diversifiable for risks that are highly systematic. As a result, securities produced by structured finance activities have far less chance of surviving a severe economic downturn than traditional corporate securities of equal rating.”).

used to inform credit ratings if deemed appropriate by the NRSRO, and thereby improve the quality of credit ratings as assessments of relative creditworthiness. The requirement that an NRSRO have policies and procedures to disclose the meaning of credit rating symbols, numbers, and scores could benefit users of credit ratings by promoting a better understanding of credit rating terminology and allowing these parties to better compare the various credit ratings issued by a single NRSRO and credit ratings across NRSROs.

The records the NRSRO must retain under the amendments to Rule 17g-2 will be used by Commission examiners to evaluate whether a given NRSRO's policies and procedures are reasonably designed and the NRSRO is adhering to them. Setting forth the policies and procedures in writing also will promote adherence to them by the NRSRO.

Relative to the baseline, paragraph (b) of Rule 17g-8 will result in costs for NRSROs. NRSROs will need to expend resources to develop the policies and procedures required by the rule, to document, comply with, and enforce them, and to update them periodically as appropriate. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b) of Rule 17g-8 will result in total industry-wide one-time costs to NRSROs of approximately \$566,000 and total industry-wide annual costs to NRSROs of approximately \$142,000.¹⁸²⁰

NRSROs may also incur costs expending resources to modify credit rating symbols, numbers, scores, and their definitions in order to conform to the requirement that these symbols, numbers, and scores be applied consistently across applicable asset classes. For example, one NRSRO claimed that the new rule would require some NRSROs to change their rating symbol

¹⁸²⁰ See section V.L. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

systems or how they apply their symbols to certain categories of obligors or obligations.¹⁸²¹

However, another NRSRO stated that the new rule “is generally consistent” with what it “does today.”¹⁸²² This cost will likely vary significantly across NRSROs and depend on the number of asset classes rated and the degree to which their current symbols, numbers, and scores are applied consistently.

Relative to the baseline, the amendments to Rule 17g-2 prescribing retention requirements for the documentation of the policies and procedures will result in costs to NRSROs. NRSROs already have recordkeeping systems in place to comply with the recordkeeping requirements in Rule 17g-2 before today’s amendments. Therefore, the recordkeeping costs of this rule will be incremental to the costs associated with these existing requirements. Specifically, the incremental costs will consist largely of updating their record retention policies and procedures and retaining and producing the additional record. Based on analysis for purposes of the PRA, the Commission estimates that paragraph (b)(14) of Rule 17g-2 and the amendment to paragraph (c) of Rule 17g-2 will result in total industry-wide one-time costs to NRSROs of approximately \$12,000 and total industry-wide annual costs to NRSROs of approximately \$3,000.¹⁸²³

As an additional possible cost, the final rule has the potential to decrease the quality of credit ratings in circumstances where the subjective judgment of participants in the rating process could improve the quality of ratings. In order to ensure that rating symbols, numbers, and scores are applied consistently across applicable ratings in compliance with these

¹⁸²¹ See Moody’s Letter.

¹⁸²² See DBRS Letter.

¹⁸²³ See section V.L. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.3. of this release.

requirements, an NRSRO may establish credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. The credit ratings may not therefore benefit fully from the expertise of the participants in the rating process. These amendments may also increase costs associated with understanding the definition of rating symbols, numbers, and scores. In order to ensure that rating symbols, numbers, and scores are applied consistently across applicable ratings in compliance with these requirements, an NRSRO may create different rating symbols, numbers, and scores for different asset classes. As a result, users of credit ratings may need to expend more effort in understanding a greater number of definitions.

The amendments and new rule should have a number of effects related to efficiency, competition, and capital formation.¹⁸²⁴ First, they could improve the quality and consistency of credit ratings as well as increasing the information available to users of credit ratings regarding the meaning of rating symbols, numbers, and scores. As a result, users of credit ratings could make more efficient investment decisions based on this higher-quality information. Market efficiency could also improve if this information is reflected in asset prices. Consequently, capital formation also could improve as capital could flow to more efficient uses with the benefit of this enhanced information. Alternatively, the quality of credit ratings may decrease in certain circumstances if an NRSRO establishes credit rating procedures and methodologies that diminish the ability of participants in the rating process to exercise subjective judgment. In this case, the quality of credit ratings may decrease, which could decrease the efficiency of investment decisions made by users of credit ratings. Market efficiency and capital formation also may be adversely impacted if lower quality information is reflected in asset prices, which may impede

¹⁸²⁴

See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

the flow of capital to efficient uses. These amendments will result in costs, some of which may have a component that is fixed in magnitude across NRSROs, and does not vary with the size of the NRSRO. Therefore, the operating costs per credit rating of smaller NRSROs may increase relative to that of larger NRSROs, creating adverse effects on competition. As a result of these amendments, the barriers to entry for credit rating agencies to register as an NRSRO might be higher for credit rating agencies, while some NRSROs, particularly smaller firms, may decide to withdraw from registration as an NRSRO.

K. ANNUAL REPORT OF DESIGNATED COMPLIANCE OFFICER

Section 932(a)(5) of the Dodd-Frank Act amended section 15E(j) of the Exchange Act to re-designate paragraph (j) as paragraph (j)(1) and to add paragraphs (j)(2) through (j)(5).¹⁸²⁵ Section 15E(j)(1) of the Exchange Act contains a self-executing provision that requires that an NRSRO designate an individual (the “designated compliance officer”) responsible for administering the policies and procedures that are required to be established pursuant to sections 15E(g) and (h) of the Exchange Act,¹⁸²⁶ and for compliance with the securities laws and the rules and regulations under the securities laws, including those promulgated by the Commission under section 15E of the Exchange Act.¹⁸²⁷ Sections 15E(j)(2) through (4) of the Exchange Act contain self-executing requirements with respect to, among other things, the activities, duties, and compensation of the designated compliance officer.¹⁸²⁸

Section 15E(j)(5)(A) of the Exchange Act contains a self-executing requirement that the designated compliance officer must submit to the NRSRO an annual report on the compliance of

¹⁸²⁵ See Pub. L. No. 111-203, 932(a)(5); 15 U.S.C. 78o-7(j)(1) through (5).

¹⁸²⁶ See 15 U.S.C. 78o-7(g) (“Prevention of misuse of nonpublic information”); 15 U.S.C. 78o-7(h) (“Management of conflicts of interest”).

¹⁸²⁷ See 15 U.S.C. 78o-7(j)(1).

¹⁸²⁸ See 15 U.S.C. 78o-7(j)(1) through (4).

the NRSRO with the securities laws and the policies and procedures of the NRSRO that includes: (1) a description of any material changes to the code of ethics and conflict of interest policies of the NRSRO; and (2) a certification that the report is accurate and complete.¹⁸²⁹

Section 15E(j)(5)(B) of the Exchange Act contains a self-executing requirement that the NRSRO shall file the report required under section 15E(j)(5)(A) together with the financial report that is required to be submitted to the Commission under section 15E of the Exchange Act.¹⁸³⁰

Section 15E(k) of the Exchange Act provides that each NRSRO shall, on a confidential basis, file with the Commission, at intervals determined by the Commission, such financial statements, certified (if required by the rules or regulations of the Commission) by an independent public accountant, and information concerning its financial condition, as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.¹⁸³¹ The Commission implemented section 15E(k) by adopting Rule 17g-3.¹⁸³² Therefore, under the self-executing requirement in section 15E(j)(5)(B) of the Exchange Act, an NRSRO must file the report of the designated compliance officer with the reports required to be filed with the Commission pursuant to Rule 17g-3.¹⁸³³

Before today's amendments, paragraph (a) of Rule 17g-3 required an NRSRO to furnish five or, in some cases, six separate reports within ninety days after the end of the NRSRO's

¹⁸²⁹ See 15 U.S.C. 78o-7(j)(5)(A).

¹⁸³⁰ See 15 U.S.C. 78o-7(j)(5)(B).

¹⁸³¹ The Dodd-Frank Act replaced the phrase "furnish to the Commission" with the phrase "file with the Commission" in section 15E(k) of the Exchange Act. See 15 U.S.C. 78o-7(k).

¹⁸³² See 17 CFR 240.17g-3; see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33590-33593.

¹⁸³³ See 15 U.S.C. 78o-7(j)(5)(B); 15 U.S.C. 78o-7(k); 17 CFR 240.17g-3.

fiscal year and identified the reports that must be furnished.¹⁸³⁴ The first report – on the NRSRO’s financial statements – must be audited; the remaining reports may be unaudited.

1. Amendment to Rule 17g-3

The Commission proposed adding paragraph (a)(8) to Rule 17g-3 to identify the report on the compliance of the NRSRO with the securities laws and the policies and procedures of the NRSRO required to be filed with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other reports required under Rule 17g-3.¹⁸³⁵ Paragraph (a)(8) of Rule 17g-3 would provide that the report would be “unaudited.”¹⁸³⁶ As stated above, section 15E(j)(5)(A)(ii) of the Exchange Act provides that the designated compliance officer must certify that the report is accurate and complete.

Commenters addressed this proposal.¹⁸³⁷ One commenter supported the Commission’s proposal to include the report as one of the annual financial reports an NRSRO is required to file with the Commission,¹⁸³⁸ and another stated that the proposed requirement would facilitate effective NRSRO oversight by the Commission.¹⁸³⁹ This commenter stated that the requirement could be strengthened, however, by requiring the annual report be subjected to a third-party audit.¹⁸⁴⁰ Two commenters stated that the rule should not prescribe how the report must be certified because another section of the Exchange Act already provides that the designated

¹⁸³⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33481-33482. As discussed above in section II.A.3. of this release, an NRSRO must file an additional internal controls report and, as discussed below, an NRSRO must file the report of the designated compliance officer. See paragraphs (a)(7) and (a)(8) of Rule 17g-3. Consequently, an NRSRO must now file seven or, in some cases, eight reports.

¹⁸³⁵ See paragraph (a)(8) of Rule 17g-3, as proposed; Nationally Recognized Statistical Rating Organizations, 76 FR at 33481-33482, 33539.

¹⁸³⁶ See paragraph (a)(8) of Rule 17g-3, as proposed.

¹⁸³⁷ See DBRS Letter; Levin Letter; S&P Letter.

¹⁸³⁸ See DBRS Letter.

¹⁸³⁹ See Levin Letter.

¹⁸⁴⁰ See id.

compliance officer must certify that the report is accurate and complete.¹⁸⁴¹ Specifically, one commenter stated that this requirement would be “unnecessarily duplicative.”¹⁸⁴² The other commenter stated that the certification already required by section 15E(j)(5)(A)(ii) of the Exchange Act is sufficient.¹⁸⁴³

The Commission is adopting paragraph (a)(8) to Rule 17g-3 as proposed. In response to the comment suggesting that the Commission require that the report be subject to a third-party audit,¹⁸⁴⁴ the Commission is not persuaded that such a requirement is necessary at this time, given the cost of requiring a third-party audit. Section 15E(j)(5)(A) of the Exchange Act provides that the report shall be filed with “together with the financial report that is required to be submitted to the Commission under” section 15E.¹⁸⁴⁵ Section 15E(k) provides, in pertinent part, that the financial reports shall be filed on a confidential basis.¹⁸⁴⁶ Consequently, the report of the designated compliance officer is not a public document that will be relied upon by investors and other users of credit ratings. The report is a non-public report that will be used by Commission examiners, who can consider the accuracy of the report in the context of their annual examinations of NRSROs.¹⁸⁴⁷ Finally, the Commission agrees with the commenters that it is not necessary to prescribe how the report must be certified because section 15E(j)(5)(A)(ii)

¹⁸⁴¹ See DBRS Letter; S&P Letter.

¹⁸⁴² See S&P Letter.

¹⁸⁴³ See DBRS Letter.

¹⁸⁴⁴ See Levin Letter.

¹⁸⁴⁵ See 15 U.S.C. 78o-7(j)(5)(B).

¹⁸⁴⁶ See 15 U.S.C. 78o-7(k).

¹⁸⁴⁷ The report also will be used as governance tool by the NRSRO to evaluate its compliance with the securities laws and its policies and procedures.

of the Exchange Act provides that the designated compliance officer must certify that the report is accurate and complete.¹⁸⁴⁸

2. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the amendment regarding the annual report of the designated compliance officer.¹⁸⁴⁹ The economic baseline which existed before today's amendments was one in which section 15E(j)(5)(A) of the Exchange Act requires that the designated compliance officer of an NRSRO submit to the NRSRO an annual report on the NRSRO's compliance with its policies and procedures and the securities laws, that includes a description of any material changes to the NRSRO's code of ethics and conflicts of interest policies and a certification that the report is accurate and complete. In addition, section 15E(j)(B) of the Exchange Act requires the NRSRO to file the report with the financial report that is required to be submitted to the Commission under section 15E of the Exchange Act. The Commission is adding paragraph (a)(8) to Rule 17g-3 to reflect the baseline requirement that the report must be filed with the other reports filed pursuant to Rule 17g-3. The amendment is not expected to result in benefits or costs relative to the economic baseline and is not expected to affect efficiency, competition, or capital formation.

One reasonable alternative to the amendment, as adopted, is to establish a requirement that the report be audited by a third party, as suggested by one commenter.¹⁸⁵⁰ This alternative would increase the cost of compliance with the rule, as NRSROs would be required to pay a third party to conduct the audit. However, an audit by a third party may improve the accuracy,

¹⁸⁴⁸ See 15 U.S.C. 78o-7(j)(5)(A)(ii).

¹⁸⁴⁹ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁸⁵⁰ See Levin Letter.

reliability, and thoroughness of the report. As a result, this alternative could enhance Commission oversight of NRSROs as well as improve an NRSRO's internal compliance controls, which could improve the integrity and quality of an NRSRO's credit ratings.

As discussed above, the Commission is not persuaded that such a requirement is necessary at this time, given the cost of requiring a third-party audit and how the audit would be used.¹⁸⁵¹ The report of the designated compliance officer is not a public document that will be relied upon by investors and other users of credit ratings. Instead, it will be used by Commission examiners, who can consider the accuracy of the report in the context of their annual examinations of NRSROs.

L. ELECTRONIC SUBMISSION OF FORM NRSRO AND THE RULE 17g-3 ANNUAL REPORTS

1. Amendments to Rule 17g-1, Form NRSRO, Rule 17g-3, and Regulation S-T

Before today's amendments, applicants for registration as an NRSRO and NRSROs submitted Form NRSRO to the Commission in paper form.¹⁸⁵² In addition, NRSROs submitted their annual reports under Rule 17g-3 in paper form.¹⁸⁵³ The Commission proposed amending Rule 17g-1, the instructions to Form NRSRO, Rule 17g-3, and Regulation S-T¹⁸⁵⁴ to implement a program for filing Forms NRSRO (other than in the case of a registration application) and the annual reports electronically.¹⁸⁵⁵ Under the proposals, an NRSRO would be required to use the Commission's EDGAR system to: (1) electronically file or furnish, as applicable, Form NRSRO and the information and documents contained in the exhibits required to be submitted with Form

¹⁸⁵¹ See section II.K.1. of this release (discussing how the report is not a public document that will be relied upon by investors and other users of credit ratings but rather will be used by Commission examiners).

¹⁸⁵² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33482.

¹⁸⁵³ See id. at 33482.

¹⁸⁵⁴ 17 CFR 232 et seq. Regulation S-T contains "General Rules and Regulations for Electronic Filers."

¹⁸⁵⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33482-33485.

NRSRO if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g-1 (an update of registration, an annual certification, or a withdrawal from registration, respectively);¹⁸⁵⁶ and (2) electronically file or furnish, as applicable, the annual reports required by Rule 17g-3.¹⁸⁵⁷ In the proposing release, the Commission stated that it intended that Form NRSRO would be an electronic, fillable, form and that the exhibits would be submitted with the Form.¹⁸⁵⁸

Under the proposal, an applicant or NRSRO would continue to submit in paper format Forms NRSRO pursuant to paragraphs (a), (b), (c), and (d) of Rule 17g-1 (initial applications for registration, applications to register for an additional class of credit ratings, supplements to an initial application or application to register for an additional class of credit ratings, and withdrawals of initial applications or applications to register for an additional class of credit ratings, respectively). The Commission stated in the proposing release that these materials are appropriately received in paper form because of the iterative nature of the NRSRO registration application process.¹⁸⁵⁹ For example, an applicant often will have a number of phone conferences and meetings with the Commission staff during the application process to clarify the information submitted in the application. These interactions may result in applicants informally

¹⁸⁵⁶ See *id.* at 33538. Under the proposal, the electronic submissions of Form NRSRO and the exhibits required to be submitted with Form NRSRO would be made available to the public on EDGAR immediately upon filing. The amendments to paragraph (f) of Rule 17g-1 referred to a Form NRSRO and Exhibits 1 through 9 as the submissions that would be required to be made electronically. The proposed amendments to paragraph (e) of Rule 17g-1 also referred to a Form NRSRO and Exhibits 1 through 9. However, Exhibit 1 (performance statistics) should not have been included with respect to the proposed amendments to paragraph (e) because section 15E(b)(1)(A) of the Exchange Act provides that NRSROs are not required to update performance statistics if they become materially inaccurate, but that NRSROs must file updated performance statistics with the annual certification. Accordingly, as adopted, the amendments to paragraph (e) of Rule 17g-1 refer to Exhibits 2 through 9 to Form NRSRO. The proposed amendments to paragraph (g) of Rule 17g-1 did not refer to exhibits to Form NRSRO because an NRSRO is not required to include exhibits to Form NRSRO with a notice of withdrawal from registration under this paragraph.

¹⁸⁵⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33539. Under the proposal, the electronic submission of the annual reports required under Rule 17g-3 would not be available to the public. The information submitted under Rule 17g-3 is, and would continue to be, kept confidential to the extent permitted by law.

¹⁸⁵⁸ See *id.* at 33483.

¹⁸⁵⁹ See *id.*

providing additional information relating to the application and informally amending or augmenting information provided in the form and its exhibits. The Commission continues to believe paper submissions facilitate this type of iterative process.

The Commission also proposed amending Items A.8 and A.9 of the instructions to Form NRSRO to distinguish between Form NRSRO submissions under paragraph (a), (b), (c), or (d) of Rule 17g-1 and submissions under paragraph (e), (f), or (g) of Rule 17g-1.¹⁸⁶⁰ Before today's amendments, Item A.8 provided the address of Commission headquarters as the address where a Form NRSRO submitted under paragraph (a), (b), (c), (d), (e), (f), or (g) of Rule 17g-1 must be submitted.¹⁸⁶¹ The Commission proposed amending Item A.8 to add above the address a sentence that would instruct an applicant to submit to the Commission at the address indicated two paper copies of a Form NRSRO submitted pursuant to paragraph (a), (b), (c), or (d) of Rule 17g-1 and adding a sentence below the address providing that after registration, an NRSRO must submit Form NRSRO electronically to the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T, if the submission is made pursuant to paragraph (e), (f), or (g) of Rule 17g-1.¹⁸⁶²

Before today's amendments, Item A.9 of the Instructions to Form NRSRO provided that a Form NRSRO will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form.¹⁸⁶³ The Commission proposed amending the instruction to provide that a Form NRSRO will be considered filed with or furnished to, as applicable, the Commission on the date

¹⁸⁶⁰ See *id.* at 33552.

¹⁸⁶¹ See *id.* at 33483.

¹⁸⁶² See *id.* at 33552.

¹⁸⁶³ See *id.* at 33483.

the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form, including the instructions in Item A.8 with respect to how a Form NRSRO must be filed with or furnished to the Commission.¹⁸⁶⁴

The Commission proposed amending Rule 17g-3 to add paragraphs (d) and (e).¹⁸⁶⁵ Proposed paragraph (d) of Rule 17g-3 would provide that the reports required by the rule must be submitted electronically with the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.¹⁸⁶⁶ In addition, because the Rule 17g-3 annual reports are not required to be made public, the Commission proposed adding paragraph (e) to Rule 17g-3, which would provide that information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law and that confidential treatment may be requested by marking each page "Confidential Treatment Requested" and by complying with Commission rules governing confidential treatment.¹⁸⁶⁷

Electronic submissions using the EDGAR system are subject to Regulation S-T and the EDGAR Filer Manual.¹⁸⁶⁸ The EDGAR Filer Manual contains detailed technical specifications concerning EDGAR submissions and provides technical guidance concerning how to begin making submissions on EDGAR.

One technical specification the EDGAR Filer Manual includes is the electronic "submission type" for each submission made through the EDGAR system, and under the

¹⁸⁶⁴ See *id.* at 33552.

¹⁸⁶⁵ See *id.* at 33484.

¹⁸⁶⁶ See *id.* at 33539.

¹⁸⁶⁷ See *id.*

¹⁸⁶⁸ See 17 CFR 232.101 et seq. See also *EDGAR Filer Manual*, available at <http://www.sec.gov/info/edgar/edmanuals.htm>; *Information for EDGAR Filers*, available at <http://www.sec.gov/info/edgar.shtml#guidance>.

proposal, the EDGAR Filer Manual and the EDGARLink software would provide for two EDGAR electronic submission types: one for the submission of Form NRSRO and one for the submission of the annual reports under Rule 17g-3.¹⁸⁶⁹

The Commission proposed amending Rule 101 of Regulation S-T¹⁸⁷⁰ by adding paragraph (a)(1)(xiv).¹⁸⁷¹ Proposed paragraph (a)(1)(xiv) would identify the Forms NRSRO and the information and documents submitted in Exhibits 1 through 9 to Form NRSRO submitted to the Commission under paragraphs (e), (f), and (g) of Rule 17g-1 and the annual reports submitted under Rule 17g-3 as submissions to the Commission that must be made in electronic format.¹⁸⁷²

The Commission also proposed an amendment to Rule 201 of Regulation S-T.¹⁸⁷³ Rules 201 and 202¹⁸⁷⁴ of Regulation S-T address hardship exemptions from EDGAR filing requirements, and paragraph (b) of Rule 13 of Regulation S-T¹⁸⁷⁵ addresses the related issue of filing date adjustments. Under Rule 201, if an electronic filer experiences unanticipated technical difficulties that prevent the timely preparation and submission of an electronic filing, the filer may file a properly legended paper copy of the filing under cover of Form TH¹⁸⁷⁶ no later than one business day after the date on which the filing was to be made.¹⁸⁷⁷ A filer who

¹⁸⁶⁹ See, e.g., EDGAR Filer Manual, Vol. II, section 5.1 (“Non-Public and Confidential”), section 5.4 (“Document Types in EDGAR”), available at <http://www.sec.gov/info/edgar/edgarfm-vol2-v26.pdf>.

¹⁸⁷⁰ 17 CFR 232.101(a)(1).

¹⁸⁷¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33484.

¹⁸⁷² See id. at 33537.

¹⁸⁷³ 17 CFR 232.201. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33484.

¹⁸⁷⁴ 17 CFR 232.202.

¹⁸⁷⁵ 17 CFR 232.13(b).

¹⁸⁷⁶ 17 CFR 239.65, 249.447, 269.10, and 274.404.

¹⁸⁷⁷ See 17 CFR 232.201(a).

files in paper form under the temporary hardship exemption must submit an electronic copy of the filed paper document within six business days of the filing of the paper document.¹⁸⁷⁸

In addition, an electronic filer may apply for a continuing hardship exemption under Rule 202 of Regulation S-T if it cannot file all or part of a filing without undue burden or expense.¹⁸⁷⁹ The application must be made at least ten business days before the due date of the filing. In contrast to the self-executing temporary hardship exemption process, a filer can obtain a continuing hardship exemption only by submitting a written application, upon which the Commission, or the Commission staff pursuant to delegated authority, must then act. Under paragraph (b) of Rule 13 of Regulation S-T, if an electronic filer in good faith attempts to file a document, but the filing is delayed due to technical difficulties beyond the filer's control, the filer may request that the Commission grant an adjustment of the filing date.

The Commission proposed making the temporary hardship exemption in Rule 201 unavailable for the submissions of Form NRSRO and the information and documents submitted in Exhibits 1 through 9 to Form NRSRO under paragraph (e), (f), or (g) of Rule 17g-1 and the annual reports required under Rule 17g-3 by amending the introductory text of paragraph (a) of Rule 201 of Regulation S-T to add this group of submissions to the list of submissions for which the temporary hardship exemption is unavailable.¹⁸⁸⁰ An NRSRO would continue to have the ability to apply for a continuing hardship exemption under Rule 202 if it could not submit all or

¹⁸⁷⁸ See 17 CFR 232.201(b).

¹⁸⁷⁹ See 17 CFR 232.202(a).

¹⁸⁸⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33537. The Commission previously has made the temporary hardship exemption unavailable for EDGAR submissions of beneficial ownership reports filed by officers, directors and principal security holders under section 16(a) of the Exchange Act. See Mandated Electronic Filing and Web Site Posting for Forms 3, 4 and 5, Securities Act Release No. 8230 (May 7, 2003), 68 FR 25788 (May 13, 2010).

part of an application without undue burden or expense or for an adjustment of the due date under paragraph (b) of Rule 13 if there were technical difficulties beyond the NRSRO's control.

The Commission received three comments that addressed these proposals.¹⁸⁸¹ One commenter stated that it supported the proposal, and that having information available immediately and in one location would benefit users of credit ratings by making it easier to access information about NRSROs and to compare the information provided by different NRSROs.¹⁸⁸² An NRSRO stated that it would have no objection to the proposal, that providing the information as PDF documents would be "the preferred and simplest" way to provide the information, and that providing the information in XBRL or XML format would not provide additional analytical benefit and could make it more difficult for users to access Form NRSRO.¹⁸⁸³ This commenter also stated, however, that the temporary hardship exemption should be available for electronic filings of Form NRSRO.

One NRSRO objected to the proposal, stating that the Commission "vastly overstated the benefits and understated the costs" of the proposal.¹⁸⁸⁴ The commenter stated that having the public information available immediately and in one place would not be useful to users of credit ratings, as the information is not time-sensitive and it is relatively easy to retrieve the information from the NRSROs' websites. This commenter also stated that the Commission did not estimate "the expense an NRSRO would incur in compiling Form NRSRO, its exhibits, and the annual reports into an EDGAR-acceptable format" and that the Commission underestimated the costs of becoming familiar with Regulation S-T and the EDGAR Filer Manual and other

¹⁸⁸¹ See DBRS Letter; ICI Letter; S&P Letter.

¹⁸⁸² See ICI Letter.

¹⁸⁸³ See S&P Letter.

¹⁸⁸⁴ See DBRS Letter.

“start-up tasks” as well as ongoing expenses. In addition, the commenter stated that requiring that the documents be submitted in XBRL format would increase costs without conferring benefits. The commenter suggested, alternatively, that NRSROs be required to make the submissions as PDF documents via electronic mail to a designated Commission e-mail address, with confidential information encrypted before transmission.

The Commission is adopting the amendments to Rule 17g-1, Form NRSRO, Rule 17g-3, and Regulation S-T substantially as proposed, with modifications, in response to comment.¹⁸⁸⁵ The amendments specify that the information that is required to be submitted to the Commission electronically on EDGAR be submitted as PDF documents and, in contrast to the proposal, make the temporary hardship exemption in Rule 201 of Regulation S-T available for these submissions.

In response to the comment objecting to the proposal, stating that the Commission underestimated the costs and overstated the benefits of the proposal, and stating that the Commission should instead require that NRSROs e-mail the submissions as PDF documents to the Commission,¹⁸⁸⁶ the final amendments provide that the submissions must be made as PDF documents, which another NRSRO described as “the most preferred and simplest” way to provide the information.¹⁸⁸⁷ However, in response to this comment, as explained below in the economic analysis, the Commission has increased its estimate of the cost of the proposal. In addition, as explained below in the economic analysis, the Commission agrees with another

¹⁸⁸⁵ See DBRS Letter; S&P Letter.

¹⁸⁸⁶ See DBRS Letter.

¹⁸⁸⁷ See S&P Letter.

commenter that the amendments will benefit users of credit ratings¹⁸⁸⁸ and also that the amendments will benefit NRSROs and Commission staff.

Accordingly, the amendments to paragraphs (e), (f), and (g) of Rule 17g-1, as adopted, provide that a Form NRSRO and the information and documents in the exhibits required to be submitted with the form must be filed electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.¹⁸⁸⁹ Similarly, amended Item A.8 to the Instructions for Form NRSRO has been modified from the proposal to provide that an NRSRO must make these submissions “electronically on EDGAR as a PDF document in the format required by the EDGAR Filer Manual as defined in Rule 11 of Regulation S-T.”¹⁸⁹⁰ The amendments to Instruction A.9 to Form NRSRO, to include a reference to the instructions in Item A.8, are adopted as proposed.¹⁸⁹¹

Paragraph (d) of Rule 17g-3 has similarly been modified from the proposal to provide that the reports must be filed with or furnished to, as applicable, the Commission electronically on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.¹⁸⁹² Paragraph (e) of Rule 17g-3 is adopted as proposed.¹⁸⁹³

Rule 104 of Regulation S-T¹⁸⁹⁴ provides for “unofficial PDF copies” that are included in electronic submissions through EDGAR. Under the amendments, however, the electronic submissions will be “official” filings with the Commission. Accordingly, as adopted, paragraph (xiv) of Regulation S-T adds Form NRSRO and the information and documents in Exhibits 1

¹⁸⁸⁸ See ICI Letter.

¹⁸⁸⁹ See paragraphs (e) through (g) of Rule 17g-1.

¹⁸⁹⁰ See Instruction A.8 to Form NRSRO.

¹⁸⁹¹ See Instruction A.9 to Form NRSRO.

¹⁸⁹² See paragraph (d) of Rule 17g-3.

¹⁸⁹³ See paragraph (e) of Rule 17g-3.

¹⁸⁹⁴ 17 CFR 232.104.

through 9 of Form NRSRO, filed with or furnished to, as applicable, the Commission pursuant to paragraphs (e), (f), and (g) of Rule 17g-1 and the annual reports filed with or furnished to, as applicable, the Commission pursuant to Rule 17g-3 as documents that must be filed electronically with the Commission; that the documents must be filed or furnished on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T; and that notwithstanding Rule 104 of Regulation S-T, the PDF documents filed or furnished pursuant to this paragraph will be considered as officially filed with or furnished to, as applicable, the Commission.¹⁸⁹⁵

Finally, the Commission is modifying the proposal in response to comment,¹⁸⁹⁶ to make the temporary hardship exemption in Rule 201 available for the submissions of Form NRSRO and the information and documents submitted in the exhibits that must be filed with the form under paragraph (e), (f), or (g) of Rule 17g-1 and the annual reports required under Rule 17g-3. Accordingly, if an NRSRO has unanticipated technical difficulties beyond its control, such as a power outage or equipment failure, that prevent the timely preparation and submission of an electronic submission, the NRSRO may make the submission in paper form under the temporary hardship exemption under cover of Form TH no later than one business day after the submission was to be made. The NRSRO must submit an electronic copy within six business days of the submission of the paper document. This should mitigate the burden for an NRSRO that experiences a technical problem.

2. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the specific amendments

¹⁸⁹⁵ See paragraph (a)(1)(xiv) of Rule 101 of Regulation S-T.

¹⁸⁹⁶ See S&P Letter.

relating to the requirement that NRSROs make certain submissions to the Commission electronically.¹⁸⁹⁷ The baseline that existed before today's amendments was one in which, as discussed above, applicants for registration as an NRSRO and NRSROs were required to submit Form NRSRO to the Commission in paper form.¹⁸⁹⁸ In addition, NRSROs were required to submit their annual reports under Rule 17g-3 in paper form.¹⁸⁹⁹ NRSROs were also required under paragraph (i) of Rule 17g-1 to make the public portions of their most recent Forms NRSRO publicly available within ten business days after submission to the Commission (or, in the case of an application for registration as an NRSRO or for an additional class of credit ratings, within ten business days after a Commission order granting such an application), and did so by posting electronic copies of their current Forms NRSRO and Exhibits 1 to 9 to these forms on their public websites. Investors interested in comparing the content of these forms across all NRSROs could visit each of the individual NRSRO websites to locate the forms, or use direct hyperlinks to the relevant web pages published on the Commission's website.¹⁹⁰⁰

Relative to the baseline, the amendments may provide benefits to users of credit ratings. In the proposing release, the Commission preliminarily identified potential benefits resulting from the proposed amendments.¹⁹⁰¹ As discussed above, one commenter stated that having the information available immediately and in one location would benefit users of credit ratings by making it easier to access information about NRSROs and to compare the information provided

¹⁸⁹⁷ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁸⁹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33482.

¹⁸⁹⁹ See id.

¹⁹⁰⁰ Hyperlinks to the NRSROs' Forms NRSRO are available on the Commission's website at <http://www.sec.gov/ocr>.

¹⁹⁰¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33531.

by different NRSROs.¹⁹⁰² However, an NRSRO commented that the Commission “vastly overstated” the benefits of the proposal.¹⁹⁰³ In response, the Commission more specifically identifies the sources of expected benefits in this release.

The electronic submission of Form NRSRO will allow the Commission to make the public portions of the Form NRSRO of each NRSRO publicly available on EDGAR immediately upon submission. Moreover, past submissions of Form NRSRO on the EDGAR system will remain available even after updated versions are submitted, benefitting users of credit ratings relative to the baseline by maintaining the availability of historical data that they may find useful in evaluating and comparing NRSROs.¹⁹⁰⁴ The Commission believes that the availability of these forms on EDGAR may also marginally benefit users of credit ratings by reducing the time and effort required to retrieve Forms NRSRO, since they will be consolidated in a single location rather than located on separate websites, and potentially reducing (by up to ten days, given the time allowed for NRSROs to post these forms on their websites) the delay before the forms are made publicly available. One NRSRO commented that users of credit ratings would be “far more likely” to continue to access Forms NRSRO from NRSRO websites instead of EDGAR, given that they may use these websites to access other useful information.¹⁹⁰⁵ In response, the Commission notes that Forms NRSRO are likely to be a helpful starting point for evaluating and comparing NRSROs.

The Commission believes that the electronic submission of the Forms NRSRO and the Rule 17g-3 annual reports may marginally benefit NRSROs because they will avoid the

¹⁹⁰² See ICI Letter.

¹⁹⁰³ See DBRS Letter.

¹⁹⁰⁴ See section II.E.4. of this release (discussing the limitations of interpreting performance statistics computed using the single cohort approach using only the most current Forms NRSRO, since these forms would only contain information about the most recent cohorts of credit ratings).

uncertainties, delay, and expense related to the physical delivery of multiple paper copies of the submissions.

The Commission believes that the requirement that Forms NRSRO and the Rule 17g-3 annual reports be submitted through the EDGAR system may promote efficiency. As stated above, the availability of the public portions of Forms NRSRO on EDGAR will provide a centralized location for users of credit ratings to access these disclosures. The electronic submission of Forms NRSRO, including the confidential portions of these forms, and the annual reports, which will not be made public, will also assist the Commission staff in storing and accessing these records in furtherance of the Commission's NRSRO oversight function. To the extent that the ready access to the public portions of the current and, in the future, previous Forms NRSRO on EDGAR improves the ability of users of credit ratings to evaluate and compare NRSROs, the electronic submission requirement may also indirectly enhance competition.¹⁹⁰⁶

These amendments will result in compliance costs to NRSROs, including costs to gain access to and become familiar with the EDGAR system. In the proposing release, the Commission stated that it believed that the initial costs to become familiar with the EDGAR system and adopt processes for using the system would be minimal and that the annual costs would be no greater than the costs attributable to paper submissions.¹⁹⁰⁷ One NRSRO commented that the Commission understated the initial costs of the proposal as "an NRSRO will have to familiarize itself with the roughly 35 Rules of Regulation S-T as well as the first two volumes of the EDGAR Filer Manual (which currently total more than 600 pages) and related

¹⁹⁰⁶ See section I.B.3. of this release (providing a broader discussion of the potential impacts of the amendments and new rules on efficiency, competition, and capital formation).

¹⁹⁰⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33531.

EDGAR technical guidance.”¹⁹⁰⁸ However, the commenter did not provide a different estimate of the cost associated with the proposal.¹⁹⁰⁹ In response to this comment, the Commission notes that not all of Regulation S-T or the EDGAR Filer Manual applies to NRSRO submissions. In addition, the Commission has published on its website staff guidance for EDGAR filers and staff answers to frequently asked questions that may reduce the time required for NRSROs to familiarize themselves with the EDGAR system. Nonetheless, as discussed in section IV.D.1. of this release, the Commission has revised its estimate of the time required for an NRSRO to become familiar with the EDGAR system. The same commenter also stated that the Commission failed to consider the significant annual costs of monitoring changes in EDGAR filing requirements, but the commenter did not provide an estimate of these costs.¹⁹¹⁰ In response, the Commission has added an estimated annual burden attributable to monitoring changes in EDGAR filing requirements.¹⁹¹¹ The Commission’s estimates of these costs are provided below.

As discussed above, the Commission has also modified the requirement to submit certain Forms NRSRO and annual reports under Rule 17g-3 to the Commission electronically. One NRSRO described documents in PDF format as “the most preferred and simplest” way to provide the information.¹⁹¹² Another NRSRO commented that submission formats other than PDF would require “very expensive” reformatting and, because NRSROs post PDF versions of Form NRSRO on their websites, would result in costs of “producing two sets of these documents

¹⁹⁰⁸ See DBRS Letter.

¹⁹⁰⁹ See id.

¹⁹¹⁰ See id.

¹⁹¹¹ See section IV.D.1. of this release.

¹⁹¹² See S&P Letter.

in two different electronic formats on an ongoing basis.”¹⁹¹³ In response to these comments, the Commission has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents.

Based on analysis for purposes of the PRA, the Commission estimates that the amendments to Rule 17g-1, Form NRSRO, Rule 17g-3, and Regulation S-T regarding electronic submission of certain Forms NRSRO and NRSRO annual reports under Rule 17g-3 will result in total industry-wide one-time costs to NRSROs of approximately \$46,000 and total industry-wide annual costs to NRSROs of approximately \$6,000.¹⁹¹⁴

As discussed above, the Commission has modified the proposal to make the temporary hardship exemption available to NRSROs. Because the temporary hardship exemption process is self-executing, the Commission expects that any costs borne by NRSROs when availing of the temporary hardship exemption, including the cost to make the submission in paper form under the cover of Form TH, will be de minimis. Also, given that the Commission has simplified the technical requirements for the submissions by requiring PDF rather than XML or XBRL documents, and that the temporary hardship exemption will be available if an NRSRO nonetheless experiences unanticipated technical difficulties that prevent the timely preparation and submission of an electronic filing, the Commission does not expect NRSROs to apply for continuing hardship exemptions.

As discussed above, one reasonable alternative to the Commission’s approach would be to require that the electronic submissions be made in XBRL or XML format. Two NRSROs stated that such formats would not provide incremental benefits, while one of these commenters

¹⁹¹³ See DBRS Letter.

¹⁹¹⁴ See section V.N. of this release (discussing implementation and annual compliance considerations). The one-time and annual costs are determined by monetizing internal hour burdens and adding external costs identified in the PRA analysis in section IV.D.1. and section IV.D.12. of this release.

stated that requiring such formats “would substantially increase an NRSRO’s costs” and the other noted that “a detailed technical analysis would need to be performed to determine the impact and any associated costs.”¹⁹¹⁵ However, one commenter suggested that requiring Exhibit 1 to Form NRSRO in particular to be submitted in XML or XBRL format would benefit investors, regulators, and other market participants.¹⁹¹⁶ While the Commission agrees that submissions in these formats may benefit certain users of credit ratings by facilitating the comparative analysis of the quantitative data in the forms over time and across NRSROs, the Commission is sensitive to the concerns raised by NRSROs and has determined not to impose at this time a requirement that the submissions be made in XML or XBRL formats, in part to limit the additional compliance costs that would be borne by NRSROs. One NRSRO suggested that PDF copies of the required submissions should be transmitted via e-mail, with the confidential submissions being encrypted before transmission.¹⁹¹⁷ While such an approach may reduce the compliance costs associated with electronic submission, the Commission believes that the costs of using the EDGAR system are balanced by the benefits discussed above of using this system not only for delivery of electronic submissions to the Commission, but also for the dissemination and storage of these submissions.

M. OTHER AMENDMENTS

The Commission proposed additional amendments to several NRSRO rules in response to amendments the Dodd-Frank Act made to sections of the Exchange Act that authorize or otherwise are relevant to these rules and to clarify certain provisions of the NRSRO rules.¹⁹¹⁸ The Commission is adopting these amendments as proposed.¹⁹¹⁹

¹⁹¹⁵ See DBRS Letter; S&P Letter.

¹⁹¹⁶ See CFA II Letter.

¹⁹¹⁷ See DBRS Letter.

¹⁹¹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33485-33489.

¹⁹¹⁹ The Commission is also making a technical amendment to paragraphs (e) and (f) of Rule 17g-1 to replace

1. Changing “Furnish” to “File”

Before the enactment of the Dodd-Frank Act, the Exchange Act contained provisions requiring NRSROs to “furnish” certain items to the Commission. For example, section 15E(k) of the Exchange Act required NRSROs to “furnish” financial information to the Commission.¹⁹²⁰ Section 932(a) of the Dodd-Frank Act amended several Exchange Act provisions relating to NRSROs to replace the word “furnish” with the word “file” in section 15E(b) (which addresses NRSRO submission of updates of registration and annual certifications to the Commission); section 15E(d) (which addresses Commission sanctions on NRSROs); section 15E(k) (which addresses NRSRO submission of financial information to the Commission); and section 15E(l) (which provides that registration under section 15E of the Exchange Act is the sole method of registration as an NRSRO).¹⁹²¹ For example, section 15E(b)(2), as amended, provides that an NRSRO shall “file” its annual certification with the Commission. In accordance with the Dodd-Frank Act amendment to section 15E(b) of the Exchange Act, the Commission proposed amending paragraphs (e) and (f) of Rule 17g-1, which address the submission of updates of registration and annual certifications, respectively, to require that the Forms NRSRO submitted to the Commission under those provisions be filed with, rather than furnished to, the Commission.¹⁹²² Similarly, in accordance with the Dodd-Frank Act amendment to section 15E(k) of the Exchange Act, the Commission proposed amending paragraphs (a)(1) through

the phrase “Exhibits...of Form NRSRO” to the phrase “Exhibits...to Form NRSRO” for consistency with paragraph (i) of Rule 17g-1 and a technical amendment to paragraph (i) of Rule 17g-1 to replace the word “paragraphs” with the word “paragraph.”

¹⁹²⁰ See Pub. L. No. 109-291, 4(a) (adding section 15E to the Exchange Act).

¹⁹²¹ See Pub. L. No. 111-203, 932(a); 15 U.S.C. 78o-7(b), (d), (k), and (l). Among other things, an application, report, or document “filed” with the Commission pursuant to the Exchange Act or rules under the Exchange Act is subject to the provisions of section 18 of the Exchange Act. See 15 U.S.C. 78o-7r. As explained below, however, the Dodd-Frank Act did not replace all references in Exchange Act provisions relating to NRSROs from “furnish” to “file.”

¹⁹²² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33538.

(a)(5) of Rule 17g-3 to require that the reports submitted to the Commission under those provisions be filed with, rather than furnished to, the Commission.¹⁹²³

The Dodd-Frank Act, however, did not replace the word “furnish” with the word “file” in sections 15E(a) and 15E(e) of the Exchange Act (which address the submission of initial applications for registration as an NRSRO and the submission of voluntary withdrawals from registration, respectively), or in section 17(a)(1) of the Exchange Act (which provides the Commission with authority to, among other things, require NRSROs to furnish reports to the Commission).¹⁹²⁴

The Commission stated in the proposing release that it preliminarily believed that the failure to replace the word “furnish” with the word “file” in section 15E(a) of the Exchange Act was an inadvertent omission.¹⁹²⁵ For example, section 15E(b)(1) of the Exchange Act, as amended by the Dodd-Frank Act, refers to information “required to be filed” under section 15E(a)(1)(B)(i) of the Exchange Act (emphasis added).¹⁹²⁶ Similarly, section 15E(d)(1)(B) of the Exchange Act, as amended by the Dodd-Frank Act, refers to “the date on which an application for registration is filed with the Commission” (emphasis added).¹⁹²⁷ In addition, the legislative history of section 932(a) states that “[Title IX, Subtitle C, of the Dodd-Frank Act] requires all references to ‘furnish’ be replaced with the word ‘file’ in existing law.”¹⁹²⁸ Consequently, the Commission proposed amending paragraphs (a), (b), and (c) of Rule 17g-1

¹⁹²³ See *id.* at 33539. The Commission adopted paragraphs (a)(1) through (a)(5) of Rule 17g-3 under section 15E(k). See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33590-33593.

¹⁹²⁴ See 15 U.S.C. 78o-7(e); 15 U.S.C. 78q(a)(1).

¹⁹²⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33485.

¹⁹²⁶ See 15 U.S.C. 78o-7(a)(1)(B)(i).

¹⁹²⁷ See 15 U.S.C. 78o-7(d)(1)(B).

¹⁹²⁸ See Conference Report, H.R. 4173 (June 29, 2010), p. 872.

(which address initial applications for registration as an NRSRO, applications to register for an additional class of credit ratings, and supplementing an application, respectively) to substitute the words “file with the Commission two paper copies of” in place of the words “furnish the Commission with.”¹⁹²⁹

The Commission did not propose replacing the word “furnish” with the word “file” in paragraph (d) of Rule 17g-1 (which addresses the withdrawal of an application for registration) or in paragraph (g) of Rule 17g-1 (which addresses the submission of voluntary withdrawals from registration).¹⁹³⁰ Consequently, as proposed, when referencing the submission of Form NRSRO to the Commission, paragraphs (h) and (i) of Rule 17g-1 (which include provisions relating to when a Form NRSRO will be considered filed with or furnished to the Commission and the public availability of Form NRSRO, respectively) would use phrases such as “filing with or furnishing to, as applicable.”¹⁹³¹

The Commission also did not propose to amend paragraph (a)(6) of Rule 17g-3 to treat the report identified in that paragraph (an unaudited report of the number of credit rating actions taken during the fiscal year) as a filing. That paragraph was adopted under section 17(a)(1) of the Exchange Act.¹⁹³² Section 17(a)(1) of the Exchange Act provides that any report an NRSRO “is required by Commission rules under this paragraph to make and disseminate to the Commission shall be deemed furnished to the Commission.”¹⁹³³ As stated above, the Dodd-Frank Act did not amend this provision.

¹⁹²⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33538.

¹⁹³⁰ See id.

¹⁹³¹ See id.

¹⁹³² See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6464-6465.

¹⁹³³ See 15 U.S.C. 78o-7q(a)(1).

The Commission proposed amending Form NRSRO and the instructions to Form NRSRO to conform the form and its instructions to the proposed amendments discussed above.¹⁹³⁴ Under the proposed amendments, Form NRSRO and the Instructions to Form NRSRO would use the word “file” instead of the word “furnish” when referring to a Form NRSRO submitted under paragraphs (a), (b), (c), (e), and (f) of Rule 17g-1. In addition, in some cases, the Commission proposed using the term “submit” when referring to a Form NRSRO that may have been submitted prior to enactment of the Dodd-Frank Act when the submission would have been “furnished to” as opposed to “filed with” the Commission. The Commission intended the word “submit” as used in this context to mean the submission was either “furnished” or “filed” depending on the applicable securities laws in effect at the time of the submission.

The Commission did not receive comments on the proposals to amend Rule 17g-1, Rule 17g-3, Form NRSRO, and the instructions to Form NRSRO to replace the word “furnish” with the word “file” and is adopting the amendments as proposed.

2. Amended Definition of NRSRO

The first prong of the definition of nationally recognized statistical rating organization in section 3(a)(62) of the Exchange Act, prior to being amended by the Dodd-Frank Act, provided that the entity “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 under section 15E.”¹⁹³⁵ Section 932(b) of the Dodd-Frank Act deleted this prong of the definition.¹⁹³⁶ Instruction F.4 to Form NRSRO contained a definition of nationally recognized statistical rating organization that

¹⁹³⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33546-33561.

¹⁹³⁵ See Pub. L. No. 109-291, 3(a) (adding section 3(a)(62) to the Exchange Act).

¹⁹³⁶ See Pub. L. No. 111-203, 932(b).

incorporated the section 3(a)(62) definition as originally enacted.¹⁹³⁷ The Commission proposed amending this definition to conform it to the section 3(a)(62) definition as amended by the Dodd-Frank Act.¹⁹³⁸

Two NRSROs supported this amendment,¹⁹³⁹ and the Commission is adopting it as proposed.

3. Definition of Asset-Backed Security

Prior to today's amendments, several of the Commission's NRSRO rules had requirements that were specific to credit ratings for structured finance products by providing that the rules apply to credit ratings with respect to "a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction."¹⁹⁴⁰ This text mirrors the text of section 15E(i) of the Exchange Act, which provides the Commission with authority to prohibit an NRSRO from the practice of "lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the [NRSRO]."¹⁹⁴¹ The Commission has provided the following interpretation with respect to this text in its rules:

The term "structured finance product" as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-

¹⁹³⁷ This instruction, "Explanation of Terms," was numbered as "Instruction F" before today's amendments. It should have been numbered as "Instruction I."

¹⁹³⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33560. The Instruction is numbered I.4 in the Instructions to Form NRSRO.

¹⁹³⁹ See DBRS Letter; S&P Letter.

¹⁹⁴⁰ Nationally Recognized Statistical Rating Organizations, 76 FR at 33486 (referencing paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g-2, paragraph (a)(6) of Rule 17g-3, paragraphs (a)(3) and (b)(9) of Rule 17g-5, and paragraph (a)(4) of Rule 17g-6).

¹⁹⁴¹ See 15 U.S.C. 78o-7(i).

backed or mortgage-backed securities transaction. This broad category of financial instrument includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities ("RMBS") and to other types of structured debt instruments such as collateralized debt obligations ("CDOs"), including synthetic and hybrid CDOs, or collateralized loan obligations ("CLOs").¹⁹⁴²

Section 941(a) of the Dodd-Frank Act amended section 3 of the Exchange Act to add paragraph (a)(79), which defines the term asset-backed security.¹⁹⁴³ The Exchange Act definition of asset-backed security includes a "collateralized mortgage obligation."¹⁹⁴⁴ Consequently, the Commission stated in the proposing release that the current identification of structured finance products in the Commission's rules (namely, "a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction") may have redundant terms because the new definition of asset-backed security in section 3(a)(79) of the Exchange Act as an "asset-backed securities transaction" would include a "mortgage-backed securities transaction."¹⁹⁴⁵ Consequently, the Commission stated in the proposing release that it preliminarily believed that the inclusion of the term "mortgage-backed securities transactions" in certain of the Commission's NRSRO rules may be redundant.¹⁹⁴⁶ The Commission therefore proposed deleting the term "or mortgage-backed" from the identification of structured finance products in these rules.¹⁹⁴⁷ One NRSRO supported the proposal,¹⁹⁴⁸ and

¹⁹⁴² Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63832, footnote 3 (Dec. 4, 2009).

¹⁹⁴³ See Pub. L. No. 111-203, 941(a); 15 U.S.C. 78c(a)(77).

¹⁹⁴⁴ See 15 U.S.C. 78c(a)(77)(A)(i).

¹⁹⁴⁵ See 15 U.S.C. 78c(a)(77)(A).

¹⁹⁴⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33486-33487; 15 U.S.C. 78c(a)(79)(A).

¹⁹⁴⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33539-33540.

¹⁹⁴⁸ See DBRS Letter.

another NRSRO stated that it would not change the requirements of the affected rules.¹⁹⁴⁹ The Commission is adopting the amendments as proposed.

4. Other Amendments to Form NRSRO

The Commission proposed clarifying amendments to Form NRSRO to better ensure that disclosures on Form NRSRO are consistent across applicants and NRSROs.¹⁹⁵⁰

a. Clarification with Respect to Items 6 and 7

Items 6 and 7 of Form NRSRO elicit information concerning the number of credit ratings an applicant or NRSRO has outstanding in each class of credit ratings for which the applicant is applying to be registered or for which the NRSRO is registered, respectively.¹⁹⁵¹ Item 6 applies to initial applications for registration as an NRSRO, application supplements, and applications to add a class of credit ratings. Item 7 applies for updates of registration, annual certifications, withdrawals from registration, and applications to add a class of credit ratings. The classes of credit ratings for which an NRSRO can be registered are: (1) financial institutions, brokers, or dealers;¹⁹⁵² (2) insurance companies;¹⁹⁵³ (3) corporate issuers;¹⁹⁵⁴ (4) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of Title 17, Code of Federal Regulations, “as in effect on the date of enactment of this paragraph”);¹⁹⁵⁵ and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.¹⁹⁵⁶

¹⁹⁴⁹ See S&P Letter. The Commission agrees with the commenter.

¹⁹⁵⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33487-33489.

¹⁹⁵¹ See Form NRSRO, Items 6-7.

¹⁹⁵² See 15 U.S.C. 78c(a)(62)(A)(i).

¹⁹⁵³ See 15 U.S.C. 78c(a)(62)(A)(ii).

¹⁹⁵⁴ See 15 U.S.C. 78c(a)(62)(A)(iii).

¹⁹⁵⁵ See 15 U.S.C. 78c(a)(62)(A)(iv).

¹⁹⁵⁶ See 15 U.S.C. 78c(a)(62)(A)(v).

NRSROs have raised questions about how they should count the number of credit ratings outstanding in a given class of credit ratings for the purposes of Form NRSRO.¹⁹⁵⁷ For example, the GAO has found that some NRSROs counted the number of issuers rated but not the number of securities or money market instruments rated, some NRSROs counted the number of securities or money market instruments rated and excluded the number of rated obligors in the total, and some NRSROs counted the number of obligors, securities, and money market instruments rated.¹⁹⁵⁸

The Commission's intent in Items 6 and 7 is to elicit the total number of obligors, securities, and money market instruments in a given class of credit ratings for which the applicant or NRSRO has assigned a credit rating that was outstanding as of the applicable date (the date of the application in the case of Item 6 and the date of the most recent calendar year-end in the case of Item 7). Consequently, the Commission proposed amending Items 6.A and 7.A of Form NRSRO to specify that an applicant or NRSRO must provide the "approximate number of obligors, securities, and money market instruments" for each class of credit ratings for which the applicant or NRSRO has an outstanding credit rating.¹⁹⁵⁹

In addition, the Commission proposed amending Instruction H to Form NRSRO (as it relates to Items 6.A and 7.A) in four ways.¹⁹⁶⁰ First, in conformity with the proposed amendments to the text of Items 6.A and 7.A in the Form, the instructions would be amended to provide that the applicant or NRSRO must, for each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments

¹⁹⁵⁷ See, e.g., GAO Report 10-782, pp. 46-47.

¹⁹⁵⁸ See *id.*

¹⁹⁵⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33487-33488, 33547-33549.

¹⁹⁶⁰ See *id.* at 33487-33488, 33554-33555.

in that class for which the applicant or NRSRO presently has a credit rating outstanding as of the date of the application (Item 6.A) or had a credit rating outstanding as of the most recently ended calendar year (Item 7.A).

Second, Instruction H was proposed to be amended to provide that the applicant or NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer.¹⁹⁶¹ This proposed instruction was designed to clarify that each security or money market instrument of an issuer must be included in the count if it is assigned a credit rating by the applicant or NRSRO. For example, if the issuer is in the structured finance class, each tranche of the structured finance product that is assigned a credit rating must be included in the count. In addition, if an issuer issues securities or money market instruments that have different maturities, the applicant or NRSRO must include each such security in the count if the NRSRO assigns a credit rating to the security or money market instrument.

Third, Instruction H was proposed to be amended to provide that the applicant or NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating.¹⁹⁶² In other words, the applicant or NRSRO cannot double count an obligor, security, or money market instrument by including it in the totals for two or more classes of credit ratings. For example, some securities have characteristics that could cause an applicant or

¹⁹⁶¹ See id.

¹⁹⁶² See id.

NRSRO to classify them as municipal securities or structured finance products.¹⁹⁶³ Nonetheless, under the proposed amendment, the applicant or NRSRO would need to select the most appropriate class for the security or money market instrument and include it in the count for that class.

Fourth, Instruction H was proposed to be amended to provide that the applicant or NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities), to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction.¹⁹⁶⁴ Section 3(a)(62)(B)(iv) contains a narrower definition of asset-backed security than the Commission uses for the purposes of its NRSRO rules.¹⁹⁶⁵ In fact, the definition is narrower than the new definition of asset-backed security in section 3(a)(79) of the Exchange Act.¹⁹⁶⁶ The Commission intends an applicant and an NRSRO to use the broader definition that captures all structured finance products when providing the number of credit ratings outstanding in this class. The proposed amendments to Instruction H to Form NRSRO were designed to make this intention more clear.

Two NRSROs supported the proposed amendments to Items 6 and 7 of Form NRSRO and the related Instructions to Form NRSRO.¹⁹⁶⁷ The Commission is adopting them as proposed.

Because some obligors, securities, and money market instruments have characteristics that could cause them to be assigned to more than one class of credit rating, the Commission

¹⁹⁶³ For example, tax exempt housing bonds share characteristics of both municipal securities and structured finance products.

¹⁹⁶⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33487-33488, 33554-33555.

¹⁹⁶⁵ Compare 15 U.S.C. 78c(a)(62)(B)(iv), with: Instructions for Exhibit 1 to Form NRSRO; paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g-2; paragraph (a)(6) of Rule 17g-3; paragraphs (a)(3) and (b)(9) of Rule 17g-5; and paragraph (a)(4) of Rule 17g-6.

¹⁹⁶⁶ Compare 15 U.S.C. 78c(a)(62)(B)(iv), with 15 U.S.C. 78c(a)(79).

¹⁹⁶⁷ See DBRS Letter; S&P Letter.

sought comment on which class would be the most appropriate for these types of obligors, securities, and money market instruments. For example, the Commission requested comment on how tax-exempt housing bonds should be classified for purposes of Items 6 and 7 of Form NRSRO.¹⁹⁶⁸ Several NRSROs provided comment in response to this request.¹⁹⁶⁹ One NRSRO stated that the Commission should create a new subclass of credit ratings under the insurance company class to distinguish traditional insurance companies from the special-purpose vehicles set up solely to provide reinsurance to insurance carriers.¹⁹⁷⁰ Two NRSROs stated that tax-exempt housing bonds should be classified in the category for issuers of government securities; supra-national issuers should be classified in the category for issuers of government securities; and covered bonds should be classified in the category for financial institutions.¹⁹⁷¹ One NRSRO stated that if a municipality issues securities on behalf of a for-profit healthcare company, the securities should be classified as government securities, and that securitizations of healthcare receivables and insurance-linked securities are both typically classified in the asset-backed security category.¹⁹⁷² Another NRSRO stated that covered bonds that are effectively “repackaged” should be classified as issuers of asset-backed securities; that healthcare revenue bonds or industrial revenue bonds should be classified as corporate securities; that insurance-linked securities should be classified as insurance companies; that energy prepay transactions should be classified as a corporate issuer; and that Airline Enhanced Equipment Trust Certificates should be classified as corporate debt.¹⁹⁷³

¹⁹⁶⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33488.

¹⁹⁶⁹ See A.M. Best Letter; DBRS Letter; S&P Letter.

¹⁹⁷⁰ See A.M. Best Letter.

¹⁹⁷¹ See DBRS Letter; S&P Letter.

¹⁹⁷² See DBRS Letter.

¹⁹⁷³ See S&P Letter.

Given the complexity of trying to classify every type of obligor, security, or money market instrument that potentially could straddle two or more classes of credit ratings, the Commission is deferring making specific classifications for purposes of Items 6 and 7 of Form NRSRO. Instead, an NRSRO should make reasonable and consistent judgments about the classification of these types of obligors, securities, and money instruments.

b. Clarification with Respect to Exhibit 8

The Commission proposed amending Instruction H to Form NRSRO as it relates to Exhibit 8.¹⁹⁷⁴ Exhibit 8 requires an applicant or NRSRO to provide the number of credit analysts it employs and the number of its credit analyst supervisors. The Commission proposed two amendments to the instructions for Exhibit 8. The first amendment would delete a parenthesis that instructs the applicant or NRSRO to “see definition below” of the term credit analyst because that term is not defined in the Form. The second amendment would clarify that the applicant or NRSRO, in providing the number of its credit analysts, should include the number of its credit analyst supervisors. This was designed to ensure that the disclosures in Form NRSRO are consistent across applicants and NRSROs.¹⁹⁷⁵

One NRSRO stated that it supported the proposal to amend Instruction H as it relates to Exhibit 8 to Form NRSRO,¹⁹⁷⁶ and the Commission is adopting it as proposed.

c. Clarification with Respect to Exhibits 10 through 13

Before today’s amendments, paragraph (i) of Rule 17g-1 required an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 to Form NRSRO publicly available on its Internet website, or through another comparable, readily

¹⁹⁷⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33489, 33555.

¹⁹⁷⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33489.

¹⁹⁷⁶ See DBRS Letter.

accessible means within ten business days after the date of the Commission order granting an initial application for registration or an application to register for an additional class of credit ratings and within ten business days after submitting a Form NRSRO under paragraph (e), (f), or (g) of Rule 17g-1 (an update of registration, an annual certification, or a withdrawal from registration).¹⁹⁷⁷ An NRSRO is not required to make Exhibits 10 through 13 to Form NRSRO publicly available or update them after registration. Instead, an NRSRO must provide similar information in the annual reports required to be filed with the Commission under Rule 17g-3.¹⁹⁷⁸ In the past, some NRSROs have submitted the annual reports required by Rule 17g-3 in the form of Exhibits 10 through 13, on a confidential basis, as part of the annual certification. Consequently, the Commission proposed amending Instruction H as it relates to Exhibits 10 through 13 to add a “Note” instructing that after registration, Exhibits 10 through 13 should not be updated with the filing of the annual certification, but that similar information must be filed with the Commission not more than ninety days after the end of each fiscal year under Rule 17g-3.¹⁹⁷⁹

One NRSRO supported the proposal to amend Instruction H as it relates to Exhibits 10 through 13 to Form NRSRO,¹⁹⁸⁰ and the Commission is adopting it as proposed.

5. Economic Analysis

This section builds on the economic analysis in section I.B. of this release by presenting a focused analysis of the potential economic effects that may derive from the additional amendments to several NRSRO rules made in response to amendments the Dodd-Frank Act made to sections of the Exchange Act that authorize or otherwise are relevant to these rules and

¹⁹⁷⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33489.

¹⁹⁷⁸ See 17 CFR 240.17g-3.

¹⁹⁷⁹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33489, 33559-33560.

¹⁹⁸⁰ See DBRS Letter.

to clarify certain provisions of the NRSRO rules.¹⁹⁸¹ Many of these amendments clarify what is required of NRSROs by making terms in Commission rules applicable to NRSROs consistent with the amendments that the Dodd-Frank Act made to terms in section 15E of the Exchange Act. These clarifying amendments – including the replacement of “furnish” with “file” with respect to updates of registration and annual certifications and the amended definitions of nationally recognized statistical rating organization and asset-backed security – should result in no incremental costs and may benefit NRSROs by removing the potential ambiguity caused by inconsistent terms.

As discussed above, beyond these clarifying amendments made for consistency with section 15E of the Exchange Act, the Commission has adopted amendments to replace the word “furnish” with the word “file” in paragraphs (a), (b), and (c) of Rule 17g-1 (which address initial applications for registration as an NRSRO, applications to register for an additional class of credit ratings, and supplementing an application, respectively) based on its belief, as stated in the proposing release, that the failure to make this replacement in section 15E(a) of the Exchange Act was an inadvertent omission and that the legislative history of the Dodd-Frank Act states that the statute requires all references to “furnish” to be replaced with “file.”¹⁹⁸² These replacements of “furnish” with “file” may cause applicants for registration as an NRSRO and NRSROs applying to register for an additional class of credit ratings to take the same care in composing these applications as they would in any updates of registration and annual certifications (which are required to be “filed” under the baseline), given that section 18 of the Exchange Act imposes

¹⁹⁸¹ The economic analysis in section I.B. of this release discusses the primary economic impacts that may derive from the amendments and new rules being adopted today.

¹⁹⁸² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33485.

liability for material misstatements or omissions contained in reports and other information filed with the Commission, which may result in marginal incremental costs to these applicants.

The amendments discussed in section II.M.4. of this release regarding clarifications to the instructions to Form NRSRO should benefit users of credit ratings. The use by NRSROs of different approaches to computing the numbers of outstanding credit ratings, credit rating analysts, and credit rating analyst supervisors reported in Form NRSRO – without disclosing the method employed – has made it difficult to interpret and compare these numbers in the past.¹⁹⁸³ The amendments therefore will improve the ability of users of credit ratings to interpret this information regarding the breadth of NRSRO coverage and NRSRO staffing and compare the information across NRSROs. Also, the amendments will allow the Commission to develop a clearer picture of the NRSROs and their activities and thus facilitate the Commission's oversight, which may indirectly lead to enhancements in the quality of credit ratings to the benefit of users of credit ratings. The amendments may impose one-time costs on NRSROs because they may need to adjust their calculations of their numbers of outstanding credit ratings, credit rating analysts, and credit rating analyst supervisors. However, the Commission believes these costs will be de minimis.

III. EFFECTIVE DATES

As discussed below, the Commission is establishing effective dates for the amendments to existing rules and new rules that are intended to take into account the period of time NRSROs, issuers, underwriters, and providers of third-party due diligence services will need in order to establish new, or adapt existing, policies, procedures, controls, systems, standards, and practices

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See, e.g., GAO Report 10-782, p. 46-47. In its review of the disclosure of outstanding credit ratings, the GAO concluded that "[b]ecause of the inconsistencies in how the NRSROs count their total outstanding ratings, users cannot rely on the disclosures to assess how broad an NRSRO's coverage is within a particular class of credit ratings." The GAO also found that NRSROs did not disclose the methodologies applied to count credit ratings, "so users have no way of knowing that these differences exist."

to comply with the new requirements. If any provision of these amendments or new rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

A. AMENDMENTS EFFECTIVE SIXTY DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER

The following amendments to existing rules are effective sixty days after this release is published in the Federal Register: the amendment to Rule 101 of Regulation S-T; the amendments to paragraphs (e), (f), and (g) of Rule 17g-1; and new paragraph (d) of Rule 17g-3. These amendments require Form NRSRO and applicable exhibits (in the case of an update of registration, an annual certification, or a withdrawal from registration) and the annual reports under Rule 17g-3 to be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system. However, these Forms NRSRO (and applicable exhibits) and the annual reports should continue to be submitted to the Commission in paper form until the Commission provides notice that the EDGAR system is ready to receive the forms and reports and specifies a date on or after which the forms and reports must be submitted through the EDGAR system.

Also effective sixty days after publication in the Federal Register are: (1) the amendments to paragraphs (a), (b), (c), (e), and (f) of Rule 17g-1 and paragraphs (a)(1), (a)(2), (a)(3), (a)(4), and (a)(5) of Rule 17g-3 replacing the word "furnish" with the word "file;" (2) the amendments to paragraphs (a), (b), (c), and (d) of Rule 17g-1 requiring two paper copies of submissions; the amendment to paragraph (i) of Rule 17g-1 requiring NRSROs to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet websites and to provide a paper copy of Exhibit 1 to individuals who request a

paper copy; (3) the amendments to paragraphs (a)(2)(iii), (a)(7), and (b)(9) of Rule 17g-2, the note to paragraph (a)(6) of Rule 17g-3, paragraphs (a)(3) and (b)(9) of Rule 17g-5, and paragraph (a)(4) of Rule 17g-6, which delete the term “or mortgage-backed” from the identification of structured finance products; (4) new paragraph (b)(12) of Rule 17g-2, which identifies the internal control structure an NRSRO must establish, maintain, enforce, and document under section 15E(c)(3)(A) of the Exchange Act as a record that must be retained; (5) the amendment to paragraph (c) of Rule 17g-2, which identifies each record an NRSRO must retain until three years after it is replaced with an updated record; (6) the amendment to paragraph (d) of Rule 17g-2, which repeals paragraph (d)(2) (the 10% Rule); (7) new paragraph (a)(8) of Rule 17g-3, which identifies the annual report of the designated compliance officer as one of the unaudited reports that must be filed with the Commission under that rule; (8) new paragraph (e) of Rule 17g-3, which relates to information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules; (9) new paragraph (f) of Rule 17g-5, which provides that upon written application by an NRSRO, the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest; (10) new paragraph (g) of Rule 17g-5, which provides for penalties the Commission may impose on an NRSRO in a proceeding in which the Commission finds that the NRSRO has violated rules under section 15E(h) of the Exchange Act and the violation affected a credit rating; and (11) the amendments to paragraphs (h) and (i) of Rule 17g-1, paragraphs (b)(1) and (b)(11) of Rule 17g-2, paragraphs (a)(1), (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), and (b)(1) of Rule 17g-3 and the heading thereof, and paragraphs

(a)(3)(i), (a)(3)(ii), (a)(3)(iii)(A), (a)(3)(iii)(B), (a)(3)(iii)(C), (a)(3)(iii)(D), and (e) of Rule 17g-5, which are minor amendments such as wording changes. The Commission did not receive comments specifically addressing the effective date for these amendments and does not believe that additional time is needed in order to prepare for the changes that will result from these amendments.

B. AMENDMENTS EFFECTIVE ON JANUARY 1, 2015

The Commission is delaying the effective date for new paragraphs (a)(7) and (b)(2) of Rule 17g-3 and the amendments to Form NRSRO until January 1, 2015. The Commission intends that the practical effect of having these amendments become effective on January 1, 2015 is that the first internal controls report required to be submitted by an NRSRO will cover the fiscal year that ends on or after January 1, 2015, and the first annual certification on Form NRSRO that follows the amended instructions for Exhibit 1 relating to performance statistics and the amended instructions to Item 7.A relating to the number of credit ratings outstanding will be required for the annual certifications filed after the end of the 2015 calendar year.

Paragraph (a)(7) of Rule 17g-3 requires an NRSRO to include an additional report – a report on the NRSRO’s internal control structure established under section 15E(c)(3)(A) of the Exchange Act – with its annual submission of reports to the Commission pursuant to Rule 17g-3, and paragraph (b)(2) requires the NRSRO’s CEO or, if the firm does not have a CEO, an individual performing similar functions to provide a signed statement that must be attached to the report.

One NRSRO stated that the Commission should not require the internal controls report to be submitted until “the Commission publishes its guidance and provides a reasonable time for

the implementation of this guidance to be completed and timely exam feedback is provided.”¹⁹⁸⁴

The Commission notes that, in addition to the guidance provided above in section II.A.3. of this release, the final amendment provides more specificity than the proposed rule as to the information that must be included in the internal controls report in terms of assessing the effectiveness of the NRSRO’s internal control structure. Moreover, the final amendment specifies when the NRSRO is not permitted to conclude that its internal control structure is effective and includes a description of when a material weakness exists, which will provide greater certainty to NRSROs in terms of how to assess the effectiveness of the internal control structure. The delayed effective date will provide NRSROs with time to prepare processes to obtain the evidentiary matter necessary to make the assessments necessary to support the information that must be provided in the report. Consequently, an NRSRO must begin filing with the Commission an annual internal controls report no later than ninety calendar days after the end of the NRSRO’s fiscal year that ends on or after January 1, 2015.¹⁹⁸⁵

The amendments to Form NRSRO include the following: (1) the amendment to the instructions for Form NRSRO adding new Instruction A.10, which provides notice to credit rating agencies applying for registration as NRSROs, and NRSROs, that an NRSRO is subject to the fine and penalty provisions and other available sanctions in sections 15E, 21, 21A, 21B, 21C,

¹⁹⁸⁴ See Morningstar Letter.

¹⁹⁸⁵ Based on the most recent submissions of Form NRSRO, eight of the NRSROs have December 31 fiscal year ends. Consequently, for these firms, the first internal controls report of the NRSRO must be filed no later than ninety days after December 31, 2015. One NRSRO has a fiscal year end of November 30 and, consequently, the first internal controls report for this firm must be filed no later than ninety days after November 30, 2015. Another NRSRO has a fiscal year end of March 31 and, consequently, the first internal controls report for this firm must be filed no later than ninety days after March 31, 2015. If an NRSRO’s fiscal year ends in 2015 before December 31, the NRSRO may submit an internal controls report for that fiscal year that covers the period beginning on January 1, 2015 through the end of the NRSRO’s then-current fiscal year. Alternatively, the NRSRO may instead elect to have the report cover its entire fiscal year. See Frequently Asked Questions Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule (Apr. 4, 2014), available at <http://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-reporting-rule-faq.htm> (providing guidance to broker-dealers with respect to the transition period for a similar reporting requirement).

and 32 of the Exchange Act for violations of the securities laws; (2) the amendment to the instructions for Form NRSRO requiring that Form NRSRO and Exhibits 1 through 9 to Form NRSRO, as applicable, under paragraph (e), (f), or (g) of Rule 17g-1 (an update of registration, an annual certification, or a withdrawal from registration, respectively) be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system;¹⁹⁸⁶ (3) the clarifying amendments with respect to Items 6 and 7 of Form NRSRO, which elicit information concerning the number of credit ratings an applicant or NRSRO has outstanding in each class of credit ratings for which the applicant is applying to be registered or for which the NRSRO is registered;¹⁹⁸⁷ (4) the amendments to the instructions for Exhibit 1 to Form NRSRO, which requires standardized "Transition/Default Matrices" and prescribes the method of calculating transition and default rates;¹⁹⁸⁸ and (5) the amendments to Form NRSRO not discussed above, including technical amendments.

C. AMENDMENTS AND NEW RULES EFFECTIVE NINE MONTHS AFTER PUBLICATION IN THE FEDERAL REGISTER

The Commission is delaying the effective date for new paragraphs (a)(9), (b)(13), (b)(14), and (b)(15) of Rule 17g-2, new paragraphs (a)(3)(iii)(E) and (c)(8) of Rule 17g-5, the amendments to paragraphs (c)(6) and (c)(7) of Rule 17g-5, the amendments to paragraphs (a) and (b) of Rule 17g-7, paragraphs (a), (b), (c), and (d) of new Rule 17g-8, new Rule 17g-9, new Rule 17g-10, new Form ABS Due Diligence-15E, new Rule 15Ga-2, and the amendment to

¹⁹⁸⁶ As discussed above, NRSROs should continue to submit Forms NRSRO and applicable exhibits to the Commission in paper form until the Commission provides notice that the EDGAR system is ready to receive the forms and specifies a date on and after which the forms and reports must be submitted through the EDGAR system.

¹⁹⁸⁷ The Commission notes that although the amendments to the instructions for Item 7.A of Form NRSRO will not be effective on December 31, 2014, an NRSRO may elect to use the instructions for Item 7.A that are in effect on that date for purposes of submitting an annual certification covering calendar year 2014.

¹⁹⁸⁸ The Commission notes that although the amendments to the instructions for Exhibit 1 to Form NRSRO will not be effective on December 31, 2014, an NRSRO may elect to use the instructions for Exhibit 1 that are in effect on that date for purposes of submitting an annual certification covering calendar year 2014.

Form ABS-15G until nine months after this release is published in the Federal Register. This delayed effective date is intended to provide time for NRSROs, issuers, underwriters, and providers of third-party due diligence services to prepare for the changes that will result from these new requirements.

Paragraph (c)(8) of Rule 17g-5 prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations. The amendments to paragraphs (c)(6) and (c)(7) of Rule 17g-5 remove an “or” after paragraph (c)(6) and add an “or” after paragraph (c)(7) because of the addition of paragraph (c)(8) to the rule.

The amendments to paragraph (a) of Rule 17g-7 require NRSROs, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action and any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.

One NRSRO urged the Commission to provide “sufficient lead time” of “at least one year” for complying with the proposed amendments to paragraph (a) of Rule 17g-7 to enable NRSROs to “employ a rigorous process for developing and testing the changes to software and systems needed to implement the requirement,” stating that several processes and technological systems would need to be updated and implemented.¹⁹⁸⁹ Another NRSRO stated that it would

¹⁹⁸⁹

See Moody's Letter; see also Morningstar Letter.

take at least 270 days to achieve compliance with the requirements of the proposed rule.¹⁹⁹⁰ The Commission agrees that NRSROs may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements related to the form and certifications to accompany credit ratings. Accordingly, the Commission is delaying the effective date for the amendments to paragraph (a) of Rule 17g-7 until nine months after this release is published in the Federal Register.

The amendments to paragraph (b) of Rule 17g-7 recodify requirements formerly prescribed in paragraph (d)(3) of Rule 17g-2 and substantially enhance the requirements, requiring NRSROs to disclose rating history information in XBRL format for free on an easily accessible portion of their websites, add more rating histories to the disclosure, provide more information about each rating action, and not remove a rating history from the disclosure until fifteen years after the NRSRO withdraws the rating.

One NRSRO stated that implementing the changes required in proposed paragraph (b) of Rule 17g-7 would generally require “significant lead time,”¹⁹⁹¹ and another NRSRO stated that it would take at least 270 days to achieve compliance with the proposed rule.¹⁹⁹² A third NRSRO requested that the Commission provide more time to comply with the proposed new requirements to NRSROs offering subscription-based services which include frequent surveillance.¹⁹⁹³ The Commission agrees that NRSROs may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements relating to rating histories disclosures. Accordingly, the Commission is

¹⁹⁹⁰ See DBRS Letter.

¹⁹⁹¹ See S&P Letter.

¹⁹⁹² See DBRS Letter.

¹⁹⁹³ See Morningstar Letter.

delaying the effective date for the amendments to paragraph (b) of Rule 17g-7 until nine months after this release is published in the Federal Register. The Commission believes that this delayed effective date provides a sufficient amount of time for all NRSROs, including those with a subscription-based business model, to comply with the new requirements.

Paragraph (a) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies the NRSRO uses to determine credit ratings, and new paragraph (b)(13) of Rule 17g-2 identifies the policies and procedures with respect to the procedures and methodologies used to determine credit ratings that an NRSRO must document pursuant to paragraph (a) of new Rule 17g-8 as a record that must be retained.

Paragraph (b) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings, and new paragraph (b)(14) of Rule 17g-2 identifies the policies and procedures with respect to credit rating symbols, numbers, or scores that an NRSRO must document under paragraph (b) of Rule 17g-8 as a record that must be retained.

One NRSRO stated that proposed paragraph (b) of Rule 17g-8 could require some NRSROs to change their rating symbol systems for certain categories of obligors or obligations and requested a compliance deadline of at least twenty-four months for any such change.¹⁹⁹⁴ The Commission does not believe that all NRSROs will need to change their rating symbol systems in order to comply with new requirements relating to universal rating symbols. If an NRSRO must make such change, however, the Commission believes that the delayed effective date of nine months after this release is published in the Federal Register provides sufficient time for

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See Moody's Letter.

such NRSRO to comply with the new requirements in paragraph (b) of new Rule 17g-8 and new paragraph (b)(14) of Rule 17g-2.

Paragraph (c) of Rule 17g-8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed. New paragraph (a)(9) of Rule 17g-2 identifies the policies and procedures of an NRSRO with respect to look-back reviews as a record that must be made and retained.

Paragraph (d) of Rule 17g-8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act.

Rule 17g-9 requires NRSROs to establish, maintain, enforce, and document standards of training, experience, and competence for their credit analysts that are reasonably designed to achieve the objective that the NRSROs produce accurate credit ratings in the classes of credit ratings for which they are registered. The rule identifies four factors the NRSRO must consider when designing the standards and provides that the standards must include a requirement for periodic testing and a requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, must participate in the

determination of a credit rating. New paragraph (b)(15) of Rule 17g-2 requires that NRSROs retain a record of the standards required to be documented under Rule 17g-9.

One NRSRO stated that the compliance date for proposed Rule 17g-9 should take into account that it will take a significant amount of time to develop, test, and implement the standards.¹⁹⁹⁵ The Commission agrees that it may take several months for NRSROs to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the requirements relating to the standards of training, experience, and competence for credit analysts. Accordingly, the Commission is delaying the effective date for Rule 17g-9 and paragraph (b)(15) of Rule 17g-2 until nine months after this release is published in the Federal Register.

Rule 17g-10 requires that the written certification a provider of third-party due diligence services must provide to an NRSRO be made on Form ABS Due Diligence-15E. New paragraph (a)(3)(iii)(E) of Rule 17g-5 requires an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.

One commenter suggested that proposed Rule 17g-10 should have at least a nine-month transition period because implementation “will require coordination among market participants...as well as the development of industry standards.”¹⁹⁹⁶ Another commenter stated that a “reasonable transition period” should be provided to allow adequate time “to assess the applicability of the new requirements...and to implement appropriate processes and

¹⁹⁹⁵ See S&P Letter.

¹⁹⁹⁶ See ABA Letter.

procedures.”¹⁹⁹⁷ A third commenter stated a compliance date of at least 180 days following publication in the Federal Register would be required “in order to get necessary systems and procedures in place.”¹⁹⁹⁸ The Commission agrees that market participants may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements related to third-party due diligence for asset-backed securities. Accordingly, the Commission is delaying the effective date for the requirements relating to Rule 17g-10 and new Form ABS Due Diligence-15E until nine months after this release is published in the Federal Register.

Finally, new Rule 15Ga-2 generally requires an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS-15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.¹⁹⁹⁹

One commenter suggested that Rule 15Ga-2 should have at least a nine-month transition period because implementation “will require coordination among market participants...as well as the development of industry standards.”²⁰⁰⁰ Another commenter stated that a “reasonable transition period” should be provided to allow adequate time “to assess the applicability of the

¹⁹⁹⁷ See Deloitte Letter.

¹⁹⁹⁸ See ASF Letter (“We also note that a 180-day period will minimize the possibility that a TPDDS Provider might issue a report prior to the publication date of the final rules, which would later be subject to the requirement for a TPDDS Provider Certification because it was provided to and used by an NRSRO in connection with a rating.”).

¹⁹⁹⁹ The Commission today is providing no-action relief for municipal issuers and underwriters with regard to the required disclosures under the provisions of section 15E(s)(4)(A) of the Exchange Act for any municipal Exchange Act-ABS issued prior to the effective date of Rule 15Ga-2. Municipal issuers and underwriters are excluded from the application of Rule 15Ga-2, but will have to comply with the statutory requirement in section 15E(s)(4)(A) of the Exchange Act to make the findings and conclusions of any third-party due diligence reports publicly available commencing with the effective date of Rule 15Ga-2. The Commission believes it is appropriate to provide such no-action relief because it proposed to include municipal issuers and underwriters within the scope of Rule 15Ga-2, but has determined not to do so.

²⁰⁰⁰ See ABA Letter.

new requirements...and to implement appropriate processes and procedures.”²⁰⁰¹ A third commenter stated there should be a single compliance date of not less than 180 days following publication in the Federal Register.²⁰⁰² The Commission agrees that market participants may need several months to establish new, or adapt existing, policies, procedures, controls, systems, and practices to comply with the new requirements related to third-party due diligence for asset-backed securities. Accordingly, the Commission is delaying the effective date for Rule 15Ga-2 and the amendments to Form ABS-15G until nine months after this release is published in the Federal Register.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the rule amendments and new rules contain new “collection of information” requirements within the meaning of the PRA.²⁰⁰³ The Commission solicited comment on the estimated burden associated with the proposed collection of information requirements in the proposing release.²⁰⁰⁴ The Commission submitted the proposed collection of information requirements to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11.

An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. The titles and OMB control numbers for the collections of information are:

²⁰⁰¹ See Deloitte Letter.

²⁰⁰² See ASF Letter (“We believe this amount of time, at a minimum, will be required in order to get necessary systems and procedures in place, especially in light of other regulatory changes in the securitization markets coming into effect in the near term. In the event that the Commission does not use a single compliance date, we note that the compliance date for Rule 15Ga-2 must be no earlier than the compliance date for Rules 17g-7 and 17g-10.”).

²⁰⁰³ 44 U.S.C. 3501 et seq.

²⁰⁰⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33490-33511.

(1) Rule 17g-1, Application for registration as a nationally recognized statistical rating organization; Form NRSRO, and Form NRSRO Instructions (OMB Control Number 3235-0625);

(2) Rule 17g-2, Records to be made and retained by nationally recognized statistical rating organizations (OMB Control Number 3235-0628);

(3) Rule 17g-3, Annual financial reports to be furnished by nationally recognized statistical rating organizations²⁰⁰⁵ (OMB Control Number 3235-0626);

(4) Rule 17g-5, Conflicts of interest (OMB Control Number 3235-0649);

(5) Rule 17g-7, Disclosure requirements (OMB Control Number 3235-0656);

(6) Rule 17g-8, Policies and procedures (a new collection of information);

(7) Rule 17g-9, Standards of training, experience, and competence for credit analysts (a new collection of information);

(8) Rule 17g-10, Certification of providers of third-party due diligence services in connection with asset-backed securities; Form ABS Due Diligence-15E (a new collection of information);

(9) Form ABS-15G (OMB Control Number 3235-0675);

(10) Rule 15Ga-2 (a new collection of information);

(11) Regulation S-T, General Rules and Regulations for Electronic Filing (OMB Control Number 3235-0424); and

(12) Form ID (OMB Control Number 3235-0328).

As discussed above, the Commission received a number of comments regarding the proposal. Some of these comments relate directly or indirectly to the estimates of the burden

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The Commission is amending the title of Rule 17g-3 to read, "Annual financial and other reports to be filed or furnished by nationally recognized statistical rating organizations."

associated with the collection of information requirements within the meaning of the PRA. These comments are addressed below. In part in response to these comments, the Commission has modified the amendments and new rules being adopted today from the proposals. The impact on the Commission's burden estimates of these modifications, as well as adjustments to reflect updated information used to make the estimates, are also discussed below.

A. SUMMARY OF THE COLLECTION OF INFORMATION REQUIREMENTS

The Commission is adopting amendments to existing rules and new rules that apply to NRSROs, providers of third-party due diligence services for Exchange Act-ABS, and issuers and underwriters of Exchange Act-ABS. The following rule amendments and new rules contain collections of information within the meaning of the PRA.

1. Amendments to Rule 17g-1

The Commission is amending Rule 17g-1. First, the Commission is amending paragraph (i) of Rule 17g-1.²⁰⁰⁶ The amendments require an NRSRO to make Form NRSRO and Exhibits 1 through 9 to the form publicly and freely available on an easily accessible portion of its corporate Internet website (eliminating an option to make the form and exhibits available "through another comparable, readily accessible means") and to make its most recent Exhibit 1 freely available in writing to any individual who requests a copy of the exhibit.

Second, the Commission is amending paragraphs (e), (f), and (g) of Rule 17g-1 to require NRSROs to use the Commission's EDGAR system to electronically submit Forms NRSRO and required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.²⁰⁰⁷

²⁰⁰⁶ See section II.E.2. of this release (providing a more detailed discussion of the amendments).

²⁰⁰⁷ See section II.L. of this release (providing a more detailed discussion of the amendments).

2. Amendments to Instructions for Exhibit 1 to Form NRSRO

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.²⁰⁰⁸ The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample “Transition/Default Matrix.” The amendments also enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

3. Amendments to Rule 17g-2

The Commission is amending Rule 17g-2. First, the Commission is adding paragraph (a)(9) to Rule 17g-2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g-8 as a record that must be made and retained.²⁰⁰⁹ Second, the Commission is adding paragraph (b)(12) to Rule 17g-2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.²⁰¹⁰ Third, the Commission is adding paragraph (b)(13) to Rule 17g-2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g-8 as a record

²⁰⁰⁸ See section II.E.1. of this release (providing a more detailed discussion of the amendments).

²⁰⁰⁹ See section II.C.2. of this release (providing a more detailed discussion of this amendment).

²⁰¹⁰ See section II.A.2. of this release (providing a more detailed discussion of this amendment).

that must be retained.²⁰¹¹ Fourth, the Commission is adding paragraph (b)(14) to Rule 17g-2 to identify the policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g-8 as a record that must be retained.²⁰¹² Fifth, the Commission is adding paragraph (b)(15) to Rule 17g-2 to identify the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g-9 as a record that must be retained.²⁰¹³ In addition, the Commission is amending paragraph (c) of Rule 17g-2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g-2 must be retained until three years after the date the record is replaced with an updated record, instead of three years after the record is made or received, which is the retention period for other records identified in paragraphs (a) and (b) of Rule 17g-2.²⁰¹⁴ The Commission also repealed paragraph (d)(2) of Rule 17g-2 (the 10% Rule) and has re-codified (with significant amendments) the requirements in paragraph (d)(3) of Rule 17g-2 (the 100% Rule) in paragraph (b) of Rule 17g-7.²⁰¹⁵

4. Amendments to Rule 17g-3

The Commission is amending Rule 17g-3. First, the Commission is amending paragraphs (a) and (b) of Rule 17g-3.²⁰¹⁶ The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an unaudited report – a report on the NRSRO’s internal control

²⁰¹¹ See section II.F.2. of this release (providing a more detailed discussion of this amendment).

²⁰¹² See section II.J.2. of this release (providing a more detailed discussion of this amendment).

²⁰¹³ See section II.I.2. of this release (providing a more detailed discussion of this amendment).

²⁰¹⁴ See section II.A.2. of this release (providing a more detailed discussion of this amendment).

²⁰¹⁵ See section II.E.3. of this release (providing a more detailed discussion of this amendment).

²⁰¹⁶ See section II.A.3. of this release (providing a more detailed discussion of these amendments).

structure – with its annual submission of reports to the Commission pursuant to Rule 17g-3.²⁰¹⁷ The amendment to paragraph (b) of Rule 17g-3 requires that the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the internal controls report that must be attached to the report.²⁰¹⁸

Second, the Commission is adding paragraph (d) to Rule 17g-3 to require that the annual reports required to be submitted to the Commission pursuant to Rule 17g-3 be submitted electronically through the Commission's EDGAR system as PDF documents.²⁰¹⁹

Third, the Commission is adding paragraph (a)(8) to Rule 17g-3 to identify the report of the NRSRO's designated compliance officer that an NRSRO is required to file with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other annual reports.²⁰²⁰ This requirement will not result in a collection of information because the statute requires the NRSRO to file the report with the Commission and to file the report with the other annual reports.²⁰²¹ Consequently, paragraph (a)(8) of Rule 17g-3 standing alone does not impose a burden. Moreover, the Commission is not adding any additional requirements with respect to the filing other than the requirement that this report and the other annual reports be submitted through the EDGAR system and the burden for filing the reports through the EDGAR system is being allocated to Rule 17g-1.²⁰²²

²⁰¹⁷ See paragraph (a)(7) of Rule 17g-3.

²⁰¹⁸ See paragraph (b)(2) of Rule 17g-3.

²⁰¹⁹ See section II.L. of this release (providing a more detailed discussion of this amendment).

²⁰²⁰ See section II.K. of this release (providing a more detailed discussion of this amendment).

²⁰²¹ See 15 U.S.C. 78o-7(j)(5)(B).

²⁰²² Compare 15 U.S.C. 78o-7(j)(5)(B), with paragraph (a)(8) of Rule 17g-3.

5. Amendments to Rule 17g-5

The Commission is amending Rule 17g-5. First, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g-5 to require an NRSRO to obtain a representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.²⁰²³

Second, the Commission is adding paragraph (c)(8) to Rule 17g-5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.²⁰²⁴

Third, the Commission is adding paragraph (f) to Rule 17g-5, which provides that upon written application by an NRSRO the Commission may exempt, either conditionally or unconditionally, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.²⁰²⁵

²⁰²³ See sections II.G.5. and II.H.2. of this release (providing more detailed discussions of this amendment).

²⁰²⁴ See section II.B.1. of this release (providing a more detailed discussion of this amendment).

²⁰²⁵ See section II.B.2. of this release (providing a more detailed discussion of this amendment).

6. Amendments to Rule 17g-7

The Commission is amending Rule 17g-7. First, the Commission is incorporating the disclosure requirement in Rule 17g-7 regarding representations, warranties, and enforcement mechanisms available to investors in asset-backed securities that existed before today's amendments into paragraph (a) of the rule and is adding significant disclosure provisions to paragraph (a) of the rule that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.²⁰²⁶ The amendments prescribe: (1) the types of rating actions that trigger the requirement to publish the form and, if applicable, any due diligence certifications;²⁰²⁷ (2) the format of the form;²⁰²⁸ (3) the content of the form (which must include certain qualitative and quantitative information relating to the credit rating);²⁰²⁹ and (4) an attestation requirement for the form.²⁰³⁰

Second, the Commission is re-codifying in paragraph (b) of Rule 17g-7 the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g-2 before today's amendments.²⁰³¹ The amendments to Rule 17g-7 also increase the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the

²⁰²⁶ See section II.G. of this release (providing a more detailed discussion of these amendments).

²⁰²⁷ See section II.G.1. of this release (providing a more detailed discussion of these amendments). As discussed in section II.G.1. of this release, the Commission is adopting an exemption from the requirements of paragraph (a) for certain non-U.S. rating actions.

²⁰²⁸ See section II.G.2. of this release (providing a more detailed discussion of these amendments).

²⁰²⁹ See section II.G.3. of this release (providing a more detailed discussion of these amendments).

²⁰³⁰ See section II.G.4. of this release (providing a more detailed discussion of these amendments).

²⁰³¹ See section II.E.3. of this release (providing a more detailed discussion of these amendments). The Commission also is repealing paragraph (d)(2) of Rule 17g-2 (the 10% Rule).

histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.

7. New Rule 17g-8

The Commission is adopting Rule 17g-8, which requires an NRSRO to establish, maintain, enforce, and document certain types of policies and procedures and to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure pursuant to section 15E(c)(3)(A) of the Exchange Act.

Specifically, paragraph (a) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.²⁰³² The required policies and procedures include policies and procedures relating to: (1) board approval of the procedures and methodologies for determining credit ratings;²⁰³³ (2) the development and modification of the procedures and methodologies for determining credit ratings;²⁰³⁴ (3) applying material changes to the procedures and methodologies for determining credit ratings;²⁰³⁵ (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;²⁰³⁶ and (5) disclosing the version of a procedure or methodology for determining credit ratings used with respect to a particular credit rating.²⁰³⁷

²⁰³² See section II.F.1. of this release (providing a more detailed discussion of this paragraph).

²⁰³³ See paragraph (a)(1) of Rule 17g-8.

²⁰³⁴ See paragraph (a)(2) of Rule 17g-8.

²⁰³⁵ See paragraph (a)(3) of Rule 17g-8.

²⁰³⁶ See paragraph (a)(4) of Rule 17g-8.

²⁰³⁷ See paragraph (a)(5) of Rule 17g-8.

Paragraph (b) of Rule 17g-8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.²⁰³⁸ The required policies and procedures include policies and procedures relating to: (1) assessing the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or money market instrument;²⁰³⁹ (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO;²⁰⁴⁰ and (3) applying any symbol, number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.²⁰⁴¹

Paragraph (c) of Rule 17g-8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.²⁰⁴²

Paragraph (d) of Rule 17g-8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for

²⁰³⁸ See section II.J.1. of this release (providing a more detailed discussion of this paragraph).

²⁰³⁹ See paragraph (b)(1) of Rule 17g-8.

²⁰⁴⁰ See paragraph (b)(2) of Rule 17g-8.

²⁰⁴¹ See paragraph (b)(3) of Rule 17g-8.

²⁰⁴² See section II.C.1. of this release (providing a more detailed discussion of this paragraph).

determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act. This requirement does not contain a collection of information requirement within the meaning of the PRA.

8. New Rule 17g-9

The Commission is adopting Rule 17g-9. Rule 17g-9 requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.²⁰⁴³ Paragraph (b) identifies four factors the NRSRO must consider when designing the standards.²⁰⁴⁴ Paragraph (c)(1) requires NRSROs to include a requirement for periodic testing in their standards.²⁰⁴⁵ Paragraph (c)(2) provides that the standards must include a requirement that at least one individual with an “appropriate level of experience in performing credit analysis, but not less than three years” must participate in the determination of a credit rating.²⁰⁴⁶

9. New Rule 17g-10 and New Form ABS Due Diligence-15E

The Commission is adopting Rule 17g-10 and Form ABS Due Diligence-15E.²⁰⁴⁷ Paragraph (a) of Rule 17g-10 provides that the written certification providers of third-party due diligence services must provide to NRSROs pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence-15E.²⁰⁴⁸ Paragraph (b) of Rule 17g-10 provides

²⁰⁴³ See section II.I.1.a. of this release (providing a more detailed discussion of this paragraph).

²⁰⁴⁴ See section II.I.1.b. of this release (providing a more detailed discussion of this paragraph).

²⁰⁴⁵ See section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

²⁰⁴⁶ See section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

²⁰⁴⁷ See section II.H.2. of this release (providing a more detailed discussion of Rule 17g-10); section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence-15E).

²⁰⁴⁸ See paragraph (a) of Rule 17g-10.

that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.²⁰⁴⁹

Paragraph (c) of Rule 17g-10 provides a “safe harbor” for a provider of third-party due diligence services to meet its obligation under section 15E(s)(4)(B).²⁰⁵⁰ Paragraph (d) of Rule 17g-10 contains four definitions to be used for the purposes of section 15E(s)(4)(B) and Rule 17g-10; namely, definitions of due diligence services,²⁰⁵¹ issuer,²⁰⁵² originator,²⁰⁵³ and securitizer.²⁰⁵⁴

Form ABS Due Diligence-15E contains five line items identifying information the provider of third-party due diligence services must provide.²⁰⁵⁵ It also contains a signature line with a corresponding representation.²⁰⁵⁶ Item 1 elicits the identity and address of the provider of third-party due diligence services.²⁰⁵⁷ Item 2 elicits the identity and address of the issuer, underwriter, or NRSRO that paid the provider to provide the services.²⁰⁵⁸ Item 3 requires the provider of the due diligence services to identify each NRSRO whose published criteria for performing due diligence the third party intended to satisfy in performing the due diligence review.²⁰⁵⁹ Item 4 requires the provider of third-party due diligence services to describe the

²⁰⁴⁹ See paragraph (b) of Rule 17g-10.

²⁰⁵⁰ See paragraphs (c)(1) and (2) of Rule 17g-10. See also paragraph (a)(3)(iii)(E) of Rule 17g-5 (provisions under which the issuer or underwriter must promptly post the form on the Rule 17g-5 website).

²⁰⁵¹ See paragraph (d)(1) of Rule 17g-10.

²⁰⁵² See paragraph (d)(2) of Rule 17g-10.

²⁰⁵³ See paragraph (d)(3) of Rule 17g-10.

²⁰⁵⁴ See paragraph (d)(4) of Rule 17g-10.

²⁰⁵⁵ See section II.H.3. of this release (providing a more detailed discussion of the information to be reported in the form).

²⁰⁵⁶ See Form ABS Due Diligence-15E.

²⁰⁵⁷ See Item 1 of Form ABS Due Diligence-15E.

²⁰⁵⁸ See Item 2 of Form ABS Due Diligence-15E.

²⁰⁵⁹ See Item 3 of Form ABS Due Diligence 15E.

scope and manner of the due diligence performed.²⁰⁶⁰ Item 5 requires the provider of third-party due diligence services to describe the findings and conclusions resulting from the review.²⁰⁶¹

10. New Rule 15Ga-2 and Amendments to Form ABS-15G

The Commission is adopting Rule 15Ga-2 and amendments to Form ABS-15G.²⁰⁶² Rule 15Ga-2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish a Form ABS-15G on the Commission's EDGAR system containing the findings and conclusions of any third-party "due diligence report" obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. These requirements do not apply to issuers or underwriters of certain offshore offerings of Exchange Act-ABS.²⁰⁶³ The rule and form also do not apply to issuers and underwriters of municipal Exchange Act-ABS but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. Based on staff experience, the Commission estimates that many of these issuers and underwriters are likely to satisfy this obligation by furnishing Form ABS-15G on EMMA. Rule 15Ga-2 defines third-party due diligence report as any report containing findings and conclusions relating to due diligence services as defined in Rule 17g-10 performed by a third party.²⁰⁶⁴ Under the rule, the disclosure must be furnished using Form ABS-15G for both registered and unregistered offerings of Exchange Act-ABS. However, if the disclosure required by Rule 15Ga-2 has been made in the applicable prospectus, the issuer or

²⁰⁶⁰ See Item 4 of Form ABS Due Diligence 15E.

²⁰⁶¹ See Item 5 of Form ABS Due Diligence 15E.

²⁰⁶² See section II.H.1. of this release (providing a more detailed discussion of the rule and form).

²⁰⁶³ See paragraph (e) of Rule 15Ga-2.

²⁰⁶⁴ See paragraph (d)(1) of Rule 17g-10.

underwriter may refer to that section of the prospectus in Form ABS-15G rather than providing the findings and conclusions directly on the form.²⁰⁶⁵

11. Amendments to Regulation S-T

As stated above, the Commission is requiring that certain Forms NRSRO and all Rule 17g-3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system as PDF documents.²⁰⁶⁶ In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S-T to require that Forms NRSRO and Exhibits 1 through 9 submitted pursuant to paragraphs (e), (f), and (g) of Rule 17g-1 and the annual reports submitted pursuant to Rule 17g-3 be submitted through the EDGAR system as PDF documents.²⁰⁶⁷

12. Form ID

NRSROs will need to submit Forms NRSRO and the required exhibits to the forms under paragraphs (e), (f), and (g) of Rule 17g-1 and their annual reports under Rule 17g-3 to the Commission through the EDGAR system. NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to make electronic submissions to the Commission.²⁰⁶⁸

Issuers and underwriters of Exchange Act-ABS also will need to furnish Form ABS-15G to the Commission through the EDGAR system pursuant to Rule 15Ga-2. The Commission believes that these issuers and underwriters already have access to the EDGAR system because, for example, they need such access for purposes of Rule 15Ga-1.

²⁰⁶⁵ See section II.H.1. of this release (providing a more detailed discussion of this rule).

²⁰⁶⁶ See section II.L. of this release (providing a more detailed discussion of this amendment).

²⁰⁶⁷ See paragraph (a)(xiv) of Rule 101 of Regulation S-T.

²⁰⁶⁸ See section II.L. of this release (providing a more detailed discussion of these requirements).

B. USE OF INFORMATION

1. Amendments to Rule 17g-1

The amendments to Rule 17g-1 that require an NRSRO to use the EDGAR system to file Form NRSRO and Exhibits 1 through 9 and to make the form and exhibits freely available on an easily accessible portion of the NRSRO's corporate Internet website are designed to make the information disclosed in the form and exhibits more readily accessible to investors and other users of credit ratings.²⁰⁶⁹ In addition, the filing of the Forms NRSRO and the exhibits on the EDGAR system will allow Commission examiners to more easily retrieve the submissions of a specific NRSRO to prepare for an examination. Furthermore, having the forms filed and stored through the EDGAR system will assist the Commission from a records management perspective by establishing a more automated storage process and creating efficiencies in terms of reducing the volume of paper filings that must be manually processed and stored.

2. Amendments to Instructions for Exhibit 1 to Form NRSRO

The amendments to the instructions for Exhibit 1 to Form NRSRO that standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics an NRSRO must disclose in the exhibit and enhance the information disclosed about these statistics will allow users of credit ratings to evaluate the accuracy of credit ratings and compare the performance of credit ratings by different NRSROs.²⁰⁷⁰ As the Commission stated when originally adopting Form NRSRO, the information provided in Exhibit 1 is an important indicator of the performance of an NRSRO in terms of its ability to assess the creditworthiness of issuers and obligors and, consequently, will be useful to users of credit ratings in evaluating an

²⁰⁶⁹ See section II.E.2. of this release (providing a more detailed discussion of the requirement to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of the NRSRO's corporate Internet website) and section II.L. of this release (providing a more detailed discussion of the requirement to use the EDGAR system to file Form NRSRO and Exhibits 1 through 9).

²⁰⁷⁰ See section II.E.1. of this release (providing a more detailed discussion of the amendments).

NRSRO.²⁰⁷¹ The amendments to the instructions for Exhibit 1 to Form NRSRO are designed to make the required disclosure of an NRSRO's performance statistics more useful to those who use or might use credit ratings, including investors and creditors.

In addition, the amendments should improve the Commission's ability to carry out its oversight of NRSROs, which, in turn, will benefit investors. Improving and standardizing performance statistics provided in an applicant's initial application for registration and in an NRSRO's Form NRSRO could aid the Commission in, among other things, reviewing an applicant's or NRSRO's performance and consistency of performance, which, in turn, could aid in assessing whether the applicant or NRSRO has adequate financial and managerial resources to consistently produce credit ratings with integrity.²⁰⁷²

3. Amendments to Rule 17g-2

The requirement to make and retain a record of the policies and procedures identified in paragraph (a)(9) of Rule 17g-2 will promote better understanding of the policies and procedures among individuals within the NRSRO and, therefore, promote compliance with such policies and procedures.²⁰⁷³ The requirement that the internal controls structure, policies and procedures, and standards identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15), respectively, be

²⁰⁷¹ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33574; see also Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6474 ("The amendments to the instructions for Exhibit 1 to Form NRSRO will require NRSROs to provide more detailed performance statistics and, thereby, make it easier for users of credit ratings to compare the performance of the NRSROs. In addition, these amendments will make it easier for an NRSRO to demonstrate that it has a superior ratings methodology or competence and, thereby, attract clients.").

²⁰⁷² See, e.g., 15 U.S.C. 78o-7(a)(2)(C) (setting forth grounds to deny an initial application); 15 U.S.C. 78o-7(d)(1)(E) and (d)(2) (setting forth grounds to sanction an NRSRO, including revoking the NRSRO's registration); see also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33612 ("Form NRSRO requires that a credit rating agency provide information required under Section 15E(a)(1)(B) of the Exchange Act and certain additional information. The additional information will assist the Commission in making the assessment regarding financial and managerial resources required under Section 15E(a)(2)(C)(2)(ii)(I) of the Exchange Act.").

²⁰⁷³ See section II.C.2. of this release (providing a more detailed discussion of this amendment).

retained will subject these records to the various retention and production requirements of paragraphs (c), (d), (e), and (f) of Rule 17g-2.²⁰⁷⁴ The Commission staff will use these records to examine an NRSRO's compliance with the provisions of the securities laws requiring the NRSRO to establish, maintain, enforce, and document these controls, policies, procedures, and standards.²⁰⁷⁵ The amendment to paragraph (c) of Rule 17g-2 requiring that these records must be retained until three years after the date the record is replaced with an updated record, rather than three years after the record is made or received, will help the Commission better perform its oversight function. For example, if the three-year retention period in Rule 17g-2 began to run when the record is made, an NRSRO could discard the record that is replaced with an updated record if that update occurred more than three years after the replaced record was made. This could prevent the Commission from reviewing whether the NRSRO adhered to its previous internal control structure, policies and procedures, or standards.

4. Amendments to Rule 17g-3

The amendments to Rule 17g-3 requiring an NRSRO to submit to the Commission an annual internal controls report will be used by the Commission to perform its NRSRO oversight function.²⁰⁷⁶ For example, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to “establish, maintain, enforce, and document an effective internal control structure governing the

²⁰⁷⁴ See section II.C.2. of this release (providing a more detailed discussion of paragraph (a)(9) of Rule 17g-2); section II.A.2. of this release (providing a more detailed discussion of paragraph (b)(12) of Rule 17g-2); section II.F.2. of this release (providing a more detailed discussion of paragraph (b)(13) of Rule 17g-2); section II.J.2. of this release (providing a more detailed discussion of paragraph (b)(14) of Rule 17g-2); section II.I.2. of this release (providing a more detailed discussion of paragraph (b)(15) of Rule 17g-2).

²⁰⁷⁵ See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33582 (June 18, 2007) (“The Commission designed [Rule 17g-2] based on its experience with recordkeeping rules for other regulated entities. These other books and records rules have proven integral to the Commission’s investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws. Rule 17g-2 is designed to ensure that an NRSRO makes and retains records that will assist the Commission in monitoring, through its examination authority, whether an NRSRO is complying with the provisions of Section 15E of the Exchange Act and the rules thereunder.”) (footnotes omitted).

²⁰⁷⁶ See section II.A.3. of this release (providing a more detailed discussion of these amendments).

implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.”²⁰⁷⁷ Paragraph (a)(7) of Rule 17g-3 requires that the report describe material weaknesses identified in the internal control structure and how they were addressed and that it state whether the internal control structure was effective as of the end of the NRSRO’s fiscal year. Consequently, the Commission can use the information provided in the report as part of reviewing whether the NRSRO is complying with the requirement in section 15E(c)(3)(A) of the Exchange Act. An NRSRO also can use the report to evaluate the effectiveness of its internal control structure.

The amendment to Rule 17g-3 requiring that NRSROs use the Commission’s EDGAR system to file the annual reports as PDF documents will assist the Commission in performing its oversight function.²⁰⁷⁸ For example, Commission examiners will be able to more easily retrieve the reports of an NRSRO to prepare for an examination. Moreover, having these reports submitted and stored through the EDGAR system will assist the Commission from a records management perspective by establishing a more automated storage process and reducing the volume of paper submissions that must be manually processed and stored.

5. Amendments to Rule 17g-5

The collection required under the amendment adding paragraph (a)(3)(iii)(E) to Rule 17g-5 will be used by the providers of third-party due diligence services to meet their statutory obligation to deliver the certification to any NRSRO that produces a credit rating to which the services relate.²⁰⁷⁹ Furthermore, disclosing these certifications on the Rule 17g-5 websites will

²⁰⁷⁷ 15 U.S.C. 78o-7(c)(3)(A).

²⁰⁷⁸ See section II.L. of this release (providing a more detailed discussion of this amendment).

²⁰⁷⁹ See sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this amendment, which will require an NRSRO to obtain a representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E delivered by a person employed to provide third-

make them available to NRSROs that may not otherwise be aware that third-party due diligence services are being employed with respect to an Exchange Act-ABS because, for example, they are not hired to rate the Exchange Act-ABS.

The amendment adding paragraph (c)(8) to Rule 17g-5 will require an NRSRO to update its policies and procedures for addressing and managing conflicts of interest to account for this new absolutely prohibited conflict of interest.²⁰⁸⁰ The updated policies and procedures will be used by the NRSRO to address this conflict and comply with Rule 17g-5. Furthermore, Exhibit 7 to Form NRSRO requires an applicant for registration as an NRSRO or an NRSRO to provide a copy in the exhibit of the written policies and procedures an applicant or NRSRO must establish, maintain, and enforce to address and manage conflicts of interest pursuant to section 15E(h) of the Exchange Act.²⁰⁸¹ This disclosure by an NRSRO can be reviewed by investors and other users of credit ratings to evaluate the NRSRO's policies and procedures (including those addressing the new absolutely prohibited conflict) and to compare them with the policies and procedures of other NRSROs.

The amendment adding paragraph (f) to Rule 17g-5 to provide a means for an NRSRO to seek an exemption from the Commission because of its small size from the provision establishing the new absolutely prohibited conflict will be used by NRSROs to seek conditional or unconditional exemptions from the new requirement.²⁰⁸²

6. Amendments to Rule 17g-7

The amendments to paragraph (a) of Rule 17g-7 that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting

party due diligence services with respect to the security or money market instrument).

²⁰⁸⁰ See section II.B.1. of this release (providing a more detailed discussion of this amendment).

²⁰⁸¹ See instructions for Exhibit 7 to Form NRSRO.

²⁰⁸² See section II.B.2. of this release (providing a more detailed discussion of this amendment).

from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating will be used by investors and other users of credit ratings to better understand the credit rating issued by the NRSRO.²⁰⁸³ In addition, the disclosure of the certification will allow investors and other users of credit ratings to determine the adequacy and level of due diligence services provided by the third party executing the certification.²⁰⁸⁴

The amendments to Rule 17g-7 (codified in paragraph (b) of the rule) that require an NRSRO to disclose rating histories may be used by investors and other users of credit ratings to evaluate the performance of the NRSRO's credit ratings.²⁰⁸⁵ As the Commission stated when adopting the original rating history disclosure requirement, the "intent of the rule is to facilitate comparisons of credit rating accuracy across all NRSROs – including direct comparisons of different NRSROs' treatment of the same obligor or instrument – in order to enhance NRSRO accountability, transparency, and competition."²⁰⁸⁶ The amendments also are designed to provide persons (such as market participants and academics and other market observers) with the "raw data" necessary to generate statistical information about the performance of each NRSRO's credit ratings.²⁰⁸⁷ The information disclosed pursuant to the amendments also may be used by

²⁰⁸³ See section II.G. of this release (providing a more detailed discussion of these amendments).

²⁰⁸⁴ See 15 U.S.C. 78o-7(s)(4)(D).

²⁰⁸⁵ See section II.E.3. of this release (providing a more detailed discussion of these amendments).

²⁰⁸⁶ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63838 (Dec. 4, 2009) ("Ratings history information for outstanding credit ratings is the most direct means of comparing the performance of two or more NRSROs. It allows an investor or other user of credit ratings to compare how all NRSROs that maintain a credit rating for a particular obligor or instrument initially rated that obligor or instrument and, thereafter, how and when they adjusted their credit rating over time.").

²⁰⁸⁷ See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63837-63838 ("The raw data to be provided by NRSROs pursuant to the new ratings history disclosure requirements... will enable market participants to develop performance measurement statistics that would supplement those required to be published by NRSROs themselves in Exhibit 1, tapping into the expertise of credit market observers and participants in order to create better and more useful means to compare the credit ratings performance of NRSROs.").

economists to study the performance of NRSRO credit ratings. The Commission also may use the information as part of its oversight function.

7. New Rule 17g-8

Paragraph (a) of Rule 17g-8 requires an NRSRO to have policies and procedures with respect to the procedures and methodologies the NRSRO uses to determine credit ratings.²⁰⁸⁸

These policies and procedures will be used by the NRSRO to achieve the objectives identified in section 15E(r) of the Exchange Act,²⁰⁸⁹ namely, that the NRSRO:

- determines credit ratings using procedures and methodologies, including qualitative and quantitative data and models, that are approved by the board of the NRSRO, or a body performing a function similar to that of a board;²⁰⁹⁰
- determines credit ratings using procedures and methodologies, including qualitative and quantitative data and models, that are in accordance with the policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies;²⁰⁹¹
- when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), applies the changes consistently to all credit ratings to which the changed procedures and methodologies apply;²⁰⁹²
- when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), to the extent that changes are made to credit rating surveillance procedures and methodologies, applies the changes to then-current credit ratings within a reasonable time period determined by the Commission, by rule;²⁰⁹³
- when material changes are made to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models), the NRSRO publicly discloses the reason for the change;²⁰⁹⁴

²⁰⁸⁸ See section II.F.1. of this release (providing a more detailed discussion of this paragraph).

²⁰⁸⁹ See 15 U.S.C. 78o-7(r)(1) through (3).

²⁰⁹⁰ See 15 U.S.C. 78o-7(r)(1)(A).

²⁰⁹¹ See 15 U.S.C. 78o-7(r)(1)(B).

²⁰⁹² See 15 U.S.C. 78o-7(r)(2)(A).

²⁰⁹³ See 15 U.S.C. 78o-7(r)(2)(B).

²⁰⁹⁴ See 15 U.S.C. 78o-7(r)(2)(C).

- notifies users of credit ratings of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating;²⁰⁹⁵
- notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input;²⁰⁹⁶
- notifies users of credit ratings when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions;²⁰⁹⁷ and
- notifies users of credit ratings when a material change is made to a procedure or methodology, including to a qualitative model or quantitative input, of the likelihood the change will result in a change in current credit ratings.²⁰⁹⁸

Paragraph (b) of Rule 17g-8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.²⁰⁹⁹ These policies and procedures will be used by the NRSRO to achieve the objectives identified in sections 938(a)(1) through (3) of the Dodd-Frank Act,²¹⁰⁰ namely, that the NRSRO establishes, maintains, and enforces written policies and procedures to: (1) assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument;²¹⁰¹ (2) clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating;²¹⁰² and (3) apply any symbol described in item (2) in a manner that is

²⁰⁹⁵ See 15 U.S.C. 78o-7(r)(3)(A).

²⁰⁹⁶ See 15 U.S.C. 78o-7(r)(3)(B).

²⁰⁹⁷ See 15 U.S.C. 78o-7(r)(3)(C).

²⁰⁹⁸ See 15 U.S.C. 78o-7(r)(3)(D).

²⁰⁹⁹ See section II.J.1. of this release (providing a more detailed discussion of this paragraph).

²¹⁰⁰ See Pub. L. No. 111-203, 938(a)(1) through (3).

²¹⁰¹ See Pub. L. No. 111-203, 938(a)(1).

²¹⁰² See Pub. L. No. 111-203, 938(a)(2).

consistent for all types of securities and money market instruments for which the symbol is used.²¹⁰³

Paragraph (c) of Rule 17g-8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.²¹⁰⁴ These policies and procedures will be used by the NRSRO to achieve the objective specified in section 15E(h)(4)(A)(ii) of the Exchange Act to revise a credit rating, if appropriate, when a look-back review determines the credit rating was influenced by the conflict of interest of the credit analyst seeking employment with the person subject to the credit rating or the issuer, underwriter, or sponsor of a security or money market instrument subject to the credit rating.²¹⁰⁵

8. New Rule 17g-9

The Commission is adopting Rule 17g-9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings.²¹⁰⁶ These standards will be used by the NRSRO to achieve the objectives specified in sections 936(1) and (2) of the Dodd-Frank Act that any person employed by the NRSRO to perform credit ratings produces accurate ratings for the categories of issuers whose securities the person rates and is tested for knowledge of the credit

²¹⁰³ See Pub. L. No. 111-203, 938(a)(3).

²¹⁰⁴ See section II.C.1. of this release (providing a more detailed discussion of this paragraph).

²¹⁰⁵ See 15 U.S.C. 78o-7(h)(4)(A)(ii).

²¹⁰⁶ See section II.I.1. of this release (providing a more detailed discussion of this rule).

rating process.²¹⁰⁷ The requirement that the standards be documented in writing will be used by the NRSRO to promote an understanding of the standards within the NRSRO and will be used by the Commission to examine the NRSRO's compliance with Rule 17g-9.

9. New Rule 17g-10 and New Form ABS Due Diligence-15E

The disclosure of information about third-party due diligence services on Form ABS Due Diligence-15E pursuant to Rule 17g-10 will be used by NRSROs, investors, and other market participants to evaluate the adequacy and level of the reviews of the assets underlying an Exchange Act-ABS performed by the third party.²¹⁰⁸

10. New Rule 15Ga-2 and Amendments to Form ABS-15G

Users of credit ratings who may or may not be investors may use the disclosure of information about third-party due diligence services on Form ABS-15G pursuant to Rule 15Ga-2 to evaluate the adequacy and level of the reviews of the assets underlying an Exchange Act-ABS performed by the third party.²¹⁰⁹

11. Amendments to Regulation S-T

The amendments to Rule 101 of Regulation S-T, as part of implementing the requirement that NRSROs use the EDGAR system to submit Forms NRSRO and their annual reports under Rule 17g-3 to the Commission, will be used by the Commission as part of its oversight of NRSROs.²¹¹⁰ In addition, the submission of the Forms NRSRO using the EDGAR system will be used by investors and other users of credit ratings to evaluate and compare NRSROs.

²¹⁰⁷ See Pub. L. No. 111-203, 936(1) and (2).

²¹⁰⁸ See section II.H.2. (providing a more detailed discussion of Rule 17g-10) and section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence-15E).

²¹⁰⁹ See section II.H.1. of this release (providing a more detailed discussion of the rule and form).

²¹¹⁰ See section II.L. of this release (providing a more detailed discussion of these amendments).

12. Form ID

NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to file Form NRSRO (including applicable exhibits) and their annual reports with the Commission.²¹¹¹ The Commission will use the filings of this form to process NRSRO requests for access to the EDGAR system.

C. RESPONDENTS

In adopting the first rules under the Rating Agency Act of 2006, the Commission estimated that approximately thirty credit rating agencies ultimately would be registered as NRSROs.²¹¹² Currently, ten credit rating agencies are registered with the Commission as NRSROs.²¹¹³ This number has remained fairly constant for several years.²¹¹⁴ Consequently, while the Commission believes several more credit rating agencies may become registered as NRSROs over the next few years, the Commission stated in the proposing release that it believed that the actual number of NRSROs should be used for purposes of the burden estimates under the PRA.²¹¹⁵ The Commission did not receive comments regarding this statement, and the number of credit rating agencies registered with the Commission as NRSROs has not changed since the proposal was published in 2011. Therefore, the Commission is estimating that there are ten credit rating agencies registered with the Commission as NRSROs for purposes of the burden estimates.

²¹¹¹ See section II.L. of this release (providing a more detailed discussion of this requirement).

²¹¹² See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33607.

²¹¹³ See section I.B.2.a. of this release (discussing the economic baseline with respect to NRSROs).

²¹¹⁴ One NRSRO – R&I – withdrew its registration as an NRSRO effective November 27, 2011. See Notice of Effectiveness of Rating and Investment Information, Inc.'s ("R&I") Withdrawal from Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO"), available at <http://www.sec.gov/news/digest/2011/dig112811.htm#rinotice>. HR Ratings registered as an NRSRO on November 5, 2012.

²¹¹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33499.

In the proposing release, the Commission stated that it believed that there were approximately 270 unique “securitizers” that would be subject to the requirements of Rule 17g-10, Form ABS Due Diligence-15E, Rule 15Ga-2, and the amendments to Form ABS-15G.²¹¹⁶ In using the term securitizer, the Commission meant the person who organizes and initiates the Exchange Act-ABS, rather than the issuing entity.²¹¹⁷ As discussed above, in this release, the issuer of a structured finance product can mean, depending on the context, the issuing entity or the person that organizes and initiates the offering of the structured finance product (for example, the sponsor or depositor). Consequently, for consistency in this release, the Commission is referring to the respondents as issuers (rather than securitizers) but in doing so means the person that organizes and initiates the offering of the Exchange Act-ABS. This is consistent with the Commission’s intention in referring to these respondents as securitizers in the proposing release. Further, the Commission is adjusting its estimate of the number of unique securitizers (now referred to as issuers) from approximately 270 to approximately 336.²¹¹⁸ This estimate includes issuers of municipal Exchange Act-ABS.²¹¹⁹

The Commission also stated in the proposing release that it believed that there were approximately ten firms that provide, or would begin providing, third-party due diligence services to issuers and underwriters of Exchange Act-ABS and, therefore, be subject to the

²¹¹⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33499.

²¹¹⁷ Section 15G(a)(3) of the Exchange Act defines the term securitizer to mean: “(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.” See 15 U.S.C. 78o-9(a)(3).

²¹¹⁸ See section I.B.2.b. of this release (discussing the economic baseline with respect to issuers and providers of third-party due diligence services).

²¹¹⁹ Based on the Asset-Backed Alert database, the Commission estimates there were nine unique issuers of municipal Exchange Act-ABS in 2013.

requirements of Rule 17g-10 and Form ABS Due Diligence-15E.²¹²⁰ However, the Commission now estimates that there are approximately fifteen providers of third-party due diligence services.²¹²¹

D. TOTAL INITIAL AND ANNUAL RECORDKEEPING AND REPORTING BURDENS

NRSROs vary, in terms of size and complexity, from small entities that employ fewer than ten credit analysts to complex global organizations that employ over a thousand credit analysts.²¹²² Given the significant variance in size between the largest and the smallest NRSROs, certain estimates described below are averages across all NRSROs that will be affected by the amendments and new rules being adopted today.

The Commission stated in the proposing release that it believed that it was reasonable to base some of its burden estimates on the approximate number of NRSRO credit ratings outstanding or the number of credit analysts employed by NRSROs, based on the most recent annual certifications submitted to the Commission by the NRSROs.²¹²³ An NRSRO objected to this method of estimating the burden attributable to the proposal, stating that “to properly evaluate the actual burden of the rules, particularly as they relate to the seven NRSROs that must compete with the largest three NRSROs, the burden analysis must take into account not only the number of ratings or analysts in isolation, but also must include the amount of legal and compliance resources necessary to implement systemic and simultaneous changes” and that “the investments will not be diminished relative to financial resources because an NRSRO may have

²¹²⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33499.

²¹²¹ See section I.B.2.b. of this release.

²¹²² See 2013 Annual Staff Report on NRSROs, pp. 13-14.

²¹²³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33500.

fewer analysts or credit ratings issued.”²¹²⁴ Similarly, another NRSRO stated that “the burden on smaller rating agencies may be even more severe than the Commission’s numbers suggest” and that “[w]hile some aspects of the proposals (such as disclosures and updates) scale in a linear fashion with the number of published ratings, other costs (such as the development of new disclosure templates and implementing new systems) are fixed.”²¹²⁵ The commenter stated that these “fixed costs have a disproportionate impact on smaller firms.”²¹²⁶ As discussed below, the Commission based some of its burden estimates for three of the proposed amendments or new rules on the number of NRSRO credit ratings outstanding or the number of credit analysts employed by NRSROs and has reviewed these estimates to determine whether they should be modified in response to these comments.

First, the Commission based its estimate of the one-time and annual burden associated with the amendments to the instructions for Exhibit 1 to Form NRSRO on the number of NRSRO credit ratings outstanding. In response to the above comments, the Commission is adding to its one-time burden estimate to account for aspects of the burden that do not depend on the number of NRSRO credit ratings outstanding. For example, some of the burden associated with establishing systems for determining performance statistics according to the amended instructions may not depend on the number of credit ratings in the start-date cohort.²¹²⁷

Second, the Commission based its estimate of the annual burden associated with publishing the form and due diligence certifications with the taking of a rating action under paragraph (a) of Rule 17g-7, as proposed, in part, on its estimate of the number of rating actions

²¹²⁴ See A.M. Best Letter.

²¹²⁵ See DBRS Letter.

²¹²⁶ See id.

²¹²⁷ See section IV.D.2. of this release (discussing the PRA burden resulting from the amendments to the instructions for Exhibit 1 to Form NRSRO).

taken by NRSROs. The annual burden estimate also included a component representing the time an NRSRO would spend to update its standard disclosures and to tailor disclosures to particular rating actions. In addition, the Commission estimated a one-time burden to develop the standardized disclosures and to create the systems, protocols, and procedures for generating the forms to accompany rating actions. However, while the Commission agrees that its estimate in the proposal may have been low, as discussed in detail below (and above in section II.G. of this release), the Commission has modified the proposed requirements in a number of ways that will mitigate to some degree the burden of compliance with the requirements. The Commission is therefore not increasing its estimate of the annual and one-time burdens to update disclosures and create systems and procedures to comply with the rule.²¹²⁸

Third, the Commission based its estimate of the one-time and annual burden attributable to establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for the individuals it employs to determine credit ratings pursuant to Rule 17g-9, as proposed, on the number of credit analysts employed by NRSROs. In response to the above comments, the Commission is adding to its burden estimate for this rule to account for a fixed burden that does not depend on the number of credit analysts employed by an NRSRO, in recognition of the fact that the burden associated with establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for credit analysts may not be directly proportional to the number of credit analysts employed by an NRSRO.²¹²⁹

The Commission is updating its estimates of the number of NRSRO credit ratings outstanding and the number of NRSRO credit analysts based on more recent information

²¹²⁸ See section IV.D.6. of this release (discussing the PRA burden resulting from the amendments to Rule 17g-7).

²¹²⁹ See section IV.D.8. of this release (discussing the PRA burden resulting from Rule 17g-9).

submitted to the Commission by the NRSROs on Form NRSRO. The Commission now estimates that NRSROs have a total of 2,437,046 credit ratings outstanding in all classes of credit ratings.²¹³⁰ The Commission further estimates that NRSROs employ a total of 4,218 credit analysts.²¹³¹

Finally, in the proposing release, the Commission based some of its estimates for purposes of the PRA on the number of Exchange Act-ABS offerings per year.²¹³² For purposes of these estimates, the Commission estimated that there would be approximately 2,067 Exchange Act-ABS offerings per year.²¹³³ The Commission estimates that in calendar year 2013 there were approximately 715 offering of Exchange Act-ABS.²¹³⁴ The Commission believes that the more recent data on the number of offerings of Exchange Act-ABS should be used for purposes of the PRA estimates given significant difference between the 715 offerings per year estimate (which is based on data for calendar year 2013) and the 2,067 offerings per year estimate (which was derived from older data).²¹³⁵ Consequently, the Commission is revising the estimate from 2,067 offerings per year to 715 offerings per year.

²¹³⁰ See Table 2 in section I.B.2.a. of this release. In the proposing release, the Commission estimated that NRSROs had a total of 2,905,824 credit ratings outstanding in all classes of credit ratings. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33500.

²¹³¹ See Table 1 in section I.B.2.a. of this release. In the proposing release, the Commission estimated that NRSROs employed a total of 3,520 credit analysts. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33500.

²¹³² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33506, 33509-33510.

²¹³³ See id. at 33506, 33509-33510. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4508 (providing an estimate of 2,067 upon which the estimate in the proposing release was based).

²¹³⁴ See Table 6 in section I.B.2.b. of this release.

²¹³⁵ Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4508, n.217 (noting that the 2,067 estimate was based, in part, on the average number of registered and Rule 144A offerings of asset-backed securities over the period 2004-2009).

1. Amendments to Rule 17g-1

The Commission is amending paragraph (i) of Rule 17g-1 to require that an NRSRO make Form NRSRO and Exhibits 1 through 9 to Form NRSRO freely available on an easily accessible portion of its corporate Internet website.²¹³⁶ The amendment removes the option for an NRSRO to make the form publicly available “through another comparable, readily accessible means” as an alternative to Internet website disclosure.

As stated above, the Commission believes that a Form NRSRO and Exhibits 1 through 9 will be “easily accessible” if they can be accessed through a clearly and prominently labeled hyperlink (including through a hyperlink labeled “Regulatory Disclosures”) on the homepage of the NRSRO’s corporate Internet website. NRSROs may need to make changes to their corporate Internet websites to place clearly and prominently labeled hyperlinks to Form NRSRO and Exhibits 1 through 9 on the websites.²¹³⁷ In the proposing release, the Commission estimated that reconfiguring a corporate Internet website for this purpose would take an average of approximately five hours (and would be accomplished by NRSROs using their corporate Internet website administrators), resulting in an estimated industry-wide one-time burden of approximately fifty hours.²¹³⁸ The Commission did not receive comment on this estimate and is adopting the amendment as proposed. Therefore, the Commission is retaining this estimate without revision.

The Commission also is amending paragraph (i) of Rule 17g-1 to require that NRSROs make their most recent Exhibit 1 freely available in writing to any individual who requests a

²¹³⁶ See section II.E.2. of this release (providing a more detailed discussion of this amendment).

²¹³⁷ See section II.E.2. of this release.

²¹³⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33501 (5 hours x 10 NRSROs = 50 hours).

copy of the Exhibit to implement the rulemaking mandated in section 15E(q)(2)(D) of the Exchange Act.²¹³⁹

In the proposing release, the Commission stated that it believed that NRSROs would need to establish procedures and protocols for receiving and processing these requests and that this would take an average of approximately forty-eight hours per NRSRO, resulting in an industry-wide one-time hour burden of approximately 480 hours.²¹⁴⁰ The Commission did not receive comment on this estimate and is adopting the amendments as proposed. Therefore, the Commission is retaining this estimate without revision.

The Commission also estimated that each NRSRO would on average receive approximately 200 requests per year and would spend an average of twenty minutes processing each request, resulting in an industry-wide annual hour burden of approximately 670 hours.²¹⁴¹ The Commission did not receive comments on this estimate and is adopting the amendments as proposed. Therefore, the Commission is retaining this estimate without revision.

In response to comments stating that NRSROs should be able to charge the requesting individual postage and handling fees,²¹⁴² the Commission agrees, as stated above, that an NRSRO may charge a reasonable postage and handling fee.²¹⁴³ Because NRSROs may choose not to pass the postage costs on to persons requesting the exhibit in writing, the Commission

²¹³⁹ See 15 U.S.C. 78o-7(q)(2)(D).

²¹⁴⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33501 (10 NRSROs x 48 hours = 480 hours).

²¹⁴¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33501 (200 requests x 20 minutes per request = 67 hours per year; 10 NRSROs x 67 hours per year = 670 hours per year).

²¹⁴² See DBRS Letter; S&P Letter.

²¹⁴³ See section II.E.2. of this release.

estimates that the cost of postage will be approximately two dollars per request, for an industry-wide annual cost of approximately \$4,000.²¹⁴⁴

The Commission is also amending paragraphs (e), (f), and (g) of Rule 17g-1 to require NRSROs to use the Commission's EDGAR system to electronically submit Form NRSRO and the required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.²¹⁴⁵ NRSROs currently submit these documents to the Commission in paper form.

The Commission estimated in the proposing release that each NRSRO would spend an average of approximately four and 3/4 hours becoming familiar with the EDGAR filing system, resulting in an estimated industry-wide one-time hour burden of forty-seven and a half hours.²¹⁴⁶

An NRSRO stated that it would have no objection to the proposal, that providing the information as PDF documents would be "the most preferred and simplest" way to provide the information, and that providing the information in and XBRL or XML format would not provide additional analytical benefit and could make it more difficult for users to access Form NRSRO.²¹⁴⁷ Another NRSRO, however, stated that the Commission's estimate of the cost of the proposal "accounts for only a small fraction of the expected cost of compliance" as "an NRSRO will have to familiarize itself with the roughly 35 Rules of Regulation S-T as well as the first two volumes of the EDGAR Filer Manual (which currently total more than 600 pages) and related EDGAR technical guidance."²¹⁴⁸ This commenter also stated that the Commission did not

²¹⁴⁴ 200 requests x \$2.00 = \$400; 10 NRSROs x \$400 = \$4,000.

²¹⁴⁵ See section II.L. of this release (providing a more detailed discussion of these amendments).

²¹⁴⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33501 (10 NRSROs x 4.75 hours = 47.5 hours).

²¹⁴⁷ See S&P Letter.

²¹⁴⁸ See DBRS Letter.

estimate “the expense an NRSRO would incur in compiling Form NRSRO, its exhibits, and the annual reports into an EDGAR-acceptable format.”²¹⁴⁹ However, the commenter did not provide a different estimate of the costs associated with the proposal.

In response to the comment from an NRSRO that the Commission’s proposed cost estimate for the proposal “accounts for only a small fraction of the expected cost of compliance” and that instead PDF copies of the required submissions should be transmitted via e-mail,²¹⁵⁰ the Commission notes that it has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents, which, as noted above, another NRSRO described as “the most preferred and simplest” way to provide the information.²¹⁵¹ The Commission also points out that not all of Regulation S-T or the EDGAR Filer Manual applies to NRSRO submissions, in particular, as these submissions will be made as PDF documents.²¹⁵² Moreover, having the reports submitted via the EDGAR system – rather than to a Commission e-mail box – will assist the Commission staff in storing and accessing these records in furtherance of the Commission’s NRSRO oversight function.

In response to the comment that the Commission underestimated the burden of becoming familiar with the EDGAR system,²¹⁵³ the Commission is revising its estimate, based on staff experience, from 4 and 3/4 hours on a one-time basis as the amount of time, on average, an NRSRO would need to spend to become familiar with the EDGAR system to sixteen hours, for

²¹⁴⁹ See id.

²¹⁵⁰ See DBRS Letter.

²¹⁵¹ See S&P Letter.

²¹⁵² See EDGAR Filer Manual, available at <http://www.sec.gov/info/edgar/edmanuals.htm>. Significant portions of the manual relate to public company filing of information on various Commission forms and to filing forms in formats other than PDF (ASCII, HTML, XML, or XBRL). The third volume of the manual relates to the filing of Form N-SAR by investment management companies registered with the Commission.

²¹⁵³ See DBRS Letter.

an industry-wide one-time burden of approximately 160 hours.²¹⁵⁴ This includes developing an understanding of how to use the system for both submitting Forms NRSRO (and applicable exhibits) and for submitting the Rule 17g-3 annual reports. The Commission is allocating this one-time hour burden and corresponding cost solely to Rule 17g-1.

The Commission stated in the proposing release that it did not believe that changing the method of submitting Form NRSRO and Exhibits 1 through 9 from a paper submission to an electronic submission would increase the current annual hour burden for Rule 17g-1.²¹⁵⁵ An NRSRO stated that the Commission failed to consider the significant ongoing expenses of monitoring changes in EDGAR filing requirements.²¹⁵⁶ Because the amendments to Rule 17g-1 require the submission to be made in PDF (the simplest process), the Commission does not believe that changes to the EDGAR filer manual generally will impact the NRSROs. However, the Commission agrees with the commenter that NRSROs will need to spend some time each year reviewing changes to the EDGAR filer manual to determine whether they relate to the NRSRO's submissions.²¹⁵⁷ Consequently, the Commission now estimates, based on Commission staff experience, that each NRSRO will spend an average of approximately two hours per year monitoring changes in EDGAR filing requirements, resulting in a total industry-wide annual hour burden of approximately twenty hours.²¹⁵⁸ This includes monitoring changes

²¹⁵⁴ 16 hours x 10 NRSROs = 160 hours. In addition, as discussed below in section IV.D.12. of this PRA analysis, the Commission estimates that the one-time industry-wide burden resulting from filing Form ID to gain access to the EDGAR system to be approximately two and half hours, for a total industry-wide one-time burden of approximately 162.5 hours.

²¹⁵⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33501.

²¹⁵⁶ See DBRS Letter.

²¹⁵⁷ See, e.g., Adoption of Updated EDGAR Filer Manual, Securities Act Release No. 9600 (June 16, 2014), 79 FR 35280 (June 20, 2014); Adoption of Updated EDGAR Filer Manual, Securities Act Release No. 9554 (Mar. 4, 2014), 79 FR 13216 (Mar. 10, 2014). The Commission succinctly summarizes the updates to the EDGAR filer manual in these releases, which are less than ten pages long.

²¹⁵⁸ 10 NRSROs x 2 hours = 20 hours.

in EDGAR filing requirements for both submitting Forms NRSRO and for submitting the Rule 17g-3 annual reports.

The Commission is allocating the one-time and annual hour burdens and corresponding costs of the requirement to submit Form NRSRO and the Rule 17g-3 annual reports to the Commission electronically on EDGAR as PDF documents solely to Rule 17g-1.

The Commission therefore estimates that the total industry-wide one-time hour burden resulting from the amendments to Rule 17g-1 is approximately 690 hours²¹⁵⁹ to reconfigure NRSROs' corporate Internet websites, to establish procedures and protocols for receiving and processing requests for a paper copy of Exhibit 1, and for becoming familiar with the EDGAR system, and the total industry-wide annual burden is approximately 690 hours to process requests for a paper copy of Exhibit 1 and to monitor changes in EDGAR filing requirements.²¹⁶⁰ The Commission further estimates that the total industry-wide annual external cost to NRSROs resulting from the amendments to Rule 17g-1 is approximately \$4,000.

2. Amendments to Form NRSRO Instructions

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.²¹⁶¹ The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample "Transition/Default Matrix." The amendments also will enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured

²¹⁵⁹ 50 hours + 480 hours + 160 hours = 690.

²¹⁶⁰ 670 hours + 20 hours = 690 hours.

²¹⁶¹ See section II.E.1. of this release (providing a more detailed discussion of the amendments).

finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

In the proposing release, the Commission stated that it believed that the burdens attributable to the amendments to the instructions for Exhibit 1 should be based on the number of NRSRO credit ratings outstanding (which, based on annual certifications submitted by the NRSROs for the 2009 calendar year end, totaled 2,905,824 credit ratings outstanding across the ten NRSROs), that the one-time hour burden would be approximately three seconds per outstanding credit rating, and that the annual hour burden would be approximately one and a half seconds per outstanding credit rating, for an industry-wide one-time burden of approximately 2,420 hours and an industry-wide annual burden of approximately 1,210 hours.²¹⁶²

An NRSRO stated that collecting the data required for purposes of the proposed amendments to the instructions for Exhibit 1 to Form NRSRO would be burdensome, and this NRSRO suggested that NRSROs be exempt from the requirement to include historical data to the extent that the NRSRO does not already capture such information “in a readily retrievable format.”²¹⁶³ Another NRSRO stated that the definition of paid off as applied to obligors “is not practicable” because some obligors do not have rated debt outstanding and it would be difficult to track whether all obligations of an obligor are paid off.²¹⁶⁴ In addition, an NRSRO objected to basing burden estimates on the number of credit ratings outstanding or the number of credit analysts employed by NRSROs, stating that the burden estimates “must include the amount of legal and compliance resources necessary to implement systemic and simultaneous changes.”²¹⁶⁵

²¹⁶² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33502.

²¹⁶³ See Moody’s Letter.

²¹⁶⁴ See S&P Letter.

²¹⁶⁵ See A.M. Best Letter. See also DBRS Letter.

As discussed in section II.E.1. of this release, in response to comment, the Commission has modified the proposed instructions for Exhibit 1 to Form NRSRO. The final amendments provide that, except for the issuers of asset-backed securities class of credit ratings, to determine the number of credit ratings outstanding as of the beginning of the applicable period, the NRSRO must include only credit ratings assigned to an obligor as an entity or, if there is no such credit rating, the credit rating of the obligor's senior unsecured debt, instead of all of the credit ratings of individual securities or money-market instruments issued by the obligor. Because the Commission has narrowed the scope of the types of credit ratings that will have to be included in the performance statistics for four of the five classes of credit ratings, this should substantially reduce the amount of historical information that will need to be analyzed. The Commission has also revised the standard definition of paid off, in response to comment,²¹⁶⁶ to eliminate the prong that applied to credit ratings of obligors as entities. The Commission has clarified that the rule does not require NRSROs to track the outcomes of obligors, securities, or money market instruments after the credit ratings assigned to them have been withdrawn, in response to comments from two NRSROs,²¹⁶⁷ one of which stated that "the proposed requirement to separately track rating withdrawals, because of repayments and other reasons, likely would be impractical in many cases."²¹⁶⁸

The Commission believes that it is appropriate to base some of the burden estimates attributable to the amendments to the instructions for Exhibit 1 on the number of NRSRO credit ratings outstanding, as the time required to retrieve information will depend on the number of credit ratings outstanding and the time required to calculate the performance statistics should be

²¹⁶⁶ See S&P Letter.

²¹⁶⁷ See Moody's Letter; S&P Letter.

²¹⁶⁸ See S&P Letter.

greater for a larger start-date cohort. However, as stated above, in response to comment, the Commission is adding to its one-time burden estimate to account for burden that does not depend on the number of NRSRO credit ratings outstanding.²¹⁶⁹ For example, some of the burden associated with establishing systems for determining performance statistics according to the amended instructions may not depend on the number of credit ratings outstanding. While commenters did not provide an estimate of the amount of one-time burden that would be unrelated to the number of credit ratings outstanding, the Commission is adding to the one-time hour burden estimated in the proposing release a one-time hour burden that is not linked to the number of credit ratings outstanding. Specifically, the Commission estimates, based on Commission staff experience, a one-time burden of approximately fifty hours per NRSRO, for an industry-wide total of approximately 500 hours on a one-time basis,²¹⁷⁰ attributable to the amendments to the instructions for Exhibit 1 that is in addition to the one-time burden based on the number of credit ratings outstanding.

In order to be conservative, the Commission is not revising its time per credit rating estimates as a result of the modifications to the proposed amendments to the instructions for Exhibit 1 in the final rule, although the modifications may result in lower burdens compared to those of the proposed amendments. However, the Commission is updating its estimate of the number of NRSRO credit ratings outstanding. Based on the annual certifications submitted by the NRSROs for the 2013 calendar year, there were approximately 2,437,046 credit ratings outstanding across all ten NRSROs.²¹⁷¹ The Commission therefore estimates that the industry-wide one-time hour burden for NRSROs to establish systems to process the relevant information

²¹⁶⁹ See A.M. Best Letter; DBRS Letter.

²¹⁷⁰ 50 hours x 10 NRSROs = 500 hours.

²¹⁷¹ See Table 2 in section I.B.2.a. of this release.

necessary to complete Exhibit 1 to Form NRSRO that is based on the number of outstanding credit ratings is approximately 2,031 hours²¹⁷² and that the industry-wide annual burden is approximately 1,015 hours.²¹⁷³

The Commission therefore estimates that the total industry-wide one-time hour burden to NRSROs resulting from the amendments to the instructions for Exhibit 1 to Form NRSRO is approximately 2,531 hours²¹⁷⁴ to establish systems for determining performance statistics according to the amended instructions and that the annual burden is approximately 1,015 hours to calculate and format the performance statistics according to the amended instructions.

3. Amendments to Rule 17g-2

The Commission is adding paragraph (a)(9) to Rule 17g-2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g-8 as a record that must be made and retained.²¹⁷⁵ In addition, the Commission is adding the following paragraphs to Rule 17g-2 to identify records that must be retained: (1) paragraph (b)(12) identifies the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act;²¹⁷⁶ (2) paragraph (b)(13) identifies the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g-8;²¹⁷⁷ (3) paragraph (b)(14) identifies the policies and

²¹⁷² 2,437,046 credit ratings x 3 seconds = 2,030.9 hours (rounded to 2,031 hours).

²¹⁷³ 2,437,046 credit ratings x 1.5 seconds = 1015.4 hours (rounded to 1015 hours).

²¹⁷⁴ 500 hours + 2,031 hours = 2,531 hours.

²¹⁷⁵ See section II.C.2. of this release (providing a more detailed discussion of this amendment).

²¹⁷⁶ See section II.A.2. of this release (providing a more detailed discussion of this amendment).

²¹⁷⁷ See section II.F.2. of this release (providing a more detailed discussion of this amendment).

procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g-8;²¹⁷⁸ and (4) paragraph (b)(15) identifies the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g-9.²¹⁷⁹ In addition, in a modification from the proposal, the Commission is amending paragraph (c) of Rule 17g-2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g-2 must be retained until three years after the date record is replaced with an updated record, instead of three years after the date the record is made or received (the retention period for other records identified in paragraphs (a) and (b) of Rule 17g-2).²¹⁸⁰

With respect to paragraph (b)(12) of Rule 17g-2, one commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, and argued that an NRSRO should be allowed to establish its own documentation policies and procedures.²¹⁸¹ However, the Commission is not imposing documentation requirements. Rather, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO, among other things, to document its internal control structure.²¹⁸²

The Commission is adding paragraph (a)(9) to Rule 17g-2 to require NRSROs to make and retain a record documenting the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce under section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of proposed Rule 17g-8. The Commission is providing estimates below in section IV.D.7. of this PRA analysis to address the burdens associated with

²¹⁷⁸ See section II.J.2. of this release (providing a more detailed discussion of this amendment).

²¹⁷⁹ See section II.I.2. of this release (providing a more detailed discussion of this amendment).

²¹⁸⁰ See paragraph (c) of Rule 17g-2.

²¹⁸¹ See A.M. Best Letter.

²¹⁸² See 15 U.S.C. 78o-7(c)(3)(A).

Rule 17g-8, including the one-time and annual hour burdens that will result from establishing, maintaining, enforcing, and documenting the policies and procedures with respect to look-back reviews required by section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g-8.

Consequently, for purposes of Rule 17g-2, the Commission is providing estimates of the one-time and annual hour burdens resulting from the requirement to retain the records that are identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g-2. The Commission believes that the one-time hour burden will result from the NRSRO needing to update its record retention policies and procedures to incorporate these new records that will need to be retained. NRSROs already have a recordkeeping system in place to comply with the retention requirements of Rule 17g-2 before today's amendments. The Commission estimated in the proposing release that each NRSRO would spend an average of approximately twenty hours updating its record retention policies and procedures, resulting in an industry-wide one-time hour burden of approximately 200 hours.²¹⁸³ The Commission did not receive comment on this estimate.

The Commission estimated in the proposing release that it would take approximately one hour per record each year to retain updated versions of these records,²¹⁸⁴ for an annual hour burden for each NRSRO attributable to these proposals of approximately five hours,²¹⁸⁵ and an industry-wide annual hour burden of approximately fifty hours.²¹⁸⁶ The Commission did not receive comment on this estimate and, except for the amendment to paragraph (c) requiring that the record be retained until three years after the date the record is replaced with an updated

²¹⁸³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33503 (10 NRSROs x 20 hours = 200 hours).

²¹⁸⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33503.

²¹⁸⁵ 5 records x 1 hour = 5 hours.

²¹⁸⁶ 10 NRSROs x 5 hours = 50 hours.

record, is adopting the amendments to Rule 17g-2 as proposed. The Commission believes that the amendment to paragraph (c) of Rule 17g-2 will not affect the burdens estimated for Rule 17g-2 in the proposing release because the amendment removes an ambiguity in the proposal that could be read to make the retention period shorter than the Commission intended and shorter than the retention period upon which the Commission's estimate in the proposing release was based. Therefore, the Commission is retaining the one-hour per record estimate in the proposing release without revision.

The Commission is repealing paragraph (d)(2) of Rule 17g-2 (the 10% Rule) and re-codifying, with substantial amendments, the requirements in former paragraph (d)(3) of Rule 17g-2 in paragraph (b) of Rule 17g-7 (the 100% Rule).²¹⁸⁷ The one-time and annual hour burdens resulting from the enhancements to the 100% Rule are discussed below in section IV.D.6. of this release, which addresses the one-time and annual hour burdens resulting from the amendments to Rule 17g-7.

Consequently, the Commission estimates that the total industry-wide one-time hour burden for NRSROs resulting from the amendments to Rule 17g-2 to update their record retention policies and procedures to incorporate these new records that will need to be retained is approximately 200 hours and the annual hour burden to retain the records is approximately fifty hours.²¹⁸⁸

²¹⁸⁷ See section II.E.2. of this release (providing a more detailed discussion of these amendments).

²¹⁸⁸ The adjusted industry-wide annual hour burden for Rule 17g-2 before today's amendments was 4,000 hours. The elimination of the requirements in paragraph (d)(2) of Rule 17g-2 will subtract seventy hours from that amount. See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6472. In addition, the re-codification of paragraph (d)(3) of Rule 17g-2 in paragraph (b) of Rule 17g-7 will subtract an additional 450 hours from the adjusted industry-wide annual hour burden for Rule 17g-2 and that burden will be attributed to the industry-wide annual hour burden for Rule 17g-7. See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63853; section IV.D.6. of this release. Consequently, after these subtractions, the adjusted industry-wide annual hour burden for Rule 17g-2 will be 3,480 hours (4,000 hours - 70 hours - 450 hours = 3,480 hours). The amendments to add paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) to Rule 17g-2 being adopted

4. Amendments to Rule 17g-3

The Commission is amending paragraphs (a) and (b) of Rule 17g-3.²¹⁸⁹ The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an additional report – a report on the NRSRO’s internal control structure – with its annual submission of reports to the Commission pursuant to Rule 17g-3. The amendment to paragraph (b) of Rule 17g-3 requires that the NRSRO’s CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report.

In the proposing release, the Commission stated that because NRSROs already should have developed processes and protocols to prepare the annual reports required by Rule 17g-3, the internal hour burden associated with the first submission of the report on the NRSRO’s internal control structure would not be materially different than the hour burden associated with submitting subsequent reports, although the time required to prepare subsequent reports could decrease incrementally over time as the NRSRO gains experience with the requirement.²¹⁹⁰ The Commission stated that an NRSRO likely would engage outside counsel to analyze the requirements for the report and to assist in drafting and reviewing the first report, that the time outside counsel would spend on this work would depend on the size and complexity of the NRSRO, and that an attorney would spend an average of approximately 100 hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the first report,

today will, as discussed above, add approximately fifty hours to the adjusted industry-wide annual hour burden resulting in a total adjusted industry-wide annual hour burden of 3,530 hours (3,480 hours + 50 hours = 3,530 hours).

²¹⁸⁹ See section II.A.3. of this release (providing a more detailed discussion of these amendments).

²¹⁹⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33504.

resulting in an industry-wide external one-time hour burden of approximately 1,000 hours.²¹⁹¹

Based on industry sources, the Commission estimated that the cost of outside counsel would be approximately \$400 per hour,²¹⁹² and that the average one-time cost to an NRSRO would be approximately \$40,000,²¹⁹³ resulting in an industry-wide one-time cost of approximately \$400,000.²¹⁹⁴

In connection with the proposed amendments to Rule 17g-7, an NRSRO stated that the Commission underestimated the hourly rate for retaining outside counsel.²¹⁹⁵ The commenter, however, did not provide alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate without revision.²¹⁹⁶

In terms of the annual burden relating to the submission of the reports, the Commission estimated, based on staff experience, that each NRSRO would spend on average approximately 150 hours preparing the internal controls report, resulting in an industry-wide annual burden of approximately 1,500 hours.²¹⁹⁷

In addition, the Commission stated that an NRSRO likely would continue to engage outside counsel to assist in preparing the reports (after filing the first report) and that the time outside counsel would spend assisting in the preparation of subsequent reports would be less than

²¹⁹¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (10 NRSROs x 100 hours = 1,000 hours).

²¹⁹² See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63889 (providing an estimate of \$400 per hour to engage outside counsel).

²¹⁹³ 100 hours x \$400 = \$40,000.

²¹⁹⁴ 10 NRSROs x \$40,000 = \$400,000.

²¹⁹⁵ See DBRS Letter.

²¹⁹⁶ See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63889 ("Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately \$400 per hour").

²¹⁹⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (10 NRSROs x 150 hours = 1,500 hours).

the time spent on preparing the first report, since the counsel's work will not need to include an initial analysis of the new requirements. Consequently, the Commission estimated that an attorney would spend an average of approximately fifty hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the report, resulting in an industry-wide annual hour burden of approximately 500 hours.²¹⁹⁸ As stated above, the Commission estimated that the cost of outside counsel would be approximately \$400 per hour.²¹⁹⁹ For these reasons, the Commission estimated that the average annual cost to an NRSRO to comply with this requirement would be approximately \$20,000,²²⁰⁰ resulting in an industry-wide annual cost of approximately \$200,000.²²⁰¹ The Commission did not receive comment on the hour estimates.

As proposed, paragraph (a)(7) of Rule 17g-3 would require that the internal controls report contain a description of the responsibility of management in establishing and maintaining an effective control structure and an assessment of the effectiveness of the internal control structure. In response to comment, paragraph (a)(7), as adopted, has been modified from the proposal to require that the report describe material weaknesses identified in the internal control structure during the fiscal year and how they were addressed and to state whether the internal control structure was effective as of the end of the fiscal year.²²⁰² In order to include an assessment of the effectiveness of the NRSRO's internal control structure in the annual internal controls report, the NRSRO will need to identify any material weaknesses in the internal control

²¹⁹⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (10 NRSROs x 50 hours = 500 hours). The Commission is adopting paragraph (a)(7) of Rule 17g-3 as proposed. Accordingly, this estimate remains unchanged from the Commission's preliminary estimate in the proposing release.

²¹⁹⁹ See also Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63889 ("Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately \$400 per hour").

²²⁰⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (50 hours x \$400 = \$20,000).

²²⁰¹ See id. (10 NRSROs x \$20,000 = \$200,000).

²²⁰² See section II.A.3. of this release (providing a more detailed discussion of these modifications).

structure. In addition, since the statute requires that the internal control structure be “effective,” the NRSRO will have to remediate any such weaknesses to comply with the statutory requirement.²²⁰³ Therefore, the Commission does not believe the modifications discussed above necessitate adjusting the burdens from those that were proposed.

However, the modifications to the amendment from the proposal also require that the internal controls report include a description of material weaknesses identified during the fiscal year and how they were remediated. The Commission believes that documenting these items for inclusion in the internal controls report will take NRSROs an average of approximately fifteen hours per year, resulting in an internal burden of approximately 165 hours per NRSRO per year for preparing the internal controls report, resulting in a total industry-wide annual burden of approximately 1,650 hours.²²⁰⁴

As discussed above in section IV.D.1. of this release, the amendments to Rule 17g-3 also require that the annual reports be submitted electronically on the Commission’s EDGAR system.²²⁰⁵ The discussion of the Commission’s estimates of the burdens associated with the requirement to submit the Rule 17g-3 annual reports electronically through the EDGAR system in the proposing release, relevant comments on those burdens, the Commission’s responses to those comments, and the Commission’s final burden estimates (which are revised in response to comments) are discussed in section IV.D.1. of this release. Further, as discussed below in section IV.D.12. of this release, the Commission estimates there will be burdens to complete Form ID for purposes of submitting Form NRSRO (and Exhibits 1 through 9) and the Rule 17g-3

²²⁰³ See 15 U.S.C. 78o-7(c)(3)(A).

²²⁰⁴ 150 hours + 15 hours = 165 hours; 165 hours x 10 NRSROs = 1,650 hours.

²²⁰⁵ See section II.L. of this release (providing a more detailed discussion of this amendment).

annual reports electronically through EDGAR. For purposes of this PRA analysis, the Commission is allocating the burdens discussed above to Rule 17g-1 and Form ID.

The Commission therefore estimates that the amendments to Rule 17g-3 will result in a total industry-wide one-time cost for NRSROs of approximately \$400,000 to engage outside counsel to analyze the requirements for the internal controls report, a total industry-wide annual hour burden of approximately 1,650 hours to prepare the internal controls report, and a total industry-wide annual cost of approximately \$200,000 to engage outside counsel to assist in the preparation of the annual internal controls report.

5. Amendments to Rule 17g-5

The Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g-5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E delivered by a person employed to provide third-party due diligence services with respect to the security.²²⁰⁶ This provision, which was not included in the proposal, may require NRSROs to redraft the agreement templates they use with respect to obtaining representations from issuers, sponsors, or underwriters as required under Rule 17g-5. Based on staff experience, the Commission estimates that an NRSRO will spend approximately two hours on a one-time basis to redraft these templates, for a total industry-wide one-time burden of approximately 6,720 hours.²²⁰⁷ In addition, based on the Commission's estimate that there will be 715 offerings of Exchange Act-ABS per year,²²⁰⁸ the

²²⁰⁶ See sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this provision).

²²⁰⁷ 336 issuers, sponsors, and underwriters x 2 hours = 672 hours; 672 hours x 10 NRSROs = 6,720 hours.

²²⁰⁸ See Table 6 in section I.B.2.b. of this release. Issuers, underwriters, and NRSROs may not use providers of third-party due diligence services with respect to every issuance of Exchange Act-ABS. For example, the Commission believes that providers of third-party due diligence services are used primarily for RMBS transactions. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471. However, the

Commission estimates that issuers, sponsors, and underwriters will need to post approximately 715 Forms ABS Due Diligence-15E on Rule 17g-5 websites per year (in addition to the information that is already posted to the websites). Based on staff experience, the Commission estimates that it will take the issuer, sponsor, or underwriter approximately ten minutes to upload each form and post it to the website, for a total industry-wide annual burden of approximately 119 hours.²²⁰⁹

The Commission is adding paragraph (c)(8) to Rule 17g-5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.²²¹⁰ As a consequence of the new absolute prohibition, the Commission believes that an NRSRO will need to update the written policies and procedures to address and manage conflicts of interest the NRSRO must establish, maintain, and enforce under section 15E(h) of the Exchange Act and Rule 17g-5. The Commission estimates below that it will take an NRSRO an average of approximately 100 hours to establish and make a record of its policies and procedures with respect to look-back reviews.²²¹¹ Based on Commission staff experience, the Commission estimates that updating the conflicts of interest policies and procedures would take

Commission's estimate uses the total number of estimated Exchange Act-ABS offerings (as opposed to a lesser amount based on an estimate of RMBS offerings) because the use of providers of third-party due diligence services may migrate to other types of Exchange Act-ABS.

²²⁰⁹ 715 Forms ABS Due Diligence-15E per year x 10 minutes = 119.17 hours, rounded to 119 hours.

²²¹⁰ See section II.B.1. of this release (providing a more detailed discussion of this provision).

²²¹¹ See section IV.D.7. of this release.

an NRSRO an average of approximately 100 hours, for an industry-wide one-time burden of approximately 1,000 hours.²²¹²

Exhibit 7 to Form NRSRO requires an NRSRO to provide a copy of the written policies and procedures in the exhibit. Paragraph (e) of Rule 17g-1 requires an NRSRO to promptly file with the Commission an update of its registration on Form NRSRO when information on the form is materially inaccurate. The update of registration must be filed electronically on the Commission's EDGAR system. The Commission estimates, based on staff experience, that it would take an NRSRO an average of approximately twenty-five hours on a one-time basis to prepare and file the update of registration to account for the update of the NRSRO's written policies and procedures to address and manage conflicts of interest, for an industry-wide one-time burden of approximately 250 hours and a total industry-wide one-time burden of approximately 1,250 hours to update the NRSRO's conflicts of interest policies and procedures and to prepare and file an update of registration to account for the update of the NRSRO's written policies and procedures.²²¹³

The Commission is adding paragraph (f) to Rule 17g-5, which provides that upon written application by an NRSRO the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) of Rule 17g-5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest.²²¹⁴ Based on staff experience, the Commission believes that an NRSRO applying for

²²¹² 100 hours x 10 NRSROs = 1,000 hours.

²²¹³ 10 NRSROs x 25 hours = 250 hours; 1,000 hours + 250 hours = 1,250 hours. See also Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33614 (providing a PRA estimate of twenty-five hours for an NRSRO to prepare and furnish an update of its registration).

²²¹⁴ See section II.B.2. of this release (providing a more detailed discussion of this provision).

the exemption would likely engage outside counsel to assist in drafting an exemption request, that counsel would spend an average of approximately fifty hours for a cost of approximately \$20,000 to assist in drafting the request, and that the NRSRO would likely spend an average of approximately 150 hours to draft and submit the application to the Commission.²²¹⁵

6. Amendments to Rule 17g-7

The Commission is incorporating the disclosure requirement with respect to representations, warranties, and enforcement mechanisms in Rule 17g-7 before today's amendments into paragraph (a) of Rule 17g-7 and is adding to paragraph (a) significant disclosure provisions that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.²²¹⁶

With respect to the one-time burden attributable to paragraph (a) of Rule 17g-7, the Commission estimated in the proposing release that an NRSRO would spend an average of approximately 5,000 hours to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process, allocated 75% of these burden hours (3,750 hours) to internal burden and 25% of these burden hours (1,250 hours) to external burden, and estimated a \$400 per hour cost for outside professionals such as counsel and information technology consultants, resulting in an industry-wide one-time hour burden of approximately 50,000 hours and an industry-wide one-time cost of approximately \$5,000,000.²²¹⁷ As discussed below, the Commission is not

²²¹⁵ 50 hours x \$400 per hour for outside counsel = \$20,000.

²²¹⁶ See section II.G. of this release (providing a more detailed discussion of these amendments).

²²¹⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33505. This estimate was based on

modifying its estimate with respect to the one-time burden attributable to paragraph (a) of Rule 17g-7. Further, as stated above, in response to a comment stating that the Commission's estimate of \$400 per hour for retaining outside counsel is too low,²²¹⁸ the Commission notes that the commenter did not provide an alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate without revision.²²¹⁹

With respect to the annual hour burden for paragraph (a) of Rule 17g-7, the Commission stated in the proposing release that it believed that the estimate should be divided into two components: the amount of time an NRSRO would spend to update its standardized disclosures and to tailor disclosures to particular rating actions and asset classes; and the amount of time the NRSRO would spend generating and publishing each form and attaching the required certifications to the form.²²²⁰ With regard to the first component, the Commission estimated that an NRSRO would spend an average of approximately 500 hours per year updating the standardized disclosures, for an industry-wide annual hour burden of 5,000 hours.²²²¹ The Commission stated that it believed that the burden attributable to the second component should be based on the number of rating actions taken per year by the NRSROs because the requirement to generate and publish the form and attach the certifications will be triggered upon the taking of

the Commission's estimate for the amount of time it would take a securitizer to set-up a system to make the disclosures required by Form ABS-15G. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507. The Commission significantly increased the estimate for Form ABS-15G because the form required pursuant to Rule 17g-7 contains substantially more qualitative information.

²²¹⁸ See DBRS Letter.

²²¹⁹ See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63889 ("Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately \$400 per hour"); Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506 (providing an estimate of \$400 an hour to engage outside professionals).

²²²⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33505.

²²²¹ See id.

a rating action.²²²² The Commission further estimated that the ten NRSROs take approximately 2,909,958 credit rating actions per year,²²²³ and estimated that the time it would take to generate a form with the required disclosures and to publish the form with the credit rating would be an average of approximately fifteen minutes, for an industry-wide annual hour burden of approximately 727,490 hours, which would be allocated to the NRSROs based on the number of credit ratings they have outstanding.²²²⁴

The Commission received comments from NRSROs stating that the Commission underestimated these costs and time burdens.²²²⁵ However, these commenters did not provide estimates of the costs and time burden. Another NRSRO generally objected to the use of the number of credit ratings outstanding to estimate the burden of the proposed amendments and new rules, because “the burden analysis must take into account not only the number of ratings or analysts in isolation, but also must include the legal and compliance resources necessary to implement systemic and simultaneous changes.”²²²⁶

In part in response to comments,²²²⁷ the Commission has modified paragraph (a) of Rule 17g-7 from the proposal in a number of ways to reduce burdens.²²²⁸ For example, the Commission narrowed the scope of rating actions that will trigger the disclosure requirement and

²²²² See id.

²²²³ Based on information submitted to the Commission by NRSROs, the Commission estimated that NRSROs took approximately 2,000,000 rating actions in 2009, consisting of upgrades, downgrades, placements on credit watch, and withdrawals of credit ratings. The Commission also estimated that NRSROs would issue expected or preliminary ratings primarily with respect to new issuances of structured finance products, which the Commission estimated at 2,067 per year, plus other issuances, for a total of 4,134 preliminary ratings per year. The Commission also estimated that approximately 415,117 initial credit ratings are issued per year and that 490,707 affirmations are issued per year. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33505-33506

²²²⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33505-33506.

²²²⁵ See A.M. Best Letter; DBRS Letter; Morningstar Letter.

²²²⁶ See A.M. Best Letter. See also DBRS Letter.

²²²⁷ See A.M. Best Letter; DBRS Letter; Morningstar Letter.

²²²⁸ See section II.G. of this release (providing a more detailed discussion of these modifications).

provided an exemption for certain rating actions involving foreign obligors or foreign-issued securities or money market instruments. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. All of these modifications were made in response to concerns about burdens raised by commenters.²²²⁹ Based on the comments above, the Commission believes it underestimated the amount of the burden in the proposing release. However, the Commission also believes the modifications discussed above will ease the burden to the extent that they will compensate for the amount by which the Commission underestimated the burden. Consequently, the Commission is retaining the original burden estimate.

The Commission continues to believe that the estimate of the time required to generate and publish the form and attach the certifications should be based on the number of rating actions taken per year by the NRSROs because the requirement will be triggered upon the taking of a rating action. Based on staff experience, the Commission believes that expected or preliminary credit ratings are published primarily (but not exclusively) with respect to new issuances of structured finance products. The Commission estimates that there will be approximately 715 offerings of structured finance products per year.²²³⁰ As stated in the proposing release, the Commission, based on staff experience, believes that expected or preliminary credit ratings are used in other types of offerings as well and, therefore, is increasing that estimate by 100%, to 1,430 preliminary or expected credit ratings per year.²²³¹

In terms of estimating the number of initial credit ratings, as stated above, the Commission estimates that there are approximately 2,437,046 credit ratings outstanding across

²²²⁹ See A.M. Best Letter; ASF Letter; Better Markets Letter; CFA/AFR Letter; DBRS Letter; Deloitte Letter; FSR Letter; Moody's Letter; S&P Letter.

²²³⁰ See Table 6 in section I.B.2.b. of this release.

²²³¹ $715 \times 2 = 1,430$. See also Nationally Recognized Statistical Rating Organizations, 76 FR at 33506.

all ten NRSROs.²²³² Based on staff experience, as stated in the proposing release, the Commission estimates that the average maturity of rated securities and money market instruments is approximately seven years.²²³³ Consequently, assuming 2,437,046 is the approximate average number of credit ratings outstanding at any given time, the Commission estimates that approximately 348,149 initial credit ratings are issued per year.²²³⁴

Based on information submitted to the Commission by NRSROs pursuant to paragraph (a)(6) of Rule 17g-3,²²³⁵ the Commission estimates that in calendar year 2013 NRSROs made a total of approximately 236,521 credit rating upgrades and downgrades, placed 176,374 credit ratings on credit watch, and withdrew 191,062 credit ratings. However, the Commission notes that the definition of rating action in the prefatory text of paragraph (a) of Rule 17g-7, as adopted, has been modified from the proposed definition to exclude placements of credit ratings on credit watch and to only include an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the NRSRO using applicable procedures and methodologies for determining credit ratings. The Commission estimates that virtually all withdrawals of credit ratings by NRSROs are in connection with routine debt maturities, calls, or

²²³² See Table 2 in section I.B.2.a. of this release.

²²³³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33506.

²²³⁴ $2,437,046 \text{ credit ratings} / 7 = 348,149 \text{ credit ratings}$. In other words, the Commission estimates that issuers pay in full all outstanding principal and interest outstanding with respect to approximately 348,149 rated securities or money market instruments and, consequently, the credit ratings for these securities and money market instruments are withdrawn. Those withdrawn credit ratings, in turn, are replaced by 348,149 initial (or new) credit ratings. Outstanding credit ratings assigned to securities and money market instruments are withdrawn for other reasons, including that the security or money market instrument went into default. In addition, a percent of the outstanding credit ratings are assigned to obligors as entities and, therefore, these credit ratings would not be withdrawn because an obligation was extinguished. However, the credit ratings might be withdrawn for other reasons, including that the obligor went into default. Nonetheless, the Commission continues to believe these estimates are reasonable approximations of the number of initial credit ratings determined per year. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33506, n.1011.

²²³⁵ See paragraph (a)(6) of Rule 17g-3.

redemptions in which case the withdrawal would result from the extinguishment of the debtor's obligation and not from an analysis of the debtor's creditworthiness. Consequently, virtually all withdrawals would not result from the application of the NRSRO's rating procedure or methodology to analyze the creditworthiness of the debtor. Therefore, virtually all withdrawals under the modified definition of rating action would not trigger the requirements of paragraph (a) of Rule 17g-7. Consequently, the Commission is excluding the number of withdrawals per year from the total number of rating actions per year that will trigger the requirements of paragraph (a) of Rule 17g-7.

Finally, with respect to affirmations of existing credit ratings, the Commission believes that NRSROs generally affirm existing credit ratings at least once a year. Consequently, the Commission estimates that the number of affirmations would be the total number of credit ratings outstanding (2,437,046), less the number of credit ratings that are upgraded and downgraded (236,521), placed on credit watch (176,374), withdrawn (191,062), and paid off during the year (348,149), for a total of 1,485,940 estimated NRSRO affirmations of existing credit ratings.

Based on these estimates, the Commission estimates that the ten NRSROs take an aggregate of approximately 2,071,040 credit rating actions per year, according to the definition of rating action in paragraph (a) of Rule 17g-7, as adopted.²²³⁶ The Commission notes that the exemption in the rule for rating actions involving certain foreign obligors, securities, or money market instruments could reduce the number of rating actions that trigger the requirement to publish the form and any applicable due diligence certifications. However, in light of the

²²³⁶ 236,521 upgrades and downgrades + 1,484,940 affirmations + 348,149 initial credit ratings + 1,430 preliminary or expected credit ratings = 2,071,040 rating actions per year. For purposes of paragraph (a) of Rule 17g-7, credit ratings placed on credit watch and withdrawn credit ratings are not included in this calculation due to the definition of rating action.

comments arguing that the Commission underestimated the burden of the rule, taken in conjunction with the modifications from the proposal that reduce the number of rating actions covered, the Commission is not adjusting the number of rating actions for the purposes of these estimates.

The Commission preliminarily estimated that it would take approximately fifteen minutes on average to generate a form by populating it with the required disclosures and to publish the form. Commenters made general statements that the rule would result in significant burden²²³⁷ or that the Commission underestimated the burden.²²³⁸ Commenters, however, did not provide alternative estimates of the burden. Nonetheless, the Commission is revising its estimate, based on staff experience and in light of the comments, to twenty minutes on average for each rating action, resulting in an industry-wide annual hour burden of approximately 690,347 hours.²²³⁹

The Commission is not revising its estimate of the amount of time an NRSRO would spend to update its standardized disclosures and to tailor disclosures to particular rating actions and asset classes. The Commission therefore estimates an annual burden per NRSRO of approximately 500 hours and an industry-wide annual hour burden of approximately 5,000 hours.²²⁴⁰ Based on staff experience, the Commission believes that the update process will be handled by the NRSROs internally.

²²³⁷ See A.M. Best Letter ("We believe that expanding 17g-7 disclosure requirements to non-asset-backed ratings is extremely overly-burdensome...").

²²³⁸ See DBRS Letter ("DBRS believes that the Commission has grossly underestimated...the amount of time it will take to compile a disclosure form for each rating action"); Morningstar Letter ("We disagree with the Commission's estimation that the form of these certificates will be largely standardized and take 15 minutes to complete per rating action. We believe that the Commission's estimation is too low since proposed provisions will not be able to be standardized across rating actions or asset class types and will still require an individual analysis of the securities transaction.") (footnote omitted).

²²³⁹ 2,071,040 rating actions x 1/3 hour = 690,346.67 hours, rounded to 690,347 hours.

²²⁴⁰ 500 hours x 10 NRSROs = 5,000 hours.

The Commission is also amending paragraph (b) to Rule 17g-7 to re-codify the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g-2 before today's amendments (the 100% Rule) and increases the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.²²⁴¹

In the proposing release, the Commission estimated that the average one-time burden attributable to the enhancements to the 100% Rule per NRSRO would be approximately 135 hours to program existing systems and initially add the ratings histories for all outstanding credit ratings as of June 26, 2007, for an industry-wide one-time burden of approximately 1,350 hours, and that the average annual burden per NRSRO to comply with the increased requirements, including updating and administering the database, would be approximately forty-five hours per year, for an industry-wide annual burden of approximately 450 hours.²²⁴²

One NRSRO stated that constantly updating the database for the 100% Rule "would impose an unwarranted burden on NRSROs."²²⁴³ Another NRSRO stated that NRSROs may not have, or may find it difficult to obtain, the additional information required by the amendments.²²⁴⁴ A third NRSRO stated that because it does not consider affirmations, confirmations, placement of credit ratings on watch or review, and assignment of default status to be credit rating actions and does not subdivide withdrawn credit ratings into the subcategories of withdrawn due to default, withdrawn because paid in full, and "other," it does not capture

²²⁴¹ See section II.E.3. of this release (providing a more detailed discussion of these provisions).

²²⁴² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33506.

²²⁴³ See DBRS Letter.

²²⁴⁴ See S&P Letter.

some of that information in a format that is readily retrievable and therefore it recommends that the rule exempt NRSROs from providing historical data to the extent it does not already capture the data in a readily retrievable format.²²⁴⁵ One NRSRO that generally supported the amendments also stated that NRSROs may not be able to provide XBRL information as of June 26, 2007, since those rating actions are beyond the scope of the 3-year record retention requirement.²²⁴⁶ Three NRSROs objected to the requirement to disclose the legal name and CIK number of the rated obligor or issuer of the security or money market instrument and the CUSIP of the security or money market instrument.²²⁴⁷ One NRSRO stated that it was “unnecessarily burdensome” to require the use of identifiers that may become obsolete, that require NRSROs to pay a fee, or that may not be used outside the United States, as long as NRSROs “use some kind of identifier system sufficient to identify the rated obligor and obligation,” for example, “an internationally recognized LEI [Legal Entity Identifier] system.”²²⁴⁸

In response to these comments, the Commission notes that it has modified paragraph (b) of Rule 17g-7 from the proposal to reduce the burden.²²⁴⁹ To focus the disclosure of rating histories on the rating actions that are most relevant to evaluating performance, the final amendments eliminate the proposed requirement to include placements on watch and affirmations (and the required data associated with these actions) in the rating histories.²²⁵⁰ The

²²⁴⁵ See Moody's Letter.

²²⁴⁶ See Morningstar Letter.

²²⁴⁷ See DBRS Letter; Moody's Letter; S&P Letter.

²²⁴⁸ See Moody's Letter. As discussed in section II.E.3. of this release, the Commission believes the requirement to disclose the CUSIP of the security or money market instrument that is the subject of the rating action is necessary to make the disclosures readily searchable.

²²⁴⁹ See section II.E.3. of this release (providing a more detailed discussion of the modifications). See also DBRS letter (stating that the 100% Rule “would impose an unwarranted burden on NRSROs”); Moody's Letter (stating that collecting data for past rating actions “would require tens of thousands of hours of analysis”).

²²⁵⁰ See Moody's Letter (stating that it does not consider these activities to be rating actions).

final amendments also significantly shorten the time horizon of historical information that must be retrieved for inclusion in the rating histories. In particular, the proposed requirement to include information for all credit ratings outstanding on or after June 26, 2007 has been replaced with a standard three-year backward looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This, together with the elimination of two types of rating actions that would trigger a requirement to add information to a credit rating's history – placements of the security on credit watch or review and affirmations of the credit rating – should significantly mitigate the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures.²²⁵¹ The modifications also should mitigate to some extent concerns about having to obtain information that was not traditionally retained by the NRSRO as it will significantly narrow the scope of such information that will need to be included in the rating histories. Further, the modifications should reduce the burden of updating the XBRL data file with new information. The final amendments also specify a standard for updating the file – no less frequently than monthly – in response to a suggestion by a commenter.²²⁵² This will make the costs resulting from the requirement lower than if the file needed to be updated more frequently. In addition, the final rule prioritizes identifier disclosure to an LEI and then to a CIK, if the LEI is not available.²²⁵³ Finally, the final amendments modify the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This should reduce the data retention and maintenance costs associated with the final rule as compared to the proposed rule.

²²⁵¹ See Moody's Letter, Morningstar Letter, S&P Letter.

²²⁵² See DBRS Letter.

²²⁵³ See DBRS Letter; Moody's Letter; S&P Letter.

The modifications are expected to reduce the burden associated with the rule. However, the Commission is not decreasing the burden estimates, notwithstanding the modifications to the rule that reduce the burdens from the rule as proposed, in light of comments that the estimates in the proposal were too low.

In summary, the Commission estimates that the burden associated with paragraph (a) of Rule 17g-7 will result in a total industry-wide one-time hour burden to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process of approximately 37,500 hours and a total industry-wide one-time cost of approximately \$5,000,000 to engage outside professionals such as counsel and information technology consultants to assist in developing the standardized disclosures and programming existing systems, and a total industry-wide annual hour burden to update standardized disclosures, to tailor disclosures to particular rating actions and asset classes, and to generate and publish each form and attach the required certifications to the form, of approximately 695,347 hours.²²⁵⁴ With respect to the amendments to paragraph (b) of Rule 17g-7, the Commission estimates that the burden associated with the enhancements to the 100% Rule will result in a total industry-wide one-time hour burden of approximately 1,350 hours to program existing systems and initially add the ratings histories for all applicable outstanding credit ratings and a total industry-wide annual hour burden to comply with the increased requirements, including updating and administering the database, of approximately 450 hours.²²⁵⁵

²²⁵⁴ 5,000 hours + 690,347 hours = 695,347 hours.

²²⁵⁵ As stated above in section IV.D.3. of this release, the re-codification of paragraph (d)(3) of Rule 17g-2 (the 100% Rule before today's amendments) in paragraph (b) of Rule 17g-7 will subtract 450 hours from the industry-wide annual hour burden for Rule 17g-2. This burden will be attributed to the industry-wide annual hour burden for Rule 17g-7.

7. New Rule 17g-8

Paragraph (a) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.²²⁵⁶ In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 200 hours establishing the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 2,000 hours,²²⁵⁷ and that an NRSRO would spend an average of approximately fifty hours per year reviewing the policies and procedures, updating them (if necessary), and enforcing them, resulting in an industry-wide annual hour burden of approximately 500 hours.²²⁵⁸ The Commission did not receive comments on these estimates and is adopting the amendments to paragraph (a) of Rule 17g-8 substantially as proposed. The Commission does not believe the modifications will change the burden estimates as they either remove ambiguities or make minor wording revisions. Consequently, the Commission is retaining the estimates without revision.

In addition, the Commission estimates that it will take an NRSRO an average of approximately twenty hours to promptly publish on an easily accessible portion of its Internet website information about material changes to its procedures and methodologies to determine credit ratings and the likelihood such changes will result in changes to any current credit ratings, or a notice of significant errors identified in a procedure or methodology.

Paragraph (b) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the symbols, numbers, or scores it uses to

²²⁵⁶ See section II.F.1. of this release (providing a more detailed discussion of this paragraph).

²²⁵⁷ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33507.

²²⁵⁸ See id.

denote credit ratings.²²⁵⁹ In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 200 hours establishing the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 2,000 hours,²²⁶⁰ and that an NRSRO would spend an average of approximately fifty hours per year reviewing the policies and procedures, updating them (if necessary), and enforcing them, resulting in an industry-wide annual hour burden of approximately 500 hours.²²⁶¹ The Commission did not receive comment on these estimates and is adopting the amendments to paragraph (b) of Rule 17g-8 substantially as proposed. The Commission does not believe the modifications will change the burden estimates as they are minor wording revisions. Consequently, the Commission is retaining the estimates without revision.

Paragraph (c) of Rule 17g-8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed in the form required under paragraph (a) of Rule 17g-7.²²⁶² In the proposing release, the Commission estimated that an NRSRO would spend an average of approximately 100 hours establishing and making a record of the policies and procedures, resulting in an industry-wide one-time hour burden of approximately 1,000 hours,²²⁶³

²²⁵⁹ See section II.J.1. of this release (providing a more detailed discussion of this paragraph).

²²⁶⁰ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33507.

²²⁶¹ See id.

²²⁶² See section II.C.1. of this release (providing a more detailed discussion of this paragraph).

²²⁶³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33507.

and that an NRSRO would spend an average of approximately twenty-five hours per year reviewing, and, if necessary, updating the policies and procedures and its record documenting the policies and procedures, maintaining and enforcing the policies and procedures, and taking steps pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict, resulting in an average industry-wide annual hour burden of approximately 250 hours.²²⁶⁴ The Commission did not receive comment on these estimates and is adopting the amendments to paragraph (c) of Rule 17g-8 with modifications that reduce the burden in terms of the steps an NRSRO must take pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict. However, the PRA burden accounts for the time an NRSRO will spend establishing, reviewing and updating, and documenting the policies and procedures. The time spent establishing, reviewing, updating, and documenting the policies and procedures will not change because of the modifications to the rule from the proposal. Consequently, the Commission is retaining these estimates without revision.

The Commission therefore estimates that the total industry-wide one-time hour burden to the NRSROs resulting from Rule 17g-8, as adopted, is approximately 5,000 hours to: (1) establish and document policies and procedures with respect to an NRSRO's procedures and methodologies to determine credit ratings; (2) establish and document policies and procedures with respect to the symbols, numbers, or scores an NRSRO uses to denote credit ratings; and (3) establish and make a record of its policies and procedures with respect to look-back reviews.²²⁶⁵ The Commission estimates that the total industry-wide annual hour burden resulting from Rule

²²⁶⁴ See *id.*

²²⁶⁵ 2,000 hours + 2,000 + 1,000 hours = 5,000 hours. The burden associated with retaining the record documenting the procedures is attributed to Rule 17g-2.

17g-8, as adopted, is approximately 1,250 hours to: (1) maintain, review, update (if necessary), and enforce an NRSRO's policies and procedures with respect to an NRSRO's procedures and methodologies to determine credit ratings; (2) maintain, review, update (if necessary), and enforce its procedures and methodologies with respect to the symbols, numbers, or scores it uses to denote credit ratings; and (3) maintain, review, update (if necessary), and enforce its policies and procedures with respect to look-back reviews and its record documenting the policies and procedures and take steps when a look-back review determines that a credit rating was influenced by a conflict.²²⁶⁶

8. New Rule 17g-9

The Commission is adopting Rule 17g-9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to determine credit ratings.²²⁶⁷

The Commission stated in the proposing release that in order to account for the significant variance in the size and complexity of NRSROs, the one-time and annual hour burden estimates attributable to Rule 17g-9 should be based on the number of credit analysts employed by the NRSROs.²²⁶⁸ Based on 2009 annual certifications, the Commission estimated that NRSROs employed approximately 3,520 credit analysts and that the one-time burden to establish the standards required under proposed Rule 17g-9 would be approximately five hours per credit analyst, resulting in an industry-wide one-time hour burden of 17,600 hours.²²⁶⁹ In addition, the Commission allocated 75% of these burden hours (13,200 hours) to internal burden and 25% of

²²⁶⁶ 500 hours + 500 hours + 250 hours = 1,250 hours. The burden associated with retaining the record documenting the procedures is attributed to Rule 17g-2.

²²⁶⁷ See section II.I.1. of this release (providing a more detailed discussion of this rule).

²²⁶⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33508.

²²⁶⁹ See id.

these burden hours (4,400 hours) to external burden to hire outside professionals to assist in setting up training programs.²²⁷⁰ The Commission stated in the proposing release that it believed that the annual hour burden to comply with Rule 17g-9 would be less than the one-time hour burden since NRSROs will have established the standards of training, experience, and competence for the individuals they employ to determine credit ratings. The Commission estimated that the industry-wide annual hour burden to update the standards and to enforce them would be approximately one hour per credit analyst employed, resulting in an industry-wide annual hour burden of approximately 3,520 hours and allocated 75% of the burden hours (2,640 hours) to internal burden and the remaining 25% of the burden hours (880 hours) to external burden.²²⁷¹ The Commission did not receive comment on these allocation percentages and is retaining them as proposed.

However, as stated above, an NRSRO objected to using the number of credit ratings or credit analysts in estimating the burdens associated with the proposal, stating that the burden must also “include the amount of legal and compliance resources necessary to implement system and simultaneous changes” and that “the investments will not be diminished relative to financial resources because an NRSRO may have fewer analysts or credit ratings issued.”²²⁷² In response to this comment, the Commission is adding to its burden estimate for Rule 17g-9 to account for burdens that do not depend on the number of credit analysts employed by an NRSRO. For example, the cost of establishing, maintaining, enforcing, and documenting standards of training, experience, and competence for credit analysts, establishing testing programs, and administering training and testing programs may not be directly proportional to the number of credit analysts

²²⁷⁰ See id.

²²⁷¹ See id.

²²⁷² See A.M. Best Letter. See also DBRS Letter.

employed by an NRSRO. The Commission believes that it is appropriate, however, to retain the burdens based on the number of credit analysts employed by NRSROs as some of the burden attributable to Rule 17g-9 (for example, the burden associated with testing credit analysts on their knowledge of the procedures and methodologies used by the NRSRO to determine credit ratings) may be proportional to the number of credit analysts employed by an NRSRO.

Based on staff experience, the Commission estimates that the additional burden attributable to Rule 17g-9 that does not depend on the number of credit analysts employed by an NRSRO is approximately 400 hours per NRSRO on a one-time basis and approximately 100 hours per NRSRO annually, for an industry-wide one-time hour burden of approximately 4,000 hours and an industry-wide annual hour burden of approximately 1,000 hours. The Commission continues to believe that it is appropriate to allocate 75% of the one-time and annual burden hours to internal burden and the remaining 25% to external burden to hire outside professionals to assist in establishing and updating credit analyst training programs. Of the totals, therefore, 3,000 hours are allocated to internal one-time burden,²²⁷³ 1,000 hours are allocated to external one-time burden,²²⁷⁴ 750 hours are allocated to internal annual burden,²²⁷⁵ and 250 hours are allocated to external annual burden.²²⁷⁶ The Commission estimated that it would cost \$400 per hour to retain outside professionals, resulting in industry-wide one-time costs of approximately \$400,000²²⁷⁷ and industry-wide annual costs of approximately \$100,000.²²⁷⁸

²²⁷³ 4,000 hours x .75 = 3,000 hours.

²²⁷⁴ 4,000 hours x .25 = 1,000 hours.

²²⁷⁵ 1,000 hours x .75 = 750 hours.

²²⁷⁶ 1,000 hours x .25 = 250 hours.

²²⁷⁷ 1,000 hours x \$400 = \$400,000. See Nationally Recognized Statistical Rating Organizations, 76 FR 33508. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506 (providing an estimate of \$400 an hour engage outside professionals).

²²⁷⁸ 250 hours x \$400 = \$100,000.

As stated above, the burdens the Commission estimated above that do not depend on the number of credit analysts are additional to the burdens that depend on the number of credit analysts. In addition, the Commission believes that the modifications to Rule 17g-9 from the proposal will not affect the burden per credit analyst or the allocation of that burden to internal and external burdens that the Commission estimated in the proposing release, as those modifications should not affect the burdens associated with establishing, maintaining, enforcing, and documenting the standards. However, the Commission is revising the total number of credit analysts employed by the NRSROs based on updated information. The Commission now estimates that NRSROs employ a total of approximately 4,218 credit analysts.²²⁷⁹ Therefore, the Commission estimates the industry-wide one-time hour burden based on the number of credit analysts employed by the NRSROs to be approximately 21,090 hours.²²⁸⁰ Of this total, 15,818 hours are allocated to internal burden and 5,272 hours are allocated to external burden.²²⁸¹ The Commission estimates that it would cost \$400 per hour for retaining outside professionals, resulting in an industry-wide one-time cost of approximately \$2,108,800.²²⁸²

Similarly, the Commission now estimates an industry-wide annual hour burden based on the number of credit analysts employed by the NRSROs of approximately 4,218 hours.²²⁸³ The Commission is allocating 75% of these burden hours (3,164 hours) to internal burden and 25% these burden hours (1,054 hours) to external burden to hire outside professionals to assist in

²²⁷⁹ See Table 1 in section I.B.2.a. of this release.

²²⁸⁰ 4,218 credit analysts x 5 hours = 21,090 hours.

²²⁸¹ 21,090 hours x 0.75 = 15,818 hours; 21,090 hours x 0.25 = 5,272 hours. These allocations remain unchanged from the Commission's preliminary allocation in the proposing release.

²²⁸² 5,272 hours x \$400 = \$2,108,800.

²²⁸³ 4,218 credit analysts x 1 hour = 4,218 hours.

reviewing and updating training and testing programs.²²⁸⁴ The Commission continues to estimate a cost of \$400 per hour for retaining outside professionals, which results in an industry-wide annual cost of \$421,600.²²⁸⁵ Finally, although larger NRSROs may realize economies of scale, the Commission believes that the industry-wide annual and one-time hour burdens and external costs would be allocated to each NRSRO based on the number of credit analysts the firm employs.²²⁸⁶

Accordingly, the Commission estimates that Rule 17g-9 will result in a total industry-wide one-time hour burden for NRSROs to establish and document the standards of training, experience, and competence for their credit analysts required under the rule and to establish testing programs of approximately 18,818 hours,²²⁸⁷ a total industry-wide one-time cost of approximately \$2,508,800 to hire outside professionals to assist in setting up training and testing programs,²²⁸⁸ a total industry-wide annual hour burden to maintain, review, update (if necessary), and enforce the standards and to administer the training and testing programs of approximately 3,914 hours,²²⁸⁹ and a total industry-wide annual external cost of approximately \$521,600 to hire outside professionals to assist in reviewing and updating training and testing programs.²²⁹⁰

²²⁸⁴ 4,218 hours x 0.75 = 3,164 hours; 4,218 hours x 0.25 = 1,054 hours.

²²⁸⁵ 1,054 hours x \$400 = \$421,600. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506 (providing an estimate of \$400 an hour engage outside professionals).

²²⁸⁶ See Table 1 in section I.B.2.a. of this release.

²²⁸⁷ 3,000 + 15,818 = 18,818.

²²⁸⁸ \$400,000 + \$2,108,800 = \$2,508,800.

²²⁸⁹ 750 + 3,164 = 3,914.

²²⁹⁰ \$100,000 + \$421,600 = \$521,600.

In addition, the Commission estimates that NRSROs will spend approximately five hours per credit analyst per year to conduct periodic testing of their credit analysts, for a total industry-wide annual hour burden to NRSROs of approximately 21,090 hours.²²⁹¹

9. New Rule 17g-10 and New Form ABS Due Diligence-15E

The Commission is adopting Rule 17g-10 and Form ABS Due Diligence-15E. Rule 17g-10 provides that the written certification a provider of third-party due diligence services must provide to an NRSRO must be made on Form ABS Due Diligence-15E.²²⁹²

In the proposing release, the Commission estimated that there would be ten providers of third-party due diligence services and each would spend an average of approximately 300 hours per firm developing certain processes and protocols to provide the required information and submit the certifications, and that 75% of these burden hours (225 hours) would be internal burden and 25% of these burden hours (75 hours) would be external burden to hire outside counsel to provide legal advice on the requirements of the new rule and form.²²⁹³ The Commission did not receive comment on these estimates. Further, the modifications to Rule 17g-10 and Form ABS Due Diligence-15E from the proposal will not impact the one-time hour burden or allocation of that burden to internal and external burdens because the modifications – which create a “safe harbor” from the requirement to provide the forms to NRSROs – do not require the third party due diligence provider to expend more effort to meet the statutory requirement because they will make the process more certain and efficient. Consequently, the processes and protocols to meet the safe harbor should be no more complex than would have been the case if the provider of third-party due diligence services had to determine each NRSRO

²²⁹¹ 4,218 credit analysts x 5 hours = 21,090 hours.

²²⁹² See sections II.H.2. and II.H.3. of this release (providing a more detailed discussion of this rule and form).

²²⁹³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33509.

that was producing a credit rating in order to provide the NRSRO with the certification as required by 15E(s)(4)(B) of the Exchange Act. For these reasons, the Commission is not revising the estimated one-time and annual hour burdens for the providers of third-party due diligence services.

However, the Commission now estimates that there are approximately fifteen providers of third-party due diligence services.²²⁹⁴ Accordingly, the Commission estimates that providers of third-party due diligence services will spend an average of approximately 300 hours per firm developing these processes and protocols, resulting in an industry-wide one-time hour burden for providers of third-party due diligence services of approximately 4,500 hours.²²⁹⁵ In addition, the Commission allocates 75% of these burden hours (3,375 hours) to internal burden and 25% of these burden hours (1,125 hours) to external burden to hire outside counsel to provide legal advice on the requirements of Rule 17g-10 and Form ABS Due Diligence-15E.²²⁹⁶ The Commission estimates \$400 per hour for external costs for retaining outside counsel, resulting in an industry-wide one-time cost of \$450,000.²²⁹⁷

With respect to the annual burden, the Commission stated in the proposing release that the estimate should be based on the number of issuances per year of Exchange Act-ABS because

²²⁹⁴ See section I.B.2.b. of this release.

²²⁹⁵ 15 providers of third-party due diligence services x 300 hours = 4,500 hours. The estimate of 300 hours remains unchanged from the Commission's preliminary estimate in the proposing release. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33509. This estimate is based on the Commission's estimate for the amount of time it would take a securitizer to set-up a system to make the disclosures required by Form ABS-15G. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506. The Commission, however, has reduced the hour estimate of 850 hours used for Form ABS-15G by approximately two-thirds because information required to be provided in proposed Form ABS Due Diligence-15E is substantially less detailed and complex than the information required in Form ABS-15G.

²²⁹⁶ 4,500 hours x 0.75 = 3,375 hours; 4,500 hours x 0.25 = 1,125 hours. This allocation remains unchanged from the Commission's preliminary allocation in the proposing release.

²²⁹⁷ 1,125 hours x \$400 = \$450,000. See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63889 (providing an estimate of \$400 per hour to engage outside counsel).

the requirement to produce the certification and provide it to NRSROs and issuers or underwriters will be triggered when an issuer, underwriter, or NRSRO hires a provider of third-party due diligence services. The Commission estimated that a provider of third-party due diligence services would spend approximately thirty minutes to complete and transmit Form ABS Due Diligence-15E and that there would be an average of 2,067 Exchange Act-ABS offerings per year, for an industry-wide annual burden of approximately 1,034 hours.²²⁹⁸ The Commission did not receive comments on this estimate. The Commission believes that the modification to the proposal creating the “safe harbor” will decrease the annual burden as compared to the burden estimated in the proposal. In particular, the provider of third-party due diligence services in many cases may need to submit only one certification to another party; namely, to the issuer or underwriter that maintains the Rule 17g-5 website. Without a safe harbor, the third party would have needed to submit the certification to each NRSRO producing a credit rating for the Exchange Act-ABS, which frequently would include two or more hired NRSROs and possibly additional non-hired NRSROs. Moreover, the certainty of meeting the “safe harbor” provisions will eliminate the additional time a third party may have spent seeking to determine whether it has identified all NRSROs producing a credit rating and provided them with the certification in accordance with its statutory obligation to provide the certification to every NRSRO rating the applicable Exchange Act-ABS. For these reasons, the Commission believes, based on staff experience, that the modifications will reduce the burden attributable to Form ABS Due Diligence-15E from thirty minutes to twenty minutes to complete and transmit Form ABS Due Diligence-15E.

²²⁹⁸

See Nationally Recognized Statistical Rating Organizations, 76 FR at 33509 (2,067 offerings x 30 minutes = 1,034 hours).

The Commission estimates that there will be 715 Exchange Act-ABS offerings per year.²²⁹⁹ For these reasons, the Commission estimates that the industry-wide annual hour burden for providers of third-party due diligence services resulting from Rule 17g-10 and Form ABS Due Diligence-15E is approximately 238 hours.²³⁰⁰

In summary, the Commission estimates that Rule 17g-10 and Form ABS Due Diligence-15E will result in a total industry-wide one-time burden for providers of third-party due diligence services to develop processes and protocols to provide the required information and submit the certifications of approximately 3,375 hours, a total industry-wide one-time cost to hire outside counsel to provide legal advice on the requirements of the new rule and form of approximately \$450,000, and a total industry-wide annual hour burden to provide the required information and submit the certifications of approximately 238 hours.

10. New Rule 15Ga-2 and Amendments to Form ABS-15G

The Commission is adopting Rule 15Ga-2 and amendments to Form ABS-15G.²³⁰¹ Rule 15Ga-2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish the Commission with a Form ABS-15G on the Commission's EDGAR system containing the findings and conclusions of any third-party "due-diligence report" obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. Under the rule, the disclosure will be furnished using Form ABS-15G for both registered and unregistered offerings of Exchange Act-ABS.

The final rule has been modified from the proposal to provide that if the disclosure required by Rule 15Ga-2 has been made in the applicable prospectus, the issuer or underwriter

²²⁹⁹ See Table 6 in section I.B.2.b. of this release.

²³⁰⁰ 715 Exchange Act-ABS offerings x 20 minutes = 238.33 hours, rounded to 238 hours.

²³⁰¹ See section II.H.1. of this release (providing a more detailed discussion of this rule and form).

may refer to that section of the prospectus in Form ABS-15G rather than providing the findings and conclusions directly in the form. It also has been modified to provide an exemption for certain offshore issuances of Exchange Act-ABS. Further, the final rule has been modified so that it does not apply to issuers or underwriters of municipal Exchange Act-ABS, but section 15E(s)(4)(A) of the Exchange Act nonetheless requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

The Commission estimated in the proposing release that the new rule and amended form would result in a one-time hour burden to issuers and underwriters in offerings of registered and unregistered Exchange Act-ABS in connection with developing processes and protocols to provide the required information to comply with the statutory disclosure requirement and Rule 15Ga-2, as applicable, including modifying their existing Form ABS-15G processes and protocols to accommodate the requirements of Rule 15Ga-2.²³⁰² The Commission also estimated that 270 unique issuers would be required to file the form.²³⁰³ Finally, the Commission estimated that each issuer would require approximately 100 hours to develop processes and protocols to comply with Rule 15Ga-2 and to modify their existing Form ABS-15G processes and protocols to provide for the disclosure of the information required pursuant to Rule 15Ga-2 and that this work would be done internally by issuers and underwriters.²³⁰⁴

²³⁰² See Nationally Recognized Statistical Rating Organizations, 76 FR at 33510.

²³⁰³ See id. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4506.

²³⁰⁴ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33510. This estimate was based on the Commission's estimate for the amount of time it would take a securitizer to set up a system to make the disclosures required by Form ABS-15G as originally adopted by the Commission. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506. The Commission, however, estimated that the hour burden for amending existing Form ABS-15G processes and protocols will be significantly lower than the estimate of 850 hours used to initially develop those processes and protocols. See Nationally Recognized Statistical

The Commission did not receive comments on these estimates. Further, the Commission does not believe the modifications to the rule from the proposal will impact the one-time burden because issuers and underwriters will still need to develop processes and protocols to provide the required information to comply with Rule 15Ga-2, or section 15E(s)(4)(A) of the Exchange Act in the case of issuers or underwriters of municipal Exchange Act-ABS, including modifying their existing Form ABS-15G processes and protocols to accommodate the requirements of Rule 15Ga-2 or the statute, as applicable. The Commission, however, is adjusting its estimate of the number of unique issuers from approximately 270 to approximately 336 unique issuers that will be required to file the form.²³⁰⁵ Moreover, this estimate includes issuers and underwriters of municipal Exchange Act-ABS because, even though these offerings are excluded from Rule 15Ga-2, the statutory disclosure requirements apply to them.²³⁰⁶ Consequently, the Commission estimates an industry-wide one-time burden of approximately 33,600 hours.²³⁰⁷

The annual PRA burden associated with Form ABS-15G reflects the burden associated with preparing and furnishing the form on EDGAR. As noted above, the amendment to Form ABS-15G will require that it be furnished by issuers and underwriters in offerings of certain registered and unregistered Exchange Act-ABS. Consequently, the Commission believes that the estimate of the annual hour burden for furnishing Form ABS-15G should be based on an estimate of the number of Exchange Act-ABS offerings per year. In the proposing release, the

Rating Organizations, 76 FR at 33510, n.1069.

²³⁰⁵ See Table 6 in section I.B.2.b. of this release. The Commission recognizes that underwriters also have a requirement to furnish Form ABS-15G. However, for purposes of calculating PRA numbers, this discussion is limited to issuers because, as discussed above in section II.H.1. of this release, only a single Form ABS-15G is required to be furnished when the issuer and/or one or more underwriters have obtained the same third-party due diligence report. See paragraph (b) of Rule 15Ga-2.

²³⁰⁶ Based on the Asset-Backed Alert database, the Commission estimates there were nine unique sponsors of municipal Exchange Act-ABS in 2013.

²³⁰⁷ 336 unique issuers x 100 hours = 33,600 hours.

Commission estimated that, on average, there would be approximately 2,067 Exchange Act-ABS offerings per year.²³⁰⁸ As discussed above, the Commission now estimates that there will be approximately 715 Exchange Act-ABS offerings.²³⁰⁹ Further, the exemption for certain foreign issued Exchange Act-ABS should reduce the number of Exchange Act-ABS offerings that trigger the disclosure requirement. However, to be conservative, the Commission is retaining its estimate of 2,067 Exchange Act offerings per year for purposes of the burden estimates. Moreover, this estimate includes offerings of municipal Exchange Act-ABS because, even though these offerings are excluded from Rule 15Ga-2, the statutory disclosure requirement does apply to them.²³¹⁰

In the proposing release, the Commission estimated that an issuer or underwriter would spend approximately one hour completing and submitting Form ABS-15G for purposes of meeting the requirement in Rule 15Ga-2 and that this work would be performed internally.²³¹¹ The Commission based this estimate on the fact that Form ABS-15G will elicit much less information when used solely for the purpose of complying with Rule 15Ga-2.²³¹² In addition, the Commission based this estimate on the fact that the information required in the form could be

²³⁰⁸ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33510. See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4508. As noted above, issuers, underwriters, and NRSROs may not use providers of third-party due diligence services with respect to every issuance of Exchange Act-ABS. For example, the Commission believes that providers of third-party due diligence services are used primarily for RMBS transactions. See Nationally Recognized Statistical Rating Organizations, 76 FR at 33471. However, the Commission's estimate uses the total number of estimated Exchange Act-ABS offerings (as opposed to a lesser amount based on an estimate of RMBS offerings) because the use of providers of third-party due diligence services may migrate to other types of Exchange Act-ABS.

²³⁰⁹ See Table 6 in section I.B.2.b. of this release.

²³¹⁰ Based on the Asset-Backed Alert database, the Commission estimates there were eleven separate offerings of municipal Exchange Act-ABS in 2013.

²³¹¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33510.

²³¹² See *id.* See also Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507 (estimating thirty hours to prepare the form when filed pursuant to Rule 15Ga-1).

drawn directly from the due diligence reports the Commission expects providers of third-party due diligence services to generate with respect to their performance of due diligence services.²³¹³

The Commission did not receive comments on these estimates. The Commission believes that the modification to the proposal providing that issuers and underwriters will not need to provide the findings and conclusions directly in Form ABS-15G if the Rule 15Ga-2 disclosures are included in the applicable prospectus may decrease slightly the hour burden for issuers and underwriters. However, this reduction in burden could be offset to the extent that issuers and underwriters decide that they should keep a record to support their reliance on the off-shore exemption and because the Commission eliminated the proposed ability for an issuer or underwriter to rely on a representation from an NRSRO. Further, although Rule 15Ga-2 excludes issuers and underwriters of municipal Exchange Act-ABS, issuers and underwriters of these securities will still incur costs to comply with the statutory disclosure obligation. Based on staff experience, the Commission estimates that many of these issuers and underwriters are likely to satisfy this obligation by furnishing Form ABS-15G on EMMA and that the time to prepare and submit the form will be one hour (the same as the time to prepare and submit the form on EDGAR). However, to the extent that these issuers and underwriters use another means to make the required information publicly available, such as through a website, the burden could be incrementally more or less, depending on the method chosen to disclose the information. Accordingly, the Commission estimates that the industry-wide annual hour burden resulting from Rule 15Ga-2 and the amendments to Form ABS-15G is approximately 715 hours.²³¹⁴

For the foregoing reasons, the Commission estimates that Rule 15Ga-2, the amendments to Form ABS-15G, and section 15E(s)(4)(A) of the Exchange Act will result in a total industry-

²³¹³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33510.

²³¹⁴ 715 Exchange Act-ABS transactions x 1 hour = 715 hours.

wide one-time hour burden to develop processes and protocols to provide the required information to comply with Rule 15Ga-2 and/or section 15E(s)(4)(A), including modifying their existing Form ABS-15G processes and protocols to accommodate the requirements of Rule 15Ga-2, of approximately 33,600 hours and a total industry-wide annual hour burden to prepare and make the required disclosures of approximately 715 hours for issuers and underwriters.

11. Amendments to Regulation S-T

The Commission is requiring that certain Forms NRSRO (and applicable exhibits to the form) and all Rule 17g-3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system.²³¹⁵ In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S-T to require the electronic submission using the EDGAR system of Form NRSRO (and applicable exhibits to the form) pursuant to paragraphs (e), (f), and (g) of Rule 17g-1 and annual reports pursuant to Rule 17g-3.²³¹⁶

The Commission is adopting Rule 15Ga-2, which will require an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS-15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.²³¹⁷

The amendments revise Regulation S-T. However, the collection of information requirements are reflected in the burden hours estimated for Rule 17g-1 and Rule 15Ga-2. The rules in Regulation S-T do not impose any separate burden. Consistent with historical practice, the Commission has retained an estimate of one burden hour to Regulation S-T for administrative convenience.

²³¹⁵ The Commission is allocating the one-time and annual hour burdens and costs of these requirements solely to Rule 17g-1. See section IV.D.1. of this release.

²³¹⁶ See section II.L. of this release (providing a more detailed discussion of this amendment).

²³¹⁷ See section II.H.1. of this release (providing a more detailed discussion of this rule and form).

12. Form ID

NRSROs will need to file a Form ID with the Commission in order to gain access to the EDGAR system. Form ID is used to request the assignment of access codes to make submissions on EDGAR. The current OMB approved hour burden for Form ID is fifteen minutes per respondent.²³¹⁸ Thus, the Commission estimates that the total industry-wide one-time hour burden resulting from filing Form ID will be approximately two and a half hours.²³¹⁹

The Commission believes that the issuers and underwriters of Exchange Act-ABS that will need to furnish Form ABS-15G to the Commission through the EDGAR system pursuant to proposed Rule 15Ga-2 already have access to the EDGAR system because, for example, they need such access for the purpose of Rule 15Ga-1. Consequently, they will not need to execute and file Form ID as a result of Rule 15Ga-2.

13. Total Paperwork Burdens

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for NRSRO respondents resulting from the rule amendments and new rules will be approximately 74,062 industry-wide one-time hours,²³²⁰ \$7,908,800 industry-wide external one-time costs,²³²¹ 725,456 industry-wide annual hours,²³²² and \$725,600 industry-wide external annual costs.²³²³ In addition, as discussed above, the Commission estimates that the burden resulting from a request for an exemption under paragraph (f) of Rule 17g-5 will be approximately 150 hours in internal burden and \$20,000 in external costs; and the burden

²³¹⁸ See Form ID (OMB Number 3235-0328).

²³¹⁹ 10 NRSROs x 15 minutes = 150 minutes; 150 minutes/60 minutes = 2.5 hours.

²³²⁰ $690 + 2,531 + 200 + 6,720 + 1,250 + 37,500 + 1,350 + 5,000 + 18,818 + 2.5 = 74,061.5$, rounded to 74,062.

²³²¹ $\$400,000 + \$5,000,000 + \$2,508,800 = \$7,908,800$.

²³²² $690 + 1,015 + 50 + 1,650 + 695,347 + 450 + 1,250 + 3,914 + 21,090 = 725,456$.

²³²³ $\$4,000 + \$200,000 + \$521,600 = \$725,600$.

resulting from publishing information about material changes to an NRSRO's credit rating procedures and methodologies or a notice of significant errors identified in a procedure or methodology as described in paragraph (a)(4) of Rule 17g-8 will be approximately twenty hours in internal burden.

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for respondents that are providers of third-party due diligence services resulting from the rule amendments and new rules will be approximately 3,375 industry-wide one-time hours, \$450,000 industry-wide external one-time costs, and 238 industry-wide annual hours.

Based on the foregoing, the Commission estimates that the total burden for purposes of the PRA for issuer and underwriter respondents resulting from the rule amendments and new rules will be approximately 33,600 industry-wide one-time hours and 834 industry-wide annual hours.²³²⁴

E. COLLECTION OF INFORMATION IS MANDATORY

The collections of information pursuant to the rule amendments and new rules are mandatory, as applicable, for NRSROs, providers of third-party due diligence services, and issuers and underwriters.

F. CONFIDENTIALITY

The Forms ABS-15G furnished to the Commission by issuers and underwriters of offerings of asset-backed securities under Rule 15Ga-2 will be publicly available on the Commission's EDGAR system.

The Forms NRSRO and Exhibits 1 through 9 to the form an NRSRO must submit to the Commission electronically under the amendments to Rule 17g-1, Form NRSRO, and Regulation

²³²⁴

119 + 715 = 834.

S-T will be publicly available on the Commission's EDGAR system. In addition, an NRSRO must make its current Form NRSRO and Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet website and must make its most recently filed Exhibit 1 freely available in writing to any individual who requests a copy under Rule 17g-1, as amended.

The records that an NRSRO must make and retain or retain under the amendments to Rule 17g-2 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

The annual internal controls report an NRSRO must file with the Commission under amendments to Rule 17g-3 will be generated from the internal records of the NRSRO. Under paragraph (e) to Rule 17g-3, information in a report filed under Rule 17g-3 on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be afforded confidential treatment to the extent permitted by law.

The Forms ABS Due Diligence-15E that an issuer, sponsor, or underwriter of an asset-backed security posts on the password-protected Rule 17g-5 website under the amendments to Rule 17g-5 will be made available to other NRSROs that provide the Commission with a certification agreeing, among other things, to keep the information confidential. The representations the issuer, sponsor, or underwriter provides to the NRSRO regarding the Rule 17g-5 website will not be made public, unless the parties choose to make them public.

An NRSRO may need to update its policies and procedures to address and manage conflicts of interest in connection with the new absolutely prohibited conflict related to sales and marketing in Rule 17g-5. An NRSRO is required to disclose its policies and procedures for addressing and managing conflicts of interest in Exhibit 7 to Form NRSRO. An NRSRO

submitting an application for an exemption from the new absolutely prohibited conflict may request that the application be afforded confidential treatment for a specified period of time, not exceeding 120 days from the date of the Commission's response.²³²⁵ Otherwise, the application for an exemption must be made public as soon as practicable after the response has been sent or given to the NRSRO requesting it.²³²⁶ If the Commission grants an exemption, the Commission order granting the exemption will be publicly available on the Commission's website.

The form and certifications an NRSRO must publish when taking certain rating actions under paragraph (a) of Rule 17g-7 must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating. An NRSRO must publicly disclose credit rating histories under paragraph (b) of Rule 17g-7 for free on an easily accessible portion of its Internet website.

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to its procedures and methodologies to determine credit ratings under paragraph (a) of Rule 17g-8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. These policies and procedures will be made public to the extent that an NRSRO is required to include them in Exhibit 2 to Form NRSRO, which requires a general description of the procedures and methodologies used by the NRSRO to determine credit ratings. In addition, under paragraph (a) of Rule 17g-8, an NRSRO must have policies and procedures reasonably designed to ensure that it promptly publishes on its Internet website material changes to the policies and procedures and notice of a significant error in a procedure or methodology that may result in a change to current credit ratings.

²³²⁵ See 17 CFR 200.81(b).

²³²⁶ See 17 CFR 200.81(a).

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to credit rating symbols under paragraph (b) of Rule 17g-8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. Under paragraph (b) of Rule 17g-8, an NRSRO must have policies and procedures reasonably designed to include definitions of its credit rating symbols in Exhibit 1 to Form NRSRO, which is publicly available.

The policies and procedures an NRSRO must establish, maintain, enforce, and document with respect to look-back reviews under paragraph (c) of Rule 17g-8 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings. If a look-back review determines that a credit rating was influenced by a conflict of interest, an NRSRO must promptly publish a revised credit rating or an affirmation of the credit rating, as appropriate, which must be published in the same manner as the credit rating that is the result or subject of the revision or affirmation and made available to the same persons who can receive or access the credit rating.

The standards of training, experience, and competence an NRSRO must establish, maintain, enforce, and document under Rule 17g-9 will be made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

Forms ABS Due Diligence-15E that third-party due diligence providers must provide to an NRSRO that produces a credit rating of an Exchange Act-ABS to which the due diligence services relate and to the issuer or underwriter of the security that maintains the Rule 17g-5 website must be published by the NRSRO with certain rating actions, including initial credit ratings, in the same manner as the credit rating that is the result or

subject of the rating action and made available to the same persons who can receive or access the credit rating under paragraph (a) of Rule 17g-7.

G. RETENTION PERIOD OF RECORDKEEPING REQUIREMENTS

The records that must be retained by an NRSRO under paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g-2 must be retained until three years after the date the record is replaced with an updated record. All other records that an NRSRO must retain under Rule 17g-2 must be retained for three years after the record is made or received.²³²⁷

There are no record retention requirements for providers of third-party due diligence services or for the records issuers and underwriters are required to make and furnish to the Commission pursuant to the requirements in Rule 15Ga-2 and the amendments to Form ABS-15G.

V. IMPLEMENTATION AND ANNUAL COMPLIANCE CONSIDERATIONS

The purpose of this section is to present the Commission's estimate of the costs of the PRA burdens attributable to the amendments and new rules being adopting today. As indicated in the discussion below, these costs include monetizations of PRA hour burdens and PRA external costs estimated in section IV.D. of this release. The costs included in this section are also noted and discussed in the focused economic analyses in section II of this release.²³²⁸

A. INTERNAL CONTROL STRUCTURE

The Commission is adding paragraph (a)(7) to Rule 17g-3. This paragraph requires an NRSRO to include an additional report – a report on the NRSRO's internal control structure established under section 15E(c)(3)(A) of the Exchange Act – with its annual submission of

²³²⁷ See paragraph (c) of Rule 17g-2 as adopted.

²³²⁸ The focused economic analyses are provided in sections II.A.4., II.B.4., II.C.3., II.D.2., II.E.4., II.F.3., II.G.6., II.H.4., II.I.3., II.J.3., II.K.2., II.L.2., and II.M.5. of this release. These sections cross-reference the costs estimated in this section.

reports to the Commission pursuant to Rule 17g-3, and is amending paragraph (b) of Rule 17g-3 to require the NRSRO's CEO or, if the firm does not have a CEO, an individual performing similar functions, to provide a signed statement that must be attached to the report.²³²⁹ The Commission estimates that paragraph (a)(7) of Rule 17g-3 and the amendment to paragraph (b) of Rule 17g-3 will result in total industry-wide one-time costs for NRSROs to engage outside counsel to analyze the requirements for the internal controls report of approximately \$400,000²³³⁰ and total industry-wide annual costs for NRSROs to prepare the internal controls report and to engage outside counsel to assist in the preparation of the report of approximately \$667,000.²³³¹

The Commission is adding paragraph (b)(12) to Rule 17g-2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document under section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.²³³² Under the amendments to paragraph (c) of Rule 17g-2, the record must be retained until three years after the date the record is replaced with an updated record. The Commission estimates that paragraph (b)(12) of Rule 17g-2 will result in total industry-wide one-time costs for NRSROs to update their record retention policies and procedures to incorporate the new record of approximately \$12,000²³³³ and total industry-wide annual costs for NRSROs to retain the record of approximately \$3,000.²³³⁴

²³²⁹ See section II.A.3. of this release (providing a more detailed discussion of this amendment); section II.A.4. of this release (providing a focused economic analysis for this amendment).

²³³⁰ See section IV.D.4. of this release (PRA analysis providing cost and hour burden estimates). The internal cost to the NRSRO to prepare and file the first internal controls report is included in the annual cost.

²³³¹ 1,650 hours x \$283 per hour for a compliance manager = \$466,950 + \$200,000 = \$666,950, rounded to \$667,000. See section IV.D.4. of this release (PRA analysis providing cost and hour burden estimates). As noted earlier, the salary figures provided in this release are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for a 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

²³³² See section II.A.2. of this release (providing a more detailed discussion of this amendment) section II.A.4. of this release (providing a focused economic analysis for this amendment).

²³³³ 200 hours/5 records = 40 hours x \$291 per hour for a senior systems analyst = \$11,640, rounded to

B. CONFLICTS OF INTEREST RELATING TO SALES AND MARKETING

The Commission is adding paragraph (c)(8) to Rule 17g-5. This paragraph prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.²³³⁵ The Commission is also adding paragraph (f) to Rule 17g-5, which provides that upon written application by an NRSRO the Commission may exempt, either unconditionally or on specified terms and conditions, the NRSRO from paragraph (c)(8) of Rule 17g-5 if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation of the production of credit ratings from sales and marketing activities and the exemption is in the public interest.²³³⁶ The Commission estimates that paragraph (c)(8) of Rule 17g-5 will impose total industry-wide one-time costs for NRSROs to update the NRSRO's conflicts of interest policies and procedures and to prepare and file an update of registration to account for the update of the written policies and procedures of approximately \$354,000.²³³⁷

\$12,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³³⁴ 50 hours/5 records = 10 hours x \$291 per hour for a senior systems analyst = \$2,910, rounded to \$3,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³³⁵ See section II.B.1. of this release (providing a more detailed discussion of this amendment); section II.B.4. of this release (providing a focused economic analysis for this amendment).

²³³⁶ See section II.B.2. of this release (providing a more detailed discussion of this provision); section II.B.4. of this release (providing a focused economic analysis for this amendment).

²³³⁷ 1,250 hours x \$283 per hour for a compliance manager = \$353,750, rounded to \$354,000. See section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

The Commission also estimates that the cost of drafting and submitting a written application to the Commission under paragraph (f) of Rule 17g-5, including the cost of engaging outside counsel to assist in drafting the application, would be approximately \$62,000.²³³⁸

C. “LOOK-BACK” REVIEW

The Commission is adopting Rule 17g-8. Paragraph (c) of the rule contains requirements relating to the policies and procedures with respect to look-back reviews an NRSRO must establish, maintain, and enforce under section 15E(h)(4)(A) of the Exchange Act.²³³⁹ The Commission is also adding paragraph (a)(9) to Rule 17g-2 to identify the policies and procedures of an NRSRO with respect to look-back reviews as a record that must be made and retained.²³⁴⁰ The Commission estimates that paragraph (c) of Rule 17g-8 will result in total industry-wide one-time costs for NRSROs to establish and make a record of the policies and procedures of approximately \$283,000²³⁴¹ and total industry-wide annual costs for NRSROs of approximately \$71,000²³⁴² to review, to update (if necessary) the policies and procedures and the record documenting the policies and procedures, to maintain and enforce the policies and procedures, and to take steps pursuant to the policies and procedures when a look-back review determines that a credit rating was influenced by a conflict.

²³³⁸ 150 hours x \$283 per hour for a compliance manager = \$42,450 + \$20,000 to engage outside counsel = \$62,450, rounded to \$62,000. See section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

²³³⁹ See section II.C.1. of this release (providing a more detailed discussion of this paragraph); section II.C.3. of this release (providing a focused economic analysis for the requirements of this paragraph).

²³⁴⁰ See section II.C.2. of this release (providing a more detailed discussion of this amendment); section II.C.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g-2, the record must be retained until three years after the date it is replaced with an updated record.

²³⁴¹ 1,000 hours x \$283 per hour for a compliance manager = \$283,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

²³⁴² 250 hours x \$283 per hour for a compliance manager = \$70,750, rounded to \$71,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

The Commission estimates that paragraph (a)(9) of Rule 17g-2 will result in total industry-wide one-time costs for an NRSRO to update its record retention policies and procedures to incorporate the new record of approximately \$12,000²³⁴³ and total industry-wide annual costs for an NRSRO to retain the record of approximately \$3,000.²³⁴⁴

D. FINES AND OTHER PENALTIES

The Commission is amending the instructions for Form NRSRO by adding instruction A.10, which provides notice to credit rating agencies applying for registration as NRSROs and NRSROs that an NRSRO is subject to the fine and penalty provisions and other available sanctions in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act for violations of the securities laws.²³⁴⁵ The Commission believes that this amendment will not result in additional regulatory obligations for NRSROs.

E. ENHANCEMENTS TO DISCLOSURES OF PERFORMANCE STATISTICS

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.²³⁴⁶ The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the Exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample “Transition/Default Matrix.” The amendments also will enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured

²³⁴³ 200 hours/5 records = 40 hours x \$291 per hour for a senior systems analyst = \$11,640, rounded to \$12,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁴⁴ 50 hours/5 records = 10 hours x \$291 per hour for a senior systems analyst = \$2,910, rounded to \$3,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁴⁵ See section II.D. of this release (providing a more detailed discussion of this amendment).

²³⁴⁶ See section II.E.1. of this release (providing a more detailed discussion of the amendments) section II.E.4. of this release (providing a focused economic analysis for these amendments).

finance products and for credit ratings where the obligor or obligation paid off or the credit rating was withdrawn for reasons other than a default or the obligor or obligation paying off.

The Commission estimates that the amendments to the instructions for Exhibit 1 requiring standardized “Transition/Default Matrices” and prescribing the method of calculating transition and default rates will result in total industry-wide one-time costs for NRSROs to establish systems for determining performance statistics according to the amended instructions of approximately \$737,000²³⁴⁷ and total industry-wide annual costs for NRSROs to calculate and format the performance statistics according to the amended instructions for Exhibit 1 of approximately \$295,000.²³⁴⁸ The costs associated with calculating and presenting these performance statistics will depend in part on the number of obligors, securities, and money market instruments assigned credit ratings by the NRSRO.

Under the amendments to paragraph (i) of Rule 17g-1, NRSROs are required to make Form NRSRO and Exhibits 1 through 9 freely available on an easily accessible portion of their corporate Internet website and to provide a paper copy of Exhibit 1 to individuals who request a paper copy.²³⁴⁹ The Commission estimates that re-configuring a corporate Internet website for this purpose will result in total industry-wide one-time costs for NRSROs of approximately \$10,000.²³⁵⁰ The Commission estimates that the requirement to send a paper copy of Exhibit 1 on request will result in total industry-wide costs for NRSROs to establish procedures and protocols for receiving and processing requests for a paper copy of Exhibit 1 of approximately

²³⁴⁷ 2,531 hours x \$291 per hour for a senior systems analyst = \$736,521, rounded to \$737,000. See section IV.D.2. of this release (PRA analysis providing cost and hour burden estimates).

²³⁴⁸ 1,015 hours x \$291 per hour for a senior systems analyst = \$295,365, rounded to \$295,000. See section IV.D.2. of this release (PRA analysis providing cost and hour burden estimates).

²³⁴⁹ See section II.E.2. of this release (providing a more detailed discussion of this amendment); section II.E.4. of this release (providing a focused economic analysis for this amendment).

²³⁵⁰ 50 hours x \$207 per hour for a webmaster = \$10,350, rounded to \$10,000. See section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

\$140,000²³⁵¹ and total industry-wide annual costs for NRSROs to process requests for a paper copy of Exhibit 1 and for postage costs to send the paper copy of approximately \$121,000.²³⁵²

F. ENHANCEMENTS TO RATING HISTORIES DISCLOSURES

The Commission is amending Rule 17g-7 to recodify, in paragraph (b) of Rule 17g-7, the requirements for NRSROs to disclose credit rating histories formerly prescribed in paragraph (d)(3) of Rule 17g-2 and to substantially enhance the requirements.²³⁵³ Paragraph (b) of Rule 17g-7 also increases the amount of information that must be disclosed by expanding the scope of the credit ratings that must be included in the histories and by adding additional data elements that must be disclosed in the rating history for a particular credit rating.

The Commission estimates that the amendments will result in total industry-wide one-time costs for NRSROs registered with the Commission to program existing systems and initially add the ratings histories for all applicable outstanding credit ratings of approximately \$393,000²³⁵⁴ and total industry-wide annual costs to comply with the increased requirements, including updating and administering the database, of approximately \$131,000.²³⁵⁵

G. CREDIT RATING METHODOLOGIES

The Commission is adopting Rule 17g-8. Paragraph (a) of the rule requires an NRSRO to have policies and procedures with respect to the procedures and methodologies the NRSRO

²³⁵¹ 480 hours x \$291 per hour for a senior systems analyst = \$139,680, rounded to \$140,000. See section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

²³⁵² 670 hours x \$175 per hour for a paralegal = \$117,250, rounded to \$117,000 + \$4,000 for postage = \$121,000. See section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

²³⁵³ See section II.E.3. of this release (providing a more detailed discussion of this amendment); section II.E.4. of this release (providing a focused economic analysis for this amendment).

²³⁵⁴ 1,350 hours x \$291 per hour for a senior systems analyst = \$392,850, rounded to \$393,000. See section IV.D.6. of this release (PRA analysis providing for cost and hour burden estimates).

²³⁵⁵ 450 hours x \$291 per hour for a senior systems analyst = \$130,950, rounded to \$131,000. See section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

uses to determine credit ratings.²³⁵⁶ The Commission estimates that this requirement will result in total industry-wide one-time costs for NRSROs of approximately \$566,000²³⁵⁷ to establish and document the policies and procedures and total industry-wide annual costs for NRSROs to maintain, review, update (if necessary), and enforce the policies and procedures of approximately \$142,000.²³⁵⁸

In addition, the Commission estimates that an NRSRO will spend an average of approximately \$5,700²³⁵⁹ to promptly publish on an easily accessible portion of its website information about material changes to procedures and methodologies and the likelihood such changes will result in changes to any current ratings, or notice of significant errors identified in a procedure or methodology.

The Commission is adding paragraph (b)(13) to Rule 17g-2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO must establish, maintain, enforce and document pursuant to paragraph (a) of Rule 17g-8 as a record that must be retained.²³⁶⁰ The Commission estimates that paragraph (b)(13) of Rule 17g-2 will result in total industry-wide one-time costs for an NRSRO to update its record

²³⁵⁶ See section II.F.1. of this release (providing a more detailed discussion of this paragraph); section II.F.3. of this release (providing a focused economic analysis for the requirements of this paragraph).

²³⁵⁷ 2,000 hours x \$283 per hour for a compliance manager = \$566,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

²³⁵⁸ 500 hours x \$273 per hour for a compliance manager = \$136,500, rounded to \$137,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

²³⁵⁹ 20 hours x \$283 per hour for a compliance manager = \$5,660, rounded to \$5,700. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

²³⁶⁰ See section II.F.2. of this release (providing a more detailed discussion of this amendment) section II.F.3. of this release (providing a focused economic analysis for the requirements of this paragraph). Under the amendments to paragraph (c) of Rule 17g-2, the record must be retained until three years after it is replaced with an updated record.

retention policies and procedures to incorporate the new record of approximately \$12,000²³⁶¹ and total industry-wide annual costs for an NRSRO to retain the record of approximately \$3,000.

H. FORM AND CERTIFICATION TO ACCOMPANY CREDIT RATINGS

The Commission is amending paragraph (a) of Rule 17g-7 to require NRSROs, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action and any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.²³⁶² The Commission estimates that the amendments will result in total industry-wide one-time costs for NRSROs of approximately \$15,613,000 to develop the standardized disclosures and create the systems, protocols, and procedures for populating the form with information generated and collected during the rating process, including the cost of engaging outside professionals (counsel and information technology consultants) to assist in developing the standardized disclosures and creating the systems, protocols, and procedures for populating the form with information generated and collected during the rating process,²³⁶³ and total industry-wide annual costs for NRSROs of approximately \$196,783,000 to update standardized disclosures, to tailor disclosures to particular rating actions and asset classes, and to generate and publish each form and attach the required certifications to the form.²³⁶⁴

²³⁶¹ 200 hours/5 records = 40 hours x \$291 per hour for a senior systems analyst = \$11,640, rounded to \$12,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁶² See section II.G. of this release (providing a more detailed discussion of this amendment); section II.F.3. of this release (providing a focused economic analysis for the requirements of this amendment).

²³⁶³ 37,500 hours x \$283 per hour for a compliance manager = \$10,612,500; \$10,612,500 + \$5,000,000 to engage outside professionals = \$15,612,500, rounded to \$15,613,000. See section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

²³⁶⁴ 695,347 hours x \$283 per hour for a compliance manager = \$ 196,783,201, rounded to \$196,783,000. See section IV.D.6. of this release (PRA analysis providing cost and hour burden estimates).

I. NEW RULE 15Ga-2 AND AMENDMENTS TO FORM ABS-15G

The Commission is adopting Rule 15Ga-2 and amendments to Form ABS-15G. Rule 15Ga-2 generally requires an issuer or underwriter of any Exchange Act-ABS that is to be rated by an NRSRO to furnish a Form ABS-15G on the EDGAR system containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.²³⁶⁵ The rule does not apply to issuers or underwriters of municipal Exchange Act-ABS but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

The Commission estimates that Rule 15Ga-2 and amendments to Form ABS-15G will result in total industry-wide one-time costs for issuers and underwriters to develop processes and protocols to provide the required information to comply with Rule 15Ga-2 and/or section 15E(s)(4)(A) of the Exchange Act, including modifying their existing Form ABS-15G processes and protocols to accommodate the requirements of Rule 15Ga-2, of approximately \$9,509,000²³⁶⁶ and total industry-wide annual costs for issuers and underwriters to make the disclosures as required by Rule 15Ga-2 and/or section 15E(s)(4)(A) of the Exchange Act of approximately \$202,000.²³⁶⁷

J. NEW RULE 17g-10 AND NEW FORM ABS DUE DILIGENCE-15E

²³⁶⁵ See section II.H.1. of this release (providing a more detailed discussion of this rule and form); section II.H.4. of this release (providing a focused economic analysis for the requirements of this rule and form).

²³⁶⁶ 33,600 hours x \$283 per hour for a compliance manager = \$9,508,800, rounded to \$9,509,000. See section IV.D.10. of this release (PRA analysis providing cost and hour burden estimates).

²³⁶⁷ 715 hours x \$283 per hour for a compliance manager = \$ 202,345, rounded to \$202,000. See section IV.D.10. of this release (PRA analysis providing cost and hour burden estimates).

The Commission is adopting Rule 17g-10 and Form ABS Due Diligence-15E, which requires that the written certification a provider of third-party due diligence services must provide to an NRSRO be made on Form ABS Due Diligence-15E.²³⁶⁸

The Commission estimates that Rule 17g-10 and Form ABS Due Diligence-15E will result in total industry-wide one-time costs for providers of third-party due diligence services of approximately \$1,405,000²³⁶⁹ to develop processes and protocols to provide the required information and submit the certifications and to hire outside counsel to provide legal advice on the requirements of the new rule and form and total industry-wide annual costs for providers of third-party due diligence services of approximately \$67,000²³⁷⁰ to provide the required information and submit the certifications.

The Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g-5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due Diligence-15E delivered by a person employed to provide third-party due diligence services with respect to the security.²³⁷¹ This provision, which was not included in the proposal, may require redrafting of NRSRO agreement templates. In addition, issuers, sponsors and underwriters will incur recurring costs resulting from posting the certifications to the Rule 17g-5 website. The Commission estimates paragraph (a)(3)(iii)(E) of Rule 17g-5 will result in total industry-wide one-time costs for NRSROs of approximately

²³⁶⁸ See section II.H.2. and section II.H.3. of this release (providing a more detailed discussion of this rule and form).

²³⁶⁹ 3,375 hours x \$283 per hour for a compliance manager = \$955,125; \$955,125 + \$450,000 to engage outside counsel = \$1,405,125, rounded to \$1,405,000. See section IV.D.9. of this release (PRA analysis providing cost and hour burden estimates).

²³⁷⁰ 238 hours x \$283 per hour for a compliance manager = \$67,354, rounded to \$67,000. See section IV.D.9. of this release (PRA analysis providing cost and hour burden estimates).

²³⁷¹ See sections II.G.5. and II.H.2. of this release (providing a more detailed discussion of this provision).

\$1,902,000²³⁷² to redraft the agreement templates they use with respect to obtaining representations from issuers, sponsors, or underwriters as required under Rule 17g-5 and total industry-wide annual costs for issuers, sponsors, and underwriters of approximately \$34,000 to upload each form and post it to the website.²³⁷³

K. STANDARDS OF TRAINING, EXPERIENCE, AND COMPETENCE

The Commission is adopting Rule 17g-9, which requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes of credit ratings for which the NRSRO is registered.²³⁷⁴

The Commission estimates that Rule 17g-9 will result in total industry-wide one-time costs for NRSROs to establish and document the standards of training, experience, and competence for their credit analysts required under the rule and to establish testing programs, including the cost to hire outside professionals to assist in setting up training and testing programs, of approximately \$7,834,000²³⁷⁵ and total industry-wide annual costs for NRSROs of approximately \$1,629,000 to maintain, review, update (if necessary), and enforce the standards and to administer the training and testing programs, including the cost to hire outside

²³⁷² 6,720 hours x \$283 per hour for a compliance manager = \$1,901,760, rounded to \$1,902,000. See section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

²³⁷³ 119 hours x \$283 per hour for a compliance manager = \$33,677, rounded to \$34,000. See section IV.D.5. of this release (PRA analysis providing cost and hour burden estimates).

²³⁷⁴ See section II.I.1. of this release (providing a more detailed discussion of this rule); section II.I.3. of this release (providing a focused economic analysis for the requirements of this rule).

²³⁷⁵ 18,818 hours x \$283 per hour for a compliance manager = \$5,325,494; \$5,325,494 + \$2,508,800 to engage outside professionals = \$7,834,294, rounded to \$7,834,000. See section IV.D.8. of this release (PRA analysis providing cost and hour burden estimates).

professionals to assist in reviewing and updating training and testing programs.²³⁷⁶ In addition, the Commission estimates that Rule 17g-9 will result in total industry-wide annual costs for NRSROs to conduct periodic testing of their credit analysts of approximately \$5,990,000.²³⁷⁷

The Commission is adding paragraph (b)(15) of Rule 17g-2 to identify the records documenting the standards of training, experience, and competence as a record that must be retained.²³⁷⁸ The Commission estimates that paragraph (b)(15) of Rule 17g-2 will result in total industry-wide one-time costs for NRSROs of approximately \$12,000²³⁷⁹ and total industry-wide annual costs for NRSROs of approximately \$3,000.²³⁸⁰

L. UNIVERSAL RATING SYMBOLS

The Commission is adopting paragraph (b) of Rule 17g-8, which requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.²³⁸¹ The Commission estimates that paragraph (b) of Rule 17g-8 will result in total industry-wide one-time costs for NRSROs to establish and document the policies and procedures of approximately \$566,000²³⁸² and total industry-wide annual costs for NRSROs of

²³⁷⁶ 3,914 hours x \$283 per hour for a compliance manager = \$1,107,662; \$1,107,662 + \$521,600 to engage outside professionals = \$1,629,262, rounded to \$1,629,000. See section IV.D.8. of this release (PRA analysis providing cost and hour burden estimates).

²³⁷⁷ 21,090 hours x \$284 per hour for a fixed income research analyst (intermediate) = \$5,989,560, rounded to \$5,990,000.

²³⁷⁸ See section II.I.2. of this release (providing a more detailed discussion of this amendment); section II.I.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g-2, the record must be retained until three years after the date the record is replaced with an updated record.

²³⁷⁹ 200 hours/5 records = 40 hours x \$291 per hour for a senior systems analyst = \$11,640, rounded to \$12,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁸⁰ 50 hours/5 records = 10 hours x \$291 per hour for a senior systems analyst = \$2,910, rounded to \$3,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁸¹ See section II.J.1. of this release (providing a more detailed discussion of this paragraph); section II.I.3. of this release (providing a focused economic analysis for this the requirements of this paragraph).

²³⁸² 2,000 hours x \$283 per hour for a compliance manager = \$566,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

approximately \$142,000 to maintain, review, update (if necessary), and enforce the policies and procedures.²³⁸³

The Commission is adding paragraph (b)(14) to Rule 17g-2 to identify the policies and procedures with respect to credit rating symbols, numbers, or scores an NRSRO must establish, maintain, enforce, and document under paragraph (b) of Rule 17g-8 as a record that must be retained.²³⁸⁴ The Commission estimates that paragraph (b)(14) of Rule 17g-2 will result in total industry-wide one-time costs for NRSROs of approximately \$12,000²³⁸⁵ and total industry-wide annual costs for NRSROs of approximately \$3,000.²³⁸⁶

M. ELECTRONIC SUBMISSION OF FORM NRSRO AND THE RULE 17G-3 ANNUAL REPORTS

The Commission is amending Rule 17g-1, the Instructions to Form NRSRO, Rule 17g-3, and Regulation S-T to require that the annual reports under Rule 17g-3 and a Form NRSRO and Exhibits 1 through 9 to Form NRSRO under paragraph (e), (f), or (g) of Rule 17g-1 (an update of registration, an annual certification, or a withdrawal from registration, respectively) be submitted to the Commission electronically as PDF documents using the Commission's EDGAR system.²³⁸⁷

²³⁸³ 500 hours x \$283 per hour for a compliance manager = \$141,500, rounded to \$142,000. See section IV.D.7. of this release (PRA analysis providing cost and hour burden estimates).

²³⁸⁴ See section II.J.2. of this release (providing a more detailed discussion of this amendment); section II.I.3. of this release (providing a focused economic analysis for this amendment). Under the amendments to paragraph (c) of Rule 17g-2, the record must be retained until three years after the date the record is replaced with an updated record.

²³⁸⁵ 200 hours/5 records = 40 hours x \$291 per hour for a senior systems analyst = \$11,640, rounded to \$12,000. See the PRA analysis in section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁸⁶ 50 hours/5 records = 10 hours x \$291 per hour for a senior systems analyst = \$2,910, rounded to \$3,000. See section IV.D.3. of this release (PRA analysis providing cost and hour burden estimates).

²³⁸⁷ See section II.L. of this release (providing a more detailed discussion of these amendments) section II.L.2. of this release (providing a focused economic analysis for these amendments).

The Commission estimates that these amendments will result in total industry-wide one-time costs for NRSROs of approximately \$46,000²³⁸⁸ to become familiar with the EDGAR system and to file Form ID and total industry-wide annual costs for NRSROs of approximately \$6,000 to monitor changes in EDGAR filing requirements.²³⁸⁹

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Regulatory Flexibility Act ("RFA")²³⁹⁰ requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities.

The Commission proposed amendments to Rule 101 of Regulation S-T, Rule 201 of Regulation S-T, Rule 314 of Regulation S-T, Rule 17g-1, Rule 17g-2, Rule 17g-3, Rule 17g-5, Rule 17g-6, Rule 17g-7, Form ABS-15G, and Form NRSRO, and proposed new Rule 17g-8, new Rule 17g-9, new Rule 17g-10, new Rule 15Ga-2, and new Form ABS Due Diligence-15E. The Commission included an Initial Regulatory Flexibility Analysis ("IRFA") in the proposing release.²³⁹¹ The Commission has prepared this Final Regulatory Flexibility Analysis in accordance with the provisions of the RFA.²³⁹²

A. NEED FOR AND OBJECTIVES OF THE AMENDMENTS AND NEW RULES

Section II of this release describes the need for and objectives of the amendments and new rules. In addition, section IV.B. of this release describes the intended use of the collections of information that are required under the amendments and new rules. Moreover, as described in

²³⁸⁸ 160 hours + 2.5 hours = 162.5 hours x \$283 per hour for a compliance manager = \$45,987.50, rounded to \$46,000. See sections IV.D.1. and IV.D.12 of this release (PRA analyses providing cost and hour burden estimates).

²³⁸⁹ 20 hours x \$283 per hour for a compliance manager = \$5,660, rounded to \$6,000. See section IV.D.1. of this release (PRA analysis providing cost and hour burden estimates).

²³⁹⁰ 5 U.S.C. 601 *et seq.*

²³⁹¹ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33533-33537.

²³⁹² See 5 U.S.C. 604(a).

section II of this release, the amendments and new rules implement Title IX, Subtitle C of the Dodd-Frank Act.²³⁹³ In section 931 of Title IX, Subtitle C of the Dodd-Frank Act, Congress made findings relating to the need for the amendments and new rules.²³⁹⁴

B. SIGNIFICANT ISSUES RAISED BY PUBLIC COMMENTS

The Commission requested comment with regard to all matters discussed in the IRFA, including comments with respect to the number of small entities that may be affected by the proposed amendments and new rules and whether the effect on small entities would be economically significant.²³⁹⁵

One commenter addressed the IRFA stating that “the majority of the proposed rules set forth in the Proposing Release are more appropriate for, and aimed at, large, established agencies and overall, insufficient consideration has been given to smaller agencies.”²³⁹⁶ The Commission is sensitive to the impact the amendments and new rules will have on small entities and has taken actions to address this issue. Specifically, the amendments and new rules contain certain modifications from the proposals designed to alleviate some of the concerns regarding small entities. The Commission believes that the amendments and new rules being adopted today, as modified from the proposal, strike an appropriate balance between minimizing the impact on small entities and implementing the policies and requirements addressed by Title IX, Subtitle C of the Dodd-Frank Act.

Moreover, in response to the commenter that specifically addressed the IRFA, the Commission believes the choices it has made in implementing Title IX, Subtitle C of the Dodd-

²³⁹³ See Pub. L. No. 111-203, 931 through 939H.

²³⁹⁴ See Pub. L. No. 111-203, 931; section I.B.1. of this release (setting forth the findings).

²³⁹⁵ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33537.

²³⁹⁶ See Trade Metrics Letter. As noted below, other commenters addressed more generally issues related to the impact on small entities, which are discussed above in the relevant sections, as well as below in this analysis. See, e.g., Kroll Letter.

Frank Act have resulted in amendments and new rules that are designed to be appropriate for entities of all sizes, while still implementing the policies and requirements addressed by the Dodd-Frank Act. For example, a number of the amendments and new rules are policies and procedures-based requirements and, consequently, a small NRSRO can comply with these requirements by tailoring and scaling its policies and procedures to its size and business activities. In addition, where feasible, the Commission has implemented Title IX, Subtitle C of the Dodd-Frank Act by enhancing existing requirements (most particularly with respect to performance statistics and rating histories) rather than establishing separate new requirements. Consequently, small NRSROs that currently are subject to the existing requirements can leverage their existing systems and procedures to comply with the new requirements and will not be subject to separate new requirements. Moreover, the Commission has implemented Title IX, Subtitle C of the Dodd-Frank Act, in large part, by designing amendments and new rules that are modeled closely on the statutory text mandating the rulemaking. Consequently, the Commission has sought to limit the cumulative impact on small NRSRO resulting from the amendments and new rules to that which is necessary to implement the policies and requirements addressed by Title IX, Subtitle C of the Dodd-Frank Act. Finally, the Commission – as discussed in section III of this release – has prescribed differing dates for when the amendments and new rules will become effective, with the more technically complex amendments and rules having longer lead times before they become effective. This will provide all entities – including entities that are small NRSROs – with transition periods to prepare to comply with the new requirements, which may be particularly helpful to small NRSROs.

While the Commission has sought to limit the impact on small entities, the Commission acknowledges that Title IX, Subtitle C of the Dodd-Frank Act contains requirements – including

those resulting from this substantial package of rulemaking – that collectively and, in many cases, individually will impose costs on NRSROs, including NRSROs that are small entities. The Commission recognizes that the consequences of these amendments and new rules may be the creation of barriers to entry and negative impacts on competition. The Commission has balanced these potential impacts with the rulemaking requirements and objectives of Title IX, Subtitle C of the Dodd-Frank Act (reflected in the findings in section 931 of the Dodd-Frank Act).

In addition to the comment discussed above that specifically addressed the IRFA, several commenters discussed the potential impact of the proposed amendments and new rules on small entities. These comments – and the Commission’s response to the comments – are discussed in the various, relevant sections throughout this release, as well as below.

One commenter, with regard to the proposals relating to the internal control structure, stated that the Commission should “avoid creating a regulatory environment for NRSROs that is so burdensome and complicated that only the large NRSROs, which have enormous resources at their disposal, can address the multitude of complex requirements” and that the proposed amendments to Rule 17g-3 related to internal controls would compound barriers to entry because they are “expensive and burdensome to implement,” particularly for newer or smaller NRSROs.²³⁹⁷ Commenters also stated, in response to a question in the proposing release, that the Commission should not prescribe factors for an internal control structure because this would place a heavy burden on small NRSROs.²³⁹⁸ One commenter stated that the requirement to document internal controls is burdensome, particularly for smaller NRSROs, that the requirements are expensive, time consuming, and yield little benefit, and that documenting

²³⁹⁷ See Kroll Letter.

²³⁹⁸ See A.M. Best Letter; Kroll Letter.

policies and procedures “naturally coincide with the establishment of a properly functioning internal controls structure,” which the NRSRO should be allowed to establish on its own, and the commenter urged the Commission to exclude “extensive or overly-inclusive documentation requirements” should it adopt paragraph (b)(12) of Rule 17g-2.²³⁹⁹

In response to these comments, the Commission notes that the approach it has taken with respect to section 15E(c)(3) of the Exchange Act – which contains a self-executing requirement that an 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 – will reduce the impact on small NRSROs as compared to the proposal.²⁴⁰⁰ First, while the Commission is prescribing factors an NRSRO must consider, it is not mandating that a specific factor be implemented. Consequently, while small NRSROs must consider the factors identified by the Commission, they can tailor and scale their internal control structures to their size and business activities. Second, the modifications to the amendments to Rule 17g-3 from the proposal (because they specify that management of the NRSRO cannot state in the internal controls report that the internal control structure was effective if it contained one or more material weaknesses and provide a description of when a material weakness exists) will provide better guidance to NRSROs on the statements and information that must be included in the report compared with the proposal. Consequently, modifications may result in modest reductions of the impact on small NRSROs associated with preparing the reports, as this

²³⁹⁹ See A.M. Best Letter.

²⁴⁰⁰ See 15 U.S.C. 78o-7(c)(3). See also section II.A. of this release (discussing in detail the Commission’s approach with respect to section 15E(c)(3)).

guidance will provide more certainty as to the matters that must be specifically addressed in the reports and, therefore, reduce the effort needed to prepare them.²⁴⁰¹

One commenter stated that the prohibited conflict of interest related to sales and marketing in proposed paragraph (c)(8) of Rule 17g-5 could make compliance “a practical impossibility” for all but the largest NRSROs because small NRSROs do not have the same resources or structure as larger NRSROs to comply with an absolute prohibition.²⁴⁰² Similarly, another commenter stated that the proposed rule regarding the prohibited conflict of interest related to sales and marketing is overly-restrictive, particularly for smaller NRSROs, and would result in “grossly inefficient use of the [NRSRO’s] resources and add a substantial amount of infrastructure costs, at little to no benefit.”²⁴⁰³

In response to these comments, the Commission notes that, consistent with Exchange Act section 15E(h)(3)(B)(i), the final amendments provide a mechanism for small NRSROs to apply for an exemption from the rule’s requirements.²⁴⁰⁴ Under the final amendments, the Commission may grant an exemption if it finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.²⁴⁰⁵

An NRSRO stated that complying with the amended instructions for Exhibit 1 to Form NRSRO regarding the production and presentation of performance statistics will require “substantial technology resources” and that smaller NRSROs’ resources may be strained if

²⁴⁰¹ See section II.A.3. of this release (providing a more detailed discussion of the description of what constitutes a material weakness).

²⁴⁰² See Kroll Letter.

²⁴⁰³ See A.M. Best Letter.

²⁴⁰⁴ See paragraph (f) of Rule 17g-5.

²⁴⁰⁵ See id.

sufficient time is not provided to comply.²⁴⁰⁶ One commenter stated that the single cohort approach could lead to results that are “significantly more volatile within the shorter time period, which will make interpreting those results more difficult.”²⁴⁰⁷ This commenter stated further that “the volatility impact will be amplified for NRSROs with fewer ratings, which could lead to bias against smaller NRSROs.”²⁴⁰⁸

In response to the first comment, the Commission notes – as discussed in section III. of this release – NRSROs will not be required to provide performance statistics in Exhibit 1 to Form NRSRO that adhere to the new requirements until they file their annual certifications in 2016. This will provide all NRSROs, including small NRSROs, with a substantial transition period to prepare to comply with the new requirements. In response to the second comment, the Commission – as discussed in section II.E.1.b. of this release – has balanced this concern with section (q)(2)(B) of the Exchange Act, which provides that the Commission’s rules shall require that the performance measurement disclosures be clear and informative for investors having a wide range of sophistication).²⁴⁰⁹ The single cohort approach involves simpler computations than other approaches for calculating the performance statistics. The requirements in the instructions for Exhibit 1 provide for very transparent disclosures about the number of credit ratings in the start date cohort and in the cohort for each notch in the credit rating scale of a given class or subclass. This transparency will provide persons reviewing the performance statistics with information to assess how the small number of credit rating ratings in a given cohort may have impacted the results.²⁴¹⁰ Further, the modifications to the instructions for Exhibit 1 to Form

²⁴⁰⁶ See Morningstar Letter.

²⁴⁰⁷ See DBRS Letter.

²⁴⁰⁸ See DBRS Letter.

²⁴⁰⁹ See 15 U.S.C. 78o-7(q)(2)(B).

²⁴¹⁰ See section II.E.1.b. of this release.

NRSRO permit an NRSRO, including a small NRSRO, to include in the exhibit a short statement describing the single cohort approach and any advantages or limitations to the single cohort approach the NRSRO believes would be appropriate to disclose.

The Commission also notes that it has modified the instructions for Exhibit 1 to Form NRSRO from the proposal in ways that will reduce the impact on small NRSROs.²⁴¹¹ For example, the final amendments provide that, except for the issuers of asset-backed securities class of credit ratings, to determine the number of credit ratings outstanding as of the beginning of the applicable period, the NRSRO must include only credit ratings assigned to an obligor as an entity or, if there is no such rating, the rating of the obligor's senior unsecured debt, instead of the credit ratings of individual securities or money-market instruments issued by the obligor.²⁴¹² Because the Commission has narrowed the scope of the credit ratings included in the performance statistics for four of the five classes of credit ratings, this is expected to substantially reduce the amount of historical information that an NRSRO is required to analyze. The Commission has also revised the standard definition of paid off, in response to comment,²⁴¹³ to eliminate the prong that applied to entity ratings of obligors. The Commission has clarified that the rule does not require an NRSRO to track the outcome of an obligor, security, or money market instrument after the credit rating has been withdrawn, in response to comments.²⁴¹⁴

With respect to paragraph (a) of proposed Rule 17g-8, one NRSRO stated that to adopt policies mandating board approval of procedures and methodologies to determine credit ratings would be "overly-burdensome for many smaller NRSROs and likely cost prohibitive for a small

²⁴¹¹ See section II.E.1.b. of this release (discussing the modifications in more detail).

²⁴¹² See section II.E.1.b. of this release.

²⁴¹³ See S&P Letter.

²⁴¹⁴ See, e.g., S&P Letter (stating that that the Commission should not require that an NRSRO monitor an obligor, security, or money market instrument after withdrawal because of the lack of information available to the NRSRO to perform such monitoring).

credit rating agency seeking to become an NRSRO.”²⁴¹⁵ A second commenter stated that certain provisions of the proposal, including those related to credit rating methodologies, would compound barriers to entry, that many of the new provisions are “expensive and burdensome to implement,” especially for newer and smaller NRSROs, and do not appear to promote competition, and that the Commission should take into account the “dominance” of the larger players and expand small company exceptions that are “needed to level the competitive field.”²⁴¹⁶

In response to comments about the board’s role in approving the procedures and methodologies an NRSRO uses to determine credit ratings, the Commission notes – as discussed in section II.F.1. of this release – that section 15E(t)(3)(A) of the Exchange Act provides that the board of an NRSRO shall oversee the establishment, maintenance, and enforcement of policies and procedures for determining credit ratings.²⁴¹⁷ Consequently, the self-executing requirement in the statute governs the responsibility of the board. Paragraph (a)(1) of Rule 17g-8 governs the responsibility of the NRSRO to have policies and procedures reasonably designed to ensure that board carries out this statutory responsibility. Therefore, the rule implements a policies and procedures-based requirement and, therefore, a small NRSRO can comply with the rule requirements by tailoring and scaling its policies and procedures to its size and business activities. Moreover, with respect to the self-executing requirement, section 15E(t)(5) of the Exchange Act provides exception authority under which the Commission may permit an NRSRO to delegate responsibilities required in section 15E(t) to a committee if the Commission finds that compliance with the provisions of that section present an unreasonable burden on a small

²⁴¹⁵ See A.M. Best Letter.

²⁴¹⁶ See Kroll Letter.

²⁴¹⁷ See 15 U.S.C. 78o-7(t)(3)(A).

NRSRO.²⁴¹⁸ The ability to request an exception under section 15E(t)(5) provides a means for a small NRSRO to seek relief to delegate responsibilities to a committee if the Commission finds the costs and burdens associated with the requirements of section 15E(t) of the Exchange Act – including the requirement that the board oversee the establishment, maintenance, and enforcement of the policies and procedures for determining credit ratings – are an unreasonable burden.²⁴¹⁹

In response to the more general comment on the impact of paragraph (a) of Rule 17g-8 on smaller NRSROs, all of the provisions in the paragraph establish policies and procedures-based requirements. Therefore, a small NRSRO can comply with the requirements by tailoring and scaling its policies and procedures to its size and business activities. This should result in lower impacts on smaller NRSROs as compared to large NRSROs because the smaller NRSROs issue substantially fewer credit ratings than the large NRSROs.²⁴²⁰ Consequently, the number of credit analysts and credit ratings to which the policies and procedures will need to be applied will be significantly fewer than will be the case for a large NRSRO. Thus, the new rule should result in lower impacts for small NRSROs in terms of the scope of the activities to be addressed by the policies and procedures.

One NRSRO stated that the implementation of proposed paragraph (a) of Rule 17g-7 (requiring the publication of a form and any applicable due diligence certifications with the taking of a rating action) would result in an “enormous technological undertaking” that will require a lead time of at least one year to implement for all NRSROs and possibly longer for

²⁴¹⁸ See 15 U.S.C. 78o-7(t)(5).

²⁴¹⁹ The Commission will handle such requests in a manner similar to requests for relief under section 36 of the Exchange Act. See 15 U.S.C. 78mm. Further information about requesting relief from the Commission under section 36 of the Exchange Act is available at <http://www.sec.gov/rules/exempt.shtml>.

²⁴²⁰ See Table 4 in section I.B.2.a. of this release (showing the approximate number of credit ratings outstanding across the ten NRSROs).

smaller NRSROs who may not have the same level of financial or technological resources as the larger NRSROs.²⁴²¹

In response to this comment, the Commission notes – as discussed in section III of this release – that the requirement will not be effective until nine months after this release is published in the Federal Register. This will provide small NRSROs with a substantial transition period to prepare to comply with the new requirements. Moreover, while the transition period is not as long as suggested by the commenter (at least one year), the Commission has modified the final amendments from the proposal in a number of ways that will reduce impacts on small NRSROs and, therefore, should make a nine month transition period sufficient for small NRSROs.²⁴²² All of these modifications were made, in part, in response to concerns about burdens raised by commenters. The modifications include narrowing the scope of rating actions that will trigger the disclosure requirement. In addition, the Commission has exempted certain rating actions involving credit ratings assigned to foreign obligors or securities or money market instruments issued overseas. The Commission also significantly reduced the reporting requirements relating to representations, warranties, and enforcement mechanisms. These modifications should reduce the impact on all NRSROs, including small NRSROs, as compared with the proposal.

While commenters may not have specifically addressed the impact on small entities of other amendments and new rules being adopted today, as discussed in detail in Section II of this release, the Commission has made modifications from the proposals that will reduce the impact on small entities.

²⁴²¹ See Morningstar Letter.

²⁴²² See section II.G. of this release (providing a more detailed discussion of these modifications).

For example, the Commission has modified the requirement to submit certain Forms NRSRO and annual reports under Rule 17g-3 to the Commission electronically.²⁴²³ In response to a comment from an NRSRO that the Commission's proposed cost estimate for the proposal "accounts for only a small fraction of the expected cost of compliance" and that instead PDF copies of the required submissions should be used,²⁴²⁴ the Commission has modified the proposed amendments to require that the electronic submissions be made on EDGAR as PDF documents, which another NRSRO described as "the most preferred and simplest" way to provide the information.²⁴²⁵ This will mitigate the costs for all NRSROs, including small NRSROs, to file the forms and report.

Further, the Commission has modified proposed paragraph (b) of Rule 17g-7 (the 100% Rule) in a number of ways that will reduce the impact on small NRSROs.²⁴²⁶ To focus the disclosure of rating histories on the rating actions that are most relevant to evaluating performance, the final rule eliminates the proposed requirement to include placements on watch and affirmations (and the required data associated with these actions) in the rating histories. The final rule also significantly shortens from the proposal the time horizon of historical information that must be retrieved for inclusion in the rating histories. In particular, the proposed requirement to include information for all credit ratings outstanding on or after June 26, 2007 has been replaced with a standard three-year backward looking requirement that applies irrespective of when the NRSRO is registered in a class of credit ratings. This, together with the elimination of two proposed types of rating actions that would trigger a requirement to add information to a

²⁴²³ See section II.E.2. of this release.

²⁴²⁴ See DBRS Letter.

²⁴²⁵ See S&P Letter.

²⁴²⁶ See section II.E.3. of this release (providing a more detailed discussion of these modifications).

credit rating's history – placements of the security on credit watch or review and affirmations of the credit rating – is expected to significantly mitigate the costs of retrieving and analyzing historical information for the purposes of making the rating histories disclosures. The modifications from the proposal also should mitigate concerns about having to obtain information that was not traditionally retained by the NRSRO because it will significantly narrow the scope of such information that will need to be included in the rating histories. Further, the modifications from the proposal are expected to reduce the cost of updating the XBRL data file with new information.²⁴²⁷ The final amendments also specify a standard for updating the file – no less frequently than monthly. This will mitigate costs that would result if the Commission had not established a minimum requirement for how often the file must be updated and NRSROs updated the file more frequently than monthly as a result. Finally, the final rule modifies the proposal to reduce the time period a credit rating history must be retained after the credit rating is withdrawn from twenty years to fifteen years. This is expected to reduce to some degree the data retention and maintenance costs associated with the final rule as compared to the proposed rule. Overall, these modifications are expected to reduce the impact on NRSROs, including small NRSROs, as compared with the proposal.

The Commission also has modified proposed Rule 17g-10 and Form ABS Due Diligence-15E in ways that will reduce the impact on small entities.²⁴²⁸ In particular, Rule 17g-10, as adopted, establishes a “safe harbor” to provide certainty to providers of third-party due diligence services with respect to how they can meet their obligation under section 15E(s)(4)(B) of the Exchange Act to provide Form ABS Due Diligence-15E to any NRSRO that produces a credit

²⁴²⁷ See section II.E.3.b. of this release (discussing how the modifications narrow the types of rating actions that must be included in a rating history).

²⁴²⁸ See section II.H.2. of this release.

rating to which the due diligence services relate. Consequently, small third-party due diligence providers will not be required to identify every NRSRO that is producing a credit rating.

Finally, the amendments being adopted today eliminate the 10% Rule.²⁴²⁹ This will eliminate the costs for all NRSROs, including small NRSROs, to produce and disclose rating histories to comply with the 10% Rule.

C. SMALL ENTITIES SUBJECT TO THE RULES

1. NRSROs and Providers of Third-Party Due Diligence Services

Paragraph (a) of Rule 0-10 provides that, for purposes of the RFA, a small entity “[w]hen used with reference to an ‘issuer’ or a ‘person’ other than an investment company” means “an ‘issuer’ or ‘person’ that, on the last day of its most recent fiscal year, had total assets of \$5 million or less.”²⁴³⁰ The Commission has stated in the past that an NRSRO with total assets of \$5 million or less would qualify as a “small” entity for purposes of the RFA.²⁴³¹ The Commission continues to believe this threshold of total assets of \$5 million or less qualifies an NRSRO as “small” for purposes of the RFA. In addition, the Commission believes this is an appropriate threshold for determining whether a provider of third-party due diligence services is “small” for purposes of the RFA. Currently, there are ten credit rating agencies registered with the Commission as NRSROs.²⁴³² Based on their annual reports under Rule 17g-3 for the 2013 fiscal year, two NRSROs are small entities under the above definition.

²⁴²⁹ See section II.E.3. of this release (discussing the 10% Rule and reasons for its elimination).

²⁴³⁰ 17 CFR 240.0-10(a).

²⁴³¹ See, e.g., Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR 33618; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6481; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 63863.

²⁴³² See section I.B.2.a. of this release (discussing the economic baseline with respect to NRSROs); see also section IV.C. of this release (stating that there are ten NRSRO respondents for purposes of the PRA).

The Commission stated in the proposing release that it believed that there were approximately ten firms that provide, or would begin providing, third-party due diligence services to issuers and underwriters of Exchange Act-ABS and that all would be small entities for purposes of the RFA.²⁴³³ However, based on further analysis, the Commission estimates that there are approximately fifteen providers of third-party due diligence services.²⁴³⁴ The Commission believes that all of these firms will be small entities for purposes of the RFA.

2. Issuers

As noted above, Rule 0-10(a)²⁴³⁵ defines an issuer be a small business or small organization if it had total assets of \$5 million or less on the last day of its most recent fiscal year. In the proposing release, the Commission estimated that there were 270 issuers and certified pursuant to 5 U.S.C. 605(b) that Rule 15Ga-2 and the amendments to Form ABS-15G, if adopted, would not have a significant economic impact on a substantial number of small entities.²⁴³⁶ The Commission requested comment on this certification.²⁴³⁷ However, no commenters responded to that request or indicated that the proposed rules would have a significant economic impact on a substantial number of small entities.

The Commission estimates that there will be 336 unique issuers subject to Rule 15Ga-2 and the amendments to Form ABS-15G.²⁴³⁸ The Commission's data indicate that only one issuer

²⁴³³ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33534.

²⁴³⁴ See section I.B.2.b. of this release (discussing the economic baseline with respect to providers of third-party due diligence services and the analysis upon which the Commission bases this estimate); see also section IV.C. of this release (stating that there are fifteen respondents that are providers of third-party due diligence services for purposes of the PRA).

²⁴³⁵ 17 CFR 240.0-10(a).

²⁴³⁶ See Nationally Recognized Statistical Rating Organizations, 76 FR at 33534.

²⁴³⁷ See id. at 33537.

²⁴³⁸ See section I.B.2.b. of this release (discussing the economic baseline with respect to issuers); see also section IV.C. of this release (stating that there are 336 issuer respondents for purposes of the PRA).

would be small for purposes of the RFA.²⁴³⁹ Because only one out of 336 unique issuers is small and because commenters did not indicate that the proposed rules would have a significant economic impact on a substantial number of small issuers, the Commission certifies that Rule 15Ga-2 and the amendments to Form ABS-15G will not have a significant economic impact on a substantial number of small entities.

D. REPORTING, RECORDKEEPING, AND OTHER COMPLIANCE REQUIREMENTS

In accordance with the Dodd-Frank Act and to enhance oversight of NRSROs, the Commission is adopting amendments to existing rules and new rules that apply to NRSROs, providers of third-party due diligence services for asset-backed securities, and issuers and underwriters of asset-backed securities.

The Commission is amending Rule 17g-1. First, the Commission is amending paragraph (i) of Rule 17g-1.²⁴⁴⁰ The amendments require an NRSRO to make Form NRSRO and Exhibits 1 through 9 of the form publicly and freely available on an easily accessible portion of its corporate Internet website (eliminating an option to make the form and exhibits available “through another comparable, readily accessible means”) and to make its most recent Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit.

Second, the Commission is amending paragraphs (e), (f), and (g) of Rule 17g-1 to require NRSROs to use the Commission’s EDGAR system to electronically submit Form NRSRO and required exhibits to the form to the Commission as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.²⁴⁴¹

²⁴³⁹ This is based on data from Asset-Backed Alert, which is available at <http://www.abalert.com/ranks.php>.

²⁴⁴⁰ See section II.E.2. of this release (providing a more detailed discussion of the amendments).

²⁴⁴¹ See section II.L. of this release (providing a more detailed discussion of the amendments).

The Commission is amending the instructions for Exhibit 1 to Form NRSRO.²⁴⁴² The amendments standardize the production and presentation of the 1-year, 3-year, and 10-year transition and default statistics that an NRSRO must disclose in the Exhibit. The performance statistics must be presented in a format specified in the instructions, which include a sample “Transition/Default Matrix.” The amendments also enhance the information to be disclosed by, for example, requiring statistics to be produced and presented for subclasses of structured finance products and for credit ratings where the obligation was paid off or the credit rating was withdrawn for reasons other than a default or the obligation was paid off.

The Commission is amending Rule 17g-2. First, the Commission is adding paragraph (a)(9) to Rule 17g-2 to identify the policies and procedures with respect to look-back reviews an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act and paragraph (c) of Rule 17g-8 as a record that must be made and retained.²⁴⁴³ Second, the Commission is adding paragraph (b)(12) to Rule 17g-2 to identify the internal control structure an NRSRO must establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Exchange Act as a record that must be retained.²⁴⁴⁴ Third, the Commission is adding paragraph (b)(13) to Rule 17g-2 to identify the policies and procedures with respect to the procedures and methodologies used to determine credit ratings an NRSRO is required to establish, maintain, enforce, and document pursuant to paragraph (a) of Rule 17g-8 as a record that must be retained.²⁴⁴⁵ Fourth, the Commission is adding paragraph (b)(14) to Rule 17g-2 to identify the policies and procedures with respect to credit rating symbols, numbers, or scores an

²⁴⁴² See section II.E.1. of this release (providing a more detailed discussion of the amendments).

²⁴⁴³ See section II.C.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁴⁴ See section II.A.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁴⁵ See section II.F.2. of this release (providing a more detailed discussion of this amendment).

NRSRO must establish, maintain, enforce, and document pursuant to paragraph (b) of Rule 17g-8 as a record that must be retained.²⁴⁴⁶ Fifth, the Commission is adding paragraph (b)(15) to Rule 17g-2 to identify the standards of training, experience, and competence for credit analysts an NRSRO must establish, maintain, enforce, and document pursuant to Rule 17g-9 as a record that must be retained.²⁴⁴⁷ In addition, the Commission is amending paragraph (c) of Rule 17g-2 to provide that records identified in paragraphs (a)(9), (b)(12), (b)(13), (b)(14), and (b)(15) of Rule 17g-2 must be retained until three years after the date the record is replaced with an updated record, instead of three years after the record is made or received, which is the retention period for other records identified in paragraphs (a) and (b) of Rule 17g-2.²⁴⁴⁸ The Commission also repealed paragraph (d)(2) of Rule 17g-2 (the 10% Rule) and has re-codified (with significant amendments) the requirements in paragraph (d)(3) of Rule 17g-2 (the 100% Rule) in paragraph (b) of Rule 17g-7.²⁴⁴⁹

The Commission is amending Rule 17g-3. First, the Commission is amending paragraphs (a) and (b) of Rule 17g-3.²⁴⁵⁰ The amendment to paragraph (a) adds paragraph (a)(7) to require an NRSRO to include an additional unaudited report – a report on the NRSRO’s internal control structure – with its annual submission of reports to the Commission pursuant to Rule 17g-3.²⁴⁵¹ The amendment to paragraph (b) of Rule 17g-3 requires that the NRSRO’s CEO

²⁴⁴⁶ See section II.J.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁴⁷ See section II.I.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁴⁸ See section II.A.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁴⁹ See section II.E.3. of this release (providing a more detailed discussion of this amendment).

²⁴⁵⁰ See section II.A.3. of this release (providing a more detailed discussion of these amendments).

²⁴⁵¹ See paragraph (a)(7) of Rule 17g-3.

or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report.²⁴⁵²

Second, the Commission is adding paragraph (d) to Rule 17g-3 to require that the annual reports required to be submitted to the Commission pursuant to Rule 17g-3 be submitted electronically through the Commission's EDGAR system as PDF documents.²⁴⁵³

Third, the Commission is adding paragraph (a)(8) to Rule 17g-3 to identify the report of the NRSRO's designated compliance officer that an NRSRO is required to file with the Commission pursuant to section 15E(j)(5)(B) of the Exchange Act as a report that must be filed with the other annual reports.²⁴⁵⁴ This aspect of the requirement will not result in a collection of information requirement because the requirement to file the report with the other annual reports required under Rule 17g-3 is pursuant to section 15E(j)(5)(B) of the Exchange Act.²⁴⁵⁵

Moreover, the Commission is not adding any requirements with respect to the filing other than the requirement that this report be filed with the other annual reports. However, as discussed in more detail below, this report and the other annual reports must be submitted through the EDGAR system.²⁴⁵⁶

The Commission is amending Rule 17g-5. First, the Commission is adding paragraph (a)(3)(iii)(E) to Rule 17g-5 to require an NRSRO to obtain an additional representation from the issuer, sponsor, or underwriter of an asset-backed security that the issuer, sponsor, or underwriter will post on the Rule 17g-5 website, promptly after receipt, any executed Form ABS Due

²⁴⁵² See paragraph (b)(2) of Rule 17g-3.

²⁴⁵³ See section II.L. of this release (providing a more detailed discussion of this amendment).

²⁴⁵⁴ See section II.K. of this release (providing a more detailed discussion of this amendment).

²⁴⁵⁵ See 15 U.S.C. 78o-7(j)(5)(B).

²⁴⁵⁶ See section IV.D.11. of this release (discussing the initial and annual recordkeeping and reporting burdens resulting from the requirement to submit the annual reports to the Commission using the EDGAR system).

Diligence-15E delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.²⁴⁵⁷

Second, the Commission is adding paragraph (c)(8) to Rule 17g-5 to prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) participates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) is influenced by sales or marketing considerations.²⁴⁵⁸

Third, the Commission is adding paragraph (f) of Rule 17g-5, which provides that upon written application by an NRSRO the Commission may exempt, either conditionally or unconditionally, the NRSRO from paragraph (c)(8) if the Commission finds that due to the small size of the NRSRO it is not appropriate to require the separation within the NRSRO of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.²⁴⁵⁹

Fourth, the Commission is adding paragraph (g) of Rule 17g-5 to establish a finding that must be made in the context of a proceeding under section 15E(d)(1) of the Exchange Act that is in lieu of the findings specified in sections 15E(d)(1)(A) through (F) of the Exchange Act.²⁴⁶⁰

The Commission is amending Rule 17g-7. First, the Commission is incorporating the disclosure requirement in Rule 17g-7 relating to representations, warranties, and enforcement

²⁴⁵⁷ See sections II.G.5. and II.H.2. of this release (providing more detailed discussions of this amendment).

²⁴⁵⁸ See section II.B.1. of this release (providing a more detailed discussion of this amendment).

²⁴⁵⁹ See section II.B.2. of this release (providing a more detailed discussion of this amendment).

²⁴⁶⁰ See section II.B.3. of this release (providing a more detailed discussion of this amendment).

mechanisms available to investors in asset-backed securities before today's amendments into paragraph (a) of the rule and is adding disclosure provisions that require an NRSRO, when taking certain rating actions, to publish a form containing information about the credit rating resulting from or subject to the rating action as well as any certification of a provider of third-party due diligence services received by the NRSRO that relates to the credit rating.²⁴⁶¹ The amendments prescribe: (1) the types of rating actions that trigger the requirement to publish the form and, if applicable, any due diligence certifications;²⁴⁶² (2) the format of the form;²⁴⁶³ (3) the content of the form (which must include certain qualitative and quantitative information relating to the credit rating);²⁴⁶⁴ and (4) an attestation requirement for the form.²⁴⁶⁵

Second, the Commission is re-codifying in paragraph (b) of Rule 17g-7 the requirements to disclose rating histories that were contained in paragraph (d)(3) of Rule 17g-2 before today's amendments (the 100% Rule).²⁴⁶⁶ The amendments to Rule 17g-7 also expand the scope of the credit ratings that must be included in the histories and add additional data elements that must be disclosed in the rating history for a particular credit rating.

The Commission is adopting Rule 17g-8, which requires an NRSRO to establish, maintain, enforce, and document certain types of policies and procedures or to address certain

²⁴⁶¹ See section II.G. of this release (providing a more detailed discussion of these amendments).

²⁴⁶² The Commission is adopting an exemption for certain non-U.S. rating actions from the requirements of paragraph (a). See section II.G.1. of this release (providing a more detailed discussion of these amendments).

²⁴⁶³ See section II.G.2. of this release (providing a more detailed discussion of these amendments).

²⁴⁶⁴ See section II.G.3. of this release (providing a more detailed discussion of these amendments).

²⁴⁶⁵ See section II.G.4. of this release (providing a more detailed discussion of these amendments).

²⁴⁶⁶ See section II.E.3. of this release (providing a more detailed discussion of these amendments). The Commission is also repealing paragraph (d)(2) of Rule 17g-2 (the 10% Rule). As stated above in section II.E.3. of this release, in light of the amendments to the instructions for Exhibit 1 to Form NRSRO and the amendments to the 100% Rule, retaining the 10% Rule would provide little, if any, incremental benefit.

matters in policies and procedures the NRSRO is required to establish, maintain, and enforce pursuant to the Exchange Act.

Specifically, paragraph (a) of Rule 17g-8 requires an NRSRO to establish, maintain, enforce, and document policies and procedures with respect to the procedures and methodologies, including qualitative and quantitative data and models, the NRSRO uses to determine credit ratings.²⁴⁶⁷ The required policies and procedures include policies and procedures relating to: (1) board approval of the procedures and methodologies for determining credit ratings;²⁴⁶⁸ (2) the development and modification of the procedures and methodologies for determining credit ratings;²⁴⁶⁹ (3) applying material changes to the procedures and methodologies for determining credit ratings;²⁴⁷⁰ (4) publishing material changes to and notices of significant errors in the procedures and methodologies for determining credit ratings;²⁴⁷¹ and (5) disclosing the version of a credit rating procedure or methodology used with respect to a particular credit rating.²⁴⁷²

Paragraph (b) of Rule 17g-8 requires an NRSRO to have policies and procedures with respect to the symbols, numbers, or scores it uses to denote credit ratings.²⁴⁷³ The required policies and procedures include policies and procedures relating to: (1) assessing the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments in accordance with the terms of the security or

²⁴⁶⁷ See section II.F.1. of this release (providing a more detailed discussion of this paragraph).

²⁴⁶⁸ See paragraph (a)(1) of Rule 17g-8.

²⁴⁶⁹ See paragraph (a)(2) of Rule 17g-8.

²⁴⁷⁰ See paragraph (a)(3) of Rule 17g-8.

²⁴⁷¹ See paragraph (a)(4) of Rule 17g-8.

²⁴⁷² See paragraph (a)(5) of Rule 17g-8.

²⁴⁷³ See section II.J.1. of this release (providing a more detailed discussion of this paragraph).

money market instrument;²⁴⁷⁴ (2) clearly defining each symbol, number, or score in the rating scale used by the NRSRO and including the definitions in Exhibit 1 to Form NRSRO;²⁴⁷⁵ and (3) applying any symbol, number, or score in the rating scale used by the NRSRO in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.²⁴⁷⁶

Paragraph (c) of Rule 17g-8 requires that the policies and procedures an NRSRO is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Exchange Act with respect to look-back reviews must address instances in which a look-back review determines that a conflict of interest influenced a credit rating by including, at a minimum, procedures that are reasonably designed to ensure that the NRSRO takes certain steps reasonably designed to ensure the credit rating is no longer influenced by the conflict and that the existence and an explanation of the conflict is disclosed.²⁴⁷⁷

Paragraph (d) of Rule 17g-8 requires an NRSRO to consider certain prescribed factors when establishing, maintaining, enforcing, and documenting an effective internal structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Exchange Act.²⁴⁷⁸

The Commission is adopting Rule 17g-9. Rule 17g-9 requires an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produce accurate credit ratings in the classes

²⁴⁷⁴ See paragraph (b)(1) of Rule 17g-8.

²⁴⁷⁵ See paragraph (b)(2) of Rule 17g-8.

²⁴⁷⁶ See paragraph (b)(3) of Rule 17g-8.

²⁴⁷⁷ See section II.C.1. of this release (providing a more detailed discussion of this paragraph).

²⁴⁷⁸ See section II.A.1. of this release (providing a more detailed discussion of this paragraph).

of credit ratings for which the NRSRO is registered.²⁴⁷⁹ Paragraph (b) identifies four factors the NRSRO must consider when designing the standards.²⁴⁸⁰ Paragraph (c)(1) requires NRSROs to include a requirement for periodic testing in its standards.²⁴⁸¹ Paragraph (c)(2) provides that the standards must include a requirement that at least one individual with an “appropriate level of experience in performing credit analysis, but not less than three years” must participate in the determination of a credit rating.²⁴⁸²

The Commission is adopting Rule 17g-10 and Form ABS Due Diligence-15E.²⁴⁸³ Paragraph (a) of Rule 17g-10 provides that the written certification providers of third-party due diligence services must provide to NRSROs pursuant to section 15E(s)(4)(B) of the Exchange Act must be made on Form ABS Due Diligence-15E.²⁴⁸⁴ Paragraph (b) of Rule 17g-10 provides that the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.²⁴⁸⁵ Paragraph (c) of Rule 17g-10 provides a “safe harbor” for a provider of third-party due diligence services to meet its obligation under section 15E(s)(4)(B).²⁴⁸⁶ Paragraph (d) of Rule 17g-10 contains four definitions to be used for the purposes of section 15E(s)(4)(B) and Rule 17g-10; namely, definitions of due diligence services,²⁴⁸⁷ issuer,²⁴⁸⁸ originator,²⁴⁸⁹ and securitizer.²⁴⁹⁰

²⁴⁷⁹ See section II.I.1.a. of this release (providing a more detailed discussion of this paragraph).

²⁴⁸⁰ See section II.I.1.b. of this release (providing a more detailed discussion of this paragraph).

²⁴⁸¹ See section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

²⁴⁸² See section II.I.1.c. of this release for (providing a more detailed discussion of this paragraph).

²⁴⁸³ See section II.H.2. of this release (providing a more detailed discussion of Rule 17g-10); section II.H.3. of this release (providing a more detailed discussion of Form ABS Due Diligence-15E).

²⁴⁸⁴ See paragraph (a) of Rule 17g-10.

²⁴⁸⁵ See paragraph (b) of Rule 17g-10.

²⁴⁸⁶ See paragraphs (c)(1) and (2) of Rule 17g-10. See also paragraph (a)(3)(iii)(E) of Rule 17g-5 (provisions under which the issuer or underwriter must promptly post the form on the Rule 17g-5 website).

²⁴⁸⁷ See paragraph (d)(1) of Rule 17g-10.

²⁴⁸⁸ See paragraph (d)(2) of Rule 17g-10.

Form ABS Due Diligence-15E contains five line items identifying information the provider of third-party due diligence services must provide.²⁴⁹¹ It also contains a signature line with a corresponding representation.²⁴⁹² Item 1 elicits the identity and address of the provider of third-party due diligence services.²⁴⁹³ Item 2 elicits the identity and address of the issuer, underwriter, or NRSRO that paid the provider to provide the services.²⁴⁹⁴ Item 3 requires the provider of the due diligence services to identify each NRSRO whose published criteria for performing due diligence the provider of third-party due diligence services intended to satisfy in performing the due diligence review.²⁴⁹⁵ Item 4 requires the provider of third-party due diligence services to describe the scope and manner of the due diligence performed.²⁴⁹⁶ Item 5 requires the provider of third-party due diligence services to describe the findings and conclusions resulting from the review.²⁴⁹⁷

The Commission is adopting Rule 15Ga-2 and amendments to Form ABS-15G.²⁴⁹⁸ Rule 15Ga-2 requires an issuer or underwriter of certain Exchange Act-ABS that are to be rated by an NRSRO to furnish a Form ABS-15G on the Commission's EDGAR system containing the findings and conclusions of any third-party "due diligence report" obtained by the issuer or underwriter at least five business days prior to the first sale in the offering. The rule defines due

²⁴⁸⁹ See paragraph (d)(3) of Rule 17g-10.

²⁴⁹⁰ See paragraph (d)(4) of Rule 17g-10.

²⁴⁹¹ See section II.H.3. of this release (providing a more detailed discussion of the information to be reported in the form).

²⁴⁹² See Form ABS Due Diligence-15E.

²⁴⁹³ See Item 1 of Form ABS Due Diligence-15E.

²⁴⁹⁴ See Item 2 of Form ABS Due Diligence-15E.

²⁴⁹⁵ See Item 3 of Form ABS Due Diligence 15E.

²⁴⁹⁶ See Item 4 of Form ABS Due Diligence 15E.

²⁴⁹⁷ See Item 5 of Form ABS Due Diligence 15E.

²⁴⁹⁸ See section II.H.1. of this release (providing a more detailed discussion of the rule and form).

diligence report as any report containing findings and conclusions relating to due diligence services as defined in Rule 17g-10.²⁴⁹⁹ Under the rule, the disclosure must be furnished using Form ABS-15G for both registered and unregistered offerings of Exchange Act-ABS. However, if the disclosure required by Rule 15Ga-2 has been made in the applicable prospectus, the issuer or underwriter may refer to that section of the prospectus in Form ABS-15G rather than providing the findings and conclusions directly on the form.²⁵⁰⁰ Also, Rule 15Ga-2 provides an exemption for certain offshore issuances of Exchange Act-ABS. Further, the final rule does not apply to municipal Exchange Act-ABS, but section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of these securities to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

As stated above, the Commission is requiring that certain Forms NRSRO and all Rule 17g-3 annual reports be submitted to the Commission electronically using the Commission's EDGAR system as PDF documents.²⁵⁰¹ In order to implement this requirement, the Commission is adopting amendments to Rule 101 of Regulation S-T to require that Forms NRSRO and Exhibits 1 through 9 submitted pursuant to paragraphs (e), (f), and (g) of Rule 17g-1 and the annual reports submitted pursuant Rule 17g-3 be submitted through the EDGAR system as PDF documents.²⁵⁰²

NRSROs will need to file a Form ID with the Commission in order to gain access to the Commission's EDGAR system to make electronic submissions to the Commission.²⁵⁰³

²⁴⁹⁹ See paragraph (d)(1) of Rule 17g-10.

²⁵⁰⁰ See section II.H.1. of this release (providing a more detailed discussion of this rule).

²⁵⁰¹ See section II.L. of this release (providing a more detailed discussion of this amendment).

²⁵⁰² See paragraph (a)(xiv) of Rule 101 of Regulation S-T.

²⁵⁰³ See section II.L. of this release (providing a more detailed discussion of these requirements).

Issuers and underwriters of Exchange Act-ABS also will need to furnish Form ABS-15G to the Commission through the EDGAR system pursuant to Rule 15Ga-2. The Commission believes that these issuers and underwriters already have access to the EDGAR system because, for example, they need such access for purposes of Rule 15Ga-1. Consequently, the new rule and amendments will not require them to file a Form ID to gain access to the EDGAR system.

E. AGENCY ACTION TO MINIMIZE EFFECT ON SMALL ENTITIES

Pursuant to section 604(a)(6) of the RFA, the Commission must describe the steps it has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes.²⁵⁰⁴ In connection with adopting the amendments and new rules, the Commission considered the following alternatives: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rules, or any part of the rules, for small entities.

As discussed throughout this release, as well as in section VI.B. of this release, the Commission is sensitive to the costs and burdens the amendments and new rules will have on all entities, including small entities. Consequently, the amendments and new rules contain certain modifications from the proposals designed to alleviate as appropriate some of the concerns regarding small entities. The Commission believes that the amendments and new rules being adopted today, as modified from the proposal, strike an appropriate balance between minimizing the costs and burdens on small entities, and implementing the policies and requirements

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See 5 U.S.C. 604(a)(6).

addressed by Title IX, Subtitle C of the Dodd-Frank Act. Moreover, the Commission believes the choices it has made in implementing Title IX, Subtitle C of the Dodd-Frank Act have resulted in amendments and new rules that are appropriate for entities of all sizes.

Consistent with Exchange Act section 15E(h)(3)(B)(i), the Commission has provided for a process for small NRSROs to seek exemptions with respect to the sales and marketing conflict of interest provisions.²⁵⁰⁵ The Commission does not otherwise believe it is appropriate to establish different compliance or reporting requirements or timetables; to clarify, consolidate, or simplify compliance and reporting requirements under the amendments to existing rules and new rules for small entities; or summarily exempt small entities from coverage of the rules, or any part of the rules. As discussed throughout this release, the amendments and new rules being adopted today are designed to improve the governance of NRSROs with respect to their procedures and methodologies for determining credit ratings, increase the transparency of NRSRO activities, and improve the quality of NRSRO credit ratings. These measures will benefit NRSROs, investors, and other users of credit ratings. Moreover, the objectives of governance, transparency, and quality are as relevant to small NRSROs as they are to large NRSROs inasmuch as investors and others use the credit ratings of all NRSROs.

However, where possible in the adopted amendments and new rules and as discussed throughout this release, the Commission has used performance standards. Policies and procedures requirements allow for tailoring by the small NRSROs to their particular business models. As noted in section VI.B. of this release, a number of the amendments and new rules are policies and procedures-based requirements and, consequently, a small NRSRO can comply with these requirements by tailoring and scaling its policies and procedures to its size and business

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See section II.B.2. of this release (providing a more detailed discussion of this provision).

activities. For example, the Commission has established policies and procedures-based requirements in Rule 17g-8 to implement provisions in Title IX, Subtitle C of the Dodd-Frank Act that address: (1) the procedures and methodologies an NRSRO uses to determine credit ratings;²⁵⁰⁶ (2) the symbols, numbers, or scores an NRSRO uses to denote credit ratings;²⁵⁰⁷ and (3) look-back reviews.²⁵⁰⁸ In addition, the new rule requiring an NRSRO to establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings provides the NRSRO with flexibility to design the standards subject to certain minimum requirements.²⁵⁰⁹

Moreover, as noted in section VI.B. of this release, the Commission has modified the amendments and new rules from the proposal in ways that will reduce costs on, and burdens for, all NRSROs subject to the amendments and new rules, including small entities. For example, the Commission has modified the provisions from the proposal regarding the disclosure of performance statistics to narrow the scope of the credit ratings included in the statistics, which will make producing them less costly and burdensome.²⁵¹⁰ In addition, the Commission has significantly shortened from the proposal the time horizon of historical information that must be retrieved for inclusion in the rating histories.²⁵¹¹ Furthermore, the Commission has narrowed from the proposal the scope of rating actions that will trigger the requirement that an NRSRO publish a form and any due diligence certifications when taking a rating action and has exempted from this requirement certain rating actions involving credit ratings assigned to foreign obligors

²⁵⁰⁶ See section II.F.1. of this release (providing a more detailed discussion of these requirements).

²⁵⁰⁷ See section II.J.1. of this release (providing a more detailed discussion of this paragraph).

²⁵⁰⁸ See section II.C.1. of this release (providing a more detailed discussion of this paragraph).

²⁵⁰⁹ See section II.I.1. of this release (providing a more detailed discussion of this rule).

²⁵¹⁰ See section II.E.1.b. of this release (providing a more detailed discussion of these modifications).

²⁵¹¹ See section II.E.3. of this release (providing a more detailed discussion of these modifications).

or securities or money market instruments issued overseas.²⁵¹² These modifications and the other modifications discussed throughout this release, as well as in section VI.B. of this release, will reduce the cumulative cost and burden of the amendments and new rules as compared with the proposals.

Finally, the amendments and new rules being adopted today will make additional information about third-party due diligence services provided for Exchange Act-ABS available to market participants and others.²⁵¹³ This will benefit NRSROs, the users of credit ratings, and investors and other Exchange Act-ABS market participants who may or may not be users of credit ratings.²⁵¹⁴ As discussed in section VI.C. of this release, the Commission estimates that all fifteen providers of third-party due diligence services subject to the new requirements are small entities and that the new requirements applicable to issuers will not have a significant economic impact on a substantial number of small entities.

As noted above, the Commission included its view that the requirements applicable to issuers will not have a significant economic impact on a substantial number of small entities in the proposing release and received no comments on its conclusion and the Commission estimates that only one of the estimated 336 unique issuers is small for purposes of the PRA. For these reasons, the Commission does not believe it is appropriate to establish different compliance or reporting requirements or timetables; to clarify, consolidate, or simplify compliance and reporting requirements under the amendments to existing rules and new rules for small entities; or summarily exempt small entities from coverage of the rules, or any part of the rules.

²⁵¹² See section II.G. of this release (providing a more detailed discussion of these modifications).

²⁵¹³ See section II.H. of this release (providing a more detailed discussion of the final amendments and new rules relating to third-party due diligence services).

²⁵¹⁴ See, e.g., section II.H.4. of this release (providing a more detailed discussion of the benefits of the final amendments and new rules relating to third-party due diligence services).

VII. STATUTORY AUTHORITY

The Commission is adopting amendments to §§ 232.101, 240.17g-1, 240.17g-2, 240.17g-3, 240.17g-5, 240.17g-6, 240.17g-7, Form NRSRO, and Form ABS-15G and is adopting §§ 240.15Ga-2, 240.17g-8, 240.17g-9, 240.17g-10, and Form ABS Due Diligence-15E pursuant to the authority conferred by the Exchange Act, including sections 15E, 17(a), and 36 (15 U.S.C. 78o-7, 78q, and 78mm), and pursuant to authority in sections 936, 938, and 943 of the Dodd-Frank Act (Pub. L. No. 111-203 §§ 936, 938, and 943).

List of Subjects in 17 CFR Parts 232, 240, 249, and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

Text of Final Rules

In accordance with the foregoing, the Commission is amending Title 17, Chapter II of the Code of Federal Regulation as follows.

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

2. Section 232.101 is amended by adding paragraph (a)(1)(xiv).

The addition reads as follows:

§ 232.101 Mandated electronic submissions and exceptions.

- | | | | |
|-----|---|---|---|
| (a) | * | * | * |
| (1) | * | * | * |

(xiv) Form NRSRO (§ 249b.300 of this chapter), and the information and documents in Exhibits 1 through 9 to Form NRSRO, filed with or furnished to, as applicable, the Commission under §§ 240.17g-1(e), (f), and (g) of this chapter and the annual reports filed with or furnished to, as applicable, the Commission under § 240.17g-3 of this chapter. The filings or furnishings must be made on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T (§ 232.11). Notwithstanding Rule 104 of Regulation S-T (§ 232.104), the PDF documents filed or furnished under this paragraph will be considered as officially filed with or furnished to, as applicable, the Commission.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for part 240 is amended by adding sectional authorities for §§ 240.15Ga-2, 240.17g-8, and 240.17g-9 to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); and 18 U.S.C. 1350 unless otherwise noted.

* * * * *

Section 240.15Ga-2 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

Section 240.17g-8 is also issued under sec. 938, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

Section 240.17g-9 is also issued under sec. 936, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

4. Section 240.15Ga-2 is added to read as follows:

§ 240.15Ga-2 Findings and conclusions of third-party due diligence reports.

(a) The issuer or underwriter of an offering of any asset-backed security (as that term is defined in Section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)) that is to be rated by a nationally recognized statistical rating organization must furnish Form ABS-15G (§ 249.1400 of this chapter) to the Commission containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter at least five business days prior to the first sale in the offering.

(b) In the case where the issuer and one or more underwriters have obtained the same third-party due diligence report related to a particular asset-backed securities transaction, if any one such party has furnished all the disclosures required in order to meet the obligations under paragraph (a) of this section, the other party or parties are not required to separately furnish the same disclosures related to such third-party due diligence report.

(c) If the disclosure required by this rule has been made in the prospectus (including an attribution to the third-party that provided the third-party due diligence report), the issuer or underwriter may refer to that section of the prospectus in Form ABS-15G rather than providing the findings and conclusions itself directly in Form ABS-15G.

(d) For purposes of paragraphs (a) and (b) of this section, issuer is defined in Rule 17g-10(d)(2) (§ 240.17g-10(d)(2) of this chapter) and third-party due diligence report means any report containing findings and conclusions of any due diligence services as defined in Rule 17g-10(d)(1) (§ 240.17g-10(d)(1) of this chapter) performed by a third party.

(e) The requirements of this rule would not apply to an offering of an asset-backed security if certain conditions are met, including:

(i) The offering is not required to be, and is not, registered under the Securities Act of 1933;

(ii) The issuer of the rated security is not a U.S. person (as defined under Securities Act Rule 902(k)); and

(iii) the security issued by the issuer will be offered and sold upon issuance, and any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States.

(f) The requirements of this rule would not apply to an offering of an asset-backed security if certain conditions are met, including:

(i) The issuer of the rated security is a municipal issuer; and

(ii) The offering is not required to be, and is not, registered under the Securities Act of 1933.

(g) For purposes of paragraph (f) of this section, a municipal issuer is an issuer (as that term is defined in Rule 17g-10(d)(2) (§ 240.17g-10(d)(2) of this chapter)) that is any State or Territory of the United States, the District of Columbia, any political subdivision of any State, Territory or the District of Columbia, or any public instrumentality of one or more States, Territories or the District of Columbia.

(h) An offering of an asset-backed security that is exempted from the requirements of this rule pursuant to paragraph (f) of this section remains subject to the requirements of Section 15E(s)(4)(A) of the Act (15 U.S.C. 78o-7(s)(4)(A)), which requires that the issuer or underwriter

of any asset-backed security shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

Instruction to paragraph (a) of this section: Disclosure of the findings and conclusions includes, but is not limited to, disclosure of the criteria against which the loans were evaluated, and how the evaluated loans compared to those criteria along with the basis for including any loans not meeting those criteria. This disclosure is only required for an initial rating and does not need to be furnished in connection with any subsequent rating actions. For purposes of this rule, the date of first sale is the date on which the first investor is irrevocably contractually committed to invest, which, depending on the terms and conditions of the contract, could be the date on which the issuer receives the investor's subscription agreement or check.

5. Section 240.17g-1 is amended by:

- a. In paragraphs (a), (b), and (c), removing the phrase "furnish the Commission with" and its place adding the phrase "file with the Commission two paper copies of";
- b. In paragraph (d), adding the phrase "two paper copies of" after the phrase "the applicant must furnish the Commission with"; and
- c. Revising paragraphs (e), (f), (g), (h), and (i).

The revisions read as follows:

§ 240.17g-1 Application for registration as a nationally recognized statistical rating organization.

* * * * *

(e) Update of registration. A nationally recognized statistical rating organization amending materially inaccurate information in its application for registration pursuant to section 15E(b)(1) of the Act (15 U.S.C. 78o-7(b)(1)) must promptly file with the Commission an update of its registration on Form NRSRO that follows all applicable instructions for the Form. A Form NRSRO and the information and documents in Exhibits 2 through 9 to Form NRSRO, as applicable, filed under this paragraph must be filed electronically with the Commission on

EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T (§ 232.11 of this chapter).

(f) Annual certification. A nationally recognized statistical rating organization amending its application for registration pursuant to section 15E(b)(2) of the Act (15 U.S.C. 78o-7(b)(2)) must file with the Commission an annual certification on Form NRSRO that follows all applicable instructions for the Form not later than 90 days after the end of each calendar year. A Form NRSRO and the information and documents in Exhibits 1 through 9 to Form NRSRO filed under this paragraph must be filed electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

(g) Withdrawal from registration. A nationally recognized statistical rating organization withdrawing from registration pursuant to section 15E(e)(1) of the Act (15 U.S.C. 78o-7(e)(1)) must furnish the Commission with a notice of withdrawal from registration on Form NRSRO that follows all applicable instructions for the Form. The withdrawal from registration will become effective 45 calendar days after the notice is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors. A Form NRSRO furnished under this paragraph must be furnished electronically with the Commission on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

(h) Filing or furnishing Form NRSRO. A Form NRSRO filed or furnished, as applicable, under any paragraph of this section will be considered filed with or furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form. Information filed or furnished, as applicable, on

a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law.

(i) Public availability of Form NRSRO. A nationally recognized statistical rating organization must make its current Form NRSRO and information and documents in Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet website within 10 business days after the date of the Commission order granting an initial application for registration as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings and within 10 business days after filing with or furnishing to, as applicable, the Commission a Form NRSRO under paragraph (e), (f), or (g) of this section. In addition, a nationally recognized statistical rating organization must make its most recently filed Exhibit 1 to Form NRSRO freely available in writing to any individual who requests a copy of the Exhibit.

6. Section 240.17g-2 is amended by:
 - a. In paragraphs (a)(2)(iii) and (a)(7), removing the words “or mortgage-backed”;
 - b. Adding paragraph (a)(9);
 - c. Revising paragraph (b)(1);
 - d. In paragraph (b)(9), removing the words “or mortgage-backed”;
 - e. Revising paragraph (b)(11);
 - f. Adding paragraphs (b)(12), (b)(13), (b)(14), and (b)(15);
 - g. Revising paragraph (c);
 - h. Re-designating paragraph (d)(1) as paragraph (d); and
 - i. Removing paragraphs (d)(2) and (d)(3);

The additions and revisions read as follows:

§ 240.17g-2 Records to be made and retained by nationally recognized statistical rating organizations.

(a) * * *

(9) A record documenting the policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o-7(h)(4)(A)) and § 240.17g-8(c).

* * * * *

(b) * * *

(1) Significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports the nationally recognized statistical rating organization filed with or furnished to, as applicable, the Commission pursuant to § 240.17g-3.

* * * * *

(11) Forms NRSRO (including Exhibits and accompanying information and documents) the nationally recognized statistical rating organization filed with or furnished to, as applicable, the Commission.

(12) The internal control structure the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Act (15 U.S.C. 78o-7(c)(3)(A)).

(13) The policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g-8(a).

(14) The policies and procedures the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g-8(b).

(15) The standards of training, experience, and competence for credit analysts the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to § 240.17g-9.

(c) Record retention periods. The records required to be retained pursuant to paragraphs (a) and (b) of this section must be retained for three years after the date the record is made or received, except that a record identified in paragraph (a)(9), (b)(12), (b)(13), (b)(14), or (b)(15) of this section must be retained until three years after the date the record is replaced with an updated record.

* * * * *

7. Section 240.17g-3 is amended by:

- a. Revising the heading;
- b. Revising the introductory text of paragraph (a);
- c. In paragraph (a)(1), removing the first word “Audited” and in its place adding the phrase “File with the Commission a financial report, as of the end of the fiscal year, containing audited”;
- d. In paragraph (a)(2), removing the first word “If” and in its place adding the phrase “File with the Commission a financial report, as of the end of the fiscal year, containing, if”;
- e. In the Note to paragraph (a)(2), removing the word “furnished” and in its place adding the word “filed”;
- f. In paragraphs (a)(3), (a)(4), and (a)(5), removing the first word “An” and in its place adding the phrase “File with the Commission an unaudited financial report, as of the end of the fiscal year,”;

- g. In paragraph (a)(6), removing the first word “An” and in its place adding the phrase “Furnish the Commission with an unaudited report, as of the end of the fiscal year,”;
- h. In the Note to paragraph (a)(6), removing the words “or mortgage-backed”;
- i. Adding paragraphs (a)(7) and (a)(8);
- j. Re-designating paragraph (b) as paragraph (b)(1) and revising newly-re-designated paragraph (b)(1);
- k. Adding paragraphs (b)(2), (d), and (e).

The additions and revisions read as follows:

§ 240.17g-3 Annual financial and other reports to be filed or furnished by nationally recognized statistical rating organizations.

(a) A nationally recognized statistical rating organization must annually, not more than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO):

* * * * *

(7)(i) File with the Commission an unaudited report containing an assessment by management of the effectiveness during the fiscal year of the internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings the nationally recognized statistical rating organization is required to establish, maintain, enforce, and document pursuant to section 15E(c)(3)(A) of the Act (15 U.S.C. 78o-7(c)(3)(A)) that includes:

(A) A description of the responsibility of management in establishing and maintaining an effective internal control structure;

(B) A description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and

(C) A statement as to whether the internal control structure was effective as of the end of the fiscal year.

(ii) Management is not permitted to conclude that the internal control structure of the nationally recognized statistical rating organization was effective as of the end of the fiscal year if there were one or more material weaknesses in the internal control structure as of the end of the fiscal year.

(iii) For purposes of this paragraph (a)(7), a deficiency in the internal control structure exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect a failure of the nationally recognized statistical rating organization to:

(A) Implement a policy, procedure, or methodology for determining credit ratings in accordance with the policies and procedures of the nationally recognized statistical rating organization; or

(B) Adhere to an implemented policy, procedure, or methodology for determining credit ratings.

(iv) For purposes of this paragraph (a)(7), a material weakness exists if a deficiency, or a combination of deficiencies, in the design or operation of the internal control structure creates a reasonable possibility that a failure identified in paragraph (a)(7)(iii) of this section that is material will not be prevented or detected on a timely basis.

(8) File with the Commission an unaudited annual report on the compliance of the nationally recognized statistical rating organization with the securities laws and the policies and procedures of the nationally recognized statistical rating organization pursuant to section 15E(j)(5)(B) of the Act (15 U.S.C. 78o-7(j)(5)(B)).

(b)(1) The nationally recognized statistical rating organization must attach to the reports filed or furnished, as applicable, pursuant to paragraphs (a)(1) through (a)(6) of this section a signed statement by a duly authorized person associated with the nationally recognized statistical rating organization stating that the person has responsibility for the reports and, to the best knowledge of the person, the reports fairly present, in all material respects, the financial condition, results of operations, cash flows, revenues, analyst compensation, and credit rating actions of the nationally recognized statistical rating organization for the period presented; and

(2) The nationally recognized statistical rating organization must attach to the report filed pursuant to paragraph (a)(7) of this section a signed statement by the chief executive officer of the nationally recognized statistical rating organization or, if the nationally recognized statistical rating organization does not have a chief executive officer, an individual performing similar functions, stating that the chief executive officer or equivalent individual has responsibility for the report and, to the best knowledge of the chief executive officer or equivalent individual, the report fairly presents, in all material respects: an assessment by management of the effectiveness of the internal control structure during the fiscal year that includes a description of the responsibility of management in establishing and maintaining an effective internal control structure; a description of each material weakness in the internal control structure identified during the fiscal year, if any, and a description, if applicable, of how each identified material weakness was addressed; and an assessment by management of the effectiveness of the internal control structure as of the end of the fiscal year.

* * * * *

(d) Electronic filing. The reports must be filed with or furnished to, as applicable, the Commission electronically on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

(e) Confidential treatment. Information in a report filed or furnished, as applicable, on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law. Confidential treatment may be requested by marking each page “Confidential Treatment Requested” and by complying with Commission rules governing confidential treatment.

8. Section 240.17g-5 is amended by:

a. In paragraph (a)(3), removing the words “or mortgaged-backed”;

b. In paragraphs (a)(3)(i), (a)(3)(ii), (a)(3)(iii)(A), (a)(3)(iii)(B), (a)(3)(iii)(C), and (a)(3)(iii)(D), removing the words “Web site” and in their place adding the word “website”;

c. In paragraphs (a)(3)(i) and (a)(3)(iii)(A), after the citation “(a)(3)(iii)(C)”, removing the words “and (a)(3)(iii)(D)” and in their place adding the words “, (a)(3)(iii)(D), and (a)(3)(iii)(E)”;

d. Adding paragraph (a)(3)(iii)(E);

e. In paragraph (b)(9), removing the words “or mortgaged-backed”;

f. In paragraph (c)(6), removing the word “or” at the end of the paragraph after the “.”;

g. In paragraph (c)(7), adding the word “or” at the end of the paragraph after the “.”;

f. Adding paragraph (c)(8);

h. In paragraph (e), removing the words “Web site” and in their place adding the word “website” and removing the words “Web sites” and in their place adding the word “websites”; and

i. Adding paragraphs (f) and (g).

The additions read as follows:

§ 240.17g-5 Conflicts of interest.

(a) * * *

* * * *

(3) * * *

* * * *

(iii) * * *

* * * *

(E) Post on such password-protected Internet website, promptly after receipt, any executed Form ABS Due Diligence-15E (§ 249b.500 of this chapter) containing information about the security or money market instrument delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.

* * *

(c) * * *

* * * *

(8) The nationally recognized statistical rating organization issues or maintains a credit rating where a person within the nationally recognized statistical rating organization who participates in determining or monitoring the credit rating, or developing or approving

procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also:

(i) participates in sales or marketing of a product or service of the nationally recognized statistical rating organization or a product or service of an affiliate of the nationally recognized statistical rating organization; or

(ii) is influenced by sales or marketing considerations.

* * * * *

(f) Upon written application by a nationally recognized statistical rating organization, the Commission may exempt, either unconditionally or on specified terms and conditions, such nationally recognized statistical rating organization from the provisions of paragraph (c)(8) of this section if the Commission finds that due to the small size of the nationally recognized statistical rating organization it is not appropriate to require the separation within the nationally recognized statistical rating organization of the production of credit ratings from sales and marketing activities and such exemption is in the public interest.

(g) In a proceeding pursuant to section 15E(d)(1) of the Act (15 U.S.C. 78o-7(d)(1)), the Commission shall suspend or revoke the registration of a nationally recognized statistical rating organization if the Commission finds, in lieu of a finding specified under sections 15E(d)(1)(A), (B), (C), (D), (E), or (F) of the Act (15 U.S.C. 78o-7(d)(1)(A) through (F)), that the nationally recognized statistical rating organization has violated a rule issued under section 15E(h) of the Act (15 U.S.C. 78o-7(h)) and that the violation affected a credit rating.

9. Section 240.17g-6 is amended by, in paragraph (a)(4), removing the words “or mortgage-backed”.

10. Section 240.17g-7 is amended by removing the introductory text and revising the heading, paragraphs (a) and (b), and the Note.

The revisions read as follows:

§ 240.17g-7 Disclosure requirements.

(a) Disclosures to be made when taking a rating action. Except as provided in paragraph (a)(3) of this section, a nationally recognized statistical rating organization must publish the items described in paragraphs (a)(1) and (a)(2) of this section, as applicable, when taking a rating action with respect to a credit rating assigned to an obligor, security, or money market instrument in a class of credit ratings for which the nationally recognized statistical rating organization is registered. For purposes of this section, the term rating action means any of the following: the publication of an expected or preliminary credit rating assigned to an obligor, security, or money market instrument before the publication of an initial credit rating; an initial credit rating; an upgrade or downgrade of an existing credit rating (including a downgrade to, or assignment of, default); and an affirmation or withdrawal of an existing credit rating if the affirmation or withdrawal is the result of a review of the credit rating assigned to the obligor, security, or money market instrument by the nationally recognized statistical rating organization using applicable procedures and methodologies for determining credit ratings. The items described in paragraphs (a)(1) and (a)(2) of this section must be published in the same manner as the credit rating that is the result or subject of the rating action and made available to the same persons who can receive or access the credit rating that is the result or subject of the rating action.

(1) Information disclosure form. A form generated by the nationally recognized statistical rating organization that meets the requirements of paragraphs (a)(1)(i), (a)(1)(ii), and (a)(1)(iii) of this section.

(i) Format. The form generated by the nationally recognized statistical rating organization must be in a format that:

(A) Organizes the information into numbered items that are identified by the type of information being disclosed and a reference to the paragraph in this section that specifies the disclosure of the information, and are in the order that the paragraphs specifying the information to be disclosed are codified in this section;

Note to paragraph (a)(1)(i)(A): A given item in the form should be identified by a title that identifies the type of information and references paragraph (a)(1)(ii)(A), (B), (C), (D), (E), (F), (G), (H), (I), (J), (K), (L), (M), (N), or (a)(2) of this section based on the information being disclosed in the item. For example, the information specified in paragraph (a)(1)(ii)(C) of this section should be identified with the caption “Main Assumptions and Principles Used to Construct the Rating Methodology used to Determine the Credit Rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7”). The form must organize the items of information in the following order: items 1 through 14 must contain the information specified in paragraphs (a)(1)(ii)(A) through (N) of this section, respectively, and item 15 must contain the certifications specified in paragraph (a)(2) of this section (the information specified in each paragraph comprising a separate item). For example, item 3 must contain the information specified in paragraph (a)(1)(ii)(C) of this section.

(B) Is easy to use and helpful for users of credit ratings to understand the information contained in the form; and

(C) Provides the content described in paragraphs (a)(1)(ii)(K), (L), and (M) of this section in a manner that is directly comparable across types of obligors, securities, and money market instruments.

(ii) Content. The form generated by the nationally recognized statistical rating organization must contain the following information about the credit rating:

(A) The symbol, number, or score in the rating scale used by the nationally recognized statistical rating organization to denote credit rating categories and notches within categories assigned to the obligor, security, or money market instrument that is the subject of the credit rating and, as applicable, the identity of the obligor or the identity and a description of the security or money market instrument;

(B) The version of the procedure or methodology used to determine the credit rating;

(C) The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating, including qualitative methodologies and quantitative inputs, and, if the credit rating is for a structured finance product, assumptions about the correlation of defaults across the underlying assets;

(D) The potential limitations of the credit rating, including the types of risks excluded from the credit rating that the nationally recognized statistical rating organization does not comment on, including, as applicable, liquidity, market, and other risks;

(E) Information on the uncertainty of the credit rating including:

(1) Information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and

(2) A statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including:

(i) Any limits on the scope of historical data; and

(ii) Any limits on accessibility to certain documents or other types of information that would have better informed the credit rating;

(F) Whether and to what extent the nationally recognized statistical rating organization used due diligence services of a third party in taking the rating action, and, if the nationally recognized statistical rating organization used such services, either:

(1) A description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party; or

(2) A cross-reference to a Form ABS Due Diligence-15E executed by the third party that is published with the form, provided the cross-referenced Form ABS Due Diligence-15E (§ 249b.500 of this chapter) contains a description of the information that the third party reviewed in conducting the due diligence services and a summary of the findings and conclusions of the third party;

(G) If applicable, how servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating;

(H) A description of the types of data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating;

(I) A statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument, in relation to the quality of information available to the nationally recognized statistical rating organization in rating similar obligors, securities, or money market instruments;

(J) Information relating to conflicts of interest of the nationally recognized statistical rating organization, which must include:

(1) As applicable, a statement that the nationally recognized statistical rating organization was:

(i) Paid to determine the credit rating by the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated;

(ii) Paid to determine the credit rating by a person other than the obligor being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated; or

(iii) Not paid to determine the credit rating;

(2) If applicable, in a statement required under paragraph (a)(1)(ii)(J)(1)(i) or (ii) of this section, a statement that the nationally recognized statistical rating organization also was paid for services other than determining credit ratings during the most recently ended fiscal year by the person that paid the nationally recognized statistical rating organization to determine the credit rating; and

(3) If the rating action results from a review conducted pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o-7(h)(4)(A)) and § 240.17g-8(c), the following information (as applicable):

(i) If the rating action is a revision of a credit rating pursuant to § 240.17g-8(c)(2)(i)(A), an explanation that the reason for the action is the discovery that a credit rating assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, including a description of the nature of the conflict, the date and associated credit rating of each prior rating action that the nationally recognized statistical rating organization has determined was influenced by the conflict, and a description of the impact the conflict had on the prior rating action or actions; or

(ii) If the rating action is an affirmation of a credit rating pursuant to § 240.17g-8(c)(2)(i)(B), an explanation that the reason for the action is the discovery that a credit rating

assigned to the obligor, security, or money market instrument in one or more prior rating actions was influenced by a conflict of interest, including a description of the nature of the conflict, an explanation of why no rating action was taken to revise the credit rating notwithstanding the presence of the conflict, the date and associated credit rating of each prior rating action the nationally recognized statistical rating organization has determined was influenced by the conflict, and a description of the impact the conflict had on the prior rating action or actions.

(K) An explanation or measure of the potential volatility of the credit rating, including:

- (1) Any factors that are reasonably likely to lead to a change in the credit rating; and
- (2) The magnitude of the change that could occur under different market conditions determined by the nationally recognized statistical rating organization to be relevant to the rating;

(L) Information on the content of the credit rating, including:

- (1) If applicable, the historical performance of the credit rating; and
- (2) The expected probability of default and the expected loss in the event of default;

(M) Information on the sensitivity of the credit rating to assumptions made by the nationally recognized statistical rating organization, including:

- (1) Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if the assumptions were proven false or inaccurate; provided that, if the nationally recognized statistical rating organization has made fewer than five such assumptions, it need only disclose information on the assumptions that would have an impact on the credit rating; and

- (2) An analysis, using specific examples, of how each of the assumptions identified in paragraph (a)(1)(ii)(M)(1) of this section impacts the credit rating;

(N)(1) If the credit rating is assigned to an asset-backed security as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)), information on:

(i) The representations, warranties, and enforcement mechanisms available to investors which were disclosed in the prospectus, private placement memorandum or other offering documents for the asset-backed security and that relate to the asset pool underlying the asset-backed security; and

(ii) How they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities;

(2) A nationally recognized statistical rating organization must include the information required under paragraph (a)(1)(ii)(N)(1) of this section only if the rating action is a preliminary credit rating, an initial credit rating, or, in the case of a rating action other than a preliminary credit rating or initial credit rating, the rating action is the first rating action taken after a material change in the representations, warranties, or enforcement mechanisms described in paragraph (a)(1)(ii)(N)(1) of this section and the rating action involves an asset-backed security that was initially rated by the nationally recognized statistical rating organization on or after September 26, 2011.

(iii) Attestation. The nationally recognized statistical rating organization must attach to the form a signed statement by a person within the nationally recognized statistical rating organization stating that the person has responsibility for the rating action and, to the best knowledge of the person:

(A) No part of the credit rating was influenced by any other business activities;

(B) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and

(C) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

(2) Third-party due diligence certification. Any executed Form ABS Due Diligence-15E (§ 249b.500 of this chapter) containing information about the security or money market instrument subject to the rating action that is received by the nationally recognized statistical rating organization or obtained by the nationally recognized statistical rating organization through an Internet website maintained by the issuer, sponsor, or underwriter of the security or money market instrument pursuant to § 240.17g-5(a)(3).

(3) Exemption. The provisions of paragraphs (a)(1) and (a)(2) do not apply to a rating action if:

(i) the rated obligor or issuer of the rated security or money market instrument is not a U.S. person (as defined in § 230.902(k) of this chapter); and

(ii) the nationally recognized statistical rating organization has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument after issuance, only in transactions that occur outside the United States.

(b) Disclosure of credit rating histories.

(1) Credit ratings subject to the disclosure requirement. A nationally recognized statistical rating organization must publicly disclose for free on an easily accessible portion of its corporate Internet website:

(i) For a class of credit rating in which the nationally recognized statistical rating organization is registered with the Commission as of the effective date of paragraph (b) of this

section, the credit rating assigned to each obligor, security, and money market instrument in the class that was outstanding as of, or initially determined on or after, the date three years prior to the effective date of this rule, and any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), and a withdrawal of the credit rating; and

(ii) For a class of credit rating in which the nationally recognized statistical rating organization is registered with the Commission after the effective date of paragraph (b) of this section, the credit rating assigned to each obligor, security, and money market instrument in the class that was outstanding as of, or initially determined on or after, the date three years prior to the date the nationally recognized statistical rating organization is registered in the class, and any subsequent upgrade or downgrade of the credit rating (including a downgrade to, or assignment of, default), and a withdrawal of the credit rating.

(2) Information. A nationally recognized statistical rating organization must include, at a minimum, the following information with each credit rating disclosed pursuant to paragraph (b)(1) of this section:

(i) The identity of the nationally recognized statistical rating organization disclosing the rating action;

(ii) The date of the rating action;

(iii) If the rating action is taken with respect to a credit rating of an obligor as an entity, the following identifying information about the obligor, as applicable:

(A) The Legal Entity Identifier issued by a utility endorsed or otherwise governed by the Global LEI Regulatory Oversight Committee or the Global LEI Foundation (LEI) of the obligor, if available, or, if an LEI is not available, the Central Index Key (CIK) number of the obligor, if available; and

(B) The name of the obligor.

(iv) If the rating action is taken with respect to a credit rating of a security or money market instrument, as applicable:

(A) The LEI of the issuer of the security or money market instrument, if available, or, if an LEI is not available, the CIK number of the issuer of the security or money market instrument, if available;

(B) The name of the issuer of the security or money market instrument; and

(C) The CUSIP of the security or money market instrument;

(v) A classification of the rating action as either:

(A) An addition to the rating history disclosure because the credit rating was outstanding as of the date three years prior to the effective date of the requirements in paragraph (b) of this section or because the credit rating was outstanding as of the date three years prior to the nationally recognized statistical rating organization becoming registered in the class of credit ratings;

(B) An initial credit rating;

(C) An upgrade of an existing credit rating;

(D) A downgrade of an existing credit rating, which would include classifying the obligor, security, or money market instrument as in default, if applicable; or

(E) A withdrawal of an existing credit rating and, if the classification is withdrawal, the nationally recognized statistical rating organization also must classify the reason for the withdrawal as either:

(1) The obligor defaulted, or the security or money market instrument went into default;

(2) The obligation subject to the credit rating was extinguished by payment in full of all outstanding principal and interest due on the obligation according to the terms of the obligation; or

(3) The credit rating was withdrawn for reasons other than those set forth in paragraph (b)(2)(v)(E)(1) or (2) of this section; and

(vi) The classification of the class or subclass that applies to the credit rating as either:

(A) Financial institutions, brokers, or dealers;

(B) Insurance companies;

(C) Corporate issuers; or

(D) Issuers of structured finance products in one of the following subclasses:

(1) Residential mortgage backed securities ("RMBS") (for purposes of this subclass, RMBS means a securitization primarily of residential mortgages);

(2) Commercial mortgage backed securities ("CMBS") (for purposes of this subclass, CMBS means a securitization primarily of commercial mortgages);

(3) Collateralized loan obligations ("CLOs") (for purposes of this subclass, a CLO means a securitization primarily of commercial loans);

(4) Collateralized debt obligations ("CDOs") (for purposes of this subclass, a CDO means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds);

(5) Asset-backed commercial paper conduits ("ABCP") (for purposes of this subclass, ABCP means short term notes issued by a structure that securitizes a variety of financial assets, such as trade receivables or credit card receivables, which secure the notes);

(6) Other asset-backed securities (“other ABS”) (for purposes of this subclass, other ABS means a securitization primarily of auto loans, auto leases, floor plans, credit card receivables, student loans, consumer loans, or equipment leases); or

(7) Other structured finance products (“other SFPs”) (for purposes of this subclass, other SFPs means any structured finance product not identified in paragraphs (b)(2)(iv)(D)(1) through (6)) of this section; or

(E) Issuers of government securities, municipal securities, or securities issued by a foreign government in one of the following subclasses:

- (1) Sovereign issuers;
- (2) U.S. public finance; or
- (3) International public finance; and

(vii) The credit rating symbol, number, or score in the applicable rating scale of the nationally recognized statistical rating organization assigned to the obligor, security, or money market instrument as a result of the rating action or, if the credit rating remained unchanged as a result of the action, the credit rating symbol, number, or score in the applicable rating scale of the nationally recognized statistical rating organization assigned to the obligor, security, or money market instrument as of the date of the rating action (in either case, include a credit rating in a default category, if applicable).

(3) Format and frequency of updating. The information identified in paragraph (b)(2) of this section must be disclosed in an interactive data file that uses an XBRL (eXtensible Business Reporting Language) format and the List of XBRL Tags for nationally recognized statistical rating organizations as published on the Internet website of the Commission, and must be updated no less frequently than monthly.

(4) Timing. The nationally recognized statistical rating organization must disclose the information required in paragraph (b)(2) of this section:

(i) Within twelve months from the date the rating action is taken, if the credit rating subject to the action was paid for by the obligor being rated or by the issuer, underwriter, depositor, or sponsor of the security being rated; or

(ii) Within twenty-four months from the date the rating action is taken, if the credit rating subject to the action is not a credit rating described in paragraph (b)(4)(i) of this section.

(5) Removal of a credit rating history. The nationally recognized statistical rating organization may cease disclosing a rating history of an obligor, security, or money market instrument if at least 15 years have elapsed since a rating action classified as a withdrawal of a credit rating pursuant to paragraph (b)(2)(v)(E) of this section was disclosed in the rating history of the obligor, security, or money market instrument.

11. Section 240.17g-8 is added to read as follows:

§ 240.17g-8 Policies, procedures, and internal controls.

(a) Policies and procedures with respect to the procedures and methodologies used to determine credit ratings. A nationally recognized statistical rating organization must establish, maintain, enforce, and document policies and procedures reasonably designed to ensure:

(1) That the procedures and methodologies, including qualitative and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit ratings are approved by its board of directors or a body performing a function similar to that of a board of directors.

(2) That the procedures and methodologies, including qualitative and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit

ratings are developed and modified in accordance with the policies and procedures of the nationally recognized statistical rating organization.

(3) That material changes to the procedures and methodologies, including changes to qualitative and quantitative data and models, the nationally recognized statistical rating organization uses to determine credit ratings are:

(i) Applied consistently to all current and future credit ratings to which the changed procedures or methodologies apply; and

(ii) To the extent that the changes are to surveillance or monitoring procedures and methodologies, applied to current credit ratings to which the changed procedures or methodologies apply within a reasonable period of time, taking into consideration the number of credit ratings impacted, the complexity of the procedures and methodologies used to determine the credit ratings, and the type of obligor, security, or money market instrument being rated.

(4) That the nationally recognized statistical rating organization promptly publishes on an easily accessible portion of its corporate Internet website:

(i) Material changes to the procedures and methodologies, including to qualitative models or quantitative inputs, the nationally recognized statistical rating organization uses to determine credit ratings, the reason for the changes, and the likelihood the changes will result in changes to any current credit ratings; and

(ii) Notice of the existence of a significant error identified in a procedure or methodology, including a qualitative or quantitative model, the nationally recognized statistical rating organization uses to determine credit ratings that may result in a change to current credit ratings.

(5) That the nationally recognized statistical rating organization discloses the version of a credit rating procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating.

(b) Policies and procedures with respect to credit rating symbols, numbers, or scores. A nationally recognized statistical rating organization must establish, maintain, enforce, and document policies and procedures that are reasonably designed to:

(1) Assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument.

(2) Clearly define each symbol, number, or score in the rating scale used by the nationally recognized statistical rating organization to denote a credit rating category and notches within a category for each class of credit ratings for which the nationally recognized statistical rating organization is registered (including subclasses within each class) and to include such definitions in Exhibit 1 to Form NRSRO (§ 249b.300 of this chapter).

(3) Apply any symbol, number, or score defined pursuant to paragraph (b)(2) of this section in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.

(c) Policies and procedures with respect to look-back reviews. The policies and procedures a nationally recognized statistical rating organization is required to establish, maintain, and enforce pursuant to section 15E(h)(4)(A) of the Act (15 U.S.C. 78o-7(h)(4)(A)) must address instances in which a review conducted pursuant to those policies and procedures determines that a conflict of interest influenced a credit rating assigned to an obligor, security, or

money market instrument by including, at a minimum, procedures that are reasonably designed to ensure that the nationally recognized statistical rating organization will:

(1) Promptly determine whether the current credit rating assigned to the obligor, security, or money market instrument must be revised so that it no longer is influenced by a conflict of interest and is solely a product of the documented procedures and methodologies the nationally recognized statistical rating organization uses to determine credit ratings; and

(2)(i) Promptly publish, based on the determination of whether a current credit rating referred to in paragraph (c)(1) of this section must be revised (as applicable):

(A) A revised credit rating, if appropriate, and include with the publication of the revised credit rating the information required by § 240.17g-7(a)(1)(ii)(J)(3)(i); or

(B) An affirmation of the credit rating, if appropriate, and include with the publication of the affirmation the information required by § 240.17g-7(a)(1)(ii)(J)(3)(ii).

(ii) If the credit rating is not revised or affirmed pursuant to paragraph (c)(2)(i) of this section within fifteen calendar days of the date of the discovery that the credit rating was influenced by a conflict of interest, publish a rating action placing the credit rating on watch or review and include with the publication an explanation that the reason for the action is the discovery that the credit rating was influenced by a conflict of interest.

(d) Internal control structures. A nationally recognized statistical rating organization must take into consideration the factors identified in paragraphs (d)(1) through (d)(4) of this section when establishing, maintaining, enforcing, and documenting an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings pursuant to section 15E(c)(3)(A) of the Act.

(1) With respect to establishing the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) controls reasonably designed to ensure that a newly developed methodology or proposed update to an in-use methodology for determining credit ratings is subject to an appropriate review process (for example, by persons who are independent from the persons that developed the methodology or methodology update) and to management approval prior to the new or updated methodology being employed by the nationally recognized statistical rating organization to determine credit ratings;

(ii) controls reasonably designed to ensure that a newly developed methodology or update to an in-use methodology for determining credit ratings is disclosed to the public for consultation prior to the new or updated methodology being employed by the nationally recognized statistical rating organization to determine credit ratings, that the nationally recognized statistical rating organization makes comments received as part of the consultation publicly available, and that the nationally recognized statistical rating organization considers the comments before implementing the methodology;

(iii) controls reasonably designed to ensure that in-use methodologies for determining credit ratings are periodically reviewed (for example, by persons who are independent from the persons who developed and/or use the methodology) in order to analyze whether the methodology should be updated;

(iv) controls reasonably designed to ensure that market participants have an opportunity to provide comment on whether in-use methodologies for determining credit ratings should be updated, that the nationally recognized statistical rating organization makes any such comments

received publicly available, and that the nationally recognized statistical rating organization considers the comments;

(v) controls reasonably designed to ensure that newly developed or updated quantitative models proposed to be incorporated into a credit rating methodology are evaluated and validated prior to being put into use;

(vi) controls reasonably designed to ensure that quantitative models incorporated into in-use credit rating methodologies are periodically reviewed and back-tested;

(vii) controls reasonably designed to ensure that a nationally recognized statistical rating organization engages in analysis before commencing the rating of a class of obligors, securities, or money market instruments the nationally recognized statistical rating organization has not previously rated to determine whether the nationally recognized statistical rating organization has sufficient competency, access to necessary information, and resources to rate the type of obligor, security, or money market instrument;

(viii) controls reasonably designed to ensure that a nationally recognized statistical rating organization engages in analysis before commencing the rating of an "exotic" or "bespoke" type of obligor, security, or money market instrument to review the feasibility of determining a credit rating;

(ix) controls reasonably designed to ensure that measures (for example, statistics) are used to evaluate the performance of credit ratings as part of the review of in-use methodologies for determining credit ratings to analyze whether the methodologies should be updated or the work of the analysts employing the methodologies should be reviewed;

(x) controls reasonably designed to ensure that, with respect to determining credit ratings, the work and conclusions of the lead credit analyst developing an initial credit rating or

conducting surveillance on an existing credit rating is reviewed by other analysts, supervisors, or senior managers before a rating action is formally taken (for example, having the work reviewed through a rating committee process);

(xi) controls reasonably designed to ensure that a credit analyst documents the steps taken in developing an initial credit rating or conducting surveillance on an existing credit rating with sufficient detail to permit an after-the-fact review or internal audit of the rating file to analyze whether the analyst adhered to the nationally recognized statistical rating organization's procedures and methodologies for determining credit ratings;

(xii) controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews or internal audits of rating files to analyze whether analysts adhere to the nationally recognized statistical rating organization's procedures and methodologies for determining credit ratings; and

(xiii) any other controls necessary to establish an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(2) With respect to maintaining the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews of whether it has devoted sufficient resources to implement and operate the documented internal control structure as designed;

(ii) controls reasonably designed to ensure that the nationally recognized statistical rating organization conducts periodic reviews or ongoing monitoring to evaluate the effectiveness of the internal control structure and whether it should be updated;

(iii) controls reasonably designed to ensure that any identified deficiencies in the internal control structure are assessed and addressed on a timely basis;

(iv) any other controls necessary to maintain an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(3) With respect to enforcing the internal control structure, the nationally recognized statistical rating organization must take into consideration:

(i) controls designed to ensure that additional training is provided or discipline taken with respect to employees who fail to adhere to requirements imposed by the internal control structure;

(ii) controls designed to ensure that a process is in place for employees to report failures to adhere to the internal control structure; and

(iii) any other controls necessary to enforce an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

(4) With respect to documenting the internal control structure, the nationally recognized statistical rating organization must take into consideration any controls necessary to document an effective internal control structure taking into consideration the nature of the business of the nationally recognized statistical rating organization, including its size, activities, organizational structure, and business model.

12. Section 240.17g-9 is added to read as follows:

§ 240.17g-9 Standards of training, experience, and competence for credit analysts.

(a) A nationally recognized statistical rating organization must establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the nationally recognized statistical rating organization produces accurate credit ratings in the classes of credit ratings for which the nationally recognized statistical rating organization is registered.

(b) The nationally recognized statistical rating organization must consider the following when establishing the standards required under paragraph (a) of this section:

(1) If the credit rating procedures and methodologies used by the individual involve qualitative analysis, the knowledge necessary to effectively evaluate and process the data relevant to the creditworthiness of the obligor being rated or the issuer of the securities or money market instruments being rated;

(2) If the credit rating procedures and methodologies used by the individual involve quantitative analysis, the technical expertise necessary to understand any models and model inputs that are a part of the procedures and methodologies;

(3) The classes and subclasses of credit ratings for which the individual participates in determining credit ratings and the factors relevant to such classes and subclasses, including the geographic location, sector, industry, regulatory and legal framework, and underlying assets, applicable to the obligors or issuers in the classes and subclasses; and

(4) The complexity of the obligors, securities, or money market instruments for which the individual participates in determining credit ratings.

(c) The nationally recognized statistical rating organization must include the following in the standards required under paragraph (a) of this section:

(1) A requirement for periodic testing of the individuals employed by the nationally recognized statistical rating organization to participate in the determination of credit ratings on their knowledge of the procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings in the classes and subclasses of credit ratings for which the individual participates in determining credit ratings; and

(2) A requirement that at least one individual with an appropriate level of experience in performing credit analysis, but not less than three years, participates in the determination of a credit rating.

13. Section 240.17g-10 is added to read as follows:

§240.17g-10 Certification of providers of third-party due diligence services in connection with asset-backed securities.

(a) The written certification that a person employed to provide third-party due diligence services is required to provide to a nationally recognized statistical rating organization pursuant to section 15E(s)(4)(B) of the Act (15 U.S.C. 78o-7(s)(4)(B)) must be on Form ABS Due Diligence-15E (§ 249b.500 of this chapter).

(b) The written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification.

(c) A person employed to provide third-party due diligence services will be deemed to have satisfied its obligations under section 15E(s)(4)(B) of the Act (15 U.S.C. 78o-7(s)(4)(B)) if the person promptly delivers an executed Form ABS Due Diligence-15E (§ 249b.500 of this chapter) after completion of the due diligence services to:

(1) A nationally recognized statistical rating organization that provided a written request for the Form prior to the completion of the due diligence services stating that the services relate to a credit rating the nationally recognized statistical rating organization is producing;

(2) A nationally recognized statistical rating organization that provides a written request for the Form after the completion of the due diligence services stating that the services relate to a credit rating the nationally recognized statistical rating organization is producing; and

(3) The issuer or underwriter of the asset-backed security for which the due diligence services relate that maintains the Internet website with respect to the asset-backed security pursuant to § 240.17g-5(a)(3).

(d) For purposes of section 15E(s)(4)(B) of the Act (15 U.S.C. 78o-7(s)(4)(B)) and this section:

(1) The term due diligence services means a review of the assets underlying an asset-backed security, as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)) for the purpose of making findings with respect to:

(i) The accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets;

(ii) Whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements;

(iii) The value of collateral securing the assets;

(iv) Whether the originator of the assets complied with federal, state, or local laws or regulations; or

(v) Any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the asset-backed security will pay interest and principal in accordance with applicable terms and conditions.

(2) The term issuer includes a sponsor, as defined in § 229.1101 of this chapter, or depositor, as defined in § 229.1101 of this chapter, that participates in the issuance of an asset-backed security, as defined in section 3(a)(79) of the Act (15 U.S.C. 78c(a)(79)).

(3) The term originator has the same meaning as in section 15G(a)(4) of the Act (15 U.S.C. 78o-9(a)(4)).

(4) The term securitizer has the same meaning as in section 15G(a)(3) of the Act (15 U.S.C. 78o-9(a)(3)).

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

14. The authority citation for Part 249 continues to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

15. Subpart O and Form ABS-15G (referenced in §249.1400) to Part 249 are amended to read as follows:

Subpart O – Forms for Securitizers of Asset-Backed Securities

§ 249.1400 Form ABS-15G, Asset-backed securitizer report pursuant to Section 15G of the Securities Exchange Act of 1934.

This form shall be used for reports of information required by Rule 15Ga-1 (§ 240.15Ga-1 of this chapter) and Rule 15Ga-2 (§ 240.15Ga-2 of this chapter).

Note: The text of Form ABS-15G does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS-15G

ASSET-BACKED SECURITIZER REPORT PURSUANT TO SECTION 15G OF THE SECURITIES EXCHANGE ACT OF 1934

Check the appropriate box to indicate the filing obligation which this form is intended to satisfy:

____ Rule 15Ga-1 under the Exchange Act (17 CFR 240.15Ga-1) for the reporting period
_____ to _____

Date of Report (Date of earliest event reported) _____

Commission File Number of securitizer: _____

Central Index Key Number of securitizer: _____

Name and telephone number, including area code, of the person to
contact in connection with this filing

Indicate by check mark whether the securitizer has no activity to report for the initial
period pursuant to Rule 15Ga-1(c)(1) [☐]

Indicate by check mark whether the securitizer has no activity to report for the quarterly
period pursuant to Rule 15Ga-1(c)(2)(i) [☐]

Indicate by check mark whether the securitizer has no activity to report for the annual
period pursuant to Rule 15Ga-1(c)(2)(ii) [☐]

____ Rule 15Ga-2 under the Exchange Act (17 CFR 240.15Ga-2)

Central Index Key Number of depositor: _____

(Exact name of issuing entity as specified in its charter)

Central Index Key Number of issuing entity (if applicable): _____

Central Index Key Number of underwriter (if applicable): _____

Name and telephone number, including area code, of the person to
contact in connection with this filing

GENERAL INSTRUCTIONS

A. Rule as to Use of Form ABS-15G.

This form shall be used to comply with the requirements of Rule 15Ga-1 (17 CFR 240.15Ga-1) and Rule 15Ga-2 (17 CFR 240.15Ga-2) under the Exchange Act.

B. Events to be Reported and Time for Filing of Reports.

Forms filed under Rule 15Ga-1. In accordance with Rule 15Ga-1, file the information required by Part I in accordance with Item 1.01, Item 1.02, or Item 1.03, as applicable. If the filing deadline for the information occurs on a Saturday, Sunday, or holiday on which the Commission is not open for business, then the filing deadline shall be the first business day thereafter.

Forms furnished under Rule 15Ga-2. In accordance with Rule 15Ga-2, furnish the information required by Part II no later than five business days prior to the first sale of securities in the offering.

C. Preparation of Report.

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report on paper meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

D. Signature and Filing of Report.

1. Forms filed under Rule 15Ga-1. Any form filed for the purpose of meeting the requirements in Rule 15Ga-1 must be signed by the senior officer in charge of securitization of the securitizer.
2. Forms furnished under Rule 15Ga-2. Any form furnished for the purpose of meeting the requirements in Rule 15Ga-2 must be signed by a senior officer in charge of securitization of the depositor if information required by Item 2.01 is required to be provided and must be signed by a duly authorized officer of the underwriter if information required by Item 2.02 is required to be provided.
3. Copies of report. If paper filing is permitted, three complete copies of the report shall be filed with, or furnished to, the Commission, as applicable.

INFORMATION TO BE INCLUDED IN THE REPORT

PART I: REPRESENTATION AND WARRANTY INFORMATION

Item 1.01 Initial Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) according to the filing requirements of Rule 15Ga-1(c)(1).

Item 1.02 Periodic Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) according to the filing requirements of Rule 15Ga-1(c)(2).

Item 1.03 Notice of Termination of Duty to File Reports under Rule 15Ga-1

If a securitizer terminates its reporting obligation pursuant to Rule 15Ga-1(c)(3), provide the date of the last payment on the last asset-backed security outstanding that was issued by or issued by an affiliate of the securitizer.

PART II – FINDINGS AND CONCLUSIONS OF THIRD-PARTY DUE DILIGENCE REPORTS

Item 2.01 Findings and Conclusions of a Third Party Due Diligence Report Obtained by the Issuer

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party due diligence report obtained by the issuer.

Item 2.02 Findings and Conclusions of a Third-Party Due Diligence Report Obtained by the Underwriter

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party due diligence report obtained by the underwriter.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the reporting entity has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

_____ (Securitizer, Depositor or Underwriter)

Date _____

_____ (Signature)*

*Print name and title of the signing officer under his or her signature.

PART 249b—FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934

16. The authority citation for Part 249b continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., unless otherwise noted;

* * * * *

17. Form NRSRO (referenced in § 249b.300) is amended to read as follows:

FORM NRSRO

**APPLICATION FOR REGISTRATION AS A
NATIONALLY RECOGNIZED STATISTICAL
RATING ORGANIZATION (NRSRO)**

SEC 1541 (4-09)

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

**APPLICATION FOR REGISTRATION AS A
NATIONALLY RECOGNIZED
STATISTICAL RATING ORGANIZATION (NRSRO)**

☐ INITIAL APPLICATION

☐ ANNUAL CERTIFICATION

☐ APPLICATION TO ADD CLASS
OF CREDIT RATINGS

☐ UPDATE OF REGISTRATION
Items and/or Exhibits Amended:

☐ APPLICATION SUPPLEMENT
Items and/or Exhibits Supplemented:

☐ WITHDRAWAL FROM REGISTRATION

Important: Refer to Form NRSRO Instructions for General Instructions, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO). "You" and "your" mean the person filing or furnishing, as applicable, this Form NRSRO. "Applicant" and "NRSRO" mean the person filing or furnishing, as applicable, this Form NRSRO and any credit rating affiliate identified in Item 3.

1. A. Your full name:

B. (i) Name under which your credit rating business is primarily conducted, if different from Item 1A:

(ii) Any other name under which your credit rating business is conducted and where it is used (other than the name of a credit rating affiliate identified in Item 3):

C. Address of your principal office (do not use a P.O. Box):

(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:

(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (See Instructions):

(Name and Title)

(Number and Street) (City) (State/Country) (Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form NRSRO on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including Exhibits and attachments, all of which are part of this Form, are accurate in all significant respects. If

this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate in all significant respects.

(Date) (Name of the Applicant/NRSRO)

By: _____
(Signature) (Print Name and Title)

2. A. Your legal status:

☐ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) _____

B. Month and day of your fiscal year end: _____

C. Place and date of your formation (i.e., state or country where you were incorporated, where your partnership agreement was filed, or where you otherwise were formed):

State/Country of formation: _____ Date of formation: _____

3. Your credit rating affiliates (See Instructions):

(Name) (Address)

(Name) (Address)

(Name) (Address)

(Name) (Address)

(Name) (Address)

4. The designated compliance officer of the Applicant/NRSRO (See Instructions):

(Name and Title)

(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail how this Form NRSRO and Exhibits 1 through 9 to this Form NRSRO will be made publicly and freely available on an easily accessible portion of the corporate Internet website of the Applicant/NRSRO (See Instructions):

6. **COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION, APPLICATION SUPPLEMENT, OR APPLICATION TO ADD A CLASS OF CREDIT RATINGS.**

- A. Indicate below the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. For each class, indicate the approximate number of obligors, securities, and money market instruments in that class as of the date of this application for which the Applicant/NRSRO has an outstanding credit rating and the approximate date the Applicant/NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit ratings	Applying for registration	Approximate number currently outstanding	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

- B. Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee (See Instructions):

- C. Check the applicable box and attach certifications from qualified institutional buyers, if required (See Instructions):

- ☐ The Applicant/NRSRO is attaching _____ certifications from qualified institutional buyers to this application. Each is marked "Certification from Qualified Institutional Buyer."
- ☐ The Applicant/NRSRO is exempt from the requirement to file certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: You are not required to make a Certification from a Qualified Institutional Buyer filed with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the certifications confidential upon request to the extent permitted by law.

7. DO NOT COMPLETE ITEM 7 IF THIS IS AN INITIAL APPLICATION.

- A. Indicate below the classes of credit ratings for which the NRSRO is currently registered. For each class, indicate the approximate number of obligors, securities, and money market instruments in that class for which the

NRSRO had an outstanding credit rating as of the most recent calendar year end and the approximate date the NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit rating	Currently registered	Approximate number outstanding as of the most recent calendar year end	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee (See Instructions):

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and submit the Disclosure Reporting Page with this Form NRSRO (See Instructions). You are not required to make any disclosure reporting pages submitted with this Form publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.	
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	YES	NO
A. Has the Applicant/NRSRO or any person within the Applicant/NRSRO committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934 in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the Applicant/NRSRO or any person within the Applicant/NRSRO been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
C. Is any person within the Applicant/NRSRO subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐	☐

9. Exhibits (See Instructions).

Exhibit 1. Credit ratings performance measurement statistics. ☐ Exhibit 1 is attached and made a part of this Form NRSRO.
Exhibit 2. A description of the procedures and methodologies used in determining credit ratings. ☐ Exhibit 2 is attached and made a part of Form NRSRO.
Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information. ☐ Exhibit 3 is attached and made a part of this Form NRSRO.
Exhibit 4. Organizational structure. ☐ Exhibit 4 is attached to and made a part of this Form NRSRO.
Exhibit 5. The code of ethics or a statement of the reasons why a code of ethics is not in effect. ☐ Exhibit 5 is attached to and made a part of this Form NRSRO.
Exhibit 6. Identification of conflicts of interests relating to the issuance of credit ratings. ☐ Exhibit 6 is attached to and made a part of this Form NRSRO.
Exhibit 7. Policies and procedures to address and manage conflicts of interest. ☐ Exhibit 7 is attached to and made a part of this Form NRSRO.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached to and made a part of this Form NRSRO.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer.

☐ Exhibit 9 is attached to and made a part of this Form NRSRO.

Exhibit 10. A list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application.

☐ Exhibit 10 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application.

☐ Exhibit 11 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application.

☐ Exhibit 12 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

FORM NRSRO INSTRUCTIONS

A. GENERAL INSTRUCTIONS.

1. Form NRSRO is the Application for Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO") under Section 15E of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 17g-1. Exchange Act Rule 17g-1 requires an Applicant/NRSRO to use Form NRSRO to:
 - File an initial application to be registered as an NRSRO with the U.S. Securities and Exchange Commission ("Commission");
 - File an application to register for an additional class of credit ratings with the Commission;
 - File an application supplement with the Commission;
 - File an update of registration pursuant to Section 15E(b)(1) of the Exchange Act with the Commission;
 - File an annual certification pursuant to Section 15E(b)(2) of the Exchange Act with the Commission; and
 - Furnish a withdrawal of registration pursuant to Section 15E(e) of the Exchange Act to the Commission.
2. Exchange Act Rule 17g-1(c) requires that an Applicant/NRSRO promptly file with the Commission a written notice if information filed with the Commission in an initial application for registration or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must identify the information found to be materially inaccurate. The Applicant/NRSRO must also promptly file with the Commission accurate and complete information as an application supplement on Form NRSRO.
3. Pursuant to Exchange Act Rule 17g-1(i), an NRSRO must make its current Form NRSRO and information and documents filed in Exhibits 1 through 9 to Form NRSRO publicly and freely available on an easily accessible portion of its corporate Internet website within 10 business days after the date of the Commission Order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10

business days after filing with or furnishing to, as applicable, the Commission an update of registration, annual certification, or withdrawal from registration on Form NRSRO.

The certifications from qualified institutional buyers, disclosure reporting pages, and Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Rule 17g-1(i). An Applicant/NRSRO may request that the Commission keep confidential the certifications from qualified institutional buyers, the disclosure reporting pages, and the information and documents in Exhibits 10 – 13 filed with the Commission. An Applicant/NRSRO seeking confidential treatment for these submissions should mark each page "Confidential Treatment" and comply with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep this information confidential to the extent permitted by law.

4. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny an initial application for registration as an NRSRO. These time periods also apply to an application to register for an additional class of credit ratings.
5. Type or clearly print all information. Use only the current version of Form NRSRO or a reproduction of it.
6. Section 15E of the Exchange Act (15 U.S.C. 78o-7) authorizes the Commission to collect the Information on Form NRSRO from an Applicant/NRSRO. The principal purposes of Form NRSRO are to determine whether an Applicant should be granted registration as an NRSRO, whether an NRSRO should be granted registration in an additional class of credit ratings, whether an NRSRO continues to meet the criteria for registration as an NRSRO, for an NRSRO to withdraw from registration, and to provide information about an NRSRO to users of credit ratings. Intentional misstatements or omissions may constitute federal criminal violations under 18 U.S.C. 1001.

The information collection is in accordance with the clearance requirements of Section 3507 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). The Commission may not conduct or sponsor, and you are not required to respond to, a collection of information unless it displays a valid Office of Management and Budget (OMB) control number. The time required to complete

and file or furnish, as applicable, this form, will vary depending on individual circumstances. The estimated average time to complete an initial application is displayed on the facing page of this Form. Send comments regarding this burden estimate or suggestions for reducing the burden to Chief Information Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549 or PRA Mailbox@sec.gov.

7. Under Exchange Act Rule 17g-2(b)(10), an NRSRO must retain copies of all Forms NRSRO (including Exhibits, accompanying information, and documents) filed with or furnished to, as applicable, the Commission. Exchange Act Rule 17g-2(c) requires that these records be retained for three years after the date the record is made.
8. An Applicant must file with the Commission at the address indicated below two paper copies of an initial application for registration as an NRSRO under Exchange Act Rule 17g-1(a), an application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(b), a supplement to an initial application or application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(c), or a withdrawal of an initial application or an application to register for an additional class of credit ratings under Exchange Act Rule 17g-1(d).

ADDRESS - The mailing address for Form NRSRO is:

U.S. Securities and Exchange Commission

100 F Street, NE

Washington, DC 20549

After registration, an NRSRO must file with or furnish to, as applicable, the Commission electronically on EDGAR as a PDF document in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T, an update of registration under Exchange Act Rule 17g-1(e), an annual certification under Exchange Act Rule 17g-1(f), or a withdrawal from registration under Exchange Act Rule 17g-1(g).

9. A Form NRSRO will be considered filed with or furnished to, as applicable, the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form, including the instructions in Item A.8 with respect to how a Form NRSRO must be filed with or furnished to the Commission.

10. An NRSRO is subject to applicable fines, penalties, and other available sanctions set forth in sections 15E, 21, 21A, 21B, 21C, and 32 of the Exchange Act (15 U.S.C. 78o-7, 78u, 78u-1, 78u-2, 78u-3, and 78ff, respectively) for violations of the securities laws.

B. INSTRUCTIONS FOR AN INITIAL APPLICATION

An Applicant applying to be registered with the Commission as an NRSRO must file with the Commission an initial application on Form NRSRO. To complete an initial application:

- Check the "INITIAL APPLICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, and 8. (See Instructions below for each Item). Enter "None" or "N/A" where appropriate.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers, marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- Attach Exhibits 1 through 13 (See Instructions below for each Exhibit).
- Execute the Form.

The Applicant must promptly file with the Commission a written notice if information submitted to the Commission in an initial application is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly file with the Commission an application supplement on Form NRSRO (See instructions below for an application supplement).

C. INSTRUCTIONS FOR AN APPLICATION TO ADD A CLASS OF CREDIT RATINGS

An NRSRO applying to register for an additional class of credit ratings must file with the Commission an application on Form NRSRO. To complete an application to register for an additional class of credit ratings:

- Check the "APPLICATION TO ADD CLASS OF CREDIT RATINGS" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on a

previously submitted Form NRSRO is materially inaccurate, update that information.

Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.

- Unless exempt from the requirement, attach certifications from qualified institutional buyers for the additional class of credit ratings marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- If any information in an Exhibit previously submitted is materially inaccurate, update that information.
- Execute the Form.

The Applicant must promptly file with the Commission a written notice if information submitted to the Commission in an application to add a class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application.

The notice must identify the information found to be materially inaccurate. The Applicant also must promptly file with the Commission an application supplement on Form NRSRO (See instructions below for an application supplement).

D. INSTRUCTIONS FOR AN APPLICATION SUPPLEMENT

An Applicant must file an application supplement with the Commission on Form NRSRO if information submitted to the Commission in a pending initial application for registration as an NRSRO or a pending application to register for an additional class of credit ratings is found to be or becomes materially inaccurate. To complete an application supplement:

- Check the "APPLICATION SUPPLEMENT" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being supplemented.
- Complete Items 1, 2, 3, 4, 5 and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If supplementing an initial application, also complete Item 6. If supplementing an application for registration in an additional class of credit ratings, also complete Items 6 and 7. If any information in an Item on a previously submitted Form NRSRO is materially inaccurate, update that information.

Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.

- If a certification from a qualified institutional buyer is being updated or a new certification is being added, attach the updated or new certification.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

E. INSTRUCTIONS FOR AN UPDATE OF REGISTRATION

After registration is granted, section 15E(b)(1) of the Exchange Act requires that an NRSRO must promptly amend its application for registration if information or documents provided in a previously submitted Form NRSRO become materially inaccurate. This requirement does not apply to Item 7 and Exhibit 1, which only are required to be updated annually with the annual certification. It also does not apply to Exhibits 10 – 13 and the certifications from qualified institutional buyers, which are not required to be updated on Form NRSRO after registration. An NRSRO amending its application for registration must file with the Commission an update of its registration on Form NRSRO. To complete an update of registration:

- Check the "UPDATE OF REGISTRATION" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being updated.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on a previously submitted Form NRSRO is materially inaccurate, update that information.

Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

F. INSTRUCTIONS FOR ANNUAL CERTIFICATIONS

After registration is granted, section 15E(b)(2) of the Exchange Act requires that an NRSRO file with the Commission an annual certification not later than 90 days after the end of each calendar year. The annual certification must be filed with the Commission on Form NRSRO and must

include an update of the information in Item 7 and the credit rating transition and default rates submitted in Exhibit 1, a certification that the information and documents on or with Form NRSRO continue to be accurate (use the certification on the Form), and a list of material changes to the application for registration that occurred during the previous calendar year. To complete an annual certification:

- Check the "ANNUAL CERTIFICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If any information in a non-confidential Exhibit previously submitted is materially inaccurate, update that information. (Note: After registration, Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Exchange Act Rule 17g-1(i) and they should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year under Exchange Act Rule 17g-3.)
- Attach a list of all material changes made to the information or documents in the application for registration of the NRSRO that occurred during the previous calendar year.
- Execute the Form.

G. INSTRUCTIONS FOR A WITHDRAWAL FROM REGISTRATION

Section 15E(e)(1) of the Exchange Act provides that an NRSRO may voluntarily withdraw its registration with the Commission. Under Exchange Act Rule, 17g-1(g), to withdraw from registration, an NRSRO must furnish the Commission with a notice of withdrawal from registration on Form NRSRO. The withdrawal from registration will become effective 45 calendar days after the withdrawal from registration is furnished to the Commission upon such terms and conditions

as the Commission may establish as necessary in the public interest or for the protection of investors. To complete a withdrawal from registration:

- Check the "WITHDRAWAL FROM REGISTRATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information on a previously submitted Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- Execute the Form.

H. INSTRUCTIONS FOR SPECIFIC LINE ITEMS

Item 1A. Provide the name of the person (e.g., XYZ Corporation) that is filing or furnishing, as applicable, the Form NRSRO. This means the name of the person that is applying for registration as an NRSRO or is registered as an NRSRO and not the name of the individual that is executing the Form.

Item 1E. The individual listed as the contact person must be authorized to receive all communications and papers from the Commission and must be responsible for their dissemination within the Applicant/NRSRO.

Certification. The certification must be executed by the Chief Executive Officer or the President of the person that is filing or furnishing, as applicable, the Form NRSRO or an individual with similar responsibilities.

Item 3. Identify credit rating affiliates that issue credit ratings on behalf of the person filing or furnishing, as applicable, the Form NRSRO in one or more of the classes of credit ratings identified in Item 6 or Item 7. A "credit rating affiliate" is a separate legal entity or a separately identifiable department or division thereof that determines credit ratings that are credit ratings of the person filing or furnishing, as applicable, the Form NRSRO. The information in Items 4 – 8 and all the Exhibits must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, personnel, and organizational structure of each credit rating affiliate identified in Item 3, as applicable. Any credit rating determined by a credit rating affiliate identified in Item 3 will be treated as a credit rating issued by the person filing or furnishing, as applicable, the Form NRSRO for purposes of section 15E of the Exchange Act and the Commission's rules thereunder. The terms "Applicant" and

"NRSRO" as used on Form NRSRO and the Instructions for the Form mean the person filing or furnishing, as applicable, the Form NRSRO and any credit rating affiliate identified in Item 3.

Item 4. Section 15E(j)(1) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the NRSRO established pursuant to sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations.

Item 5. Section 15E(a)(3) of the Exchange Act and Exchange Act Rule 17g-1(i) require an NRSRO to make Form NRSRO and Exhibits 1 – 9 to Form NRSRO filed with the Commission publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website within 10 business days after the date of the Commission order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after filing with or furnishing to, as applicable, the Commission an amendment, annual certification, or withdrawal from registration on Form NRSRO. The certifications from qualified institutional investors, Disclosure Reporting Pages, and Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's corporate Internet website. Describe how the current Form NRSRO and Exhibits 1 – 9 will be made publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website by providing the Internet address and link to the Form and Exhibits.

Item 6. Complete Item 6 only if filing an initial application for registration, an application to be registered in an additional class of credit ratings, or an application supplement.

Item 6A. Pursuant to section 15E(a)(1)(B)(vii) of the Exchange Act, an Applicant applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. Indicate these classes by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments in that class for which the Applicant/NRSRO presently has a credit rating outstanding as of the date of the application. In determining this amount, the Applicant/NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other

unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer. The Applicant/NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating. An Applicant/NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction. For each class of credit ratings, also provide in the appropriate box the approximate date the Applicant/NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in section 3(a)(61) of the Exchange Act. If there was a period when the Applicant/NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the Applicant/NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency" in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the Applicant/NRSRO began operating as a "credit rating agency."

Item 6B. To meet the definition of "credit rating agency" pursuant to section 3(a)(61)(A) of the Exchange Act, the Applicant must, among other things, issue "credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee." Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the Applicant/NRSRO, provide a fee schedule or describe the price(s) charged.

Item 6C. If the Applicant/NRSRO is required to file qualified institutional buyer certifications under section 15E(a)(1)(C) of the Exchange Act file a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the Applicant/NRSRO. Each certification may address more than one class of credit ratings. To be registered as an NRSRO for a class of credit ratings identified in Item 6A under "Applying for Registration," the Applicant/NRSRO must file at least two certifications that address the class of credit ratings. If this is an application of an NRSRO to be registered in one or more additional classes of credit ratings, file at least two certifications that address each additional class of credit ratings.

The required certifications must be signed by a person duly authorized by the certifying entity, must be notarized, must be marked "Certification from Qualified Institutional Buyer," and must be in substantially the following form:

"I, [Executing official], am authorized by [Certifying entity] to execute this certification on behalf of [Certifying entity]. I certify that all actions by stockholders, directors, general partners, and other bodies necessary to authorize me to execute this certification have been taken and that [Certifying entity]:

- (i) Meets the definition of a 'qualified institutional buyer' as set forth in section 3(a)(64) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(64)) pursuant to the following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];
- (ii) Has seriously considered the credit ratings of [the Applicant/NRSRO] in the course of making some of its investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings: [Insert applicable classes of credit ratings]; and
- (iii) Has not received compensation either directly or indirectly from [the Applicant/NRSRO] for executing this certification.

[Signature]

Print Name and Title"

You are not required to make a Certification from a Qualified Institutional Buyer filed with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i).

You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the certifications confidential upon request to the extent permitted by law.

Item 7. An Applicant filing Form NRSRO to apply for registration as an NRSRO should not complete Item 7. An NRSRO filing or furnishing, as applicable, Form NRSRO for any other reason must complete Item 7. The information in Item 7 must be updated on an annual basis with the filing of the annual certification.

Item 7A. Indicate the classes of credit ratings for which the NRSRO is currently registered by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of obligors, securities, and money market instruments in that class for which the NRSRO had a credit rating outstanding as of the end of the most recently ended calendar year. In determining this amount, NRSRO must treat as a separately rated security or money market instrument each individually rated security and money market instrument that, for example, is assigned a distinct CUSIP or other unique identifier, has distinct credit enhancement features as compared with other securities or money market instruments of the same issuer, or has a different maturity date as compared with other securities or money market instruments of the same issuer. The NRSRO must not include an obligor, security, or money market instrument in more than one class of credit rating. An NRSRO must include in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) to the extent not described in section 3(a)(62)(B)(iv), any rated security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction. For each class of credit ratings, also provide in the appropriate box the approximate date the NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in section 3(a)(61) of the Exchange Act. If there was a period when the NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency" in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the NRSRO began operating as a "credit rating agency."

Item 7B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the NRSRO, provide a fee schedule or describe the price(s) charged.

Item 8. Answer each question by checking the appropriate box. Refer to the definition of "person within an Applicant/NRSRO" set forth below to determine the persons to which the questions apply. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and filed with Form NRSRO. Submit a separate Disclosure Reporting Page (NRSRO) for each person that:

(a) has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions. Note: the definition of "person within an Applicant/NRSRO" is narrower than the definition of "person associated with a nationally recognized statistical rating organization" in Section 3(a)(63) of the Exchange Act.

You are not required to make any disclosure reporting pages submitted with this Form NRSRO publicly available on your corporate Internet website pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires a credit rating agency's application for registration as an NRSRO to contain certain specific information and documents and, pursuant to section 15E(a)(1)(B)(x), any other information and documents concerning the applicant and any person associated with the applicant that the Commission requires as necessary or appropriate in the public interest or for the protection of investors. If any information or document required to be included with any Exhibit is maintained in a language other than English, file a copy of the original document and a version of the document translated into English. Attach a certification by an authorized person that the translated version is a true, accurate, and complete English translation of the information or document. Attach the Exhibits to Form NRSRO in numerical order. Bind each Exhibit separately, and mark each Exhibit or bound volume of the Exhibit with the appropriate Exhibit number. The information in the Exhibits must be sufficiently detailed to allow for verification. The information and documents in Exhibits 1 through 9 must

be made publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website pursuant to Exchange Act Rule 17g-1(i). The information and documents in Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's corporate Internet website pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep these Exhibits confidential by marking each page of them "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in these Exhibits confidential upon request to the extent permitted by law. (Note: After registration, Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Exchange Act Rule 17g-1(i) and they should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3.)

Exhibit 1. (1) An Applicant/NRSRO must provide in this Exhibit performance measurement statistics consisting of transition and default rates for each class (and applicable subclass of credit ratings as listed below) for which it is seeking registration as an NRSRO or for which it is registered as an NRSRO. For each applicable class and subclass of credit ratings, an Applicant/NRSRO must provide transition and default rates for 1-year, 3-year, and 10-year time periods through the most recent calendar year end. The transition and default rates for each time period must be presented together in tabular form ("Transition/Default Matrix"). The Transition/Default Matrices must be presented on a calendar year basis even if the Applicant/NRSRO has a fiscal year end other than December 31. Exhibit 1 must be updated annually with the filing of the NRSRO's Annual Certification pursuant to Exchange Act Rule 17g-1(f). Pursuant to Exchange Act Rule 17g-1(i), an NRSRO must make the Annual Certification publicly and freely available on an easily accessible portion of the NRSRO's corporate Internet website within 10 business days after the filing and must make its most recently filed Exhibit 1 freely available in writing to any individual who requests a copy of the Exhibit. The classes and subclasses of credit ratings for which an Applicant/NRSRO must provide Transition/Default Matrices are (as applicable):

- (A) The class of credit ratings described in section 3(a)(62)(B)(i) of the Exchange Act (financial institutions, brokers, or dealers).

(B) The class of credit ratings described in section 3(a)(62)(B)(ii) of the Exchange Act (insurance companies);

(C) The class of credit ratings described in section 3(a)(62)(B)(iii) of the Exchange Act (corporate issuers);

(D) The following subclasses of credit ratings described in section 3(a)(62)(B)(iv) of the Exchange Act (issuers of asset-backed securities) and, to the extent not described in section 3(a)(62)(B)(iv), any security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction:

(i) Residential mortgage backed securities ("RMBS") (for the purposes of Exhibit 1, RMBS means a securitization primarily of residential mortgages);

(ii) Commercial mortgage backed securities ("CMBS") (for the purposes of Exhibit 1, CMBS means a securitization primarily of commercial mortgages);

(iii) Collateralized loan obligations ("CLOs") (for the purposes of Exhibit 1, a CLO means a securitization primarily of commercial loans);

(iv) Collateralized debt obligations ("CDOs") (for the purposes of Exhibit 1, a CDO means a securitization primarily of other debt instruments such as RMBS, CMBS, CLOs, CDOs, other asset backed securities, and corporate bonds);

(v) Asset-backed commercial paper ("ABCP") (for the purposes of Exhibit 1, ABCP means short term notes issued by a structure that securitizes a variety of financial assets (e.g., trade receivables or credit card receivables), which secure the notes);

(vi) other asset-backed securities ("other ABS") (for the purposes of Exhibit 1, other ABS means a securitization primarily of auto loans, auto leases, floor plan financings, credit card receivables, student loans, consumer loans, or equipment leases); and

(vii) other structured finance products ("other SFPs") (for the purposes of Exhibit 1, other SFPs means any structured finance product not identified in subparagraphs (i) through (vi) above -- the Applicant/NRSRO must provide a description of the products in this subclass); and

(E) The following subclasses of credit ratings described in section 3(a)(62)(B)(v) of the Exchange Act (issuers of government securities, municipal securities, or securities issued by a foreign government):

- (i) Sovereign issuers;
- (ii) U.S. public finance; and
- (iii) International public finance.

(2) The Transition/Default Matrices for applicable classes and subclasses of credit ratings must be presented in the same order that the classes and subclasses of credit ratings are identified in paragraphs (1)(A) through (E) above. For a given class or subclass, Transition/Default Matrices must be presented in the following order: 1-year matrix, 3-year matrix, and then 10-year matrix. If the Applicant/NRSRO has not been determining credit ratings in the applicable class or subclass for the length of time necessary to produce a 1-year, 3-year, and/or 10-year Transition/Default Matrix, it must explain that fact in the location where the Transition/Default Matrix would have been presented in the Exhibit. The Applicant/NRSRO must clearly define, after the presentation of all applicable Transition/Default Matrices, each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for each class and subclass of credit ratings in any Transition/Default Matrix presented in the Exhibit. In addition the Applicant/NRSRO must clearly explain the conditions under which it classifies obligors, securities, or money market instruments as being in default. Next, the Applicant/NRSRO must provide the uniform resource locator (URL) of its corporate Internet website where the credit rating histories required to be disclosed pursuant to 17 CFR 17g-7(b) will be located (in the case of an Applicant) or are located (in the case of an NRSRO). Exhibit 1 must contain no performance measurement statistics or information other than as described in, and required by, these Instructions for Exhibit 1; except that the Applicant/NRSRO may provide after the presentation of all required Transition/Default Matrices and other disclosures: (1) a short statement describing the required method of calculating the performance measurement statistics in Exhibit 1 (the single cohort approach) and any advantages or limitations to the single cohort approach the Applicant/NRSRO believes would be appropriate to disclose; (2) a short statement that the Applicant/NRSRO has calculated and published on an Internet website performance measurement statistics using the average cohort approach (if applicable), a description of the differences between the single cohort approach and the average cohort approach used to calculate the performance measurement statistics, and the Internet website URL where the performance measurements statistics calculated using the average cohort approach are located; and

(3) the Internet website URLs where any other information relating to performance measurement statistics of the Applicant/NRSRO is located.

(3) The Transition/Default Matrices must be presented using the format of the sample matrix ("Sample Matrix") below. The first row of a Transition/Default Matrix must contain the column headings: "Credit Ratings as of [insert the period start date]"; "Credit Ratings as of [insert the period end date] percent"; and "Other Outcomes During [insert the period start date and end date] (percent)". The second row must contain column headings that are grouped under the three top row headings. The first and second columns in Transition/Default Matrix are for entering information about the credit ratings as of the period start date and must be grouped under the first heading in the first row. The cells in the second row for the first two columns must contain the headings, respectively: "Credit Rating Scale" and "Number of Ratings Outstanding." The applicable date is the date 1, 3, or 10 years prior to the most recent calendar year end depending on whether the Transition/Default Matrix is for a 1-year, 3-year, or 10-year period. The next sequence of columns are for entering information about the credit ratings as of the period end date and must be grouped under the second heading in the first row. The cells in the second row for this series of columns must contain, from left to right, each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for the applicable class or subclass of credit ratings in descending order from the highest to the lowest notch. The Applicant/NRSRO must not include a "default" category if its rating scale has such a category. The final three columns in the header row are for entering information about credit ratings that were classified as in default or paid off during the period, or were withdrawn during the period for reasons other than default or having been paid off (see explanations below). These columns must be grouped under the third heading in the top row. The cells in the header rows for these columns must have the following headings from left to right, "Default", "Paid Off", and "Withdrawn (other)". The first column of a Transition/Default Matrix must have a separate cell containing each symbol, number, or score in the rating scale used by the Applicant/NRSRO to denote a credit rating category and notches within a category for the applicable class or subclass of credit ratings in descending order from the highest to the lowest notch. The Applicant/NRSRO must not include a "default" category in the column if its rating scale has such a category. The last cell of the first column must contain the word "Total." The cells representing no

change in the credit rating as of the period end date must be highlighted. Finally, the Transition/Default Matrix must have a title identifying the applicable class or subclass of credit ratings, the period covered, and the start date and end date of the period.

The Transition/Default Matrix must resemble the Sample Matrix below except that the number of credit rating symbols depicted in the cells of the first column and header row of a matrix will depend on the number of notches in the applicable rating scale of the Applicant/NRSRO (excluding a "default" category).

Corporate Issuers – 10-Year Transition and Default Rates
(December 31, 2000 through December 31, 2010)

Credit Ratings as of 12/31/2000		Credit Ratings as of 12/31/2010 (Percent)									Other Outcomes During 12/31/2000-12/31/2010 (Percent)		
Credit Rating	Number of Ratings Outstanding	AAA	AA	A	BBB	BB	B	CCC	CC	C	Default	Paid Off	Withdrawn (other)
AAA	10	50%	10%									40%	
AA	2000	1%	39%	12%	10%	8%	5%	4%			1%	19%	1%
A	4000		6%	34%	15%	10%	6%	4%	3%		2%	18%	2%
BBB	3600		2%	9%	28%	15%	10%	6%	5%	1%	4%	17%	3%
BB	1000			2%	4%	20%	14%	5%			2%	16%	37%
B	500			1%	3%	6%	20%	20%	15%		15%	15%	5%
CCC	300					4%	6%	15%	25%	20%	20%	4%	6%
CC	200						2%	8%	10%	38%	30%	2%	10%
C	160							2%	8%	10%	67%	1%	12%
Total	11,770												

(4) An Applicant/NRSRO must complete a Transition/Default Matrix as follows:

(A) *Second Column Showing Number of Ratings Outstanding as of the Period Start Date.* To determine the number of credit ratings outstanding as of the period start date (the "start-date cohort") for all classes of credit ratings other than the class of issuers of asset-backed securities, the Applicant/NRSRO must: (1) identify each obligor that the Applicant/NRSRO assigned a credit rating to as an entity where the credit rating was outstanding as of the period start date; (2) identify each additional obligor that issued securities or money market instruments that the Applicant/NRSRO assigned credit ratings to where the credit ratings were outstanding as of the period start date; and (3) include in the start-date cohort only credit ratings assigned to an obligor as an entity, or, if the obligor is not assigned a credit rating as an entity, the credit rating of the obligor's senior unsecured debt. All other credit ratings outstanding as of the period start date assigned to securities or money market instruments issued by the obligor must be excluded from the start-date cohort. For the class of issuers of asset-backed securities, the start-date cohort

must consist of credit ratings that the Applicant/NRSRO assigned to all securities or money market instruments in the class where the credit ratings were outstanding as of the period start date, excluding expected or preliminary credit ratings.

In determining the start-date cohort for all classes of credit ratings, the Applicant/NRSRO must exclude credit ratings that the Applicant/NRSRO classified as in default as of the period start date or that were expected or preliminary credit ratings.

The Applicant/NRSRO must next determine the number of credit ratings in the start-date cohort in each notch in the "Credit Rating Scale" column as of the period start date and enter this number in the appropriate cell. The Applicant/NRSRO must enter the total number of credit ratings in the start-date cohort in the last cell of the column.

(B) Rows Representing Credit Rating Notches. Each row representing a credit rating notch must contain percents indicating the credit rating outcomes as of the period end date of all the credit ratings at that notch as of the period start date. The percents in a row must add up to 100%. To compute the percents for each row in the Transition/Default Matrix representing a notch in the rating scale:

(i) The Applicant/NRSRO must determine the number of credit ratings in the start-date cohort at that notch as of the period start date that were assigned a credit rating at the same notch as of the period end date. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the column representing the same notch. The cell must be highlighted. To determine this percent, the Applicant/NRSRO must use the credit rating as of the period end date and not a credit rating assigned between the period start date and the period end date.

(ii) The Applicant/NRSRO must determine the number credit ratings at that notch as of the period start date at each other notch as of the period end date. These numbers must be expressed as percents of the total number of credit ratings at that notch as of the period start date and the percents must be entered in the columns representing each notch. To determine these percents, the Applicant/NRSRO must use the credit rating as of the period

end date and not a credit rating assigned between the period start date and the period end date.

(iii) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date that went into *Default* (see explanation below) at any time during the applicable time period. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Default* column. The Applicant/NRSRO must classify a credit rating as a *Default* if any of the following conditions are met:

- (a) The obligor failed to timely pay principal or interest due according to the terms of an obligation during the applicable period or the issuer of the security or money market instrument failed to timely pay principal or interest due according to the terms of the security or money market instrument during the applicable period;
- (b) The security or money market instrument was subject to a write-down, applied loss, or other realized deficiency of the outstanding principal amount during the applicable period; or
- (c) The Applicant/NRSRO classified the obligor, security, or money market instrument as having gone into default using its own definition of "default" during the applicable period.

A credit rating that goes into in *Default* as defined in this paragraph (4)(B)(iii) must be classified as in *Default* even if the Applicant/NRSRO assigned a credit rating to the obligor, security, or money market instrument at a notch above default in its rating scale on or after the event of *Default* or withdrew the credit rating on or after the event of *Default*.

(iv) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date that were *Paid Off* (see explanation below) at any time during the applicable time period. This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Paid Off* column. To determine this percent, the Applicant/NRSRO must classify a credit rating as *Paid Off* if the issuer of the security or money market instrument assigned the credit rating

extinguished its obligation with respect to the security or money market instrument during the applicable time period by paying in full all outstanding principal and interest due according to the terms of the security or money market instrument (for example, because the security or money market instrument matured, was called, or was prepaid); and the Applicant/NRSRO withdrew the credit rating for the security or money market instrument because the obligation was extinguished.

(v) The Applicant/NRSRO must determine the number of credit ratings at that notch as of the period start date for which the Applicant/NRSRO withdrew a credit rating at any time during the applicable time period for a reason other than *Default* (as described in paragraph (4)(B)(iii)) or *Paid-Off* (as described in paragraph (4)(B)(iv)). This number must be expressed as a percent of the total number of credit ratings at that notch as of the period start date and the percent must be entered in the *Withdrawn (other)* column. The Applicant/NRSRO must classify the credit rating as *Withdrawn (other)* even if the Applicant/NRSRO assigned a credit rating to the obligor, security, or money market instrument after withdrawing its credit rating.

Exhibit 2. Provide in this Exhibit a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the Applicant/NRSRO is seeking registration or is registered. The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings, including, as applicable, descriptions of: policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or securities transaction is relied on in determining credit ratings; the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or securities transaction factor into the determination of credit ratings; the

methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating. An Applicant/NRSRO may provide in Exhibit 2 the location on its corporate Internet website where additional information about the procedures and methodologies is located.

Exhibit 3. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to prevent the misuse of material, nonpublic information pursuant to section 15E(g) of the Exchange Act and 17 CFR 240.17g-4. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 4. Provide in this Exhibit information about the organizational structure of the Applicant/NRSRO, including, as applicable, an organizational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the Applicant/NRSRO; an organizational chart showing the divisions, departments, and business units of the Applicant/NRSRO; and an organizational chart showing the managerial structure of the Applicant/NRSRO, including the designated compliance officer identified in Item 4.

Exhibit 5. Provide in this Exhibit a copy of the written code of ethics the Applicant/NRSRO has in effect or a statement of the reasons why the Applicant/NRSRO does not have a written code of ethics in effect.

Exhibit 6. Identify in this Exhibit the types of conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO that are material to the Applicant/NRSRO. First, identify the conflicts described in the list below that apply to the Applicant/NRSRO. The Applicant/NRSRO may use the descriptions below to identify an applicable conflict of interest and is not required to provide any further details. Second, briefly describe any other type of conflict of interest relating to the issuance of credit ratings by the Applicant/NRSRO that is not covered in the descriptions below that is material to the Applicant/NRSRO (for example, one the Applicant/NRSRO has established specific policies and procedures to address):

The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.
- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term "nationally recognized statistical rating organization."
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:

- Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
- Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
- A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).
- The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

Exhibit 7. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to address and manage conflicts of interest pursuant to section 15E(h) of the Exchange Act. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 8. Provide in this Exhibit the following information about the Applicant/NRSRO's credit analysts and the persons who supervise the credit analysts:

- The total number of credit analysts (including credit analyst supervisors).
- The total number of credit analyst supervisors.
- A general description of the minimum qualifications required of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).
- A general description of the minimum qualifications required of the credit analyst supervisors, including education level and work experience.

Exhibit 9. Provide in this Exhibit the following information about the designated compliance officer (identified in Item 4) of the Applicant/NRSRO:

- Name.
- Employment history.
- Post secondary education.

- Whether employed by the Applicant/NRSRO full-time or part-time.

Exhibit 10. Provide in this Exhibit a list of the largest users of credit rating services of the Applicant by the amount of net revenue earned by the Applicant attributable to the person during the fiscal year ending immediately before the date of the initial application. First, determine and list the 20 largest issuers and subscribers in terms of net revenue. Next, add to the list any obligor or underwriter that, in terms of net revenue during the fiscal year, equaled or exceeded the 20th largest issuer or subscriber. In making the list, rank the persons in terms of net revenue from largest to smallest and include the net revenue amount for each person. For purposes of this Exhibit:

Net revenue means revenue earned by the Applicant for any type of service or product provided to the person, regardless of whether related to credit rating services, and net of any rebates and allowances the Applicant paid or owes to the person; and

Credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 10 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 11. Provide in this Exhibit the financial statements of the Applicant, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date of the Applicant's initial application to the Commission, subject to the following:

- If the Applicant is a division, unit, or subsidiary of a parent company, the Applicant may provide audited consolidated financial statements of its parent company.
- If the Applicant does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date of the initial application, the Applicant may provide unaudited financial statements for the applicable year or years, but must provide audited financial statements for the fiscal or calendar year ending immediately before the date of the initial application.

Attach to the unaudited financial statements a certification by a person duly authorized by the Applicant to make the certification that the person has responsibility for the financial statements and that to the best knowledge of the person making the certification the financial statements fairly present, in all material respects, the Applicant's financial condition, results of operations, and cash flows for the period presented.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 11 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 12. Provide in this Exhibit the following information, as applicable, and which is not required to be audited, regarding the Applicant's aggregate revenues for the fiscal or calendar year ending immediately before the date of the initial application:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings; and
- Revenue from all other services and products offered by your credit rating organization (include descriptions of any major sources of revenue).

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website, pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 12 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3).

Exhibit 13. Provide in this Exhibit the approximate total and median annual compensation of the Applicant's credit analysts for the fiscal or calendar year ending immediately before the date of this initial application. In calculating total and median annual compensation, the Applicant may exclude deferred compensation, provided such exclusion is noted in the Exhibit.

An NRSRO is not required to make this Exhibit publicly available on its corporate Internet website pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law. (Note: After registration, Exhibit 13 should not be updated with the filing of the annual certification. Instead, similar information must be filed with the Commission not more than 90 days after the end of each fiscal year pursuant to Exchange Act Rule 17g-3.)

I. EXPLANATION OF TERMS.

1. COMMISSION - The U.S. Securities and Exchange Commission.
2. CREDIT RATING [Section 3(a)(60) of the Exchange Act] - An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.
3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act] - Any person:

- 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;
 - employing either a quantitative or qualitative model, or both to determine credit ratings; and
 - receiving fees from either issuers, investors, other market participants, or a combination thereof.
4. **NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION** [Section 3(a)(62) of the Exchange Act] - A credit rating agency that:
- issues credit ratings certified by qualified institutional buyers in accordance with section 15(a)(1)(B)(ix) of the Exchange Act with respect to:
 - financial institutions, brokers, or dealers;
 - insurance companies;
 - corporate issuers;
 - issuers of asset-backed securities;
 - issuers of government securities, municipal securities, or securities issued by a foreign government; or
 - a combination of one or more of the above; and
 - is registered as an NRSRO.
6. **PERSON** - An individual, partnership, corporation, trust, company, limited liability company, or other organization (including a separately identifiable department or division).
7. **PERSON WITHIN AN APPLICANT/NRSRO** - The person filing or furnishing, as applicable, Form NRSRO identified in Item 1, any credit rating affiliates identified in Item 3, and any partner, officer, director, branch manager, or employee of the person or the credit rating affiliates (or any person occupying a similar status or performing similar functions).

8. SEPARATELY IDENTIFIABLE DEPARTMENT OR DIVISION - A unit of a corporation or company:
- that is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities; and
 - for which all of the records relating to its credit rating activities are separately created or maintained in or extractable from such unit's own facilities or the facilities of the corporation, and such records are so maintained or otherwise accessible as to permit independent examination and enforcement by the Commission of the Exchange Act and rules and regulations promulgated thereunder.
8. QUALIFIED INSTITUTIONAL BUYER [Section 3(a)(64) of the Exchange Act] - An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency.

DISCLOSURE REPORTING PAGE (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to provide information concerning affirmative responses to **Item 8** of Form NRSRO.

Submit a separate DRP for each person that: (a) has committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.

Name of Applicant/NRSRO

Date

Check Item being responded to:

- ☐ Item 8A
- ☐ Item 8B
- ☐ Item 8C

Full name of the person for whom this DRP is being submitted:

If this DRP provides information relating to a "Yes" answer to Item 8A, describe the act(s) that was (were) committed or omitted; or the order(s) or finding(s); or the injunction(s) (provide the relevant statute(s) or regulation(s)) and provide jurisdiction(s) and date(s):

If this DRP provides information relating to a "Yes" answer to Item 8B, describe the crime(s) and provide jurisdiction(s) and date(s):

If this DRP provides information relating to a "Yes" answer to Item 8C, attach the relevant Commission order(s) and provide the date(s):

18. Section 249b.500 and Form ABS Due Diligence-15E are added to read as follows:

§ 249b.500 Form ABS Due Diligence-15E, Certification of third-party provider of due diligence services for asset-backed securities

Note: The text of Form ABS Due Diligence-15E will not appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS DUE DILIGENCE-15E
CERTIFICATION OF PROVIDER OF THIRD-PARTY DUE DILIGENCE SERVICES
FOR ASSET-BACKED SECURITIES

Pursuant to 17 CFR 240.17g-10, this Form must be used by a person providing third-party due diligence services in connection with an asset-backed security to comply with section 15E(s)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7(s)(4)(B)). Section 15E(s)(4)(B) of the Securities Exchange Act of 1934 requires a person providing the due diligence services to provide a written certification to any nationally recognized statistical rating organization that produces a credit rating to which such due diligence services relate.

Item 1. Identity of the person providing third-party due diligence services

Legal Name: _____

Business Name (if Different): _____

Principal Business Address: _____

Item 2. Identity of the person who paid the person to provide third-party due diligence services

Legal Name: _____

Business Name (if Different): _____

Principal Business Address: _____

Item 3. Credit rating criteria

If the due diligence performed by the third party is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization, identify the nationally recognized

statistical rating organization and the title and date of the published criteria (more than one nationally recognized statistical rating organization may be identified).

Identity of NRSRO	Title and Date of Criteria

Item 4. Description of the due diligence performed

Provide a description of the scope and manner of the due diligence services performed in connection with the review of assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review. Include in the description: (1) the type of assets that were reviewed; (2) the sample size of the assets reviewed; (3) how the sample size was determined and, if applicable, computed; (4) whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; (5) whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria or other requirements was reviewed and, if so, how the review was conducted; (6) whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted; (7) whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and (8) any other type of review that was part of the due diligence services conducted by the person executing this Form. This description should be attached to the Form and contain the heading "Item 4." Provide this description regardless of whether the due diligence performed is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization.

Item 5. Summary of findings and conclusions of review

Provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2. This summary should be attached to the Form and contain the heading "Item 5."

CERTIFICATION

The undersigned has executed this Form ABS Due Diligence 15E on behalf of, and on the authority of, the person identified in Item 1 of the Form. The undersigned, on behalf of the person, represents that the person identified in Item 1 of the Form conducted a thorough review in performing the due diligence

described in Item 4 attached to this Form and that the information and statements contained in this Form, including Items 4 and 5 attached to this Form, which are part of this Form, are accurate in all significant respects on and as of the date hereof.

Name of Person Identified in Item 1: _____

By: _____
(Print name of duly authorized person) (Signature)

Date: _____

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: August 27, 2014

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 270 and 274

[Release No. IC-31184A; File No. S7-07-11]

RIN 3235-AL02

**Removal of Certain References to Credit Ratings and Amendment to the Issuer
Diversification Requirement in the Money Market Fund Rule; Correction**

AGENCY: Securities and Exchange Commission.

ACTION: Re-proposed rule; proposed rule; correction.

SUMMARY: On August 14, 2014, the Securities and Exchange Commission ("Commission") published a document in the Federal Register (79 FR 47986). The document contained an incorrect RIN. The Commission is publishing this document to correct that RIN.

DATES: Effective on [insert date of publication in the *Federal Register*].

FOR FURTHER INFORMATION CONTACT: Erin C. Loomis, Senior Counsel; Amanda Hollander Wagner, Senior Counsel; Penelope W. Saltzman, Senior Special Counsel; Investment Company Rulemaking Office, at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-8549.

CORRECTION:

In the Federal Register of August 14, 2014, in FR Doc. 2014-17746, on page 47986, in the first column, seventh line, the RIN is corrected to read as noted above.

Dated: August 27, 2014.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

73 of 82

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72925 / August 27, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16039

In the Matter of

China Wood, Inc.,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT ¹

1. China Wood, Inc. ("CNWD") (CIK No. 1368960) is a revoked Nevada corporation located in Lanshan District, Linyi City, Shandong, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CNWD is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2010. As of August 20, 2014, the common stock of CNWD was quoted on OTC Link operated by OTC Markets Group, Inc. (formerly "Pink Sheets"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic

¹ The short form of the issuer's name is also its ticker symbol.

reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 27, 2014

In the Matter of

China Wood, Inc.,

File No. 500-1

ORDER OF SUSPENSION OF
TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of China Wood, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on August 27, 2014, through 11:59 p.m. EDT on September 10, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

75 of 82

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72935 / August 27, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16043

In the Matter of

**Alto Group Holdings, Inc.,
Gametech International, Inc.,
Rosewood Acquisition Corporation,
Sunshine State Capital Investments, Inc.,
Trinergy Global, Inc. (f/k/a PyroTec, Inc.),
Voyager Two, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Alto Group Holdings, Inc., Gametech International, Inc., Rosewood Acquisition Corporation, Sunshine State Capital Investments, Inc., Trinergy Global, Inc. (f/k/a PyroTec, Inc.), and Voyager Two, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Alto Group Holdings, Inc. (CIK No. 1430124) is a revoked Nevada corporation located in Wenatchee, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alto Group Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2012, which reported a net loss of \$180,276 for the prior six months. As of August 11, 2014, the company's stock (symbol "ALTO") was traded on the over-the-counter markets.

76 of 82

2. Gametech International, Inc. (CIK No. 1045014) is a forfeited Delaware corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Gametech International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 29, 2012. On July 2, 2012, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was still pending as of May 21, 2014.

3. Rosewood Acquisition Corp. (CIK No. 1534098) is a void Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Rosewood Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2011, which reported a net loss of \$1,343 from the company's September 21, 2011 inception through December 31, 2011.

4. Sunshine State Capital Investments, Inc. (CIK No. 1543668) is a Florida corporation located in Seattle, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sunshine State Capital Investments is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended May 31, 2012, which reported a net loss of \$2,000 for the prior three months.

5. Trinerger Global, Inc. (f/k/a PyroTec, Inc.) (CIK No. 1534731) is a delinquent Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Trinerger Global is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of \$1,030 for the prior three months.

6. Voyager Two, Inc. (CIK No. 1140301) is a revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Voyager Two is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of \$1,580 for the prior three months.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the

Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

*Chair White
Not participating
Commissioner Aguilar
Disapproved*

SECURITIES EXCHANGE ACT OF 1934

Release No. 72938 / August 28, 2014

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3578 / August 28, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16045

In the Matter of

Lynn R. Blodgett and
Kevin R. Kyser, CPA

Respondents.

ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING A CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Lynn R. Blodgett ("Blodgett"), and Kevin R. Kyser ("Kyser").

II.

In anticipation of the institution of these proceedings, Blodgett and Kyser have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds¹ that:

Summary

1. At or near the end of each quarter ended September 30, 2008 through the quarter ended June 30, 2009, Affiliated Computer Services, Inc. ("ACS") arranged for an equipment manufacturer to re-direct certain of its pre-existing orders through ACS, which gave the appearance that ACS was involved. ACS, however, had no substantive involvement in the orders, and there were no changes to the terms of the pre-existing orders. Because of the nature of these arrangements, ACS should not have reported revenue from these arrangements and therefore misreported revenues in its financial reports filed on Form 10-K and Forms 10-Q for these periods. As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period.² In addition, ACS's periodic filings with the Commission inadequately or incompletely described these so-called "resale transactions." ACS improperly reported approximately \$125 million in revenue due to such arrangements.

2. During all relevant periods, Respondents Blodgett and Kyser were, respectively, ACS's chief executive officer and chief financial officer. As such, they were responsible for the content of ACS's filings with the Commission, as well as ACS's earnings releases and analyst conference calls. Blodgett and Kyser received bonuses that were higher than they would have been had ACS correctly applied generally accepted accounting principles (GAAP) with respect to determining the amount of revenue to report from the "resale transactions."³

3. Based on the conduct described below, Respondents were a cause of ACS's violations of the reporting, record-keeping, and internal controls provisions of the Exchange Act. In addition, Blodgett and Kyser violated the Exchange Act's certification requirements relating to ACS's Forms 10-Q for each fiscal quarter from September 30, 2008 through March 31, 2009 and ACS's Form 10-K for the fiscal year ended June 30, 2009.

Respondents

4. Lynn R. Blodgett, age 59, served as the President and Chief Executive Officer of ACS from November 2006 and as a director from September 2005 until Xerox Corporation

¹ The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² Internal revenue growth was a non-GAAP measure that ACS disclosed "to provide both management and investors a more complete understanding of the Company's underlying operational trends and results."

³ Financial statements filed with the Commission that are not prepared in accordance with GAAP are presumed to be misleading or inaccurate. Regulation S-X 210.4-01 [17 C.F.R. § 210.4-01].

acquired ACS in February 2010. Following Xerox Corporation's acquisition of ACS, Blodgett became an executive vice president of Xerox Corporation and has served as the President of Xerox Services since January 2012.

5. Kevin R. Kyser, age 44, served as an executive vice president and the Chief Financial Officer of ACS from September 2007 until Xerox Corporation acquired ACS in February 2010. Following Xerox Corporation's acquisition of ACS, Kyser continued as ACS's Chief Financial Officer until named the Chief Operating Officer of Xerox's Information Technology Outsourcing Group in January 2012, a position he held until he resigned in May 2013. Kyser's license as a certified public accountant in the state of Texas expired in April 2008.

Relevant Entity

6. Affiliated Computer Services, Inc. was a Delaware corporation headquartered in Dallas, Texas during the relevant period. The registration of ACS's common stock pursuant to 12(b) of the Exchange Act was withdrawn following ACS's merger in February 2010 with a subsidiary of Xerox Corporation, and the ACS corporate entity was subsequently dissolved.

Facts

7. ACS provided business process outsourcing and information technology services through two reportable operating segments: the Commercial Services Group, which accounted for approximately 60% of ACS's fiscal year 2009 revenues, and the Government Services Group, which accounted for the remaining 40% of ACS's revenues. ACS historically generated approximately 85% of its revenues from recurring, long-term contracts and 15% from non-recurring transactions. The "resale transactions" discussed below originated in ACS's Commercial Services Group and were classified as non-recurring revenue.

ACS mischaracterized "resale transactions" to increase revenue

8. In its Form 10-K for the fiscal year ended June 30, 2008, ACS disclosed that its primary goal for fiscal year 2009 was to increase internal revenue growth. In an August 7, 2008 analyst call, Blodgett characterized ACS as "well positioned to accelerate internal revenue growth in fiscal year 2009."

9. Shortly before the end of its first quarter of fiscal year 2009, ACS noted that the company's revenue would, at current rates, fall short of company guidance and consensus analyst expectations. To increase revenue, ACS arranged for an equipment manufacturer to re-direct through ACS approximately \$20 million of pre-existing orders that the manufacturer already had received from another reseller. ACS's transaction documents gave the appearance that ACS was involved in the "resale transactions," but ACS in fact had no such involvement. Among other things, even after ACS was inserted into the "resale transactions," the pricing for equipment remained unchanged, the equipment continued to be shipped from the manufacturer directly to the reseller's customers (*i.e.*, ACS never had actual or constructive possession of it), and the reseller's customers were unaware that ACS was involved. In short, these pre-existing orders between the

manufacturer and other reseller proceeded in all material respects according to their original terms and were unaffected by ACS's late insertion.

10. ACS executed virtually identical "resale transactions" at the end of the next three quarters.⁴ In total, ACS reported revenue of \$124.5 million from such arrangements during fiscal 2009.

ACS's improper accounting

11. ACS improperly applied GAAP in determining the amount of revenue to report in each of its quarters in FY 2009. In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the "resale transactions" under GAAP. In addition, ACS's internal controls were insufficient to provide reasonable assurance that ACS reported revenues in conformity with GAAP, primarily because ACS failed to appropriately evaluate the economic substance of the "resale transactions."

12. The revenue from these "resale transactions" enabled ACS to meet its publicly disclosed internal revenue growth ("IRG") guidance for three of the four quarters for that fiscal year. ACS missed its guidance for its third quarter even with the improperly reported revenue. The table below summarizes the amount of the resale revenue (as reported), ACS's public IRG guidance, IRG (as reported), IRG (as adjusted), and the percent misstated by quarter and for the year:

Period	"Resale" Revenue (as reported) (\$ in millions)	ACS's Public IRG Guidance	IRG (as reported)	IRG (as adjusted)	IRG Over Statement	% Over Statement
Q1 2009	\$ 19.9	5%	5%	3.4%	1.6%	47%
Q2 2009	\$ 40.6	4-5%	4%	1.2%	2.8%	233%
Q3 2009	\$ 39.7	5-6%	3%	(0.2)%	3.2%	1,600%
Q4 2009	\$ 24.2	3%	3%	1.7%	1.3%	76%
FY 2009	\$ 124.5	5-6%	3%	1.5%	1.5%	100%

ACS failed to properly disclose the "resale transactions" and their impact on IRG

13. Even though the "resale transactions" were the largest contributors to ACS's internal revenue growth, ACS did not disclose them in its September 30, 2008 Form 10-Q. In subsequent quarters, ACS disclosed these transactions as "information technology outsourcing related to deliveries of hardware and software." This description did not accurately disclose the

⁴ Contemporaneous with the "resale transactions" executed for the quarters ended September 30, 2008 and December 31, 2008, ACS also agreed to purchase equipment from the equipment manufacturer or the reseller.

nature of these transactions and falsely suggested that they were executed as part of existing ACS outsourcing contracts.

14. Blodgett and Kyser understood the origination of these "resale transactions" and their impact on ACS's reported revenue growth. However, Blodgett and Kyser did not ensure that ACS adequately described their significance in ACS's public filings and on analyst calls. Blodgett and Kyser certified each of ACS's fiscal year 2009 Forms 10-Q and 10-K.

Blodgett's and Kyser's bonuses

15. As part of their compensation, Blodgett and Kyser received bonus payments that were, in part, tied to ACS's financial performance, including revenue growth. As a result of the improperly reported revenue, Blodgett and Kyser received bonuses based on fiscal 2009 performance that were 43% higher than they would have received if ACS had properly applied GAAP with respect to determining the amount of revenue to report from the resale transactions.

Violations

16. ACS violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder by filing Forms 8-K, 10-Q, and 10-K for fiscal 2009 that improperly reported revenue related to the resale transactions, materially misstated ACS's internal revenue growth and either inadequately or incompletely described the significance of the resale transactions to internal revenue growth. Blodgett and Kyser were a cause of ACS's violations of these provisions.

17. ACS violated Section 13(b)(2)(A) by keeping books and records that inaccurately reported ACS's resale transactions during fiscal year 2009. ACS also violated Section 13(b)(2)(B) by failing to devise and maintain a system of internal controls sufficient to provide reasonable assurance that transactions are recorded and financial statements are prepared in accordance with GAAP. Blodgett and Kyser were a cause of ACS's violations of these provisions.

18. As a result of the conduct described above, Blodgett and Kyser violated Rule 13a-14 under the Exchange Act, which sets forth the requirements for certain reports filed under Section 13(a) of the Exchange Act to include specified certifications by each principal executive and principal financial officer of the issuer.

IV.

On the basis of the foregoing, Respondents hereby consent to the entry of an Order by the Commission that, pursuant to Section 21C of the Exchange Act:

- A. Respondent Blodgett cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-14 thereunder;

- B. Respondent Kyser cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-14 thereunder;
- C. Respondent Blodgett shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$351,050 and prejudgment interest of \$61,682 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Further, Respondent Blodgett shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$52,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.
- D. Respondent Kyser shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$133,192 and prejudgment interest of \$23,403 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Further, Respondent Kyser shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$52,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.
- E. Payment must be made in one of the following ways:

(1) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lynn Blodgett or Kevin Kyser as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to David L. Peavler, Associate Regional Director, Fort Worth Regional Office, Division of Enforcement, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, Texas, 76102.

- F. Such civil money penalties may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the

government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against either Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

*Chair White
Not participating
Commissioner Aquilar
Disapproved*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 72938A / August 28, 2014

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3578A / August 28, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16045

In the Matter of

**Lynn R. Blodgett and
Kevin R. Kyser, CPA**

Respondents.

**CORRECTED ORDER INSTITUTING
CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Lynn R. Blodgett ("Blodgett"), and Kevin R. Kyser ("Kyser").

II.

In anticipation of the institution of these proceedings, Blodgett and Kyser have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds¹ that:

Summary

1. At or near the end of each quarter ended September 30, 2008 through the quarter ended June 30, 2009, Affiliated Computer Services, Inc. ("ACS") arranged for an equipment manufacturer to re-direct certain of its pre-existing orders through ACS, which gave the appearance that ACS was involved. ACS, however, had no substantive involvement in the orders, and there were no changes to the terms of the pre-existing orders. Because of the nature of these arrangements, ACS should not have reported revenue from these arrangements and therefore misreported revenues in its financial reports filed on Form 10-K and Forms 10-Q for these periods. As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period.² In addition, ACS's periodic filings with the Commission inadequately or incompletely described these so-called "resale transactions." ACS improperly reported approximately \$125 million in revenue due to such arrangements.

2. During all relevant periods, Respondents Blodgett and Kyser were, respectively, ACS's chief executive officer and chief financial officer. As such, they were responsible for the content of ACS's filings with the Commission, as well as ACS's earnings releases and analyst conference calls. Blodgett and Kyser received bonuses that were higher than they would have been had ACS correctly applied generally accepted accounting principles (GAAP) with respect to determining the amount of revenue to report from the "resale transactions."³

3. Based on the conduct described below, Respondents were a cause of ACS's violations of the reporting, record-keeping, and internal controls provisions of the Exchange Act. In addition, Blodgett and Kyser violated the Exchange Act's certification requirements relating to ACS's Forms 10-Q for each fiscal quarter from September 30, 2008 through March 31, 2009 and ACS's Form 10-K for the fiscal year ended June 30, 2009.

Respondents

4. Lynn R. Blodgett, age 59, served as the President and Chief Executive Officer of ACS from November 2006 and as a director from September 2005 until Xerox Corporation

¹ The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² Internal revenue growth was a non-GAAP measure that ACS disclosed "to provide both management and investors a more complete understanding of the Company's underlying operational trends and results."

³ Financial statements filed with the Commission that are not prepared in accordance with GAAP are presumed to be misleading or inaccurate. Regulation S-X 210.4-01 [17 C.F.R. § 210.4-01].

acquired ACS in February 2010. Following Xerox Corporation's acquisition of ACS, Blodgett became an executive vice president of Xerox Corporation and has served as the President of Xerox Services since January 2012.

5. Kevin R. Kyser, age 44, served as an executive vice president and the Chief Financial Officer of ACS from September 2007 until Xerox Corporation acquired ACS in February 2010. Following Xerox Corporation's acquisition of ACS, Kyser continued as ACS's Chief Financial Officer until named the Chief Operating Officer of Xerox's Information Technology Outsourcing Group in January 2012, a position he held until he resigned in May 2013. Kyser's license as a certified public accountant in the state of Texas expired in April 2008.

Relevant Entity

6. Affiliated Computer Services, Inc. was a Delaware corporation headquartered in Dallas, Texas during the relevant period. The registration of ACS's common stock pursuant to 12(b) of the Exchange Act was withdrawn following ACS's merger in February 2010 with a subsidiary of Xerox Corporation, and the ACS corporate entity was subsequently dissolved.

Facts

7. ACS provided business process outsourcing and information technology services through two reportable operating segments: the Commercial Services Group, which accounted for approximately 60% of ACS's fiscal year 2009 revenues, and the Government Services Group, which accounted for the remaining 40% of ACS's revenues. ACS historically generated approximately 85% of its revenues from recurring, long-term contracts and 15% from non-recurring transactions. The "resale transactions" discussed below originated in ACS's Commercial Services Group and were classified as non-recurring revenue.

ACS mischaracterized "resale transactions" to increase revenue

8. In its Form 10-K for the fiscal year ended June 30, 2008, ACS disclosed that its primary goal for fiscal year 2009 was to increase internal revenue growth. In an August 7, 2008 analyst call, Blodgett characterized ACS as "well positioned to accelerate internal revenue growth in fiscal year 2009."

9. Shortly before the end of its first quarter of fiscal year 2009, ACS noted that the company's revenue would, at current rates, fall short of company guidance and consensus analyst expectations. To increase revenue, ACS arranged for an equipment manufacturer to re-direct through ACS approximately \$20 million of pre-existing orders that the manufacturer already had received from another reseller. ACS's transaction documents gave the appearance that ACS was involved in the "resale transactions," but ACS in fact had no such involvement. Among other things, even after ACS was inserted into the "resale transactions," the pricing for equipment remained unchanged, the equipment continued to be shipped from the manufacturer directly to the reseller's customers (*i.e.*, ACS never had actual or constructive possession of it), and the reseller's customers were unaware that ACS was involved. In short, these pre-existing orders between the

manufacturer and other reseller proceeded in all material respects according to their original terms and were unaffected by ACS's late insertion.

10. ACS executed virtually identical "resale transactions" at the end of the next three quarters.⁴ In total, ACS reported revenue of \$124.5 million from such arrangements during fiscal 2009.

ACS's improper accounting

11. ACS improperly applied GAAP in determining the amount of revenue to report in each of its quarters in FY 2009. In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the "resale transactions" under GAAP. In addition, ACS's internal controls were insufficient to provide reasonable assurance that ACS reported revenues in conformity with GAAP, primarily because ACS failed to appropriately evaluate the economic substance of the "resale transactions."

12. The revenue from these "resale transactions" enabled ACS to meet its publicly disclosed internal revenue growth ("IRG") guidance for three of the four quarters for that fiscal year. ACS missed its guidance for its third quarter even with the improperly reported revenue. The table below summarizes the amount of the resale revenue (as reported), ACS's public IRG guidance, IRG (as reported), IRG (as adjusted), and the percent misstated by quarter and for the year:

Period	"Resale" Revenue (as reported) (\$ in millions)	ACS's Public IRG Guidance	IRG (as reported)	IRG (as adjusted)	IRG Over Statement	% Over Statement
Q1 2009	\$ 19.9	5%	5%	3.4%	1.6%	47%
Q2 2009	\$ 40.6	4-5%	4%	1.2%	2.8%	233%
Q3 2009	\$ 39.7	5-6%	3%	(0.2)%	3.2%	1,600%
Q4 2009	\$ 24.2	3%	3%	1.7%	1.3%	76%
FY 2009	\$ 124.5	5-6%	3%	1.5%	1.5%	100%

ACS failed to properly disclose the "resale transactions" and their impact on IRG

13. Even though the "resale transactions" were the largest contributors to ACS's internal revenue growth, ACS did not disclose them in its September 30, 2008 Form 10-Q. In subsequent quarters, ACS disclosed these transactions as "information technology outsourcing related to deliveries of hardware and software." This description did not accurately disclose the.

⁴ Contemporaneous with the "resale transactions" executed for the quarters ended September 30, 2008 and December 31, 2008, ACS also agreed to purchase equipment from the equipment manufacturer or the reseller.

nature of these transactions and falsely suggested that they were executed as part of existing ACS outsourcing contracts.

14. Blodgett and Kyser understood the origination of these "resale transactions" and their impact on ACS's reported revenue growth. However, Blodgett and Kyser did not ensure that ACS adequately described their significance in ACS's public filings and on analyst calls. Blodgett and Kyser certified each of ACS's fiscal year 2009 Forms 10-Q and 10-K.

Blodgett's and Kyser's bonuses

15. As part of their compensation, Blodgett and Kyser received bonus payments that were, in part, tied to ACS's financial performance, including revenue growth. As a result of the improperly reported revenue, Blodgett and Kyser received bonuses based on fiscal 2009 performance that were 43% higher than they would have received if ACS had properly applied GAAP with respect to determining the amount of revenue to report from the resale transactions.

Violations

16. ACS violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder by filing Forms 8-K, 10-Q, and 10-K for fiscal 2009 that improperly reported revenue related to the resale transactions, materially misstated ACS's internal revenue growth and either inadequately or incompletely described the significance of the resale transactions to internal revenue growth. Blodgett and Kyser were a cause of ACS's violations of these provisions.

17. ACS violated Section 13(b)(2)(A) by keeping books and records that inaccurately reported ACS's resale transactions during fiscal year 2009. ACS also violated Section 13(b)(2)(B) by failing to devise and maintain a system of internal controls sufficient to provide reasonable assurance that transactions are recorded and financial statements are prepared in accordance with GAAP. Blodgett and Kyser were a cause of ACS's violations of these provisions.

18. As a result of the conduct described above, Blodgett and Kyser violated Rule 13a-14 under the Exchange Act, which sets forth the requirements for certain reports filed under Section 13(a) of the Exchange Act to include specified certifications by each principal executive and principal financial officer of the issuer.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED that:

- A. Respondent Blodgett cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-14 thereunder;

- B. Respondent Kyser cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-14 thereunder;
- C. Respondent Blodgett shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$351,050 and prejudgment interest of \$61,682 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Further, Respondent Blodgett shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$52,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.
- D. Respondent Kyser shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$133,192 and prejudgment interest of \$23,403 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Further, Respondent Kyser shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$52,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.
- E. Payment must be made in one of the following ways:
- (1) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
- Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169
- Payments by check or money order must be accompanied by a cover letter identifying Lynn Blodgett or Kevin Kyser as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to David L. Peavler, Associate Regional Director, Fort Worth Regional Office, Division of Enforcement, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, Texas, 76102.
- F. Such civil money penalties may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the

government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against either Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
August 28, 2014

In the Matter of

QSGI Inc.

File No. 500-1

**ORDER OF SUSPENSION
OF TRADING**

It appears to the Securities and Exchange Commission ("Commission") that there is a lack of current and accurate information concerning the securities of QSGI Inc. ("QSGI") because QSGI has not filed any periodic reports for any reporting period subsequent to June 30, 2011. QSGI is a Florida corporation with its principal place of business listed as West Palm Beach, Florida. Its stock is quoted on OTC Link, operated by OTC Markets Group Inc., under the ticker: QSGI. The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of QSGI.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT, August 28, 2014, through 11:59 p.m. EDT, on September 11, 2014.

By the Commission.


Jill M. Peterson
Assistant Secretary

78 of 82

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72940 / August 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16044

In the Matter of

QSGI Inc.,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent QSGI Inc. ("QSGI").

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent QSGI (CIK No. 27960) is a Delaware corporation located in West Palm Beach, Florida as reflected in information on file with the Florida Secretary of State. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of August 6, 2014, QSGI's common stock (symbol "QSGI") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc., had 10 market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. On April 30, 2014, the Division of Corporation Finance sent a delinquency letter to Respondent.

3. Prior to issuance of the delinquency letter, the most recent reporting period with respect to which Respondent had filed a periodic report was the quarter ended March 31, 2011, for which it filed a Form 10-Q on March 19, 2012.

4. Following the issuance of the delinquency letter, Respondent filed a Form 10-Q for the period ended June 30, 2011 on May 22, 2014.

79 of 82

5. On June 26, 2006, the Division of Corporation Finance sent a second letter to Respondent, reiterating that the Respondent had not fulfilled all of its reporting requirements.

6. Respondent failed to heed the second delinquency letter sent to it by the Division of Corporation Finance.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

8. As a result of the foregoing, Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2

or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940

Release No. 3906 / August 28, 2014

ADMINISTRATIVE PROCEEDING

File No. 3-16046

In the Matter of

**STRUCTURED PORTFOLIO
MANAGEMENT, L.L.C.,**

SPM JR., L.L.C., and

SPM IV, L.L.C.,

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 203(e) AND 203(k)
OF THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Structured Portfolio Management, L.L.C. ("Portfolio Management"), SPM Jr., L.L.C. ("SPM Jr."), and SPM IV, L.L.C. ("SPM IV") ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

80 of 82

III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

SUMMARY

1. This matter concerns compliance failures by hedge fund adviser Portfolio Management and its affiliated advisers, SPM Jr. and SPM IV (collectively, "SPM"). SPM failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, concerning trade allocation and the review of investor disclosures.

2. The compliance failures are the result of a disclosed, but inadequately addressed, conflict of interest wherein SPM allowed a trader to trade the same securities across three SPM-advised hedge funds. This conflict of interest presented the possibility for the trader to engage in improper allocations from February 2006 through February 2009. Despite SPM's recognition of the conflict and its awareness of internal concerns regarding trade allocations, SPM failed to adopt and implement written policies and procedures reasonably designed to detect and prevent improper trade allocations. In addition, SPM failed to adopt and implement written policies and procedures reasonably designed to prevent inaccurate disclosures concerning its funds and their investment strategies.

RESPONDENTS

3. **Structured Portfolio Management, L.L.C. ("Portfolio Management")** is a Delaware limited liability company located in Stamford, Connecticut. Portfolio Management was formed in February 1997 and advises the Structured Servicing Holdings Master Fund, L.P. Portfolio Management has been registered as an investment adviser with the Commission since April 2000.

4. **SPM Jr., L.L.C. ("SPM Jr.")** is a Delaware limited liability company located in Stamford, Connecticut. SPM Jr. was formed in January 2003 and advised the Parmenides Master Fund, L.P. During the relevant time period, Portfolio Management owned approximately 90% of SPM Jr. SPM Jr. was registered as an investment adviser with the Commission from April 2003 through January 2013.

5. **SPM IV, L.L.C. ("SPM IV")** is a Delaware limited liability company located in Stamford, Connecticut. SPM IV was formed in May 2005 and advised the Aqueous Master Fund, L.P. During the relevant time period, Portfolio Management owned approximately 44% of SPM IV. SPM IV was registered as an investment adviser with the Commission from June 2005 through April 2009.

OTHER RELEVANT ENTITIES

6. **Structured Servicing Holdings Master Fund, L.P. ("SSH")** is a Delaware limited partnership that was formed in July 2001 and was advised by Portfolio Management during the relevant time period.

7. **Parmenides Master Fund, L.P. ("Parmenides")** was a Delaware limited partnership that was formed in January 2003 and was advised by SPM Jr. during the relevant time period.

8. **Aqueous Master Fund, L.P. ("Aqueous")** was a Delaware limited partnership that was formed in September 2005 and was advised by SPM IV during the relevant time period.

FACTS

A. Background

9. Portfolio Management was formed in 1997 and registered with the Commission as an investment adviser in 2000. During the relevant time period, Portfolio Management advised hedge fund SSH and had a 90% ownership interest in affiliated adviser SPM Jr., which advised hedge fund Parmenides.

10. SSH and Parmenides invested in mortgage-related securities, including collateralized mortgage obligations, mortgage-backed securities ("MBS"), and interest-only bonds. These securities were subject to interest rate risk, which was hedged by trading a variety of liquid securities, including U.S. Treasury securities ("Treasuries").

11. SSH and Parmenides had separate portfolio managers who traded each fund's core mortgage-related securities holdings. A third trader (hereinafter, "Hedge Trader") was responsible for hedging interest rate risk for both SSH and Parmenides.

12. In 2005, the principals of Portfolio Management formed Aqueous, a new, highly liquid fund that sought to provide excess returns by investing in a wide range of financial assets drawn principally from the U.S. residential and commercial mortgage markets, and including Treasuries and other securities. They created SPM IV to advise it.

13. Aqueous was launched in February 2006 and the Hedge Trader was appointed as its portfolio manager and trader. Aqueous received seed capital from SSH and Parmenides, which were consistently among the largest investors in Aqueous.

B. SPM Failed to Adopt and Implement Policies and Procedures Reasonably Designed to Prevent Improper Trade Allocations

The Potential Conflict

14. After being named Aqueous' portfolio manager and trader, the Hedge Trader continued to trade the hedge positions for SSH and Parmenides. When trading for Aqueous, the Hedge Trader's sole responsibility was to make a profit. In contrast, when trading for SSH and Parmenides, his main responsibility was to hedge interest rate risk.

15. On an average day, the Hedge Trader traded Treasuries to hedge SSH's and Parmenides' core holdings in mortgage-related securities. He also traded the same Treasuries in Aqueous as part of its core holdings; however, those trades were for much smaller quantities and occurred much less frequently. When the Hedge Trader traded the same Treasuries across all three funds, a potential conflict of interest existed concerning how to allocate the trades among the three funds. SPM recognized and disclosed this potential conflict at Aqueous' inception but did not modify or update its written policies and procedures.

16. Portfolio Management, SPM Jr., and SPM IV were subject to the same set of compliance policies and procedures (or "Compliance Manual"). The Compliance Manual, which was created in consultation with an external consultant, stated that SPM traders would seek to allocate trades in a fair and equitable manner in light of the investment objectives and strategies of SPM's funds and other factors.

17. SPM's Compliance Manual also contained trade confirmation procedures. Pursuant to these procedures, upon executing a trade, the trader was required to complete a trade blotter identifying, among other information, the following: (i) the name of the fund purchasing or selling the security; (ii) a description of the security traded; (iii) the amount of securities traded; (iv) the price at which the trade was executed; and (v) the counterparty. On a daily basis, a member of the operations staff was required to obtain the blotter, review it, and enter all of the information into SPM's proprietary trade management system.

18. Although SPM required its traders to identify upon trade execution the fund for which the securities were traded, it did not institute any additional procedures after the creation of Aqueous to confirm that traders actually did so. Trade blotters were provided to, or collected by, the operations department on a sporadic basis throughout the day without any way of determining when the trader had identified the fund for which the securities were traded in relation to the time that the trade was executed.

Concerns Raised

19. In August 2006, internal concerns were raised as to whether Aqueous was receiving more favorable execution prices than SSH and Parmenides when trading the same Treasury security on the same day.

20. The internal concerns were based on a review of the funds' trading data for the time period April to August 2006, which showed that when Aqueous, SSH, and Parmenides each purchased the same Treasury security on the same day, Aqueous consistently bought at a lower price than the other two funds. Likewise, when all three funds sold the same Treasury security on the same day, Aqueous consistently sold at a higher price than SSH and Parmenides. After these concerns were raised, SPM removed the Hedge Trader from trading on behalf of SSH and Parmenides while he was trading for Aqueous. For approximately six months, the Hedge Trader traded solely for Aqueous.

21. In January 2007, SPM lifted the Hedge Trader's trading restriction and allowed him to resume trading for all three funds. While SPM took certain steps to address the earlier concerns as part of the decision to allow the Hedge Trader to resume executing trades for SSH and Parmenides, it did not amend its written policies and procedures to address the potential for conflicts. Instead, SPM simply instructed its traders to provide trade blotters to the operations department more frequently throughout the day and tasked a junior compliance officer with ensuring that trade blotters were provided in a timely manner.

22. These oral instructions regarding the trade blotters were not accompanied by anything in writing and no additional guidance was provided to the traders or to the junior compliance officer. For example, while traders were required to provide blotters to the operations department more frequently, there was no written guidance concerning when the blotter needed to be provided in relation to when the trade was placed. Further, SPM did not provide the junior compliance officer with any written procedures to ensure that blotters were provided in a timely manner. In November 2008, while the junior compliance officer was on vacation and there was no one assigned to carry out those responsibilities, SPM raised concerns that traders were not properly allocating their trades by fund at the time of execution.

23. During SPM's annual compliance review in November 2008, an independent firm separately raised trade allocation concerns.

24. In January 2009, concerns regarding trade allocations were again raised internally. These concerns were based on a statistical analysis that claimed Aqueous' trading performance was aberrational for the time period September 2007 through January 2009. In response to these concerns, SPM hired outside counsel to conduct a review of SPM's trade allocations. The review was inconclusive as to whether trades were or were not allocated improperly.

25. While SPM's compliance manual required traders to identify the fund for which the securities were being traded upon execution, this requirement alone was not sufficient for preventing improper trade allocations. Despite being aware of concerns about improper trade allocations, SPM failed to adopt and implement written policies and procedures reasonably designed to prevent improper trade allocations.

26. In March 2009, SPM closed the Aqueous fund.

C. SPM Failed to Adopt and Implement Written Policies and Procedures to Adequately Review Investor Disclosures

27. SPM failed to adopt and implement written policies and procedures reasonably designed to prevent inaccurate disclosures to current and prospective investors regarding the trading and investment strategy of Aqueous.

28. Aqueous' investment objective was to provide excess returns by investing in a wide range of financial assets drawn principally from the U.S. residential and commercial mortgage markets. The fund's private placement memorandum disclosed that Aqueous would invest primarily in MBS, including Fannie Maes and Freddie Macs, but that it also might invest in Treasuries and other liquid securities.

29. From Aqueous' inception in February 2006 until mid-2007, the fund traded highly liquid MBS and Treasuries as set forth in its offering documents. Over time, however, Aqueous stopped trading MBS and began almost exclusively to day-trade Treasuries. While Aqueous continued to maintain a highly liquid investment strategy, SPM failed to disclose that it was doing so by day-trading Treasuries and continued to represent that it was primarily trading mortgage-related securities.

30. In contrast to these disclosures, Aqueous had not been trading mortgage-related securities. From September 2007 through February 2009, Aqueous had made only two trades that were not trades in Treasuries.

31. SPM did not adopt and implement written policies and procedures reasonably designed to prevent inaccurate investor disclosures. As a result of not adopting and implementing reasonably designed policies and procedures, SPM did not adequately review Aqueous' offering documents and other investor disclosures on a regular basis to determine whether they were inaccurate.

VIOLATIONS

32. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

33. SPM willfully¹ violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent improper trade allocations and to prevent inaccurate disclosures in its offering and marketing materials.

¹ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

UNDERTAKINGS

Respondent Portfolio Management undertakes to complete the following actions:

34. Independent Compliance Consultant. Respondent Portfolio Management shall retain, within 30 days of the issuance of this Order, the services of an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission. The Consultant's compensation and expenses shall be borne exclusively by Respondent. Respondent shall require the Consultant to conduct a comprehensive review of Portfolio Management's supervisory, compliance, and other policies and procedures designed to prevent and detect improper trade allocations and inaccurate investor disclosures.

a. Respondent Portfolio Management shall provide to the Commission staff, within thirty (30) days of retaining the Consultant, a copy of an engagement letter detailing the Consultant's responsibilities, which shall include the reviews described above in paragraph 34.

b. At the end of the review, which in no event shall be more than 180 days after the date of the entry of this Order, Respondent Portfolio Management shall require the Consultant to submit a Report to Portfolio Management and the staff of the Commission ("Report"). The Report shall address the issues described above in paragraph 34, and shall include a description of the review performed, the conclusions reached, the Consultant's recommendations for changes in or improvements to Portfolio Management's policies and procedures, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

c. Respondent Portfolio Management shall adopt all recommendations contained in the Consultant's Report; provided, however, that within 210 days after the date of entry of this order, or within 30 days after delivery of the Report to Portfolio Management (whichever date is later), Portfolio Management shall, in writing, advise the Consultant and the Commission staff of any recommendations that it considers unnecessary, unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, Portfolio Management need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which Portfolio Management and the Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 30 days after Portfolio Management serves the advice described above. In the event that Portfolio Management and the Consultant are unable to agree on an alternative proposal, Portfolio Management and the Consultant shall jointly confer with the Commission staff to resolve the matter. In the event that, after conferring with the Commission staff, Portfolio Management and the Consultant are unable to agree on an alternative proposal, Portfolio Management will abide by the recommendations of the Consultant.

d. Within ninety (90) days of Respondent Portfolio Management's adoption of all of the recommendations in the Consultant's Report, as determined pursuant to the procedures set forth herein, Portfolio Management shall certify in writing to the Consultant and the Commission staff that it has adopted and implemented all of the Consultant's

recommendations in the Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Anthony S. Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010, or such other address as the Commission's staff may provide.

e. Respondent Portfolio Management shall cooperate fully with the Consultant and shall provide the Consultant with access to files, books, records, and personnel as are reasonably requested by the Consultant for review.

f. To ensure the independence of the Consultant, Portfolio Management (i) shall not have the authority to terminate the Consultant or substitute another independent compliance consultant for the initial Consultant, without the prior written approval of the Commission's staff; and (ii) shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

g. Respondent Portfolio Management shall require the Consultant to enter into an agreement providing that for the period of the engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Portfolio Management, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in the performance of his/her duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Portfolio Management, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

35. Recordkeeping. Portfolio Management shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of its compliance with the undertakings set forth in this Order.

36. Notice to Advisory Clients. Within twenty (20) days of the entry of this Order, Respondent Portfolio Management shall send a copy of this Order to its advisory clients and private fund investors, with a cover letter in a form not unacceptable to the Commission's staff. In addition, Portfolio Management shall promptly revise its Form ADV to disclose the existence of the Order in accordance with such Form and its instructions.

37. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

38. Certification of Compliance by Respondent. Portfolio Management shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance with the undertakings in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent Portfolio Management agrees to provide such evidence. The certification and supporting material shall be submitted to Anthony S. Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) calendar days from the date of the completion of the undertaking.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondents Structured Portfolio Management, L.L.C., SPM Jr., L.L.C., and SPM IV, L.L.C. cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.
- B. Respondents Structured Portfolio Management, L.L.C., SPM Jr., L.L.C., and SPM IV, L.L.C. are censured.
- C. Respondents Structured Portfolio Management, L.L.C., SPM Jr., L.L.C., and SPM IV, L.L.C. shall pay, jointly and severally, within ten (10) calendar days of the entry of this Order, a civil money penalty in the amount of \$300,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:
 - (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
 - (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
 - (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payment by check or money order must be accompanied by a cover letter identifying Structured Portfolio Management, L.L.C, SPM Jr, L.L.C., and SPM IV, L.L.C. as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010.

- D. Respondent Portfolio Management shall comply with the undertakings enumerated in Section III, paragraphs 34-38 above.

By the Commission.


Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72947 / August 29, 2014

WHISTLEBLOWER AWARD PROCEEDING
File No. 2014 - 9

In the Matter of the Claim for Award

in connection with

Redacted
Notice of Covered Action Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

Two claimants, Redacted and Redacted each timely filed a whistleblower award claim pursuant to Section 21F of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-6 (the "Exchange Act"), in connection with Notice of Covered Action Redacted. On Redacted the Claims Review Staff ("CRS") issued a Preliminary Determination recommending that Redacted receive an award of 20% and that Redacted be denied an award. Redacted has waived right to contest the Preliminary Determination and Redacted has filed a response contesting the Preliminary Determination. For the reasons set forth below, Redacted claim is approved in the amount of 20%, and Redacted is denied.

I. Background and Commission Action

On Redacted the Commission filed an enforcement action in Redacted Redacted (the "Covered Action"). The Commission alleged that (or the "Defendant") committed Redacted Redacted On Redacted the United States District Court Redacted entered final judgment in favor of the Commission, Redacted Redacted

On Redacted the Office of the Whistleblower ("OWB") posted Notice of Covered Action Redacted for the Covered Action. As noted above, both claimants filed timely whistleblower award claims.

81 of 82

II.

Redacted

Claim is Approved

In the Preliminary Determination, the CRS recommended that Redacted receive a whistleblower award based on information that Redacted submitted to the Commission between Redacted and Redacted. This information concerned Redacted. The CRS preliminarily determined that this information constituted original information, that Redacted voluntarily provided it to the Commission, and that this information led to the successful enforcement of the Covered Action. See Section 21F(b)(1) of the Exchange Act, and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a).¹

The CRS also recommended that Redacted award be set in the amount of twenty percent (20%) of the monetary sanctions collected in the Covered Action. In arriving at this recommendation, the CRS considered the factors set forth in Rule 21F-6, 17 C.F.R. § 240.21F-6, in relation to the facts and circumstances of Redacted application.

Upon due consideration under Rule 21F-10(f) and (h), 17 C.F.R. § 240.21F-10(f) and (h), and for the reasons set forth in the Preliminary Determination, Redacted claim is approved in the amount of 20%.²

III.

Redacted

Claim is Denied

A.

Redacted

Application

On Redacted submitted a Form WB-APP in connection with Redacted. Attached to the Form WB-APP was a four page document that included a list of seventeen different Notices of Covered Actions, including the Notice for the current matter. In the attachment to the Form WB-APP, Redacted wrote that "provided over 200 files with thousands of accounts, linked associates, mortgage documents, deeds, death certificates, announcements, tax documents, and offshore accounts and business associates around

¹ Redacted obtained the information in Redacted capacity as Redacted. As a result, in preliminarily determining that Redacted had provided original information, the CRS considered whether Redacted information was derived from Redacted independent knowledge or independent analysis. Under Rule 21F-4(b)(1), "[i]n order for [a] whistleblower submission to be considered original information, it must," among other requirements, be "[d]erived from [the whistleblower's] independent knowledge or independent analysis." 17 C.F.R. § 240.21F-4(b)(1). In turn, Rule 21F-4(b)(4)(iii)(B) provides that, *unless an exception applies*, "[t]he Commission will not consider information to be derived from [a whistleblower's] independent knowledge or independent analysis" if the whistleblower "obtained the information because" the whistleblower was "[a]n employee whose principal duties involve[d] compliance or internal audit responsibilities[.]" 17 C.F.R. § 240.21F-4(b)(4)(iii)(B). But the CRS preliminarily determined that Rule 21F-4(b)(4)(iii)(B) did not apply here to disqualify Redacted information from treatment as original information pursuant to the exception in Rule 21F-4(b)(4)(v)(C), 17 C.F.R. § 240.21F-4(b)(4)(v)(C), because Redacted had reported the information to Redacted at least 120 days before reporting the information to the Commission.

² Redacted did not contest the Preliminary Determination and it therefore became the Proposed Final Determination of the CRS pursuant to Rule 21F-10(f), 17 C.F.R. § 240.21F-10(f).

the world.” * did not reference any specific tip or complaint in connection with the Covered Action.

A search of the Commission’s Tips, Complaint and Referral (“TCR”) system—the Commission’s electronic database which records and stores information received from whistleblowers and others about potential securities law violations—did not reveal any TCRs from Redacted relating to the Covered Action. In addition, the Enforcement staff members who handled the Covered Action confirmed that they received no information from Redacted before, during or after the investigation or enforcement action.

On Redacted the CRS issued a Preliminary Determination recommending that Redacted application for an award be denied because * did not provide any information that led to the successful enforcement of the Covered Action, as required by Section 21F(b)(1) of the Exchange Act, and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a).

B. Redacted Response to the Preliminary Determination

On Redacted timely submitted a response contesting the Preliminary Determination. * response attached various documents, including: four annual reports of two organizations in Florida; a report published by the Boca Raton Regional Hospital Foundation; several public news stories about Israeli agents in Australia, a couple who pled guilty to money laundering in 2000, a merger between two banks, and the presidential pardon of Marc Rich; and press releases from Redacted regarding internal promotions and hiring. In * response, Redacted again failed to identify any specific tip or complaint that * submitted to the Commission in connection with the Covered Action.

The gist of Redacted response is that Redacted and Redacted are engaged in a Ponzi scheme and money laundering for the purpose of directing funds to Israel and possibly the Israeli national intelligence agency, and that the Commission’s case ignored evidence regarding offshore accounts and other alleged wrongdoing.

C. Analysis

To qualify for an award under Section 21F, a whistleblower must voluntarily provide the Commission with original information that leads to the successful enforcement of a covered judicial or administrative action or related action. 15 U.S.C. § 78u-6(b)(1). Original information “leads to” a successful enforcement action if either: (i) the original information caused the staff to open an investigation, reopen an investigation, or inquire into different conduct as part of a current examination or investigation, and the Commission brought a successful action based in whole or in part on conduct that was the subject of the original information; or (ii) the conduct was already under examination or investigation, and the original information significantly contributed to the success of the action. Rule 21F-4(c)(1)-(2), 17 C.F.R. § 240.21F-4(c)(1)-(2).

We find that none of the information Redacted submitted led to the successful enforcement of the Covered Action. First, the record demonstrates that Redacted did not lead to the opening of the investigation, as * only started submitting information to the Commission on Redacted which is well after the staff began its investigation into Redacted

Second, we see no evidence to suggest that * contributed to the ongoing investigation. Every TCR that Redacted has submitted to the Commission has been closed with a disposition of no further action planned, which indicates that the information was not provided to Enforcement staff for further inquiry or for use in any ongoing investigations. And there is otherwise no indication that the Enforcement staff members responsible for the Covered Action relied on any information provided by Redacted in investigating the matter or bringing the Covered Action.

Third, based on our own assessment of the information that Redacted submitted, we cannot see how this information could have led to the successful enforcement of the Covered Action given the absence of any relevant factual connections between the two. And Redacted has failed to explain how any of the information that * provided either caused the staff to open the investigation (or a new line of inquiry in the investigation) that resulted in the Covered Action, or significantly contributed to the success of the Covered Action.

Because the record demonstrates that Redacted information did not lead to the successful enforcement of the Covered Action and * has not shown otherwise in * request for reconsideration of the Preliminary Determination, we deny * application for an award.

IV. Conclusion

Accordingly, it is ORDERED that Redacted shall receive an award of twenty percent (20%) of the monetary sanctions collected in this Covered Action, including any monetary sanctions collected after the date of this Order; and it is further

ORDERED that Redacted whistleblower award claim is denied.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-9635; 34-72948/ August 29, 2014]

Order Making Fiscal Year 2015 Annual Adjustments to Registration Fee Rates

I. Background

The Commission collects fees under various provisions of the securities laws. Section 6(b) of the Securities Act of 1933 ("Securities Act") requires the Commission to collect fees from issuers on the registration of securities.¹ Section 13(e) of the Securities Exchange Act of 1934 ("Exchange Act") requires the Commission to collect fees on specified repurchases of securities.² Section 14(g) of the Exchange Act requires the Commission to collect fees on proxy solicitations and statements in corporate control transactions.³ These provisions require the Commission to make annual adjustments to the fee rates applicable under these provisions.

II. Fiscal Year 2015 Annual Adjustment to Fee Rates

Section 6(b)(2) of the Securities Act requires the Commission to make an annual adjustment to the fee rate applicable under Section 6(b).⁴ The annual adjustment to the fee rate under Section 6(b) of the Securities Act also sets the annual adjustment to the fee rates under Sections 13(e) and 14(g) of the Exchange Act.⁵

¹ 15 U.S.C. 77f(b).

² 15 U.S.C. 78m(e).

³ 15 U.S.C. 78n(g).

⁴ 15 U.S.C. 77f(b)(2). The annual adjustments are designed to adjust the fee rate in a given fiscal year so that, when applied to the aggregate maximum offering price at which securities are proposed to be offered for the fiscal year, it is reasonably likely to produce total fee collections under Section 6(b) equal to the "target fee collection amount" specified in Section 6(b)(6)(A) for that fiscal year.

⁵ 15 U.S.C. 78m(e)(4) and 15 U.S.C. 78n(g)(4).

82 of 82

Section 6(b)(2) sets forth the method for determining the annual adjustment to the fee rate under Section 6(b) for fiscal year 2015. Specifically, the Commission must adjust the fee rate under Section 6(b) to a “rate that, when applied to the baseline estimate of the aggregate maximum offering prices for [fiscal year 2015], is reasonably likely to produce aggregate fee collections under [Section 6(b)] that are equal to the target fee collection amount for [fiscal year 2015].” That is, the adjusted rate is determined by dividing the “target fee collection amount” for fiscal year 2015 by the “baseline estimate of the aggregate maximum offering prices” for fiscal year 2015.

Section 6(b)(6)(A) specifies that the “target fee collection amount” for fiscal year 2015 is \$515,000,000. Section 6(b)(6)(B) defines the “baseline estimate of the aggregate maximum offering price” for fiscal year 2015 as “the baseline estimate of the aggregate maximum offering price at which securities are proposed to be offered pursuant to registration statements filed with the Commission during [fiscal year 2015] as determined by the Commission, after consultation with the Congressional Budget Office and the Office of Management and Budget”

To make the baseline estimate of the aggregate maximum offering price for fiscal year 2015, the Commission used a methodology similar to that developed in consultation with the Congressional Budget Office (“CBO”) and Office of Management and Budget (“OMB”) to project the aggregate offering price for purposes of the fiscal years 2011 through 2014 annual adjustments.⁶ Using this methodology, the Commission determines the “baseline estimate of the aggregate maximum offering price” for fiscal year 2015 to

⁶ For the fiscal year 2011 estimate, the Commission used a ten-year series of monthly observations ending in March 2011. For fiscal years 2012-2015, the Commission used a ten-year series ending in July of the applicable year.

be \$4,433,900,707,058.⁷ Based on this estimate, the Commission calculates the fee rate for fiscal 2015 to be \$116.20 per million. This adjusted fee rate applies to Section 6(b) of the Securities Act, as well as to Sections 13(e) and 14(g) of the Exchange Act.

III. Effective Dates of the Annual Adjustments

The fiscal year 2015 annual adjustments to the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act will be effective on October 1, 2014.⁸

IV. Conclusion

Accordingly, pursuant to Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act,⁹

IT IS HEREBY ORDERED that the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act shall be \$116.20 per million effective on October 1, 2014.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

⁷ Appendix A explains how we determined the "baseline estimate of the aggregate maximum offering price" for fiscal year 2015 using our methodology, and then shows the arithmetical process of calculating the fiscal year 2015 annual adjustment based on that estimate. The appendix includes the data used by the Commission in making its "baseline estimate of the aggregate maximum offering price" for fiscal year 2015.

⁸ 15 U.S.C. 77f(b)(4), 15 U.S.C. 78m(e)(6) and 15 U.S.C. 78n(g)(6).

⁹ 15 U.S.C. 77f(b), 78m(e) and 78n(g).

APPENDIX A

Congress has established a target amount of monies to be collected from fees charged to issuers based on the value of their registrations. This appendix provides the formula for determining such fees, which the Commission adjusts annually. Congress has mandated that the Commission determine these fees based on the “aggregate maximum offering prices,” which measures the aggregate dollar amount of securities registered with the Commission over the course of the year. In order to maximize the likelihood that the amount of monies targeted by Congress will be collected, the fee rate must be set to reflect projected aggregate maximum offering prices. As a percentage, the fee rate equals the ratio of the target amounts of monies to the projected aggregate maximum offering prices.

For 2015, the Commission has estimated the aggregate maximum offering prices by projecting forward the trend established in the previous decade. More specifically, an ARIMA model was used to forecast the value of the aggregate maximum offering prices for months subsequent to July 2014, the last month for which the Commission has data on the aggregate maximum offering prices.

The following sections describe this process in detail.

A. Baseline estimate of the aggregate maximum offering prices for fiscal year 2015.

First, calculate the aggregate maximum offering prices (AMOP) for each month in the sample (July 2004 - July 2014). Next, calculate the percentage change in the AMOP from month to month.

Model the monthly percentage change in AMOP as a first order moving average process. The moving average approach allows one to model the effect that an exceptionally high (or low) observation of AMOP tends to be followed by a more “typical” value of AMOP.

Use the estimated moving average model to forecast the monthly percent change in AMOP. These percent changes can then be applied to obtain forecasts of the total dollar value of registrations. The following is a more formal (mathematical) description of the procedure:

1. Begin with the monthly data for AMOP. The sample spans ten years, from July 2004 to July 2014.
2. Divide each month's AMOP (column C) by the number of trading days in that month (column B) to obtain the average daily AMOP (AAMOP, column D).
3. For each month t , the natural logarithm of AAMOP is reported in column E.
4. Calculate the change in $\log(\text{AAMOP})$ from the previous month as
$$\Delta_t = \log(\text{AAMOP}_t) - \log(\text{AAMOP}_{t-1}).$$
 This approximates the percentage change.
5. Estimate the first order moving average model $\Delta_t = \alpha + \beta e_{t-1} + e_t$, where e_t denotes the forecast error for month t . The forecast error is simply the difference between the one-month ahead forecast and the actual realization of Δ_t . The forecast error is expressed as $e_t = \Delta_t - \alpha - \beta e_{t-1}$. The model can be estimated using standard commercially available software. Using least squares, the estimated parameter values are $\alpha = 0.0005277$ and $\beta = -0.89215$.

6. For the month of August 2014 forecast $\Delta_{t=8/12} = \alpha + \beta e_{t=7/12}$. For all subsequent months, forecast $\Delta_t = \alpha$.
7. Calculate forecasts of $\log(\text{AAMOP})$. For example, the forecast of $\log(\text{AAMOP})$ for October 2014 is given by $\text{FLAAMOP}_{t=10/12} = \log(\text{AAMOP}_{t=7/12}) + \Delta_{t=8/12} + \Delta_{t=9/12} + \Delta_{t=10/12}$.
8. Under the assumption that e_t is normally distributed, the n -step ahead forecast of AAMOP is given by $\exp(\text{FLAAMOP}_t + \sigma_n^2/2)$, where σ_n denotes the standard error of the n -step ahead forecast.
9. For October 2014, this gives a forecast AAMOP of \$17.470 billion (Column I), and a forecast AMOP of \$401.8 billion (Column J).
10. Iterate this process through September 2015 to obtain a baseline estimate of the aggregate maximum offering prices for fiscal year 2015 of \$4,433,900,707,058.

B. Using the forecasts from A to calculate the new fee rate.

1. Using the data from Table A, estimate the aggregate maximum offering prices between 10/01/14 and 9/30/15 to be \$4,433,900,707,058.
2. The rate necessary to collect the target \$515,000,000 in fee revenues set by Congress is then calculated as: $\$515,000,000 \div \$4,433,900,707,058 = 0.00011615$.
3. Round the result to the seventh decimal point, yielding a rate of 0.0001162 (or \$116.20 per million).

Table A. Estimation of baseline of aggregate maximum offering prices .

Fee rate calculation.

a. Baseline estimate of the aggregate maximum offering prices, 10/1/14 to 9/30/15 (\$Millions)	4,433,901
b. Implied fee rate (\$515 Million / a)	\$116.20

Data

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in \$Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in \$Millions	(E) log(AAMOP)	(F) Log Change in AAMOP)	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in \$Millions	(J) Forecast Aggregate Maximum Offering Prices, in \$Millions
Jul-04	21	305,519	14,549	23.401					
Aug-04	22	179,688	8,168	22.823	-0.577				
Sep-04	21	357,007	17,000	23.556	0.733				
Oct-04	21	254,489	12,119	23.218	-0.338				
Nov-04	21	363,406	17,305	23.574	0.356				
Dec-04	22	570,918	25,951	23.979	0.405				
Jan-05	20	375,484	18,774	23.656	-0.324				
Feb-05	19	338,922	17,838	23.605	-0.051				
Mar-05	22	590,862	26,857	24.014	0.409				
Apr-05	21	282,018	13,429	23.321	-0.693				
May-05	21	323,652	15,412	23.458	0.138				
Jun-05	22	517,022	23,501	23.880	0.422				
Jul-05	20	457,487	22,874	23.853	-0.027				
Aug-05	23	605,534	26,328	23.994	0.141				
Sep-05	21	312,281	14,871	23.423	-0.571				
Oct-05	21	258,956	12,331	23.235	-0.187				
Nov-05	21	192,736	9,178	22.940	-0.295				
Dec-05	21	308,134	14,673	23.409	0.469				
Jan-06	20	526,550	26,328	23.994	0.585				
Feb-06	19	301,446	15,866	23.487	-0.506				
Mar-06	23	1,211,344	52,667	24.687	1.200				
Apr-06	19	407,345	21,439	23.788	-0.899				
May-06	22	260,121	11,824	23.193	-0.595				

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in \$Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in \$Millions	(E) log(AAMOP)	(F) Log (Change in AAMOP)	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in \$Millions	(J) Forecast Aggregate Maximum Offering Prices, in \$Millions
Jun-06	22	375,296	17,059	23,560	0.367				
Jul-06	20	232,654	11,633	23,177	-0.383				
Aug-06	23	310,050	13,480	23,325	0.147				
Sep-06	20	236,782	11,839	23,195	-0.130				
Oct-06	22	213,342	9,697	22,995	-0.200				
Nov-06	21	292,456	13,926	23,357	0.362				
Dec-06	20	349,512	17,476	23,584	0.227				
Jan-07	20	372,740	18,637	23,648	0.064				
Feb-07	19	278,753	14,671	23,409	-0.239				
Mar-07	22	862,766	39,218	24,392	0.983				
Apr-07	20	562,103	28,105	24,059	-0.333				
May-07	22	470,843	21,402	23,787	-0.272				
Jun-07	21	586,822	27,944	24,053	0.267				
Jul-07	21	326,612	15,553	23,468	-0.586				
Aug-07	23	369,172	16,051	23,499	0.032				
Sep-07	19	241,059	12,687	23,264	-0.235				
Oct-07	23	239,652	10,420	23,067	-0.197				
Nov-07	21	458,654	21,841	23,807	0.740				
Dec-07	20	410,200	20,510	23,744	-0.063				
Jan-08	21	354,433	16,878	23,549	-0.195				
Feb-08	20	263,410	13,171	23,301	-0.248				
Mar-08	20	596,923	29,846	24,119	0.818				
Apr-08	22	292,534	13,297	23,311	-0.809				
May-08	21	456,077	21,718	23,801	0.491				
Jun-08	21	461,087	21,957	23,812	0.011				
Jul-08	22	232,896	10,586	23,083	-0.730				
Aug-08	21	395,440	18,830	23,659	0.576				
Sep-08	21	177,636	8,459	22,858	-0.800				
Oct-08	23	360,494	15,674	23,475	0.617				

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in \$Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in \$Millions	(E) log(AAMOP)	(F) Log (Change in AAMOP)	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in \$Millions	(J) Forecast Aggregate Maximum Offering Prices, in \$Millions
Nov-08	19	288,911	15,206	23.445	-0.030				
Dec-08	22	319,584	14,527	23.399	-0.046				
Jan-09	20	375,065	18,753	23.655	0.255				
Feb-09	19	249,666	13,140	23.299	-0.356				
Mar-09	22	739,931	33,633	24.239	0.940				
Apr-09	21	235,914	11,234	23.142	-1.097				
May-09	20	329,522	16,476	23.525	0.383				
Jun-09	22	357,524	16,251	23.511	-0.014				
Jul-09	22	185,187	8,418	22.854	-0.658				
Aug-09	21	192,726	9,177	22.940	0.086				
Sep-09	21	189,224	9,011	22.922	-0.018				
Oct-09	22	215,720	9,805	23.006	0.085				
Nov-09	20	248,353	12,418	23.242	0.236				
Dec-09	22	340,464	15,476	23.463	0.220				
Jan-10	19	173,235	9,118	22.933	-0.529				
Feb-10	19	209,963	11,051	23.126	0.192				
Mar-10	23	432,934	18,823	23.658	0.533				
Apr-10	21	280,188	13,342	23.314	-0.344				
May-10	20	278,611	13,931	23.357	0.043				
Jun-10	22	364,251	16,557	23.530	0.173				
Jul-10	21	171,191	8,152	22.822	-0.709				
Aug-10	22	240,793	10,945	23.116	0.295				
Sep-10	21	260,783	12,418	23.242	0.126				
Oct-10	21	214,988	10,238	23.049	-0.193				
Nov-10	21	340,112	16,196	23.508	0.459				
Dec-10	22	297,992	13,545	23.329	-0.179				
Jan-11	20	233,668	11,683	23.181	-0.148				
Feb-11	19	252,785	13,304	23.311	0.130				
Mar-11	23	595,198	25,878	23.977	0.665				

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in \$Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in \$Millions	(E) log(AAMOP)	(F) Log Change in AAMOP)	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in \$Millions	(J) Forecast Aggregate Maximum Offering Prices, in \$Millions
Apr-11	20	236,355	11,818	23,193	-0.784				
May-11	21	319,053	15,193	23,444	0.251				
Jun-11	22	359,727	16,351	23,518	0.073				
Jul-11	20	215,391	10,770	23,100	-0.418				
Aug-11	23	179,870	7,820	22,780	-0.320				
Sep-11	21	168,005	8,000	22,803	0.023				
Oct-11	21	181,452	8,641	22,880	0.077				
Nov-11	21	256,418	12,210	23,226	0.346				
Dec-11	21	237,652	11,317	23,150	-0.076				
Jan-12	20	276,965	13,848	23,351	0.202				
Feb-12	20	228,419	11,421	23,159	-0.193				
Mar-12	22	430,806	19,582	23,698	0.539				
Apr-12	20	173,626	8,681	22,884	-0.813				
May-12	22	414,122	18,824	23,658	0.774				
Jun-12	21	272,218	12,963	23,285	-0.373				
Jul-12	21	170,462	8,117	22,817	-0.468				
Aug-12	23	295,472	12,847	23,276	0.459				
Sep-12	19	331,295	17,437	23,582	0.305				
Oct-12	21	137,562	6,551	22,603	-0.979				
Nov-12	21	221,521	10,549	23,079	0.476				
Dec-12	20	321,602	16,080	23,501	0.422				
Jan-13	21	368,488	17,547	23,588	0.087				
Feb-13	19	252,148	13,271	23,309	-0.279				
Mar-13	20	533,440	26,672	24,007	0.698				
Apr-13	22	235,779	10,717	23,095	-0.912				
May-13	22	382,950	17,407	23,580	0.485				
Jun-13	20	480,624	24,031	23,903	0.322				
Jul-13	22	263,869	11,994	23,208	-0.695				
Aug-13	22	253,305	11,514	23,167	-0.041				

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in \$Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in \$Millions	(E) log(AAMOP)	(F) Log (Change in AAMOP)	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in \$Millions	(J) Forecast Aggregate Maximum Offering Prices, in \$Millions
Sep-13	20	267,923	13,396	23.318	0.151				
Oct-13	23	293,847	12,776	23.271	-0.047				
Nov-13	20	326,257	16,313	23.515	0.244				
Dec-13	21	358,169	17,056	23.560	0.045				
Jan-14	21	369,067	17,575	23.590	0.030				
Feb-14	19	298,376	15,704	23.477	-0.113				
Mar-14	21	564,840	26,897	24.015	0.538				
Apr-14	21	263,401	12,543	23.252	-0.763				
May-14	21	403,700	19,224	23.679	0.427				
Jun-14	21	423,075	20,146	23.726	0.047				
Jul-14	22	373,811	16,991	23.556	-0.170				
Aug-14	21					23.515918	0.361	17,425	365,931
Sep-14	21					23.516446	0.363	17,448	366,403
Oct-14	23					23.516974	0.365	17,470	401,815
Nov-14	19					23.517502	0.368	17,493	332,362
Dec-14	22					23.518029	0.370	17,515	385,335
Jan-15	20					23.518557	0.372	17,538	350,756
Feb-15	19					23.519085	0.374	17,560	333,647
Mar-15	22					23.519612	0.376	17,583	386,826
Apr-15	21					23.520140	0.378	17,606	369,718
May-15	20					23.520668	0.380	17,628	352,566
Jun-15	22					23.521196	0.382	17,651	388,322
Jul-15	22					23.521723	0.384	17,674	388,822
Aug-15	21					23.522251	0.386	17,696	371,626
Sep-15	21					23.522779	0.388	17,719	372,105

Figure A
Aggregate Maximum Offering Prices Subject to Securities Act Section 6(b)
(Dashed Line Indicates Forecast Values)

