
**2017 SUMMARY REPORT OF COMMISSION STAFF'S EXAMINATIONS OF
EACH NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION**

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



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

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

December 2017

TABLE OF CONTENTS

- I. Regulatory and NRSRO Overview..... 2**
 - A. Statutory Framework and Rules..... 2
 - B. Registered NRSROs..... 6
- II. Office of Credit Ratings and Examination Overview..... 7**
 - A. Examinations under Section 15E(p)(3)..... 7
 - B. Examination Overview 8
- III. Summary of Responses to Recommendations from Previous Examinations and Notable Improvements over the Course of the Examinations 10**
 - A. Responses to Recommendations from the 2016 Section 15E Examinations..... 10
 - B. Notable Improvements Over the Course of the Examinations 11
- IV. Summary of Essential Findings 11**
 - A. Review Area: Adherence to Policies, Procedures, and Methodologies 12
 - B. Review Area: Management of Conflicts of Interest 20
 - C. Review Area: Implementation of Ethics Policies 22
 - D. Review Area: Internal Supervisory Controls 22
 - E. Review Area: Governance 27
 - F. Review Area: DCO Activities 28
 - G. Review Area: Complaints 29
 - H. Review Area: Post-Employment..... 29
- V. Conclusion 30**

I. REGULATORY AND NRSRO OVERVIEW

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

A. Statutory Framework and Rules

Section 15E of the Exchange Act (“Section 15E”) and Exchange Act Rules 17g-1 through 17g-10 govern the registration and oversight program for credit rating agencies that are registered with the Commission as nationally recognized statistical rating organizations (“NRSROs”). This regulatory regime was established by the Credit Rating Agency Reform Act of 2006 (the “Rating Agency Act”)² and amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).³

The Dodd-Frank Act mandated the creation of the Office of Credit Ratings (“OCR”), which is responsible for oversight of credit rating agencies registered with the Commission as NRSROs.

Pursuant to the Commission’s regulatory regime for NRSROs, an NRSRO is required to, among other things:

- File with the Commission annual certifications of its Form NRSRO registrations,⁴ promptly update its filing in certain circumstances,⁵ and make its current Form NRSRO filing and most of its current Form NRSRO Exhibits available on its public website.⁶
- Disclose certain information, including information concerning the NRSRO’s performance measurement statistics and its procedures and methodologies to determine ratings.⁷

¹ 15 U.S.C. § 78o-7(p)(3)(C). Unless otherwise noted, all Section and Rule references in this report are to the Exchange Act and rules under the Exchange Act. *See* 15 U.S.C. § 78o-7; 15 U.S.C. § 78q (a) and (b); 17 CFR 240.17g-1 through 17g-10.

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

³ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 932, 124 Stat. 1376, 1872-83 (2010).

⁴ 15 U.S.C. § 78o-7(b)(2) and 17 CFR 240.17g-1(f).

⁵ 15 U.S.C. § 78o-7(b)(1) and 17 CFR 240.17g-1(e).

⁶ 15 U.S.C. § 78o-7(a)(3) and 17 CFR 240.17g-1(i).

⁷ 15 U.S.C. § 78o-7(a)(1)(B)(i) and § 78o-7(a)(1)(B)(ii).

- 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,⁸ and retain records of its internal control structure.⁹
- Consider certain factors with respect to its establishment, maintenance, enforcement, and documentation of an effective internal control structure.¹⁰
- Establish, maintain, enforce, and document policies and procedures reasonably designed to achieve certain objectives concerning its development and application of, and disclosures related to, methodologies and models.¹¹
- File an unaudited report containing an assessment by management of the effectiveness during the fiscal year of the NRSRO's internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.¹² The report must be accompanied by a signed statement by the NRSRO's chief executive officer or an individual performing similar functions.¹³
- Establish, maintain, enforce, and document policies and procedures that are reasonably designed to: assess the probability that an issuer of a security or money market instrument will default or fail to make required payments to investors,¹⁴ and ensure that it applies any rating 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.¹⁵
- Publish an information disclosure form when taking a rating action with respect to a rating assigned to an obligor, security, or money-market instrument in a class for which it

⁸ 15 U.S.C. § 78o-7(c)(3)(A). Significantly, the regulatory regime expressly prohibits the Commission from regulating the substance of credit ratings. 15 U.S.C. § 78o-7(c)(2).

⁹ 17 CFR 240.17g-2(b)(12).

¹⁰ *See, e.g.*, 17 CFR 240.17g-8(d)(1) through (4).

¹¹ *See, e.g.*, 17 CFR 240.17g-8(a)(2) through (5).

¹² 17 CFR 240.17g-3(a)(7)(i).

¹³ 17 CFR 240.17g-3(b)(2).

¹⁴ 17 CFR 240.17g-8(b)(1).

¹⁵ 17 CFR 240.17g-8(b)(3).

is registered as an NRSRO.¹⁶ The information form must disclose certain information with respect to the particular rating action.¹⁷ In addition, the NRSRO must attach to the information disclosure form a signed statement by a person within the NRSRO with responsibility for the rating action.¹⁸

- Make and retain, or retain, certain records, including a record documenting its established procedures and methodologies used to determine credit ratings¹⁹ and records related to its ratings.²⁰ An NRSRO must promptly furnish to the Commission or its representatives copies of required records, including English translations of those records, upon request.²¹
- Establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material non-public information (“MNPI”), including the inappropriate dissemination of MNPI both within and outside the NRSRO, the

¹⁶ 17 CFR 240.17g-7(a). Rule 17g-7(a) defines rating action to include an expected or preliminary rating, an initial rating, an upgrade or downgrade of an existing rating (including a downgrade to, or assignment of, default), and an affirmation or withdrawal of an existing rating if the affirmation or withdrawal is the result of the NRSRO’s review of the rating using applicable procedures and methodologies for determining credit ratings. 17 CFR 240.17g-7(a). Pursuant to Rule 17g-7(a)(3), an NRSRO is exempt from publishing an information disclosure form for a particular rating if (i) the rated obligor or issuer of the rated security or money market instrument is not a U.S. person, and (ii) 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. 17 CFR 240.17g-7(a)(3).

¹⁷ The information that must be disclosed in the information disclosure form is specified in 17 CFR 240.17g-7(a)(1)(ii)(A) - (N). These required disclosures include: the version of the procedure or methodology used to determine the credit rating; disclosures concerning the uncertainty of the rating, including regarding the reliability, accuracy, quality, and accessibility of data related to the rating; 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; and information on the sensitivity of the rating to assumptions made by the NRSRO. In addition, an NRSRO must attach to the information disclosure form 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 a Rule 17g-5(a)(3) website.

¹⁸ 17 CFR 240.17g-7(a)(1)(iii).

¹⁹ 17 CFR 240.17g-2(a)(6).

²⁰ The records that an NRSRO must make and retain, or retain, with respect to its ratings include the identity of certain persons that participated in determining or approving the rating, records used to form the basis of a rating, external and internal communications received or sent by the NRSRO and its employees related to a rating, and for ABS ratings, a record of the rationale for any material difference between the final rating assigned and the rating implied by a quantitative model that was a substantial component in determining the rating. 17 CFR 240.17g-2(a)(2)(i) and (ii), 17 CFR 240.17g-2(b)(2), (b)(7), and (a)(2)(iii).

²¹ 15 U.S.C. § 78q (a) and (b) and 17 CFR 240.17g-2(f).

inappropriate trading of securities using MNPI by a person within the NRSRO, and the inappropriate dissemination of pending credit rating actions within and outside the NRSRO before issuing the rating on the Internet or through another readily accessible means.²²

- Establish, maintain, and enforce written policies and procedures reasonably designed to address and manage conflicts of interest.²³ Certain conflicts of interest are expressly prohibited,²⁴ and for other types of conflicts of interest, the NRSRO must disclose the conflicts and have policies and procedures in place to manage them.²⁵
- Refrain from engaging in specified unfair, coercive, or abusive practices.²⁶
- Provide information on whether it has in effect a code of ethics, and if not, the reasons it does not have a code of ethics.²⁷
- Establish procedures for the receipt, retention, and treatment of complaints regarding credit ratings, models, methodologies, and compliance with the securities laws and its policies and procedures developed under this regulatory regime, and of confidential, anonymous complaints.²⁸
- Designate a compliance officer (the “DCO”) responsible for administering policies and procedures related to MNPI and conflicts of interest, ensuring compliance with the securities laws and regulations, and establishing procedures for handling complaints by employees or users of credit ratings.²⁹ The DCO must submit an annual report to the

²² 15 U.S.C. § 78o-7(g) and 17 CFR 240.17g-4.

²³ 15 U.S.C. § 78o-7(h) and 17 CFR 240.17g-5.

²⁴ 17 CFR 240.17g-5(c).

²⁵ 17 CFR 240.17g-5(a)(1) and (a)(2); 17 CFR 240.17g-5(b). Moreover, Rule 17g-5(a)(3) prohibits NRSROs from having conflicts of interest related to a rating for a security or money market instrument issued by an asset pool or as part of any ABS transaction unless the NRSRO, among other things, maintains and provides access to a password-protected Internet Web site containing a list of each such security or money market instrument for which it is currently in the process of determining an initial credit rating, and obtains certain written representations from the issuer, sponsor, or underwriter of each such security or money market instrument.

²⁶ 17 CFR 240.17g-6.

²⁷ 15 U.S.C. § 78o-7(a)(1)(B)(v).

²⁸ 15 U.S.C. § 78o-7(j)(3).

²⁹ 15 U.S.C. § 78o-7(j)(1) and (3).

NRSRO on the compliance of the NRSRO with the securities laws and the NRSRO's policies and procedures, and the NRSRO must file the report with the Commission.³⁰

- Have a board of directors or similar governing body, certain of whose members must be independent from the NRSRO.³¹ An NRSRO's board of directors or governing body, and/or members thereof, are responsible for exercising oversight of specified subjects related to the NRSRO's rating business and for approving the procedures and methodologies, including qualitative and quantitative data and models, that the NRSRO uses to determine ratings.³²
- 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 produces accurate credit ratings, and retain a record of these standards.³³
- Establish policies and procedures regarding post-employment activities of certain former personnel.³⁴

B. Registered NRSROs

In 2007, the Commission began granting registrations to credit rating agencies that applied to be registered as an NRSRO. Credit rating agencies seeking to apply to register with the Commission as an NRSRO may do so by filing a completed Form NRSRO and related Exhibits.³⁵ A credit rating agency may apply to be registered with respect to one or more of the following five classes of credit ratings: (1) financial institutions, brokers, or dealers ("financial institutions"); (2) insurance companies; (3) corporate issuers; (4) issuers of asset-backed securities ("ABS"); and (5) issuers of government securities, municipal securities, or securities issued by a foreign government ("government securities").³⁶

The 10 credit rating agencies registered as NRSROs as of December 1, 2017, and dates of their initial registrations are listed below. More information on NRSRO registration applications and the state of competition, transparency, and conflicts of interest among NRSROs is included in the

³⁰ 15 U.S.C. § 78o-7(j)(5).

³¹ 15 U.S.C. § 78o-7(t)(2).

³² 15 U.S.C. § 78o-7(t)(3) and 17 CFR 240.17g-8(a)(1).

³³ 17 CFR 240.17g-9.

³⁴ 15 U.S.C. § 78o-7(h)(4) and (5); 17 CFR 240.17g-8(c).

³⁵ 15 U.S.C. § 78o-7(a) and 17 CFR 240.17g-1(a) and (b).

³⁶ 15 U.S.C. § 78(c)(a)(62)(A).

Annual Report to Congress under Section 6 of the Rating Agency Act, available on the Commission’s website: <http://www.sec.gov/ocr>.

NRSRO	Date of Initial Registration
A.M. Best Rating Services, Inc. (“AMB”) ³⁷	September 24, 2007
DBRS, Inc. (“DBRS”)	September 24, 2007
Egan-Jones Ratings Company (“EJR”)	December 21, 2007
Fitch Ratings, Inc. (“Fitch”)	September 24, 2007
HR Ratings de México, S.A. de C.V. (“HR”)	November 5, 2012
Japan Credit Rating Agency, Ltd. (“JCR”)	September 24, 2007
Kroll Bond Rating Agency, Inc. (“KBRA”) ³⁸	February 11, 2008
Moody’s Investors Service, Inc. (“Moody’s”)	September 24, 2007
Morningstar Credit Ratings, LLC (“Morningstar”) ³⁹	June 23, 2008
S&P Global Ratings (“S&P”) ⁴⁰	September 24, 2007

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

II. OFFICE OF CREDIT RATINGS AND EXAMINATION OVERVIEW

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

Generally, the purpose of NRSRO examinations is to: (i) monitor compliance with federal securities laws and rules; (ii) identify conduct, insufficient policies and procedures, or ineffective internal controls that potentially violate such laws and rules; and (iii) encourage remedial action. To facilitate such remedial action, the Staff sends each NRSRO an examination summary letter that identifies and explains its findings related to that NRSRO and recommends remedial measures. Examinations also serve to inform the Commission and the NRSROs’ compliance personnel of regulatory obligations and noteworthy industry developments. If the examination Staff identifies potential violations of federal securities laws or rules, the Staff may refer the matter to the Commission’s Division of Enforcement, which is responsible for further investigation of these potential violations.

Section 15E(p)(3)(B) provides that each NRSRO examination shall include a review of the following eight topic areas (“Section 15E Review Areas”): (i) whether the NRSRO conducts

³⁷ Formerly known as A.M. Best Company, Inc.

³⁸ Formerly known as LACE Financial Corp.

³⁹ Formerly known as Realpoint LLC.

⁴⁰ Formerly known as Standard & Poor’s Ratings Services.

business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest by the NRSRO; (iii) the implementation of ethics policies by the NRSRO; (iv) the internal supervisory controls of the NRSRO; (v) the governance of the NRSRO; (vi) the activities of the DCO of the NRSRO; (vii) the processing of complaints by the NRSRO; and (viii) the policies of the NRSRO governing the post-employment activities of its former personnel.

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

B. Examination Overview

The 2017 Section 15E examinations generally focused on the NRSROs' activities for the period covering January 1, 2016 through December 31, 2016 (the "Review Period"). The examinations also reviewed certain activities or credit rating actions from outside the Review Period.

The 2017 Section 15E examinations reviewed the Section 15E Review Areas and examined each NRSRO's adherence to Section 15E and Rules 17g-1 through 17g-10. Each of the NRSRO examinations encompassed all of the statutorily required Section 15E Review Areas. Within each of the Section 15E Review Areas, the Staff determined areas of emphasis and issues of focus for each NRSRO based upon an individualized risk assessment performed by the Staff. The individualized risk assessments considered a number of factors, including, but not limited to: (i) the NRSRO's rating activities and operations; (ii) the Staff's findings, recommendations, and general observations from prior examinations; (iii) the impact of a potential or actual internal control or compliance failure by the NRSRO; (iv) recent industry developments affecting NRSROs and the asset classes in which the NRSRO is registered; (v) the NRSRO's filings with the Commission and public disclosures; (vi) the NRSRO's self-identified weaknesses; and (vii) relevant tips, complaints, and referrals ("TCRs") received by the Commission.

The 2017 Section 15E examinations also focused on certain subjects and activities that the Staff, through its risk assessment process, identified as relevant to several NRSROs, as summarized below.

- Information Technology ("IT"): The Staff reviewed NRSRO governance to analyze the extent to which the Boards of Directors of certain NRSROs are provided with sufficient information to engage in robust consideration of IT risk-management issues. Such issues include the management of physical IT assets and whether the NRSRO has sufficient cybersecurity policies, procedures, and controls in place to address IT vulnerabilities.
- NRSRO Rules Adopted or Amended in 2014: In August 2014, the Commission adopted new Rules 17g-8, 17g-9, and 17g-10 as well as Form ABS Due Diligence-15E, and

amended Rules 17g-1 through 17g-3 and 17g-5 through 17g-7 as well as Form NRSRO.⁴¹ Most of these rules became effective on June 15, 2015, making the 2016 Section 15E examinations the first examinations where the recently adopted or amended rules were in effect, and the first examination to assess NRSROs' compliance with the majority of these rules. In the 2017 Section 15E examinations, the Staff analyzed each NRSRO's response to the findings and recommendations made by Staff in the 2016 Section 15E examinations that related to the rules adopted or amended in 2014. The Staff's assessment of those responses and its observations in the 2017 Section 15E examinations inform the Staff's 2017 findings and recommendations regarding the NRSRO's overall compliance with the requirements set forth in the rules adopted or amended in 2014.

- Performance Challenges: The Staff's risk assessment process identified for review the potential impact on NRSRO credit ratings of the performance challenges facing NRSROs. Competition appears to be increasing in certain asset classes and subclasses on which certain NRSROs have historically depended. At the same time, several NRSROs appear to be seeking to diversify their activity into additional ratings classes. The Staff considered revenue information for NRSROs, broken down by asset class and subsector, as well as each NRSRO's policies, procedures and governance, management strategies, and business development plans.
- Accessibility of NRSRO Data in XBRL Format: Rule 17g-7(b) requires each NRSRO to publicly disclose certain information pertaining to ratings history for free on an "easily accessible portion of its corporate Internet site." The Staff conducted a review to gather information to determine the requirements for access at each NRSRO; the NRSRO's rationale for the placement of ratings data on its website and for the use of a password, if any; the NRSRO's relevant terms and conditions to which website users must agree; complaints or feedback received by the NRSROs from users; and the results of any statistical or user analysis conducted by the NRSRO concerning external access to its XBRL data.
- Quantitative Models: The Staff continued to conduct in-depth reviews of multiple NRSROs' policies, procedures, and practices regarding quantitative models used in the rating process. The Staff assessed whether certain NRSROs had clear definitions for what constitutes a deviation or exception to a methodology, criteria, or model. The Staff also considered certain NRSROs' policies, procedures, and guidelines regarding the data sources and inputs for reviewing and updating models, the inputs and assumptions regarding macro-economic conditions that are incorporated into models, and whether certain NRSROs adhered to such policies, procedures, and guidelines.

⁴¹ See Nationally Recognized Statistical Rating Organizations; Final Rule, Exchange Act Release No. 72936 (Aug. 27, 2014); 79 FR 55078 (Sept. 15, 2014).

The Staff's essential findings and recommendations concerning NRSRO rules adopted or amended in 2014, performance challenges, accessibility of data in XBRL format, quantitative models and IT are addressed in this Report in the sections concerning the relevant Section 15E Review Areas.

III. SUMMARY OF RESPONSES TO RECOMMENDATIONS FROM PREVIOUS EXAMINATIONS AND NOTABLE IMPROVEMENTS OVER THE COURSE OF THE EXAMINATIONS

A. Responses to Recommendations from the 2016 Section 15E Examinations

The Staff's determination that an NRSRO appropriately addressed a recommendation does not constitute its endorsement of that NRSRO or its policies, procedures, internal controls, or operations. In a future examination, the Staff may reevaluate the NRSRO's response to recommendations that it previously deemed to be appropriately addressed by, for example, assessing whether the NRSRO fully implemented remedial measures and whether those remedial measures appear to be effective. The Staff may also review and make recommendations concerning the NRSRO's policies, procedures, internal controls, or operations related to the general subject matter of a recommendation that it previously deemed to be appropriately addressed. The determination of whether an NRSRO appropriately addressed a recommendation reflects solely the Staff's view and does not necessarily reflect the views of the Commission.

The Staff's assessment of whether an NRSRO has appropriately addressed a recommendation depends on the specific facts and circumstances of the recommendation, including, but not limited to, the promptness of the NRSRO's response, the severity of the conduct at issue, and whether the remedial action undertaken by the NRSRO is expected to fully resolve the Staff's concerns. To assess whether NRSROs appropriately addressed findings from the 2016 Section 15E examinations, the Staff reviewed each NRSRO's written response to the Staff's examination summary letter describing its planned remedial measures, and participated in follow-up calls with each NRSRO to discuss its written response.

During the 2017 Section 15E examinations, the Staff assessed each NRSRO's progress in implementing remedial measures such as establishing policies or procedures or adding resources in areas such as compliance, IT, or analytics. In assessing the effectiveness of NRSROs' remedial measures, the Staff is cognizant that NRSROs may not be able to fully implement remedial measures before the Staff commences its Section 15E examinations for the subsequent year, and the Staff may not be able to fully assess the effectiveness of these measures in its Section 15E examinations for that subsequent year.

Based on the Staff's 2017 Section 15E examinations, the Staff has determined that, with the exception of one smaller NRSRO that is revising its look-back policies and procedures to address the requirements of Rule 17g-8(c), all recommendations from the 2016 Section 15E examinations have been appropriately addressed. NRSROs addressed the 2016 recommendations by taking remedial measures such as adopting new or enhancing existing policies or procedures, implementing new or enhancing internal controls, implementing new systems and processes, and adding personnel and resources.

B. Notable Improvements Over the Course of the Examinations

Since they were first conducted in 2010, the Staff's Section 15E examinations have identified certain improvements at one or more of the NRSROs. Generally, NRSRO personnel at all levels of seniority and responsibility have continued to display greater awareness of applicable laws and their obligations as regulated entities. Moreover, the Staff's summary reports covering the Section 15E examinations since 2012 mention specific improvements by certain NRSROs, and the NRSROs generally have maintained or augmented those improvements by further enhancing the measures undertaken and embedding them in their operations and culture.

During the 2017 Section 15E examinations, the Staff observed that NRSROs had refined their policies, procedures, and controls related to certain NRSRO rules adopted or amended in 2014, most of which became effective in mid-2015, based on their experiences with these rules and the Staff's recommendations from the 2016 Section 15E examinations. The Staff also observed that generally, NRSROs' personnel displayed a better understanding of these rules and the NRSROs' policies, procedures, processes, and controls for implementing these rules. As a result, the Staff observed substantially improved compliance with the NRSRO rules adopted or amended in 2014 across all NRSROs.

Additionally, the Staff observed that, in general, there has been improvement in the compliance monitoring and internal audit functions of NRSROs. This improvement has manifested itself in several ways, including a number of instances in which NRSROs self-identified conduct not in compliance with legal requirements, or weaknesses in policies and procedures that could potentially lead to noncompliance with legal requirements. In some of those instances, NRSROs took corrective action prior to Staff learning of the conduct or weakness.

IV. SUMMARY OF ESSENTIAL FINDINGS

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

For purposes of this Report, "essential findings" are all findings from the 2017 Section 15E examinations that were included with one or more recommendations in an examination summary letter sent to an NRSRO. "Essential findings" do not include the Staff's general observations. In this Report, essential findings are organized by the applicable Section 15E Review Areas. This Report uses the phrases "significant," "numerous," "several," and "some" to describe and distinguish the frequency of conduct or instances underlying certain findings. The particular phrase used generally reflects the number of instances during the Review Period, recognizing that the number of instances may be reflective of a test sample and not necessarily an NRSRO's comprehensive activities during the Review Period. The Commission has not determined whether any finding discussed in this Report constitutes a "material regulatory deficiency,"⁴² but may do so in the future.

⁴² 15 U.S.C. § 78o-7(p)(3)(C)(ii).

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

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

The Staff reviewed a sample of rating actions of each NRSRO in certain asset classes for which they are registered and for certain issuers and obligors to determine whether the NRSRO operated in accordance with its policies, procedures, methodologies, criteria, and models. In addition, the Staff reviewed the NRSROs' other ratings-related activities such as the development and application of methodologies, criteria, and models. The Staff also reviewed a sample of rating files and documentation of other ratings-related activities to evaluate whether each NRSRO adhered to recordkeeping requirements. To select rating actions and rating files to review, the Staff used a risk-based sampling process that is consistent with its overall risk assessment approach described in Section II.B of this Report and considered factors including but not limited to the significance of the rated asset class to the financial markets and the NRSRO's business, the NRSRO's activity in the rated asset class, the likelihood of impact on investors if a rating was not determined in accordance with the NRSRO's methodologies and procedures, news reports and developments concerning the NRSROs or particular asset classes, TCRs, and information the Staff learned during examinations.

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

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

1. In some instances, certain NRSROs did not properly apply or adhere to their methodologies, criteria, or policies and procedures for determining ratings.

A larger NRSRO did not adhere to its criteria and policies and procedures when rating certain securities supported by letters of credit. The NRSRO did not appear to rate the securities in accordance with the NRSRO's applicable criteria, because the NRSRO did not properly capture the credit of the issuers, the financial institutions that provided the letters of credit, or a combination of both, resulting in a number of erroneous ratings. The Staff recommended that the NRSRO apply criteria consistently and adhere to policies and procedures when assigning all ratings.

A larger NRSRO withdrew numerous credit ratings that had been issued using incorrect criteria, after application of the correct criteria resulted in the NRSRO not being able to maintain the ratings. In addition, although the NRSRO's policies and procedures required that a final rating

action be published generally within two days of a rating committee determination, the NRSRO delayed notification of withdrawal by one month for all but two of the affected ratings. Separately, the NRSRO withdrew a significant number of additional ratings because of a separate misapplication of criteria. The Staff recommended that the NRSRO strengthen its internal controls governing the application of criteria in its rating process, and that it ensure that rating actions are published in accordance with its policies and procedures.

A larger NRSRO did not adhere to its criteria and Code of Conduct and demonstrated weaknesses in its error correction process. The NRSRO had relied on issuer-provided debt-service coverage ratios in its analysis of certain securities, but later learned that these ratios were not calculated in compliance with the NRSRO's criteria. Subsequently, the NRSRO applied corrected ratios and downgraded several securities. However, the Staff observed that the NRSRO identified its future preventative action as, essentially, the same actions that had led to the noncompliance. The Staff recommended that the NRSRO ensure analysts adhere to published criteria as it relates to the derivation of debt coverage service ratios, that the NRSRO ensure analysts adhere to the NRSRO's Code of Conduct, and that the NRSRO enhance its internal controls, including policies and procedures, governing the error correction process.

A smaller NRSRO did not adhere to its rating committee procedures with respect to numerous private placement ratings, which required the NRSRO to keep minutes of meetings, records of attendance and voting, and a summary of the discussion. For example, rating files did not include the required summary of the discussion and it appears that the NRSRO generally did not document rating committee minutes. The Staff recommended that the NRSRO ensure it adheres to its rating committee procedures as described in its policies and procedures.

2. In some instances, certain NRSROs did not adhere to their policies and procedures with respect to the approval, development, and modification of procedures and methodologies for determining ratings.

A larger NRSRO did not comply with requirements for the approval and modification of methodologies and with documentation requirements. A group within the NRSRO responsible for a particular type of ABS rating routinely applied a set of guidelines for stress multiples that were not part of the NRSRO's approved criteria. As the guidelines were nevertheless applied consistently within the group, they functioned as *de facto* criteria that had not been subject to appropriate approval or documentation requirements. The Staff recommended that the NRSRO comply with Rule 17g-2(a)(6) and make complete records documenting all established methodologies, and that the NRSRO ensure it maintains and enforces the policies and procedures it has established to comply with Rule 17g-8(a)(1) and (2).

A larger NRSRO did not maintain and enforce its policies and procedures with respect to the development, approval, application, and modification of procedures and methodologies, including qualitative and quantitative models, for determining ratings. The NRSRO identified a number of desktop computer tools created within the NRSRO that functioned as models under the NRSRO's policies and procedures and therefore should have been subject to all of the policies and procedures established by the NRSRO to comply with Rule 17g-8(a)(1) requirements. However, while the NRSRO actively used these tools, it developed, approved, applied, and modified the tools outside the controls established for the development, approval

and validation of models used in the credit rating process. The Staff recommended that the NRSRO ensure it maintains and enforces its policies and procedures established to comply with Rule 17g-8(a).

A larger NRSRO did not adhere to its policies and procedures for the establishment and maintenance of criteria, which contained specific requirements for the presentation of key rating drivers in criteria reports. The NRSRO's criteria described the relative importance of two key measures of leverage, noting that they represented the largest contribution to expected loss. However, charts included in the criteria suggested that one of the two measures had a stronger relationship to probability of loss than what was indicated in the description. The Staff observed that, without more information, the charts could be misunderstood as to the level of importance that each key rating driver contributed to the rating analysis. The Staff recommended that the NRSRO ensure that all criteria adhere to the NRSRO's relevant policies and procedures.

A smaller NRSRO did not adhere to its procedures for rating model curation, which required oversight and tracking of major model changes and documentation in the rating model administration log. The Staff observed model changes that were not timely documented in the rating model administration log and supporting files for the model changes appear to have been created several months after the models were implemented. Because the changes were not documented at the time of their implementation, the model could have been modified and used without following the NRSRO's required procedures for model validation, review, and approval. The Staff recommended that the NRSRO adhere to its rating model curation procedures and ensure that all model changes are properly documented at the time of their implementation.

A smaller NRSRO's policies and procedures required that the establishment of, or changes to, rating criteria be approved by the NRSRO's Board of Directors prior to the criteria's use and for the Board's decision to be reported to a particular committee at the NRSRO. The Staff observed that the NRSRO did not adhere to its policies and procedures in one instance where a new methodology was reported to the committee before the Board approved the methodology. The Staff recommended that the NRSRO adhere to its policies and procedures for approving methodologies.

3. In some instances, certain NRSROs did not adhere to their policies and procedures with respect to making complete and accurate disclosures on their Rule 17g-7(a) information disclosure forms.

A larger NRSRO did not disclose the executed Form ABS Due Diligence-15E for certain ABS transactions as required by Rule 17g-7(a)(2). While the NRSRO's disclosures included a link to the executed Form ABS Due Diligence-15E, the Staff observed that in several instances the disclosed forms were missing required reports of independent accountants, and in one instance the disclosed form was for a different ABS transaction. The Staff recommended that the NRSRO ensure that it discloses Form ABS Due Diligence-15E as required by Rule 17g-7(a)(2).

A larger NRSRO did not publish the required information disclosure form when taking certain rating actions. The Staff observed that several of the information disclosure forms provided by the NRSRO as part of its rating file production were dated after the date of the respective rating actions. In addition, when retrieving the information disclosure forms from the NRSRO's

website, the Staff observed that the date on some of the post-dated information disclosure forms had been changed to a new date. The Staff recommended that the NRSRO ensure the information disclosure form is published in accordance with Rule 17g-7(a).

A smaller NRSRO's information disclosure forms for certain structured finance ratings did not list rating categories, as required by Rule 17g-7(a)(1)(ii)(A), and did not include the information required by Rule 17g-7(a)(1)(ii)(K), including information regarding potential volatility of the rating, factors that could change the rating and the magnitude of change under different market conditions. In lieu of the required disclosures, the NRSRO's information disclosure forms provided only a reference to the presale report and a link to the NRSRO's homepage of its website. The Staff recommended that the NRSRO ensure that its information disclosure forms contain or directly link to the required disclosure information, and that the NRSRO develop procedures for completing and publishing information disclosure forms.

A smaller NRSRO's information disclosure documents contained incorrect or non-functioning links to the NRSRO's external website. The Staff observed that the NRSRO's Rule 17g-7 disclosure form and two other disclosure items contained several errors on the NRSRO's external website, including incorrect links to reports for a different rating action. In addition, Exhibit 2 to the NRSRO's Form NRSRO included non-functioning links to some sections of the NRSRO's external website. The Staff recommended that the NRSRO enhance its internal controls to ensure its disclosure documents link to appropriate information on its external website.

A smaller NRSRO's disclosure reports did not disclose information specific to the ratings with regard to potential limitations of the credit rating, including certain types of risks excluded from the credit rating, information on the uncertainty of the credit rating, and information on potential volatility of the credit rating. The Staff observed that the NRSRO's disclosures contain only a non-specific reference to other risks, and no disclosure regarding the volatility that one could expect under different market conditions. The Staff also observed that the NRSRO generally used identical standardized language in forms across all asset classes for which it is registered. The Staff recommended that the NRSRO ensure that all disclosures required pursuant to Rule 17g-7(a)(1) are specific to the particular rating action.

A smaller NRSRO did not include the rating histories in its information disclosure forms for some rating actions, in contravention of Rule 17g-7(a)(1)(ii)(L)(1). The Staff recommended that the NRSRO ensure it includes rating histories in its Rule 17g-7(a) disclosures.

Two NRSROs did not provide correct attestations to their information disclosure forms. For a larger NRSRO and a smaller NRSRO, the disclosures provided the identity of the person making the attestation, but did not include a required signature. For both NRSROs, the Staff recommended that the NRSRO ensure the attestation statement attached to the information disclosure form is signed as required by Rule 17g-7(a)(1)(iii).

4. One NRSRO did not always adhere to its criteria with regard to disclosure of qualitative factors considered in the rating process.

A larger NRSRO did not disclose the rationale for, and descriptions of, qualitative factors considered when assigning ratings for a particular type of ABS, as required by the NRSRO's criteria. The Staff observed that some press releases did not provide the required rationale or description of such factors. In one instance, rating documents included a rationale for an adjustment made, but the NRSRO did not disclose the adjustment in the associated press release. In another instance, rating documents noted that a rating was higher than the model-implied rating because of the application of particular criteria, but the criteria was not disclosed in the press release. The Staff recommended that the NRSRO adhere to its criteria for making required disclosures in its media releases.

5. In some instances, certain NRSROs did not adhere to their policies and procedures concerning surveillance and/or withdrawals of outstanding ratings.

A larger NRSRO did not adhere to its policies and procedures for surveillance and its loan modification criteria. Following an approved criteria modification, the NRSRO publicly identified a significant number of ratings that might be impacted. The NRSRO removed the identifier from most of the ratings after nine months, and placed the remaining ratings on credit watch, which was extended twice. Final resolution occurred 17 months after the effective date of the modification, which was beyond the six month limit set forth in the NRSRO's procedures. In addition, the decisions to remove the identifier from most of the affected ratings and place the other ratings on credit watch were not made in accordance with the appropriate criteria, because the NRSRO did not have a model to accurately calculate a key required input. The NRSRO also did not adhere to its policies and procedures requiring documentation for criteria approval, as it did not include a required impact study. The Staff recommended that the NRSRO comply with Rule 17g-8(a)(3) and adhere to its surveillance procedures and its applicable criteria for loan modification, and that the NRSRO ensure all necessary rating impact analysis is completed prior to criteria approval.

A larger NRSRO did not adhere to its policies and procedures for surveillance for ABS ratings, which required a minimum of three analysts for quarterly or semi-annually required portfolio reviews. In a particular ABS class, the NRSRO typically assigned a single analyst to conduct the initial review of a portfolio to determine which ratings would be subject to further consideration in a portfolio review. The Staff observed that this structure led to most ratings in this particular class not being subject to full portfolio reviews at the minimum frequency denoted in the NRSRO's policies and procedures. The Staff recommended that the NRSRO ensure adherence to its surveillance procedures.

In one instance, a smaller NRSRO's inadequate surveillance resulted in the NRSRO not downgrading in a timely manner a class in a particular ABS transaction that was rated at a higher level than that which was indicated by its methodology. While the NRSRO eventually downgraded the class, its rating remained at a higher level than appropriate for over 10 months, in contravention of the NRSRO's methodology and surveillance procedures. Moreover, the Staff observed additional instances in which the NRSRO similarly did not rate a class in an ABS transaction at the level indicated by the appropriate methodology and did not perform adequate surveillance. The NRSRO's inadequate surveillance also resulted in inaccurate disclosures on the associated Rule 17g-7 forms. The Staff recommended that the NRSRO ensure it conducts adequate surveillance of affected ratings and that it adhere to its published methodologies.

6. In some instances, certain NRSROs did not adhere to applicable laws and/or their policies and procedures regarding potential influence on an analyst by business considerations or other conflicts of interest.

At a smaller NRSRO, policies and procedures specified that the NRSRO's compliance department must, when an analyst has received fee information, evaluate the circumstances in which the information was received and determine the appropriate action to be taken. In several instances, where an analyst received or viewed fee information, the NRSRO's compliance department determined that the analyst be recused from voting or working on the rated entity for one rating cycle. However, in some instances analysts were instructed to recuse themselves from voting but did, in fact, vote in the rating committees. The Staff recommended that the NRSRO enhance its internal controls to ensure adherence to its policies and procedures related to analyst exposure to fee information.

A smaller NRSRO did not adhere to its securities ownership policies and procedures, which prohibited an analyst from participating or otherwise influencing a rating determination where the analyst had any ownership interests in the entity subject to the credit rating or owned securities or derivatives of any entity related to the rated entity. The Staff observed that a senior analyst chaired a ratings committee for a transaction in which the senior analyst owned securities in a co-arranger for the transaction. The Staff recommended that the NRSRO ensure that it adheres to its policies and procedures for prohibiting individuals from participating in determining a rating where a potential or actual conflict of interest exists.

7. In some instances, certain NRSROs did not adhere to their policies and procedures concerning protection of MNPI such as pending ratings and non-public information obtained to determine ratings.

At a larger NRSRO, the Staff observed numerous instances of inadvertent dissemination of MNPI. Some instances involved external dissemination to third parties of pending transaction or rating action information, NRSRO proprietary information such as committee packages, committee notes, and financial models, and, in a few instances, transaction or rating action information unrelated to the third party recipients. Moreover, in some instances MNPI was internally disseminated to incorrect NRSRO employees and, in one instance, the NRSRO published rating information the day before the issuer's announcement of the transaction. The Staff recommended that the NRSRO ensure all employees adhere to its policies and procedures established to prevent the inadvertent release of MNPI.

A smaller NRSRO's policies and procedures required entry of a confidential information checklist into the NRSRO's compliance system. The NRSRO identified numerous rating actions for which the confidential information checklist was not entered into the NRSRO's system, and noted that in other instances checklists that were included were not always timely completed or accurately maintained. The Staff observed some instances where the checklist was not included in rating files produced to the Staff by the NRSRO. The Staff recommended that the NRSRO ensure its rating files contain required documentation regarding recipients of confidential information.

8. In some instances, certain NRSROs did not adhere to applicable laws and/or their policies and procedures concerning documentation, record retention, and production of records to examination Staff.

A larger NRSRO did not comply with its procedures governing record retention, which required retention of certain data and documents created and received that formed the basis of credit ratings and credit outlooks, including surveillance documents for a certain type of ABS. The Staff observed that for some surveillance files, the NRSRO produced evidence for only three portfolio reviews instead of the four reviews required by the NRSRO's procedures. The NRSRO was unable to locate the fourth review file for each security. The Staff recommended that the NRSRO enhance its internal controls with respect to compliance with its record retention procedures to ensure that all required records are properly retained.

A larger NRSRO did not adhere to document retention requirements and the NRSRO's policies and procedures. The Staff observed in the rating committee package for one rating action that a retired version of the criteria was indicated as applied, while the correct version of the criteria was disclosed in the corresponding information disclosure form. Another form in the committee package for the same rating action did not include certain information required by the NRSRO's policies and procedures. For another rating action, the Staff observed that certain communications containing analytical information initially were not filed in the NRSRO's electronic file management system. The Staff recommended that the NRSRO ensure that records are made and retained in accordance with Rule 17g-2(b)(2) and the NRSRO's policies and procedures.

A smaller NRSRO did not document adequately the difference between its model-implied and assigned ratings in its rating reports, in contravention of Rule 17g-2(b)(2) and the NRSRO's policies and procedures. The Staff observed several ratings in which there were no comments explaining the difference between the implied and assigned rating, even though the difference exceeded the minimum number of notches specified by the NRSRO's policies and procedures for triggering the comment requirement. The Staff recommended that the NRSRO adhere to its policies and procedures and sufficiently document the differences between the model-implied and assigned ratings within its rating reports.

A smaller NRSRO did not promptly furnish to the Commission or its representatives legible, complete, and current copies of required books and records. The NRSRO did not produce in a timely manner certain reports, memoranda, or similar documents prepared by the NRSRO's DCO, or received by the NRSRO regarding investigations, special reviews, or potential or actual violations of law or the NRSRO's policies and procedures. In addition, requested rating file documentation was not produced until a subsequent request was made by the Staff. The Staff recommended that the NRSRO ensure that all books and records requested by the Staff pursuant to Rule 17g-2(f) are produced promptly.

9. In some instances, certain NRSROs did not adhere to applicable laws and/or their policies and procedures, or demonstrated other weaknesses in standards or controls concerning periodic testing of individuals who participate in the determination of credit ratings.

A smaller NRSRO's policies and procedures did not clearly require periodic testing of all individuals employed by the NRSRO who 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. Furthermore, the Staff observed that certain analytical employees are not required to take a periodic examination even though they participate and vote in rating committees. The Staff recommended that the NRSRO revise its policies and procedures to satisfy the testing requirements of Rule 17g-9(c)(1), including clarifying who is required to take the periodic examination.

A smaller NRSRO had weaknesses in the implementation of its policies and procedures governing the periodic testing of analysts. The Staff observed that the test used did not appear to be specific to the policies and procedures used by the NRSRO to determine credit ratings, and that both the questions and answers could be obtained from an external website. In addition, the NRSRO granted one analyst an exemption from the test, in contravention of Rule 17g-9(c)(1). The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures that are reasonably designed to ensure its compliance with Rules 17g-9(a) and 17g-9(c)(1), and that the NRSRO ensure that all employees adhere to the testing requirements as set forth in Rule 17g-9(c)(1).

A smaller NRSRO's analytical training records did not appear to be accurate or complete, in contravention of Rule 17g-9(a). Training records misstated in several places the number of analysts who completed required training, and recorded some training as mandatory for the wrong internal department. The Staff recommended that the NRSRO ensure the accuracy and completeness of its analytical training records.

10. In some instances, certain NRSROs did not adhere to their policies and procedures regarding the public correction of errors.

A larger NRSRO did not publish promptly on an easily accessible portion of its website notices of the existence of significant errors identified in quantitative models as required by Rule 17g-8(a)(4)(ii) and the NRSRO's policies and procedures. The NRSRO published notices of the existence of significant model errors to a subscription website up to 25 days earlier than it published the required information on a free website. The Staff recommended that the NRSRO maintain and enforce its policies and procedures designed to ensure that it 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.

A smaller NRSRO did not adhere to its policies and procedures that required press releases to be factually accurate. A corrective press release misstated the date of the original press release and stated that a list of impacted ratings would be included. No such list was included. The Staff recommended that the NRSRO adhere to its policies and procedures in connection with issuing press releases.

A smaller NRSRO did not adhere to its policies and procedures that required the immediate issuance of a corrective press release, including the corrected credit rating, when an incorrect publication of a credit rating has occurred. In two instances, the NRSRO took remedial action once incorrect ratings were discovered, but did not issue the press release required by the NRSRO's policies and procedures. The Staff recommended that the NRSRO adhere to its policies and procedures for correcting administrative errors.

11. One NRSRO did not always adhere to its policies and procedures regarding accuracy in Form NRSRO submissions.

A smaller NRSRO's Form NRSRO submissions contained inaccurate information in contravention of Section 15E(b) and Rule 17g-1(e). The Staff observed that several persons were inadvertently omitted from certain of the NRSRO's Form NRSRO submissions. The Staff recommended that the NRSRO ensure accuracy and completeness of its Form NRSRO submissions.

B. Review Area: Management of Conflicts of Interest

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

1. One NRSRO's policies and procedures for separating analytical activities from sales and marketing activities and preventing analytical activities from being influenced by sales and marketing considerations pursuant to Rule 17g-5(c)(8), were not sufficiently documented.

At a larger NRSRO, policies and procedures for documenting and reporting potential fee discussions were not adhered to and were not sufficiently documented. The NRSRO's procedures required credit rating personnel to complete a worksheet if they received written communications or were a party to a discussion regarding fee-related information. Certain responses on the worksheet would trigger a requirement to complete a follow-up form and submit it to the NRSRO's compliance department. The Staff observed several instances where the NRSRO's personnel did not properly complete and submit the worksheet and form, or sent an email to the compliance department in lieu of the follow-up form. The Staff recommended that the NRSRO clarify the use of the worksheet and how it is to be completed by credit rating personnel and that the NRSRO align its practice for notifying the NRSRO's compliance department of potential fee discussions with the steps outlined in the NRSRO's policies and procedures.

2. In some instances, certain NRSROs did not have sufficient policies and procedures to adequately prevent potential conflicts of interest arising from their business activities.

A smaller NRSRO's internal controls with respect to managing securities trading demonstrated weakness. The NRSRO's securities trading policies and procedures restricted analytical employees from trading securities that fall within the employee's analytical responsibilities, but neither restricted trading of other rated securities nor otherwise accounted for information to which analytical employees may be exposed. In addition, the Staff observed that some support personnel with access to confidential information across all analytical groups could trade without restriction. Also, while the NRSRO required employees to obtain a written waiver in order to

trade a restricted security, the Staff observed instances where waivers were granted orally. The Staff recommended that the NRSRO enhance its internal controls related to securities trading to adequately account for access to rating information, and that the NRSRO adhere to its policies and procedures regarding granting waivers to securities trading restrictions.

A member of a smaller NRSRO's rating committee owned equity securities for which an exemption was made under the NRSRO's policies. However, the NRSRO's policies and procedures required rating committee members to recuse themselves from review and voting with regard to ratings related to such securities, and required recusals to be documented in the rating committee minutes and reviewed by the NRSRO's compliance department. The Staff observed various instances where the rating of an issuer whose security was held by this particular committee member was discussed and voted on in the rating committee. While it appears that the member did not vote, the recusal was not documented in the minutes. The Staff recommended that the NRSRO ensure that it adheres to its policies and procedures governing conflicts of interest and recusals related to securities holdings.

A smaller NRSRO's policies and procedures for managing conflicts of interest required that a conflict certification email be sent to all ratings personnel prior to participating in any credit ratings activities, and that the rating committee chair, or designee, send a conflict certification email to all participants at the start of the credit rating process. However, the Staff observed that different groups within the NRSRO had different processes for administering the conflict certification email check that were not reflected in the NRSRO's policies and procedures. The Staff is concerned that insufficient documentation of which groups are responsible for administering the conflict check may engender confusion and prevent consistent application of the process. The Staff recommended that the NRSRO consider revising its policies and procedures to document its practice for administering email conflict checks.

A smaller NRSRO's policies and procedures did not adequately manage conflicts of interest with respect to personal securities transactions. While Rule 17g-5(b)(6) identified as a conflict of interest allowing persons within the NRSRO to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO, the NRSRO's securities policies and procedures required employees to pre-clear only trades in securities that the NRSRO rates, and did not address all securities of entities rated by the NRSRO. The Staff recommended that the NRSRO consider amending its policies and procedure to require pre-clearance for transactions in all securities of entities that are rated by or have securities rated by the NRSRO.

3. One NRSRO did not have sufficient policies and procedures and effective internal controls concerning issuing or maintaining ratings of entities that have ownership interests in the NRSRO.

A smaller NRSRO's policies and procedures were insufficient to adequately prevent potential conflicts of interest. While the NRSRO had policies and procedures intended to prevent the NRSRO from issuing a rating with respect to certain affiliated entities or on their securities, the NRSRO's policies and procedures applied only to public companies and did not indicate the manner in which the NRSRO's compliance department would carry out required reviews, or the purpose of those reviews. The scope of application of the NRSRO's policies and procedures

with regard to rating withdrawal were also unclear. The Staff observed instances of non-adherence to policies and procedures by the NRSRO's compliance personnel, including not maintaining required records. The Staff recommended that the NRSRO enhance its policies and procedures to adequately prevent conflicts of interest, and adhere to its relevant policies and procedures.

4. In some instances, there were weaknesses in certain NRSRO's policies, procedures, and internal controls concerning various other conflicts of interest.

A larger NRSRO did not include an ABS transaction on the list of securities or money market instruments for which the NRSRO is currently in the process of determining an initial credit rating, as required to be maintained on a password-protected Internet website pursuant to Rule 17g-5(a)(3)(i). The Staff recommended that the NRSRO include all appropriate securities or money market instruments on its password-protected 17g-5 Internet website.

A smaller NRSRO's policies and procedures for external activities required employees to obtain written approval for outside activities that might directly or indirectly impact their duties at the NRSRO. The Staff observed an instance where an employee's request to serve as a director for an outside business enterprise was approved orally rather than in writing. In addition, the Staff observed that the NRSRO's process for approving outside activities was not sufficiently documented, as some procedural requirements were not reflected in the NRSRO's policies and procedures. The Staff recommended that the NRSRO ensure that its employees adhere to its policies and procedures regarding outside activities, and that the NRSRO revise its policies and procedures for approving outside activities to reflect its practice for approving outside activities.

C. Review Area: Implementation of Ethics Policies

Each NRSRO has implemented written ethics policies and procedures. The Staff reviewed each NRSRO's ethics policies and procedures, as well as a sample of each NRSRO's employee certifications or monitoring activities concerning its code of ethics. Much of the content of these policies and procedures addresses other related Review Areas. As such, the Staff's findings and recommendations related to an NRSRO's implemented ethics policies and procedures are addressed in other Sections of this Report.

D. Review Area: Internal Supervisory Controls

The Staff reviewed each NRSRO's overall control structure, including the internal control structure related to determining credit ratings.

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

1. In some instances, certain NRSROs' policies and procedures concerning the rating process did not meet all legal requirements or had other weaknesses.

At a larger NRSRO, on several occasions, one team in the NRSRO's ABS group assigned final ratings that differed from the preliminary rating without holding a final rating committee. In each instance, instead of convening a final rating committee, as required by the NRSRO's

policies and procedures, the analysts sent an email update to each committee member alerting them of the change in the final rating. In addition, the rating files for the transactions did not include the appropriate denotation for each of the preliminary ratings, as required by the NRSRO's policies and procedures. The Staff recommended that the NRSRO enhance its policies and procedures to require consistent practices regarding the rating committee process for the conversion from preliminary to final ratings, and that the NRSRO enhance its internal controls surrounding the rating committee process for the conversion from preliminary to final ratings.

A larger NRSRO erroneously published a rating on an issuer that was not rated by the NRSRO, due to the use of an automatic process. The Staff observed that the NRSRO did not have adequate internal controls to prevent the erroneous publication, including internal checks to ensure that certain inputs match up to a particular rating action. The Staff recommended that the NRSRO enhance its internal controls with respect to ratings-related systems.

A smaller NRSRO required that a draft rating report be shared with private placement clients prior to finalization, and represented to Staff that only client comments factual in nature or that related to non-public information would be considered; however, the NRSRO did not have policies or procedures specifying such limitations. The Staff observed an instance where the NRSRO considered and accepted a comment from a private placement client which did not raise a factual concern or relate to non-public information. In addition, the NRSRO's policies and procedures for the appeal of ratings applied exclusively to issuers and not third party clients. The Staff recommended that the NRSRO establish, maintain, and enforce policies and procedures regarding the type of comments and changes that will be considered from issuers and third party clients, and that the NRSRO revise its appeals policy and procedures to address appeals from third party clients.

When determining a model-implied rating, a smaller NRSRO incorporated a particular ratio with regard to operating leases incurred by issuers in certain industries. However, under certain conditions, the NRSRO used a different ratio that did not consistently account for operating leases, and the NRSRO did not disclose when the alternative ratio was used. By not disclosing such information, the NRSRO did not make and retain a complete record documenting its methodologies and may not have abided by the general description of the procedures and methodologies it describes in Exhibit 2 of its Form NRSRO. The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, for the consistent application of its methodology for operating lease adjustments.

A smaller NRSRO did not have adequate policies and procedures governing deviations and exceptions to rating policies, procedures, methodologies, criteria and models. The Staff observed that one rating process exception was made, despite the NRSRO not having policies and procedures governing the process and authorization for granting exceptions. The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, regarding exceptions to its rating process.

A smaller NRSRO's policies and procedures stated that an analyst may not serve as the chair of a ratings committee for a credit rating for which the analyst served as primary or secondary analyst. However, the NRSRO identified several instances in which the secondary analyst also

chaired the respective ratings committee. The Staff recommended that the NRSRO adhere to its policies and procedures for determining credit ratings by ensuring that analysts do not serve as either a primary or secondary analyst and committee chair, for a ratings committee.

2. In some instances, certain NRSROs did not have effective policies and procedures or internal controls concerning the development, documentation, or application of methodologies, criteria, or models.

Although a larger NRSRO conducted model testing to ensure that models used in the determination of credit ratings are implemented and function as designed, the testing of several models did not identify numerous inconsistencies between the model and related criteria, including several model errors with the potential to affect ratings. In addition, errors were identified in models that had undergone prior testing. Several models that had been subjected to external validation contained errors that led to several ratings being placed on credit watch and the revision of some of those ratings after corrected models were applied. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, for its model implementation testing and for outsourcing model validation activities.

A larger NRSRO demonstrated weaknesses in its process for revising certain policies and procedures. The Staff observed instances where a definition included a reference to the term being defined, a reference to a section of a document where the section did not exist, or incorrectly numbered sections and typographical errors. The Staff recommended that the NRSRO improve its internal controls for revising policies and procedures.

A smaller NRSRO required its analysts to perform a rating analysis and provide an indicative rating to private placement clients. However, the NRSRO had not documented policies or procedures describing the process for issuing an indicative rating which, according to representations made by the NRSRO is subject to certain caveats and limitations. The Staff recommended that the NRSRO strengthen its internal controls governing the process for the issuance of indicative ratings, including establishing policies and procedures that address the limitations of such ratings, and that the NRSRO ensure that documentation evidencing the issuance of indicative ratings is retained.

A smaller NRSRO discovered in numerous rating files evidence of invalid links to models and model-programming errors. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, governing the use of models in the credit rating process, and that the NRSRO consider whether similar or recurring model-related incidents may be indicative of a systemic weakness in its internal controls.

A smaller NRSRO defined a “significant deficiency” in internal controls in reference to the controls established in one particular policy. The Staff observed that this language may limit the NRSRO’s consideration of internal controls only to those established or referenced in the policy and therefore may not capture all relevant internal controls. The Staff recommended that the NRSRO revise its policies and procedures to ensure that it assesses the effectiveness of all its internal controls, not just those established in a particular policy.

A smaller NRSRO's policies and procedures concerning the surveillance of outstanding unsolicited ratings were unclear as to whether the NRSRO was obliged to surveil unsolicited ratings. While the NRSRO clarified that it does surveil all unsolicited ratings, the NRSRO reserves the right to withdraw unsolicited ratings at any time. The Staff recommended that the NRSRO revise its policies and procedures to clarify that the NRSRO surveils all outstanding ratings, including unsolicited ratings.

A smaller NRSRO acknowledged that the formulas and assumptions for certain Excel-based models it used in the credit rating process were not locked, permitting individuals to make unauthorized changes to formulas and assumptions within certain models. The Staff recommended that the NRSRO enhance internal controls to protect the integrity of its analytical models used to determine credit ratings and to ensure that the current versions of analytical models are used in the credit rating process.

At a smaller NRSRO, the Staff observed instances in which the NRSRO replaced a defined term in certain policies and procedures but not in others, creating inconsistency, as well as instances in which changes were not applied consistently within documents. The Staff recommended that the NRSRO improve its internal controls for ensuring consistency when revising policies and procedures.

A smaller NRSRO used certain defined terms in some of its policies and procedures, but did not define the terms consistently between policies and procedures. In addition, in some instances, terms defined in certain policies and procedures were used in others without being defined at all. This inconsistency compromised the ability of NRSRO personnel to fully understand whether a particular policy was applicable. The Staff recommended that the NRSRO ensure it uses consistent defined terms in its policies and procedures.

3. In some instances, there were weaknesses in certain NRSROs' policies, procedures, or internal controls to ensure that rating publications contained complete, accurate, and timely information concerning the particular rating actions or the methodologies and criteria applied to those rating actions.

A larger NRSRO did not adhere to its procedure for analytical error correction. During a surveillance review, the NRSRO reclassified an underlying asset in an ABS transaction that accounted for a substantial portion of the deal balance, significantly altering the underlying analytical parameters. The reclassification of the underlying asset was done by changing the industry code, a key model input, which resulted in a material difference in the assumptions underlying the transaction. The NRSRO's analytical error procedure required a set of specific steps to be followed in such circumstances, but the NRSRO did not treat the reclassification as an analytical error and therefore did not follow its procedure. The Staff recommended that the NRSRO adhere to its procedure for analytical error correction.

A larger NRSRO published a document outlining its surveillance committee review outcomes that were inconsistent with the NRSRO's rating committee process. The NRSRO's rating committee process stated that a rating committee may conclude a review with a result of "no rating action" under certain circumstances. However, the NRSRO's publication describing the surveillance framework and review process for a particular sector did not indicate that "no rating

action” was a potential outcome of a rating committee review, listing only potential outcomes of “rating affirmed or changed.” The Staff observed an instance where the result of such a review was a “no rating action” determination by a rating committee. The Staff recommended that the NRSRO adequately describe its rating committee review outcomes in its relevant publication.

A smaller NRSRO’s procedures for the publication of Rule 17g-7(a) information disclosure forms did not, in contravention of Rule 17g-7(a), require that the procedures be followed for withdrawals that result from a review of the credit rating assigned by the NRSRO using applicable procedures and methodologies for determining credit ratings. The Staff recommended that the NRSRO revise its procedures to comply with Rule 17g-7(a).

A smaller NRSRO’s procedures governing the attestation requirement of Rule 17g-7(a)(1)(iii) did not make clear the responsibilities of individuals who may make the required attestation regarding the credit rating. The Staff observed several instances in which the person making the attestation did not attend or vote in the rating committee, making it unclear upon what basis the attestation was made. The Staff recommended that the NRSRO revise its procedures to clarify the responsibilities of the person making attestations pursuant to Rule 17g-7(a)(1)(iii).

A smaller NRSRO discovered a systems-related error that caused the methodology listed on a significant number of information disclosure forms to be an older version of the methodology than the version used to determine the credit rating. The Staff recommended that the NRSRO enhance its internal controls to ensure that the correct versions of methodologies are listed on the Rule 17g-7 Reports. The Staff further recommended that the NRSRO enhance the scope of its rating file reviews to check for accuracy of information contained in the Rule 17g-7 Reports.

A smaller NRSRO identified a material weakness in its unaudited internal control report filed pursuant to Rule 17g-3(a)(7)(i), that involved the ratings publication and dissemination process. In addition, the NRSRO noted numerous instances in which it published incorrect ratings on tranches of ABS transactions, dating back several years. The Staff recommended that the NRSRO enhance its internal controls to ensure the accuracy of all of its published ratings.

4. One NRSRO did not have policies and procedures and internal controls to obtain required representations and make required disclosures when determining or issuing ratings of ABS.

At a larger NRSRO, the Staff observed inconsistencies in the NRSRO’s disclosure practices for Form ABS Due Diligence 15E on several occasions. In one instance, the NRSRO disclosed a Form ABS on its website that referenced a due diligence report that was neither attached nor disclosed on the NRSRO’s website. In another instance, no Form ABS was posted on the NRSRO’s website, although the NRSRO had been provided with a due diligence report from the issuer. While the NRSRO had internal and external database systems for the public dissemination of regulatory disclosures, the systems did not have adequate checks to verify consistency between them. In addition, the NRSRO did not have adequate systems to verify and confirm that the internal documentation matched the documentation it posted publicly. The Staff recommended that the NRSRO ensure compliance with Rule 17g-7(a)(2) when taking rating actions, and that the NRSRO enhance its internal controls, including establishing policies and procedures, with respect to its regulatory disclosure process when taking a rating action.

5. In some instances, there were weaknesses in certain NRSROs' policies, procedures, and controls regarding IT, cybersecurity, or access controls.

A smaller NRSRO's policies and procedures related to internal controls for information technology and cybersecurity did not adequately document the NRSRO's IT and cybersecurity practices, such as those with respect to management of IT assets, requirements for server security, patching systems, and access controls. The Staff recommended that the NRSRO enhance its policies and procedures by documenting its IT and cybersecurity practices, and consider enhancing its internal reporting of IT and cybersecurity deficiencies.

Internal controls related to information technology asset management were not fully documented in policies and procedures at a larger NRSRO and a smaller NRSRO. The Staff recommended that the larger NRSRO enhance its policies and procedures to fully document information technology asset management, and recommended that the smaller NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, which govern information technology asset management.

6. In some instances, there were weaknesses in policies, procedures, or controls related to prevention of the misuse of MNPI at certain NRSROs.

A smaller NRSRO had weaknesses in the NRSRO's internal controls related to management of file access permissions. The Staff observed that analytical and non-analytical personnel of the NRSRO may have had access to confidential information outside of their area of responsibility. The Staff further observed that the NRSRO's policies and procedures did not adequately address the granting of access controls to NRSRO staff or modification of such access controls when appropriate. The Staff recommended the NRSRO enhance its internal controls to ensure that file access controls are managed appropriately to assure safeguarding of confidential information.

A smaller NRSRO prohibited non-authorized persons within the NRSRO from disclosing non-public information about rating actions or potential actions except to the issuer or its designated agents and prohibited personnel from sharing confidential information with employees of any non-ratings businesses. However, the Staff observed that the NRSRO's publishing service was shared with a non-NRSRO entity where information regarding the names of the entities that are the subject of a pending publication could be accessed by non-authorized persons, potentially resulting in inappropriate dissemination of MNPI in contravention of Section 15E(g)(1) and Rule 17g-4(a)(3). The Staff recommended that the NRSRO enhance its policies and procedures to prevent non-authorized persons from viewing the names of NRSRO rated entities for which publication is pending.

E. Review Area: Governance

The Staff interviewed each NRSRO's board of directors or governing body (hereinafter, collectively the "Board" or "Boards"), including independent directors. The Staff also reviewed minutes and other documentation related to the activities of each NRSRO's Board.

The Staff's essential findings relating to the NRSROs' corporate governance and compliance with Section 15E(t) and Rule 17g-8(a)(1) and (2) are as follows:

1. One NRSRO's Board did not approve all methodologies, procedures, and models used to determine ratings as required by Rule 17g-8(a)(1), or did not sufficiently document such approval.

Policies at one smaller NRSRO stated that all methodologies, including qualitative and quantitative data and models, must be approved by the NRSRO's Board of Directors, but did not state that the Board was also responsible for approving procedures that the NRSRO uses to determine credit ratings, as required by Rule 17g-8(a)(1). Members of the NRSRO's Board confirmed that, according to the NRSRO's current policies and procedures, the Board was not responsible for approving the procedures and that the Board had not approved such procedures. The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures that clearly state the NRSRO's Board of Directors is responsible for approving the procedures that the NRSRO uses to determine credit ratings, that the NRSRO ensure that its Board of Directors approves procedures that it uses to determine credit ratings, and that such approval is sufficiently documented.

2. One NRSRO's Board ratified governing documents for its methodology review committee that contained weaknesses with regard to the committee's quorum requirements.

The Board of Directors of a smaller NRSRO by resolution established a committee for review of methodologies, with a quorum requirement of a majority of the members of the committee, or all members of the committee if it has only two members. The resolution further stated that if a member of the committee recuses him or herself, the committee would continue as properly constituted as long as it meets the minimum composition and quorum requirements. The Staff observed that the committee had only two members, and as a consequence, the recusal of one of those two members would result in the committee not satisfying the quorum requirement. The Staff recommended that the NRSRO ensure that the quorum requirements in the governing documents for the committee address the recusal of the committee's members.

F. Review Area: DCO Activities

The Staff reviewed the role and activities of each NRSRO's DCO and interviewed each DCO. The Staff's essential findings regarding the NRSROs' DCO activities are as follows:

1. One NRSRO's personnel in a regional office may not be subject to sufficient compliance oversight, as required by Section 15E(j)(1).

At a smaller NRSRO, it appeared that no analytical staff in a particular regional office had completed compliance training in connection with the NRSRO's policies relating to gifts, entertainment and benefits, and it also appeared that attendance records were inaccurate. The Staff observed that this office did not adopt the NRSRO's new document management processes and that compliance training for this office was typically conducted remotely. The Staff recommended that the NRSRO enhance its compliance oversight of personnel at the regional office.

G. Review Area: Complaints

All of the NRSROs have written policies and procedures to address complaints generally. The Staff's essential findings regarding complaints are as follows:

1. In some instances, certain NRSROs' policies and procedures concerning complaints did not satisfy the statutory requirements for the receipt, retention, and treatment of complaints.

A larger NRSRO's policies and procedures regarding complaints did not adequately address the retention and treatment of complaints received from the NRSRO's employees, as required by Section 15E(j)(3)(B). While the NRSRO maintained a means by which it received complaints from its employees, the NRSRO did not have policies and procedures for retention and treatment of complaints from its employees. The Staff recommended that the NRSRO enhance its policies and procedures to include retention and treatment of complaints received from its employees.

A smaller NRSRO's policies and procedures pertaining to complaints did not comply with statutory requirements because they did not address adequately the NRSRO's treatment of complaints. The Staff observed that the NRSRO's personnel were unsure about the process for resolving complaints and that, in at least one instance, the NRSRO's managers discussed the substance of a particular complaint in the presence of the individuals who were the subject of the complaint. The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures that satisfy the requirements contained in Section 15E(j)(3) and that will ensure consistent treatment of all complaints.

2. At one NRSRO, personnel did not always adhere to policies and procedures concerning complaints.

A smaller NRSRO did not identify a communication as a potential complaint pursuant to its policies and procedures regarding complaints. The NRSRO received an email from a user of credit ratings that questioned the basis for certain of the NRSRO's ratings assumptions. The email appeared to qualify as a complaint as defined in the NRSRO's policies and procedures, but the NRSRO did not process the email under its complaint procedures. The Staff recommended that the NRSRO ensure compliance with Section 15E(j)(3) and the NRSRO's policies and procedures, and that the NRSRO ensure that its employees receive adequate training related to the receipt and review of communications that could potentially be complaints.

H. Review Area: Post-Employment

The Staff reviewed whether each NRSRO's "look-back" policies and procedures satisfy the applicable statutory and Rule requirements. The Staff also requested information from each NRSRO concerning personnel that departed the NRSRO during the Review Period, and in some instances tested, on a selected and randomized basis, documentation related to such personnel to assess whether the NRSRO adhered to its look-back policies and procedures and satisfied the statutory and Rule obligations. In addition, OCR sent a letter to each NRSRO reminding it of its requirements under Section 15E(h)(4)(A) and expressing the Staff's view that under Section

15E(h)(4)(A), the look-back review period is determined based on the date of the NRSRO's most recent rating action prior to the employee's departure.⁴³

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

1. In some instances, there were weaknesses in post-employment policies, procedures, and controls at certain NRSROs.

A larger NRSRO reviewed a sample of ratings for look-back review purposes rather than reviewing all of the relevant ratings of the rated entity. In addition, the Staff observed discrepancies in questionnaires that the NRSRO used in connection with its look-back reviews, including using outdated questionnaires and errors in information regarding the departing employee's role with regard to the credit ratings of the rated entity. The Staff recommended that the NRSRO ensure that its policies and procedures related to look-back reviews comply with Section 15E(h)(4)(A) and Rule 17g-8(c), that the NRSRO use the most updated questionnaire, and that the questionnaire be properly completed.

A smaller NRSRO did not comply with Section 15E(h)(4)(A) because the NRSRO's policies and procedures for look-back reviews did not specify the appropriate review period for all such reviews. The NRSRO's policies and procedures set different review periods for former U.S.-based and non-U.S.-based employees, neither of which specified the period should be calculated from the most recent rating action prior to the employee's departure. The Staff recommended that the NRSRO revise its policies and procedures to comply with Section 15E(h)(4)(A).

At a smaller NRSRO, the NRSRO's look-back policies and procedures, as well as the questionnaire used in the look-back process, included three different look-back review periods that did not comply with Section 15E(h)(4)(A), and did not include provisions required by Rule 17g-8(c)(2) concerning promptly publishing a revised rating if the previous rating was influenced by a conflict of interest. The Staff recommended that the NRSRO revise its look-back policies and procedures to comply with Section 15E(h)(4)(A) and Rule 17g-8(c).

V. CONCLUSION

The Staff has identified findings and recommendations for the NRSROs. In future examinations, the Staff will continue to assess the NRSROs' responses to recommendations from the 2017 Section 15E examinations. The Staff will continue to evaluate its risk assessment process to review compliance with laws and regulations and to identify emerging risk areas promptly. The Staff will also continue to evaluate examination techniques to assess and test the NRSROs' compliance with applicable laws. In addition, the Staff will continue to assess the NRSROs'

⁴³ Letter from OCR Director Thomas J. Butler (July 18, 2016), available on OCR's webpage of the SEC's public website, at <https://www.sec.gov/ocr>.

compliance with the SEC rule adopted or amended in 2014, and expects continued enhanced compliance by the NRSROs with these rules.