
Annual Report on Nationally Recognized Statistical Rating Organizations

As Required by Section 6 of the
Credit Rating Agency Reform
Act of 2006



December 2017

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 in this report.

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ANNUAL REPORT ON NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

As Required by Section 6 of the Credit Rating Agency Reform Act of 2006

I. INTRODUCTION

The staff (the “Staff”) of the U.S. Securities and Exchange Commission (the “Commission” or “SEC”) is providing this report (“Report”) regarding nationally recognized statistical rating organizations (“NRSROs”) pursuant to Section 6 of the Credit Rating Agency Reform Act of 2006 (“Rating Agency Act”).¹ This Report reflects solely the Staff’s views. Section 6 of the Rating Agency Act requires the Commission to submit an annual report (“Annual Report”) to the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate and the Committee on Financial Services of the U.S. House of Representatives that, with respect to the year to which the Annual Report relates:

- identifies applicants for registration as NRSROs under Section 15E of the Securities Exchange Act of 1934 (as amended, the “Exchange Act”);²
- specifies the number of, and actions taken on, such applications; and
- specifies the views of the Commission on the state of competition, transparency, and conflicts of interest among NRSROs.

This Report relates generally to the period from June 26, 2016 to June 25, 2017 (the “Report Period”). In addition to addressing the items specified in Section 6 of the Rating Agency Act, this Report provides an overview of certain Commission and Staff activities relating to NRSROs.

Information regarding the topics covered in this Report with respect to prior periods can be found on the Office of Credit Ratings (“OCR” or the “Office”) page of the Commission’s website.³

¹ Pub. L. No. 109-291, 120 Stat. 1327 (Sept. 29, 2006). The Rating Agency Act, among other things, added Section 15E to the Securities Exchange Act of 1934 (15 U.S.C. §78o-7) to establish self-executing requirements on NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs. In June 2007, the Commission approved rules implementing such a program. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Release No. 34-55857, 72 FR 33564 (Jun. 18, 2007), available at: <https://www.sec.gov/rules/final/2007/34-55857.pdf>.

² Unless otherwise noted, all references to specific statutory sections and rules in this Report are to sections in the Exchange Act and related rules.

³ Prior Annual Reports can be found under “Annual Reports to Congress” in the “Reports and Studies” section of the OCR webpage, available at: <http://www.sec.gov/ocr>.

II. STATUS OF REGISTRANTS AND APPLICANTS

Section 3(a)(62) defines a “nationally recognized statistical rating organization” as a credit rating agency that issues credit ratings certified by qualified institutional buyers, in accordance with Section 15E(a)(1)(B)(ix), with respect to:

- (i) financial institutions, brokers, or dealers;
- (ii) insurance companies;
- (iii) corporate issuers;
- (iv) issuers of asset-backed securities (as that term is defined in 17 CFR 229.1101(c));
- (v) issuers of government securities, municipal securities, or securities issued by a foreign government; or
- (vi) a combination of one or more categories of obligors described in any of clauses (i) through (v) above

and is registered under Section 15E.

As of the date of this Report, there are ten credit rating agencies registered as NRSROs. The NRSROs, categories of credit ratings described in clauses (i) through (v) of Section 3(a)(62)(A) in which they are registered, and locations of their principal offices, as of the date of this Report, are listed below:⁴

NRSRO	Categories of Credit Ratings	Principal Office
A.M. Best Rating Services, Inc. ("A.M. Best")	(ii), (iii), and (iv)	U.S.
DBRS, Inc. ("DBRS")	(i) through (v)	U.S.
Egan-Jones Ratings Company ("EJR")	(i) through (iii)	U.S.
Fitch Ratings, Inc. ("Fitch")	(i) through (v)	U.S.
HR Ratings de México, S.A. de C.V. ("HR Ratings")	(i), (iii), and (v)	Mexico
Japan Credit Rating Agency, Ltd. ("JCR")	(i), (ii), (iii), and (v)	Japan
Kroll Bond Rating Agency, Inc. ("KBRA")	(i) through (v)	U.S.
Moody's Investors Service, Inc. ("Moody's")	(i) through (v)	U.S.
Morningstar Credit Ratings, LLC ("Morningstar")	(i), (iii), and (iv)	U.S.
S&P Global Ratings ("S&P")	(i) through (v)	U.S.

⁴ See the current Form NRSRO on each NRSRO's website for any updates to this information.

Applications for initial registration and for registration by current NRSROs in additional rating categories are filed on Form NRSRO (“Form NRSRO”).⁵ In addition, Section 15E(b) requires NRSROs to promptly amend Form NRSRO if any information or document provided therein becomes materially inaccurate. Such section also requires NRSROs to annually amend Form NRSRO to update ratings count and performance information, certify the continuing accuracy of the information and documents provided therein, and list any material change thereto during the previous calendar year. OCR Staff review such amendments to Forms NRSRO in light of the requirements of Section 15E(b), Rule 17g-1, and the instructions to Form NRSRO, and may comment on such amendments and refer certain observations regarding such amendments to OCR examination Staff.

During the Report Period, each of Morningstar and HR Ratings filed with the Commission, in accordance with Section 15E(a)(1) and Rule 17g-1, applications for registration in the financial institutions and corporate issuers rating categories.⁶ No other complete applications for initial registration as an NRSRO or for registration by current NRSROs in additional rating categories were received during the Report Period.

III. ACTIVITIES RELATING TO NRSROs

A. Activities

The creation of OCR was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)⁷ and the Office was established in June 2012. OCR is responsible for the oversight of credit rating agencies registered with the Commission as NRSROs. OCR’s Staff includes professionals with expertise in a variety of areas that relate to its regulatory mission, such as corporate, municipal, and structured debt finance.⁸

OCR’s responsibilities – as mandated by the Dodd-Frank Act – include conducting an examination of each NRSRO at least annually in eight specified review areas.⁹ Information

⁵ See Section 15E(a) and Rule 17g-1. Rule 17g-1 requires an applicant/NRSRO to use Form NRSRO for the following, as applicable:

- an initial application to be registered as an NRSRO;
- an application to register for an additional class of credit ratings;
- an application supplement;
- an update of registration pursuant to Section 15E(b)(1);
- an annual certification pursuant to Section 15E(b)(2); and
- a withdrawal of registration pursuant to Section 15E(e).

See <http://www.sec.gov/about/forms/formnrsro.pdf> for additional information.

⁶ The Commission approved Morningstar’s application on August 24, 2016. See <https://www.sec.gov/rules/other/2016/34-78671.pdf>. The Commission approved HR Ratings’ application on November 23, 2016. See <https://www.sec.gov/rules/other/2016/34-79382.pdf>.

⁷ See Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁸ See Section 15E(p)(2) for a description of OCR staffing requirements.

⁹ See Section 15E(p)(3) for a description of the scope of the required examinations.

regarding the examinations, including those that concluded during the Report Period, is included in OCR's annual examination reports.¹⁰

In connection with its regulatory mission, OCR also monitors trends and developments affecting the credit rating industry. For example, OCR Staff meets with each NRSRO to discuss rating and industry developments and meets with the boards of directors of certain NRSROs to discuss, among other things, compliance and oversight matters. OCR Staff also meets with a variety of other market participants, including investors, issuers, regulators, and industry organizations, to discuss matters relevant to the credit rating industry. OCR Staff also attends various conferences, seminars, and other events addressing topics applicable to the industry. These monitoring activities are focused on informing Commission policy and rulemaking and NRSRO examinations.

During the Report Period, OCR Staff also continued to participate in meetings that involved rating agency regulators globally, including those of the International Organization of Securities Commissions ("IOSCO") Committee 6 on Credit Rating Agencies¹¹ and the supervisory colleges that were formed at IOSCO's recommendation for the largest internationally-active credit rating agencies.¹² During the Report Period, the colleges held an in-person meeting and conducted quarterly calls. OCR Staff also conducted additional discussions with international regulators as appropriate.

B. Commission Orders and Releases and Staff Publications

The Commission and the Staff, as applicable, issued the following orders, releases, and publications relating to NRSROs or credit ratings in general from the start of the Report Period to November 28, 2017:

- Order Extending Conditional Temporary Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5(a)(3) under the Securities Exchange Act of 1934, Release No. 34-82144 (Nov. 22, 2017), 82 FR 56309 (Nov. 28, 2017).¹³ The Commission extended the order exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to credit ratings for certain structured finance products where the issuer is a non-U.S. person and the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold only in transactions outside the United States, until the earlier of (i) December 2, 2019, or (ii) the

¹⁰ The examination reports can be found under "Summary Examination Reports" in the "Reports and Studies" section of the OCR webpage, available at <http://www.sec.gov/ocr>.

¹¹ IOSCO Committee 6 was formed to evaluate and consider regulatory and policy initiatives relating to credit rating agencies' activities and oversight and facilitate regular dialogue between regulators and the credit rating industry. The SEC chairs Committee 6, and OCR Staff represents the SEC in this regard.

¹² The supervisory colleges were formed to enhance communication among credit rating agency regulators globally with respect to examinations of the relevant credit rating agencies. See Supervisory Colleges for Credit Rating Agencies, Final Report (July 2013), available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD416.pdf>. The SEC serves as chair of the colleges for S&P and Moody's, and OCR Staff represents the SEC in this regard. The European Securities and Markets Authority serves as chair of the college for Fitch.

¹³ Available at: <https://www.sec.gov/rules/exorders/2017/34-82144.pdf>.

compliance date set forth in any final rule that may be adopted by the Commission that provides for a similar exemption.

- 2016 Summary Report of Commission Staff’s Examinations of Each Nationally Recognized Statistical Rating Organization, dated December 2016, as required under Section 15E(p)(3)(C).¹⁴ The report summarizes essential findings of the examinations conducted by Staff under Section 15E(p)(3)(C), generally focusing on the period from January 1, 2015 through December 31, 2015.
- Annual Report on Nationally Recognized Statistical Rating Organizations, dated December 2016, as required by Section 6 of the Rating Agency Act.¹⁵ The Annual Report addresses the matters described in the first paragraph under Section I. of this Report, generally covering the period from June 26, 2015 to June 25, 2016.
- Order Granting Registration of HR Ratings de México, S.A. de C.V. for Two Additional Classes of Credit Ratings, Release No. 34-79382 (Nov. 23, 2016).¹⁶ The Commission granted HR Ratings’ registration for the following two additional classes of credit ratings: (1) the class of credit ratings described in clause (i) of Section 3(a)(62)(A) (i.e., financial institutions, brokers, or dealers); and (2) the class of credit ratings described in clause (iii) of Section 3(a)(62)(A) (i.e., corporate issuers).
- Order Granting Registration of Morningstar Credit Ratings, LLC for Two Additional Classes of Credit Ratings, Release No. 34-78671 (Aug. 24, 2016).¹⁷ The Commission granted Morningstar registration for the following two additional classes of credit ratings: (1) the class of credit ratings described in clause (i) of Section 3(a)(62)(A) (i.e., financial institutions, brokers, or dealers); and (2) the class of credit ratings described in clause (iii) of Section 3(a)(62)(A) (i.e., corporate issuers).
- Order Granting Conditional Exemption of Morningstar Credit Ratings, LLC from a Requirement in Section 15E(a)(1)(C)(iv) of the Securities Exchange Act of 1934 and Item 6C of Form NRSRO, Release No. 34-78670 (Aug. 24, 2016).¹⁸ The Commission granted Morningstar a conditional exemption from the requirement in Section 15E(a)(1)(C)(iv) and Item 6C of Form NRSRO that an NRSRO applying to register for additional classes of credit ratings provide at least two certifications from qualified institutional buyers stating, among other things, that they have used the credit ratings of the applicant in such classes in the course of making some of their investment decisions for at least the three years immediately preceding the date of the certifications. An exemption was requested because the related credit ratings had been issued by a non-NRSRO affiliate of Morningstar. Under the order, Morningstar is required to file certifications from qualified institutional buyers as to the additional classes of credit

¹⁴ Available at: <http://www.sec.gov/ocr/reportspubs/special-studies/nrsro-summary-report-2016.pdf>.

¹⁵ Available at: <http://www.sec.gov/ocr/reportspubs/annual-reports/2016-annual-report-on-nrsros.pdf>.

¹⁶ Available at: <https://www.sec.gov/rules/other/2016/34-79382.pdf>.

¹⁷ Available at: <https://www.sec.gov/rules/other/2016/34-78671.pdf>.

¹⁸ Available at: <https://www.sec.gov/rules/exorders/2016/34-78670.pdf>.

ratings by no later than four years following its registration in those classes of credit ratings.

- Proposed Rule: Disclosure Update and Simplification, Release Nos. 33-10110, 34-78310, and IC-32175 (July 13, 2016), 81 FR 51607 (Aug. 4, 2016).¹⁹ The Commission proposed amendments to certain disclosure requirements that may have become redundant, duplicative, overlapping, outdated, or superseded in light of other Commission disclosure requirements, U.S. Generally Accepted Accounting Principles (“U.S. GAAP”), International Financial Reporting Standards, or changes in the information environment. The proposed amendments relate to issuers of securities and other entities, including a proposed change to Rule 17g-3 to conform the financial statement reporting requirements applicable to NRSROs to U.S. GAAP.
- Staff Guidance Sent to NRSROs in July 2016.²⁰ In July 2016, OCR sent letters to the compliance officers of the NRSROs designated under Section 15E(j), setting forth OCR Staff’s view on a particular aspect of Section 15E(h)(4)(A) relating to required policies and procedures of NRSROs involving the conduct of “look-back” reviews with respect to certain former employees.

IV. COMPETITION

A. Select NRSRO Statistics

Sections 1. through 3. below summarize and discuss certain information reported by NRSROs on Form NRSRO or pursuant to Rule 17g-3 that provides insight into the state of competition among NRSROs. While this information indicates that Moody’s, S&P, and Fitch continue to account for the highest percentages of outstanding ratings, other information suggests that smaller NRSROs have been able to gain market share in certain asset classes.²¹ In addition, investor recognition of a wider range of NRSROs in investment guidelines, as discussed in Section IV.C. of this Report, may benefit the competitive position of the smaller NRSROs.

¹⁹ Available at: <https://www.sec.gov/rules/proposed/2016/33-10110.pdf>. See also Extension of the Comment Period for Disclosure Update and Simplification, Release Nos. 33-10220, 34-78926, and IC-32281 (Sept. 23, 2016), 81 FR 66898 (Sept. 29, 2016).

²⁰ Available at: <https://www.sec.gov/about/offices/ocr/dear-dco-letter-15eh4a-071816.pdf>.

²¹ As discussed in Section IV.B.1. of this Report, information available on the websites of Commercial Mortgage Alert (<https://www.cmalert.com/>) and Asset-Backed Alert (<https://www.abalert.com/>) regarding NRSRO market shares in the asset-backed securities category indicates that some of the smaller NRSROs have developed significant market shares in such category over the past few years. In addition, Section IV.B.2. of this Report provides examples of certain asset classes in which it has been reported that smaller NRSROs have been able to gain market share.

1. NRSRO Credit Ratings Outstanding

(a) Number of Outstanding Ratings in Statutory Rating Categories

Each NRSRO annually reports the number of credit ratings outstanding, as of the end of the preceding calendar year, in each rating category for which it is registered.²² This information, for the calendar year ending December 31, 2016, is summarized in Charts 1 through 4 below and can be useful in determining the breadth of an NRSRO's coverage with respect to issuers and obligors within a particular rating category.

Chart 1 depicts the number of credit ratings each NRSRO had outstanding in each rating category for which it was registered as of December 31, 2016. Chart 2 shows the percentage of credit ratings each NRSRO had outstanding across all rating categories and also breaks out the percentages for each NRSRO in each of the rating categories. Chart 3 illustrates the relative size of each rating category based on the aggregate number of ratings reported outstanding by all NRSROs. Chart 4 depicts the percentage of ratings each NRSRO had outstanding across all rating categories other than the government securities category.

Comparing the number of ratings *outstanding* for established NRSROs and newer NRSROs may not provide as comprehensive a picture of the state of competition as comparing the number of ratings *issued* by such NRSROs in a given period. Certain NRSROs (particularly S&P, Moody's, and Fitch) have a longer history of issuing ratings and their ratings include those for debt obligations and obligors that were rated well before the establishment of the newer entrants.²³ Consequently, the information described in Section IV.B.1. of this Report (relating to recent market share developments in the asset-backed securities rating category) may provide additional insight regarding how well newer entrants are competing with more established rating agencies, specifically in the asset-backed securities rating category.

There are additional limitations to assessing the state of competition in each rating category and in the aggregate based on the number of outstanding ratings. For instance, some NRSROs have pursued business strategies to specialize in particular rating categories or sub-categories²⁴ and may not desire to issue ratings in certain of the other NRSRO rating categories. Also, the reported information does not reflect any credit ratings being issued by NRSROs in rating categories in which they are not registered with the Commission, nor does it reflect ratings

²² Annual certifications on Form NRSRO must be filed with the Commission on EDGAR pursuant to Rule 17g-1(f) and made publicly and freely available on each NRSRO's website pursuant to Rule 17g-1(i). The number of outstanding credit ratings for each rating category for which an NRSRO is registered is reported on Item 7A of Form NRSRO.

²³ The ratings counts disclosed on Item 7A of Form NRSRO include outstanding credit ratings, regardless of when they were issued. As a result, the ratings counts of the more established NRSROs may include credit ratings that were issued before the newer entrants began issuing credit ratings. These earlier ratings will continue to be included in the disclosed ratings counts until the rated securities are repaid or the credit ratings are otherwise withdrawn. Because outstanding ratings are included in the ratings counts, historical results factor significantly into the disclosed number of ratings, making it more difficult to discern current-year trends and identify gains achieved by the newer entrants.

²⁴ For example, A.M. Best has traditionally focused on credit ratings with respect to insurance companies and their affiliates.

issued by an affiliate of an NRSRO unless the affiliate is identified as a credit rating affiliate on Item 3 of Form NRSRO.

Further, the outstanding ratings reported by the NRSROs are based on their own determinations of the applicable categories and number of ratings, which are not necessarily consistent among NRSROs. In addition, to the extent NRSROs have adjusted their ratings count disclosures in accordance with the new instructions to Form NRSRO, comparisons to ratings counts disclosed in prior years may also be more difficult to draw.²⁵

Chart 1 provides the number of outstanding credit ratings reported by each NRSRO in its annual certification for the calendar year ending December 31, 2016, in each of the five categories identified in Section 3(a)(62) for which the NRSRO is registered, as applicable.

NRSRO	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total Ratings
A.M. Best	N/R	7,537	1,359	18	N/R	8,914
DBRS	7,969	158	3,037	12,757	16,784	40,705
EJR	11,112	837	6,480	N/R	N/R	18,429
Fitch	44,965	3,188	17,848	39,981	197,543	303,525
HR Ratings	547	N/R	140	N/R	352	1,039
JCR	787	65	2,356	N/R	486	3,694
KBRA	705	5	1	5,561	63	6,335
Moody's	49,472	3,230	44,676	64,188	619,478	781,044
Morningstar	35	N/R	308	3,591	N/R	3,934
S&P	58,582	6,859	50,672	49,162	952,910	1,118,185
Total	174,174	21,879	126,877	175,258	1,787,616	2,285,804

* N/R indicates that the NRSRO was not registered in the applicable rating category as of the reporting date.

Source: NRSRO annual certifications for the 2016 calendar year, Item 7A on Form NRSRO

²⁵ Effective January 1, 2015, Item 7A of Form NRSRO and the corresponding instructions were amended to clarify the manner in which the number of outstanding credit ratings should be calculated and presented. The clarifying amendments are designed to ensure that disclosures on Item 7A of Form NRSRO are consistent across NRSROs. The change in instructions may have caused some NRSROs to modify the way they count ratings for purposes of Item 7A of Form NRSRO, which may affect comparisons to disclosures made in prior years. See Nationally Recognized Statistical Rating Organizations, Release No. 34-72936 (Aug. 27, 2014), 79 FR 55077 (Sept. 15, 2014) at 55220-22 (discussing the clarifying amendments to Item 7A of Form NRSRO).

Chart 2 displays the percentage of each NRSRO's outstanding credit ratings of the total outstanding credit ratings of all NRSROs, for each rating category in which the NRSRO was registered, based on information reported by the NRSROs as of December 31, 2016.²⁶

Chart 2: Percentage by Rating Category of Each NRSRO's Outstanding Credit Ratings of the Total Outstanding Credit Ratings of all NRSROs, as of December 31, 2016*						
NRSRO	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total Ratings
A.M. Best	N/R	34.4%	1.1%	<0.1%	N/R	0.4%
DBRS	4.6%	0.7%	2.4%	7.3%	0.9%	1.8%
EJR	6.4%	3.8%	5.1%	N/R	N/R	0.8%
Fitch	25.8%	14.6%	14.1%	22.8%	11.1%	13.3%
HR Ratings	0.3%	N/R	0.1%	N/R	<0.1%	<0.1%
JCR	0.5%	0.3%	1.9%	N/R	<0.1%	0.2%
KBRA	0.4%	<0.1%	<0.1%	3.2%	<0.1%	0.3%
Moody's	28.4%	14.8%	35.2%	36.6%	34.7%	34.2%
Morningstar	<0.1%	N/R	0.2%	2.0%	N/R	0.2%
S&P	33.6%	31.3%	39.9%	28.1%	53.3%	48.9%

* N/R indicates that the NRSRO was not registered in the applicable rating category as of the reporting date. Percentages have been rounded to the nearest one-tenth of one percent.

Source: NRSRO annual certifications for the 2016 calendar year, Item 7A on Form NRSRO

As illustrated in Chart 2, S&P, Moody's, and Fitch account for 96.4% of all the ratings outstanding as of December 31, 2016—slightly lower than 96.5% as of December 31, 2015.²⁷ This change is largely attributable to an approximate 2.0% decrease in the share of outstanding asset-backed securities ratings that were issued by these NRSROs, which was partially offset by an increase of approximately 1.1% of these NRSROs' share of outstanding insurance company ratings. All other categories for these NRSROs as a percentage of total outstanding ratings remained relatively constant, increasing or decreasing by no more than 0.2%.

Chart 2 also illustrates the relative percentages of ratings outstanding among the NRSROs. S&P accounts for the highest number of ratings outstanding with nearly half (48.9%) of the total number of ratings reported by all NRSROs. Moody's reported the second highest number of ratings outstanding, accounting for 34.2% of the total. Fitch was third and DBRS was fourth, with 13.3% and 1.8% of the total, respectively. Each other NRSRO reported less than 1.0% of the total number of ratings outstanding.

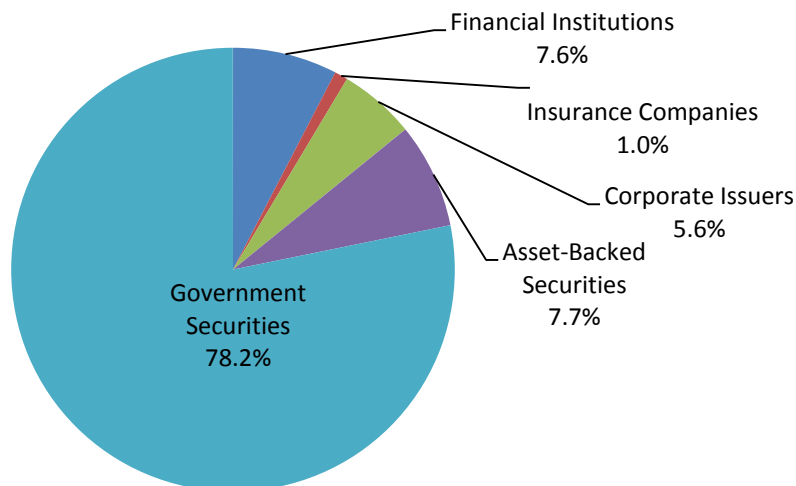
²⁶ For example, according to Chart 1, A.M. Best reported that it had 7,537 insurance company credit ratings, and the total of the credit ratings in that category reported by all NRSROs was 21,879. Dividing 7,537 by 21,879 equals (approximately) 0.344 or 34.4% (which is the percentage of NRSRO insurance company ratings attributable to A.M. Best, as shown on Chart 2).

²⁷ In 2007, the year when NRSROs began reporting outstanding ratings on Form NRSRO, these three NRSROs accounted for 98.8% of all outstanding ratings.

Finally and notably, Chart 2 shows that, in the insurance category, A.M. Best had the most credit ratings outstanding. A.M. Best has consistently reported being one of the top three issuers of insurance ratings since this information began to be reported in 2007.

Chart 3 depicts the percentages of outstanding credit ratings attributable to each rating category, based on information reported by the NRSROs as of December 31, 2016.

Chart 3: Breakdown of Ratings Reported Outstanding on December 31, 2016*



* Percentages have been rounded to the nearest one-tenth of one percent.

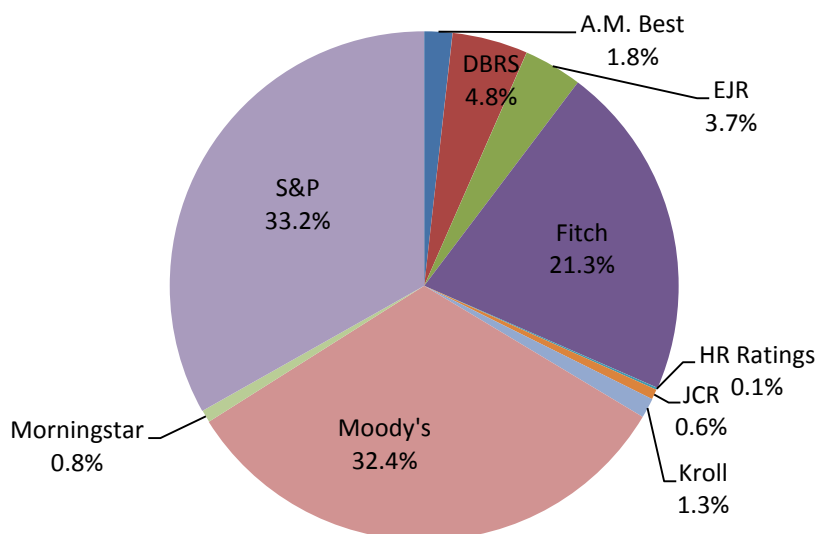
Source: NRSRO annual certifications for the 2016 calendar year, Item 7A on Form NRSRO

As illustrated by Chart 3, as of December 31, 2016, a disproportionate number of the aggregate credit ratings reported to be outstanding were in the government securities category, which may be attributable to the large number of government bond issuers and their multiple debt offerings. The government securities category accounted for 78.2% of the total number of credit ratings reported across all categories and, as shown on Chart 2, is also the most concentrated rating category, with Moody's and S&P accounting for 88.0% of all outstanding government ratings.

Given the disproportionate size of the government securities rating category relative to the other rating categories and the high concentration of NRSROs rating government securities, the inclusion of the government securities category in the calculation of total market share for each NRSRO may make it difficult to assess the relative market shares of the smaller NRSROs.

Chart 4 depicts the percentages of the credit ratings outstanding that are attributable to each NRSRO over all rating categories other than the government securities category, based on information reported by the NRSROs as of December 31, 2016.

Chart 4: Breakdown of Non-Government Securities Ratings Reported Outstanding on December 31, 2016*



* Percentages have been rounded to the nearest one-tenth of one percent.

Source: NRSRO annual certifications for the 2016 calendar year, Item 7A on Form NRSRO

A comparison of Chart 4 to Chart 2 (which shows each NRSRO's total market share over all rating categories, including government securities) illustrates that there is less concentration in the non-government securities rating categories. S&P's and Moody's percentage share of the overall market declines by 15.7 and 1.7 percentage points, respectively, when government securities are excluded. Fitch's percentage share of outstanding ratings, on the other hand, increases by 8.0 percentage points when government securities are excluded. The market share percentage for all the remaining NRSROs also increases when government securities are excluded. Further, when government securities are included in the total calculation, all but one (i.e., DBRS) of the smaller NRSROs have less than 1.0% of the market share, making it difficult to assess their relative market shares. When government securities are excluded, a clearer picture of the relative market shares of the smaller NRSROs can be observed, as illustrated in Chart 4.

As discussed above, Charts 1 through 4 reflect the number of credit ratings outstanding as of December 31, 2016, which may include credit ratings that were issued years ago. As a result, the measure may not be indicative of the current market position of each NRSRO with respect to newly issued credit ratings. For a discussion of recent market share developments in the asset-backed securities rating category and other developments that could impact NRSRO market share, see Section IV.B. of this Report.

(b) Industry Concentration

Economists generally measure industry concentration, which indicates the competitiveness of an industry, by using the Herfindahl-Hirschman Index (“HHI”).²⁸ The inverse of the HHI (“HHI Inverse”) can be used to represent the number of firms with equal market share necessary to replicate the degree of concentration in a particular industry.²⁹ In other words, an industry with an HHI Inverse of 3.0 has a concentration that is equal to an industry where the entire market is evenly divided among three firms with a market share of one third each. A highly concentrated market will have a low HHI Inverse, whereas an unconcentrated market will have a high HHI Inverse.³⁰

Calculations of the HHI and HHI Inverse for the NRSRO industry are consistent with the results included in Section IV.A.1.(a) of this Report and further illustrate gains in market share made by smaller NRSROs in the asset-backed securities rating category. Based on the number of outstanding ratings included in such section,³¹ the HHI Inverse indicates that the NRSRO industry constitutes a “highly concentrated” market, and has the equivalent concentration of an industry with approximately 2.67 firms with equal market share. This is consistent with the high proportion of outstanding ratings that have been issued by the three largest NRSROs, especially Moody’s and S&P. Although the industry remains highly concentrated, a comparison of the HHI Inverse calculations since 2008 shows that the asset-backed securities rating category and, to a lesser extent, the financial institutions rating category have become less concentrated.

²⁸ See, e.g., U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines §5.3 (2010) (discussing how the Department of Justice and the Federal Trade Commission use HHI to measure the impact of a merger on market concentration); however, since the HHI calculation does not take into account that multiple NRSROs may rate a single issue, different considerations may be applicable to the use of the HHI calculation for NRSROs.

²⁹ The HHI Inverse is calculated by dividing 10,000 (i.e., the highest possible HHI) by the HHI. For additional discussion of the HHI Inverse, see VERA PAWLOWSKY-GLAHN & ANTONELLA BUCCIANTI, COMPOSITIONAL DATA ANALYSIS: THEORY AND APPLICATIONS (2011); Toby Roberts, When Bigger is Better: A Critique of the Herfindahl-Hirschman Index’s Use to Evaluate Mergers in Network Industries, 34 PACE L. REV. 894, 908 (2014).

³⁰ A market with an HHI Inverse of less than 4.0 is considered to be highly concentrated; a market with an HHI Inverse between 4.0 and 6.67 is considered to be moderately concentrated; and a market with an HHI Inverse above 6.67 is considered to be unconcentrated. See generally U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines §5.3 (2010).

³¹ See Section IV.A.1.(a) of this Report for a discussion of certain limitations involved in determining the number of outstanding ratings reported.

Chart 5 reports the HHI Inverses calculated from 2008 to 2016 for the ratings outstanding (as reported by the NRSROs) in each rating category, in total for all rating categories, and in total for all rating categories excluding government securities.

Chart 5: HHI Inverses for Each Rating Category*							
Year	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total (all rating categories)	Total (excluding government securities)
2008	3.72	4.05	3.79	2.82	2.83	2.99	3.56
2009	3.85	3.84	3.18	3.18	2.65	2.86	3.58
2010	3.99	3.37	3.17	3.20	2.69	2.88	3.55
2011	4.16	3.76	3.02	3.38	2.47	2.74	3.70
2012	4.04	3.72	3.00	3.44	2.50	2.75	3.68
2013	3.99	3.68	3.03	3.48	2.46	2.72	3.65
2014	4.30	3.83	3.35	3.34	2.40	2.68	3.81
2015	3.72	3.82	3.23	3.53	2.40	2.65	3.67
2016	3.75	3.82	3.26	3.68	2.40	2.67	3.78

* The number of credit rating agencies registered as NRSROs varies by category and can change over time, potentially affecting comparisons across categories and with prior years. For example, Morningstar and HR Ratings each registered and had outstanding ratings in the financial institutions and corporate issuers categories in 2016, contributing to the increase in the HHI Inverse in these categories compared to the prior year.

Source: NRSRO annual certifications for the 2008-16 calendar years, Item 7A on Form NRSRO

As noted in Section IV.A.1.(a) of this Report, as of December 31, 2016, the government securities rating category (which includes sovereigns, U.S. public finance, and international public finance) was the category with the most ratings (comprising approximately 78.2% of all ratings outstanding). Given the disproportionate size of the government securities rating category relative to the other rating categories and the high concentration of NRSROs rating government securities,³² the inclusion of the government securities category in the calculation of the aggregate HHI Inverse may make it difficult to assess the overall level of market concentration in the other four rating categories. Chart 5 therefore also includes the HHI Inverse for these four rating categories in the aggregate. As shown in the chart, when the government securities rating category is excluded, the total HHI inverse with respect to the four remaining rating categories increases to 3.78, which indicates less concentration than in 2008.

Industry concentration in the asset-backed securities category is at its lowest point (i.e., having the highest HHI Inverse and reflecting the greatest historical competition) since NRSROs began reporting information regarding the number of ratings outstanding on Form NRSRO. This may reflect increased competition from some of the smaller NRSROs that have focused on rating securities in this category (see Section IV.B. of this Report for a discussion of recent NRSRO market shares in the asset-backed securities category). The other rating categories were more concentrated in 2016 than they were in 2008, except for the financial institutions rating category, which is slightly less concentrated than in 2008.

³² As shown in Chart 5, the government securities category has an HHI Inverse of 2.40, which is significantly lower than the other categories, illustrating its status as the most concentrated rating category.

2. NRSRO Analytical Staffing Levels

Chart 6 reports the number of credit analysts (including credit analyst supervisors) and the number of credit analyst supervisors employed by each of the NRSROs, as reported on Exhibit 8 of Form NRSRO, and the ratio of credit analyst supervisors to credit analysts.³³

Chart 6: NRSRO Credit Analysts and Credit Analyst Supervisors			
NRSRO	Credit Analysts (Including Credit Analyst Supervisors)	Credit Analyst Supervisors	Ratio of Credit Analyst Supervisors to Credit Analysts
A.M. Best	142	43	1 : 2.3
DBRS	248	49	1 : 4.1
EJR	13	7	1 : 0.9
Fitch	1,137	317	1 : 2.6
HR Ratings	43	8	1 : 4.4
JCR	62	31	1 : 1.0
KBRA	123	24	1 : 4.1
Moody's	1,512	203	1 : 6.4
Morningstar	81	17	1 : 3.8
S&P	1,532	158	1 : 8.7
Total	4,893	857	1 : 4.7

Source: NRSRO annual certifications for the 2016 calendar year, Exhibit 8 on Form NRSRO

The three largest NRSROs report employing 4,181 credit analysts (including supervisors), which is approximately 85.4% of the total number employed by all of the NRSROs. Although the smaller NRSROs in the aggregate employ only approximately 14.6% of all credit analysts employed by NRSROs, this percentage has increased steadily in recent years.³⁴ During this time, some of the smaller NRSROs have reported significant increases in

³³ Effective January 1, 2015, the instructions for Exhibit 8 of Form NRSRO were amended to clarify that NRSROs must include credit analyst supervisors in the total number of credit analysts disclosed on Exhibit 8. This amendment was designed to enhance consistency of the disclosures on Exhibit 8 of Form NRSRO.

³⁴ Based on reports by the currently-registered NRSROs on their annual certifications for the applicable calendar year, the smaller NRSROs employed approximately 9.6% of all NRSRO analysts in 2013, 11.4% of all NRSRO analysts in 2014, and 12.8% of all NRSRO analysts in 2015.

their analytical staff.³⁵ The trend in the number of rating analysts employed by an NRSRO can indicate the state of the NRSRO's business or its business outlook—i.e., NRSROs that are increasing their staff may be experiencing or anticipating an increase in ratings volumes or planning to enter new markets. In addition, when considered in light of the supervisory structure and business model of an NRSRO, comparing the breadth of staffing across NRSROs may provide insight into the adequacy of the managerial resources at each NRSRO.

3. NRSRO Revenue Growth

The total revenue reported to the Commission³⁶ by all of the NRSROs for their 2016 fiscal year was approximately \$5.9 billion, which was higher by approximately \$100 million than the amount reported in the 2015 fiscal year. Chart 7 shows the percentage of total NRSRO revenues since 2013 that were accounted for by S&P, Fitch, and Moody's in the aggregate and by all other NRSROs in the aggregate.

Chart 7: NRSRO Revenue Information: Fiscal Year Percentage of Total Reported NRSRO Revenue				
	2013	2014	2015	2016
S&P, Fitch, and Moody's	94.5%	94.3%	93.7%	94.4%
All Other NRSROs	5.5%	5.7%	6.3%	5.6%
Total	100.0%	100.0%	100.0%	100.0%

Source: Financial reports provided to the Commission under Rule 17g-3 for the fiscal years ended 2013-16. For the preparation of this Report, if an NRSRO reported revenue in a foreign currency, the revenue was converted to U.S. dollars using the average exchange rate over all U.S. banking days in the fiscal year of such NRSRO.

³⁵ For example, in its most recent annual certification, DBRS reported employing 248 credit analysts (including credit analyst supervisors), a 45.0% increase from the number of analysts reported on its annual certification for the prior year. Morningstar also reported a sizeable increase in analysts; the 81 credit analysts (including credit analyst supervisors) disclosed on its most recent annual certification was 19.1% higher than the number of analysts disclosed on its annual certification for the prior year. Such increase may be attributable to Morningstar's registration as an NRSRO in the financial institutions and corporate issuers rating categories. In connection with such registration, the thirteen-member corporate credit analyst team of Morningstar's parent, Morningstar, Inc., was transferred to Morningstar. See Morningstar Credit Ratings, LLC Now Registered to Rate Corporate Issuers and Financial Institutions, Morningstar, Inc., August 29, 2016, available at: <https://ratingagency.morningstar.com/PublicDocDisplay.aspx?i=GPgHDsXEMGg%3d&m=i0Pyc%2bx7qZZ4%2bsXnymazBA%3d%3d&s=LviRtUKXqs8kml5dHt7FTeE2SZmY0Fvqd4iX49Mk%2f9UapyiFTEO6TA%3d%3d>.

³⁶ Under Rule 17g-3(a)(3), NRSROs are required to provide to the Commission annual unaudited reports that include revenue information. These reports are not required to be made publicly available.

Further revenue information is available for NRSROs that are owned, in whole or in part, by public companies. The following information is from the annual reports of public companies with an ownership interest in an NRSRO:

- Moody's Corporation, the owner of Moody's, attributed a 2% increase in revenues at Moody's from the previous fiscal year to robust rated issuance volumes for high-yield corporate debt and bank loans as well as for public finance-related activity in the second half of 2016. Moody's Corporation further attributed the increase in revenue to changes in the mix of fee type, new fee initiatives, and pricing increases. Moody's Corporation notes that the increases were mostly offset by challenges in corporate debt sectors and lower U.S. securitization activity in the first half of 2016.³⁷
- S&P Global Inc. ("S&P Global"), which is S&P's parent company, indicated that revenue at S&P increased by 4% compared to its 2015 results and attributed the increase primarily to an increase in U.S. bank loan ratings revenue, corporate bond ratings revenue, and surveillance fees. S&P Global also noted that the increase in revenue was tempered by unfavorable foreign exchange rates, a decrease in structured finance revenue, and a decline in the provision of assessments of the potential credit impact of proposed strategic initiatives.³⁸
- Fimalac, S.A., an equity investor in Fitch's parent, Fitch Group, Inc. ("Fitch Group"), discussed an increase in revenue at Fitch Group in 2016, compared to 2015, noting that the ratings business saw satisfactory revenue trends across most asset classes, led by an increase in issuances, a rise in demand for Fitch's credit opinions, and business development efforts worldwide.³⁹
- Morningstar's parent company, Morningstar, Inc., noted negative trends in issuance volume for commercial mortgage-backed securities and competitive conditions when discussing a decrease in revenue at Morningstar in 2016.⁴⁰

More recent regulatory filings have indicated a growth in revenue in the first half of 2017. According to quarterly regulatory filings of their parent companies, revenues at each of Moody's and S&P increased by 18% during the first half of 2017, as compared to the first half of 2016.⁴¹ S&P Global indicated that the increase at S&P was primarily due to growth in corporate bond and bank loan ratings revenue, as well as increased structured finance revenue driven by an increase

³⁷ See Moody's Corporation Annual Report on Form 10-K for the year ended December 31, 2016, available at: <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001059556/795d327d-c6b9-48dd-8437-d82865accb86.pdf>.

³⁸ See S&P Global Inc. Annual Report on Form 10-K for the year ended December 31, 2016, available at: <http://investor.spglobal.com/Cache/38247824.PDF?O=PDF&T=&Y=&D=&FID=38247824&iid=4023623>.

³⁹ See Fimalac 2016 Annual Report, available at: http://www.fimalac.com/items/files/f5ecf37beb048fc109c9b760808cb432_FIMALAC--Rapport-annuel---exercice-2016-english-version.pdf.

⁴⁰ See Morningstar, Inc. Annual Report on Form 10-K for the year ended December 31, 2016, available at: <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001289419/3e16b6dc-63fc-41d4-9289-f551ba967060.pdf>.

⁴¹ See Moody's Corporation Quarterly Report on Form 10-Q, for the period ending June 30, 2017, available at: <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001059556/7bd33772-624b-40e9-ad7e-67d24563b419.pdf>; S&P Global Inc. Quarterly Report on Form 10-Q, for the period ending June 30, 2017, available at: <http://investor.spglobal.com/Cache/389638175.pdf>.

in collateralized loan obligation (“CLO”) and commercial mortgage-backed securities issuance in the United States.⁴² Moody’s Corporation also highlighted robust activity in the bank loan and high-yield corporate debt sectors when discussing the revenue increase at Moody’s, while noting that the comparison was to a weak prior year period.⁴³ Quarterly reports filed by Morningstar, Inc. indicated that revenue at Morningstar was down slightly in the first quarter of 2017 but had increased during the second quarter of 2017, in each case as compared to the corresponding three-month period in 2016.⁴⁴

B. Recent Developments in the State of Competition among NRSROs

1. Market Share Developments in the Asset-Backed Securities Rating Category

As noted in Section IV.A.1.(a) of this Report, the number of ratings recently issued by NRSROs may give a clearer picture of competition than the number of ratings each NRSRO currently has outstanding. For example, Chart 2 indicates that, as of December 31, 2016, the smaller NRSROs (i.e., those other than S&P, Moody’s, and Fitch) collectively have 12.5% of the ratings outstanding in the asset-backed securities rating category. However, the market share data discussed in Sections (a) and (b) below show that higher market share percentages have been obtained by smaller NRSROs in ratings issuance with respect to certain types of asset-backed securities. This market share data indicates that the growth trend the Staff has observed since the 2012 Annual Report continued during the Report Period for some smaller NRSROs in the asset-backed securities rating category.

Sections (a) and (b) below discuss NRSRO market share information with respect to certain asset-backed securities, as reported on the Commercial Mortgage Alert and Asset-Backed Alert websites.⁴⁵ Commercial Mortgage Alert and Asset-Backed Alert report market share information on three categories of asset-backed securities: (i) the CMBS category is comprised of transactions collateralized by mortgages or leases on commercial or multi-family income-producing properties;⁴⁶ (ii) the MBS category is comprised of securities secured by U.S. first-lien mortgages on residential properties (excluding Fannie Mae and Freddie Mac issues);⁴⁷ and (iii) the ABS category is comprised

⁴² See S&P Global Inc. Quarterly Report on Form 10-Q, for the period ending June 30, 2017, available at: <http://investor.spglobal.com/Cache/389638175.pdf>.

⁴³ See Moody’s Corporation Quarterly Report on Form 10-Q, for the period ending June 30, 2017, available at: <http://d18m0p25nwr6d.cloudfront.net/CIK-0001059556/7bd33772-624b-40e9-ad7e-67d24563b419.pdf>.

⁴⁴ See Morningstar, Inc. Quarterly Report on Form 10-Q for the period ending March 31, 2017, available at: <http://files.shareholder.com/downloads/MORN/4967152599x0xS1289419-17-13/1289419/filing.pdf>; Morningstar, Inc. Quarterly Report on Form 10-Q for the period ending June 30, 2017, available at: <http://files.shareholder.com/downloads/MORN/4967152599x0xS1289419-17-65/1289419/filing.pdf>.

⁴⁵ See <https://www.abalert.com/> and <https://www.cmalert.com/>. Although the information available on these websites may provide insight into recent developments regarding the state of competition among NRSROs in the asset-backed securities rating category, it has certain limitations. For instance, the information is self-reported by NRSROs. In addition, the information is presented using the number of transactions with respect to which an NRSRO has reported issuing a credit rating and the aggregate dollar amount thereof, rather than indicating where an NRSRO may have rated fewer than all tranches of a particular transaction.

⁴⁶ See https://www.cmalert.com/market/about_db.pl.

⁴⁷ See https://www.abalert.com/market/about_db.pl.

of securities that are collateralized by assets of some kind (excluding CMBS, MBS, Fannie Mae and Freddie Mac issues, issuances by municipalities (i.e., revenue bonds), tax exempt issues, issues that are fully retained by an affiliate of the deal sponsor, commercial paper, and other continuously offered securities such as medium-term notes).⁴⁸

(a) CMBS

Charts 8 through 10 provide information concerning U.S.⁴⁹ CMBS ratings by NRSROs, as reported to Commercial Mortgage Alert.⁵⁰ NRSRO market share varies between the conduit CMBS and single borrower CMBS segments,⁵¹ the two segments that account for most of the U.S. CMBS transactions rated by NRSROs. The charts include reported market share information for total U.S. CMBS transactions,⁵² U.S. conduit CMBS transactions, and U.S. single borrower CMBS transactions for calendar year 2015, calendar year 2016, and the first half of calendar year 2017.

Chart 8: Rating Agency Market Share for Total U.S. CMBS Issued in 2015, 2016, and First Half of 2017*										
1H 2017 Rank	NRSRO	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)	2015 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Fitch	25,441.0	33	65.6	53,161.7	72	70.0	55,720.2	67	55.2
2	Moody's	25,414.2	29	65.6	57,344.0	73	75.5	71,525.7	77	70.8
3	KBRA	18,510.5	26	47.8	36,280.7	51	47.7	58,557.6	70	58.0
4	S&P	14,942.8	26	38.5	19,255.7	41	25.3	25,900.9	43	25.6
5	DBRS	11,860.1	16	30.6	17,549.1	26	23.1	28,429.5	35	28.1
6	Morningstar	3,941.0	8	10.2	14,516.6	27	19.1	44,179.0	56	43.7
	Total Rated Market	38,764.2	79		75,997.3	166		101,008.5	160	

Source: <https://www.cmalert.com/rankings.pl?Q=78>

⁴⁸ See id.

⁴⁹ References to “U.S.” CMBS, MBS, and ABS issuance and market shares in this Section IV.B.1. reflect securities issued for sale primarily in the U.S., which include securities issued publicly and those issued under Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”). See https://www.abalert.com/market/about_db.pl; https://www.cmalert.com/market/about_db.pl.

⁵⁰ The charts reflect market share percentages based on dollar amounts of issuance. The market shares of individual NRSROs do not add up to 100% since more than one NRSRO may rate a particular transaction or obligor. CMBS market share data is from the Commercial Mortgage Alert, available at: <https://www.cmalert.com/rankings.pl?Q=78>.

⁵¹ The term “conduit,” which had been previously referred to by Asset-Backed Alert as “conduit /fusion,” refers to a financial intermediary that functions as a link, or conduit, between the lender(s) originating loans and the ultimate investor(s). The conduit makes loans to, or purchases loans from, third parties under standardized terms, underwriting, and documents and then, when sufficient volume has been accumulated, pools the loans for sale to investors in the CMBS market. See http://www.crefc.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Glossary.pdf. In contrast, a single borrower transaction includes commercial mortgage loans made to a single borrower.

⁵² Total U.S. CMBS ratings include conduit CMBS, single-borrower CMBS, and other types of CMBS, such as distressed/non-performing CMBS transactions and re-securitizations of CMBS transactions.

Chart 9: Rating Agency Market Share for U.S. Conduit CMBS Issued in 2015, 2016, and First Half of 2017*										
1H 2017 Rank	NRSRO	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)	2015 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Moody's	21,482.8	23	100.0	48,017.1	57	100.0	62,118.7	60	100.0
1	Fitch	21,482.8	23	100.0	46,388.8	54	96.6	39,001.9	38	62.8
3	KBRA	11,482.3	12	53.4	30,390.3	35	63.3	45,093.4	43	72.6
4	DBRS	9,821.6	11	45.7	13,755.6	17	28.6	23,769.3	22	38.3
5	S&P	3,701.2	4	17.2	4,679.6	5	9.7	0.0	0	0.0
6	Morningstar	1,061.9	1	4.9	6,443.1	8	13.4	27,568.4	26	44.4
	Total Rated Market	21,482.8	23		48,017.1	57		62,118.7	60	

Source: <https://www.cmalert.com/rankings.pl?Q=78>

Chart 10: Rating Agency Market Share for U.S. Single Borrower CMBS Issued in 2015, 2016, and First Half of 2017*										
1H 2017 Rank	NRSRO	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)	2015 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	S&P	9,040.6	17	73.2	12,697.0	30	65.6	24,285.2	40	79.1
2	KBRA	5,868.6	9	47.5	4,598.7	10	23.7	10,171.7	15	33.1
3	Moody's	3,587.0	4	29.1	8,558.9	13	44.2	7,012.0	9	22.8
4	Fitch	3,035.0	4	24.6	4,229.8	6	21.8	13,977.6	19	45.5
5	Morningstar	2,502.0	5	20.3	6,944.3	14	35.9	14,560.9	25	47.4
6	DBRS	1,645.0	3	13.3	3,025.5	6	15.6	3,378.6	8	11.0
	Total Rated Market	12,347.6	22		19,369.0	39		30,690.7	51	

Source: <https://www.cmalert.com/rankings.pl?Q=78>

* Charts 8-10 reflect market share percentages based on dollar amounts of issuance. The market shares of individual NRSROs do not add up to 100% since more than one NRSRO may rate a particular transaction or obligor.

As the charts above indicate, some of the smaller NRSROs continue to report significant market shares in rating U.S. CMBS transactions. In both 2016 and the first half of 2017, KBRA achieved the third highest U.S. CMBS market share of all NRSROs, rating close to half of the transaction volume in each such period. In the first half of 2017, KBRA rated more than half of the U.S. conduit CMBS transactions and increased its market share in the U.S. single borrower CMBS segment to 47.5%, approximately doubling its 2016 market share and moving from fourth to second in the market share rankings for this segment. DBRS increased its overall U.S. CMBS market share in the first half of 2017 to 30.6%. Such increase was largely attributable to its performance in the U.S. conduit CMBS segment, in which it finished fourth in the rankings, rating 45.7% of conduit issuances in the first half of 2017.

(b) ABS/MBS

Charts 11 and 12 provide information concerning U.S. ABS and U.S. MBS ratings by NRSROs.

Chart 11: Rating Agency Market Shares for U.S. ABS Issued in 2015, 2016, and First Half of 2017*										
1H 2017 Rank	NRSRO	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)	2015 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Fitch	84,896.4	108	60.4	122,580.6	159	55.5	115,754.1	169	54.2
2	S&P	80,799.6	120	57.5	125,032.7	201	56.6	128,625.1	212	60.3
3	Moody's	71,187.6	95	50.6	119,272.8	169	54.0	123,523.4	182	57.9
4	DBRS	28,826.3	62	20.5	46,750.6	118	21.2	44,842.6	97	21.0
5	KBRA	23,261.2	57	16.5	38,145.2	100	17.3	21,572.0	63	10.1
6	Morningstar	4,783.9	9	3.4	7,921.2	23	3.6	7,317.8	16	3.4
7	A.M. Best	0.0	0	0.0	0.0	0	0.0	115.0	1	0.1
	Total Rated Market	140,574.0	226		220,949.7	393		213,421.4	380	

Source: <https://www.abalert.com/rankings.pl?Q=102>

Chart 12: Rating Agency Market Shares for U.S. MBS Issued in 2015, 2016, and First Half of 2017*										
1H 2017 Rank	NRSRO	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)	2015 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Moody's	4,465.3	9	54.7	5,279.6	16	63.6	7,266.5	21	23.6
2	DBRS	4,445.3	7	54.5	3,245.9	10	39.1	20,921.3	76	67.8
3	KBRA	3,713.7	7	45.5	3,008.4	9	36.2	6,890.5	22	22.3
4	S&P	2,085.8	3	25.6	1,216.0	4	14.6	3,370.6	10	10.9
5	Fitch	1,540.8	2	18.9	3,478.4	12	41.9	7,614.3	26	24.7
6	Morningstar	0.0	0	0.0	585.6	4	7.1	4,585.5	9	14.9
	Total Rated Market	8,159.0	14		8,300.5	29		30,842.9	103	

Source: <https://www.abalert.com/rankings.pl?Q=102>

* Charts 11 and 12 reflect market share percentages based on dollar amounts of issuance. The market shares of individual NRSROs do not add up to 100% since more than one NRSRO may rate a particular transaction or obligor.

Chart 11 shows that smaller NRSROs, in particular DBRS and KBRA, appear to have built significant market share rating U.S. ABS.⁵³ DBRS has consistently obtained a market share of over 20% in each of 2015, 2016, and the first half of 2017, and KBRA has increased its share of the market from 10.1% in 2015 to 17.3% in 2016 and 16.5% in the first half of 2017. Also of note, Fitch for the first time achieved the highest market share for U.S. ABS transactions in the first half of 2017. In prior periods, either Moody's or S&P had the highest market share.

Chart 12 shows reported NRSRO market share information for the U.S. MBS category. Although issuance volume remains low in this category, DBRS and KBRA continue to claim a large portion of the market, with the second and third highest market shares in the first half of 2017. In fact, DBRS's first half market share was only 0.2% less than Moody's (the latter having the highest market share in U.S. MBS in the same period). Both DBRS and KBRA issued ratings with respect to half the U.S. MBS transactions issued in the first half of 2017, each rating seven transactions, as compared to nine transactions for Moody's. KBRA has increased its percentage share of the market since 2015, when it rated 22.3% of the MBS issuances for that year. Its share of 2016 U.S. MBS issuances increased to 36.2%, and its share of U.S. MBS issuances in the first half of 2017 increased further to 45.5%.

2. Other NRSRO Developments⁵⁴

As described in Section IV.B.1. of this Report, some of the smaller NRSROs have reported success in gaining market share in the asset-backed securities rating category. In particular, these NRSROs have had success rating asset-backed securities backed by newer or unique asset types, commonly referred to as "esoteric" asset-backed securities.

Smaller NRSROs are significant raters of one of the largest segments of the esoteric asset-backed securities market—marketplace lending securitizations. According to certain published research, DBRS and KBRA are the most active rating agencies for marketplace lending transactions.⁵⁵ DBRS has issued the highest number of ratings of all NRSROs in the student loan category, having issued credit ratings for 45.1% of all such rated issuances through the end of the Report Period, including all but one of the twelve student loan transactions issued during the Report Period.⁵⁶ KBRA has rated 52.7% of all rated ABS issuances in the consumer loan category through the end of the Report Period, and DBRS has rated 22.1% of such issuances through the end of the Report Period.⁵⁷ KBRA rated all the consumer loan transactions issued during the Report Period.⁵⁸

⁵³ See Section IV.B.2. of this Report for a discussion of specific ABS asset classes where the smaller NRSROs have reported success in gaining market share.

⁵⁴ Unless noted otherwise, all market share percentages in this Section IV.B.2. are based on dollar amounts of issuance.

⁵⁵ See Marketplace Lending Securitization Tracker Q2 2017, PeerIQ, available at: <http://www.peeriq.com/research/>.

⁵⁶ Id. Cumulative market share information is based on Exhibit 8 in the cited research, and observations regarding the Report Period are based on information in the appendix to the cited research, which lists all marketplace lending securitizations to date.

⁵⁷ Id.

⁵⁸ Id.

Another active segment of the esoteric asset-backed securities market is securitizations backed by property assessed clean energy (PACE) assessments.⁵⁹ Through the end of the Report Period, ratings of securities in this segment have been issued exclusively by smaller NRSROs.⁶⁰ KBRA and DBRS are the most active NRSROs rating PACE securitizations, and Morningstar has recently begun rating these transactions as well.⁶¹ PACE securitizations are a type of “green bond,” which is broadly projected to be an area of issuance growth across corporate issuers, government issuers, and financial institutions, as well as issuers of asset-backed securities.⁶²

Single family rental securitizations are predominately rated by three NRSROs, including two smaller NRSROs. During the Report Period, issuers priced ten rated single family rental securitizations with an aggregate principal amount of \$4.0 billion. Of these deals, Morningstar issued ratings on all of them and KBRA issued ratings on 77.1% of them.⁶³

A final example of market share gains achieved by smaller NRSROs rating esoteric asset-backed securities is KBRA’s performance rating securitizations backed by aircraft-lease receivables. According to the Asset-Backed Alert database, KBRA has rated approximately 78% of all such transactions (through the first half of 2017) since it began rating this type of asset-backed security in 2013, including all of the aircraft-lease receivable transactions completed in 2016 and the first half of 2017.⁶⁴

Smaller NRSROs have also been able to gain market share in rating more traditional types of asset-backed securities. Beyond the MBS and CMBS categories discussed in Section IV.B.1. of this Report, DBRS has gained the largest market share among the smaller NRSROs with respect to traditional asset-backed securities. For example, DBRS rated 64.2% of the transactions backed by student loans that priced during the Report Period, which was the second highest market share among

⁵⁹ According to the database maintained by Asset-Backed Alert, eleven PACE asset-backed securities transactions totaling \$1.8 billion priced during the Report Period.

⁶⁰ See Asset-Backed Alert database.

⁶¹ The Asset-Backed Alert database indicates that KBRA, DBRS, and Morningstar rated 87.7%, 71.4%, and 34.1%, respectively, of the transactions priced during the Report Period. The database shows that Morningstar first rated a PACE securitization in October 2016.

⁶² See Beyond Green Bonds: Sustainable Finance Comes of Age, S&P Global Market Intelligence, April 26, 2017, available at: https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1837902&SctArtId=423549&from=CM&nsl_code=LIME&sourceObjectId=10049685&sourceRevId=2&fee_ind=N&exp_date=20270426-14:09:23; Global green bond issuance could rise to USD206B in 2017 after record in 2016, Moody’s Investors Service, January 18, 2017, available at https://www.moody.com/research/Moodys-Global-green-bond-issuance-could-rise-to-USD206B-in--PR_360880. Specifically with respect to PACE securitizations, the Asset-Backed Alert database shows a significant growth in issuance in recent years. In 2014, there were two transactions totaling approximately \$233 million; in 2015, there were four transactions totaling approximately \$651 million; and in 2016, there were eleven transactions totaling approximately \$1.8 billion. In the first half of 2017, there were three transactions totaling approximately \$662 million.

⁶³ See Asset-Backed Alert database.

⁶⁴ See id. The Asset-Backed Alert database indicates that eleven aircraft lease receivable transactions totaling \$5.9 billion priced during the period beginning on January 1, 2016 and ending on June 30, 2017.

all NRSROs during this period.⁶⁵ DBRS also rated a sizable minority of two of the largest asset-backed securities asset classes, prime auto loan and credit card transactions.⁶⁶ DBRS rated 13.4% and 15.9% of the prime auto loan asset-backed securities and credit card asset-backed securities, respectively, priced during the Report Period.⁶⁷

In addition to DBRS, other smaller NRSROs continue to pursue expansion in more traditional types of asset-backed securities. For example, Morningstar issued its first credit rating with respect to a CLO transaction in November 2016 and issued credit ratings with respect to seven CLO transactions that closed during the Report Period.⁶⁸ Also during the Report Period, KBRA has focused on efforts to expand into more traditional types of asset-backed securities, such as prime auto loans and credit card securitizations.⁶⁹

Smaller NRSROs continue to pursue opportunities in rating categories other than asset-backed securities as well. For example, as discussed in Section II. of this Report, Morningstar and HR Ratings registered as NRSROs in the financial institutions and corporate issuers rating categories during the Report Period. The introduction of Morningstar and HR Ratings operating as NRSROs in these rating categories may give market participants more sources of credit opinions and could present market share opportunities for the NRSROs so registered; however, it may take several years before the effects on competition can be fully observed. In addition, DBRS announced during the Report Period plans to expand its ratings coverage of non-bank financial institutions.⁷⁰ As discussed above, DBRS is one of the most active NRSROs with respect to credit ratings of marketplace lending securitizations. DBRS indicated that increased coverage of the sponsors of these transactions on the corporate side could further enhance its position rating individual structured product transactions.⁷¹ Another example from the Report Period is KBRA's announcement that it hired a Senior Director of

⁶⁵ See id. The Asset-Backed Alert database shows that Moody's rated 79.0% of the student loan transactions priced during the Report Period.

⁶⁶ The Asset-Backed Alert database lists 87 prime auto loan transactions totaling \$67.4 billion and 66 credit card transactions totaling \$51.2 billion during the Report Period. These are the third and fourth largest asset classes shown on the database, behind only CLOs and non-U.S. residential loans.

⁶⁷ See Asset-Backed Alert database. DBRS also rates other auto-related asset-backed securities. During the Report Period, DBRS rated 36.2% of the auto-fleet lease transactions, 30.6% of the subprime auto loan transactions, 18.5% of the auto lease transactions, and 10.7% of the floorplan loan transactions. See id.

⁶⁸ See <https://ratingagency.morningstar.com/mcr/ratings-surveillance/structured-finance> (listing rated structured finance transactions and providing links to more detailed information). See also Glen Fest, Morningstar Adds CLO Ratings to Structured Finance Menu, Asset Securitization Report, November 15, 2016. Such ratings were determined in accordance with Morningstar's U.S. Asset-Backed Securitization General Ratings Methodology. Morningstar has since adopted a methodology specific to U.S. CLOs. See U.S. CLO Ratings Methodology, Morningstar Credit Ratings, LLC, October 2017, available at: <https://ratingagency.morningstar.com/PublicDocDisplay.aspx?i=6B9mipsY8sY%3d&m=i0Pyc%2bx7qZZ4%2bsXnymazBA%3d%3d&s=LviRtUKXqs8kml5dHt7FTEe2SZmY0Fvqd4iX49Mk%2f9UapyiFTEO6TA%3d%3d>.

⁶⁹ See Fitch's Dean to Aid Kroll's Growth Effort, Asset-Backed Alert, May 12, 2017.

⁷⁰ See DBRS Announces Plans to Expand Coverage within the Non-Bank Financial Institution Sector, September 19, 2016, available at: <https://www.dbrs.com/research/299535/dbrs-announces-plans-to-expand-coverage-within-the-non-bank-financial-institution-sector.html>.

⁷¹ See id.

Insurance Business Development, to “further solidif[y] [its] commitment to provide a dependable rating alternative to the insurance industry.”⁷²

Efforts by smaller NRSROs to grow their businesses across rating categories, such as those discussed above, may benefit from the broader acceptance of NRSROs in the investment guidelines of institutional investors, as discussed in Section IV.C. of this Report.

C. Barriers to Entry

Despite the notable progress made by smaller NRSROs in gaining market share in some types of asset-backed securities over the past few years (see Section IV.B. of this Report), barriers to entry continue to exist in the credit ratings industry, presenting competitive challenges for the smaller NRSROs.⁷³

There have, however, been reports of progress with respect to one such barrier—minimum ratings requirements that specify use of the ratings of particular rating agencies (traditionally, one or more of the larger NRSROs) in the investment management contracts of institutional fund managers and the investment guidelines of fixed income mutual fund managers, pension plan sponsors, and endowment fund managers.⁷⁴ The effect of these requirements can be to increase the demand and liquidity for securities bearing the ratings of the specified rating agencies.⁷⁵

An article published during the Report Period indicates that investors are increasingly changing their guidelines to allow for investments in securities rated by a wider group of NRSROs.⁷⁶ The article discusses efforts by Fitch and certain smaller NRSROs to encourage investors to expand their guidelines. For example, smaller NRSROs have asserted that expansion would give investors the flexibility to invest in asset classes (including certain types of esoteric asset-backed securities) that may not typically carry credit ratings from the larger NRSROs.⁷⁷ Although the article reports that headway has been made in alleviating this barrier to entry, it also notes that challenges persist.

⁷² Kroll Bond Rating Agency Announces Addition of Tina Bukow as Senior Director of Insurance Business Development, January 18, 2017, available at: <https://www.krollbondratings.com/announcements/3256>.

⁷³ See Shankar Ramakrishnan and Philip Scipio, Big three in credit ratings still dominate business, May 4, 2016, available at: <http://www.reuters.com/article/uscorpbonds-ratings-idUSL2N17U1L4>.

⁷⁴ See letter from KBRA to the Commission, dated August 19, 2014, available at: <http://www.sec.gov/comments/s7-18-11/s71811-88.pdf>. This barrier to entry was also mentioned during the SEC’s Credit Ratings Roundtable held on May 14, 2013. At the roundtable, a representative of Morningstar mentioned that, according to a study conducted by Morningstar, approximately 42% of the fixed income funds have investment guidelines referring to ratings of S&P, Moody’s, or a “major NRSRO.” See Credit Rating Roundtable, May 14, 2013, available at: <http://www.sec.gov/spotlight/credit-ratings-roundtable.shtml>.

⁷⁵ The effect of including particular NRSROs in investment guidelines was highlighted in a past article concerning a loan securitization. In the article, an issuer referred to the fact that many institutional buyers are limited to purchasing securities rated by one of the larger NRSROs, and that a larger NRSRO’s rating expanded the number of entities which could purchase the rated securities. See Tracy Alloway, Peer-to-Peer Lender Wins Landmark Rating, Fin. Times, July 10, 2014 at Companies and Markets, p. 18.

⁷⁶ Big Investors Accept More Rating Agencies, Asset-Backed Alert, May 19, 2017.

⁷⁷ See Section IV.B.2. of this Report for a discussion of certain esoteric asset classes commonly rated by certain smaller NRSROs.

A related barrier to entry is the inclusion requirements of some fixed income indices. To be included in many of these indices, securities must be rated by specific NRSROs.⁷⁸ During the Report Period, certain smaller NRSROs have reportedly advocated for the broadening of NRSROs in the inclusion requirements of the Bloomberg Barclays U.S. Aggregate Index, an index tracked by fixed income portfolios maintained by many large asset managers.⁷⁹

Market participants and academics have identified various other barriers to entry in the credit rating industry, including economic and regulatory barriers.⁸⁰ Among the regulatory barriers to entry for NRSROs are the costs associated with complying with the statutory provisions implemented by the Rating Agency Act and the Dodd-Frank Act and the related rules adopted by the Commission, including the rules and rule amendments that the Commission adopted pursuant to the Dodd-Frank Act (the “NRSRO Amendments”).⁸¹ Commenters on the proposed NRSRO Amendments expressed concerns that certain of the requirements would be burdensome for smaller NRSROs to implement and could raise barriers to entry for credit rating agencies that seek to register as NRSROs.⁸² In connection with the NRSRO Amendments, the Commission acknowledged that, despite efforts to limit the impact on small entities, the Dodd-Frank Act contained requirements, including those implemented by the NRSRO Amendments, which impose costs on NRSROs and may consequently create barriers to entry and have negative impacts on competition.⁸³ As discussed in more detail in a prior Annual Report, the NRSRO Amendments as adopted by the Commission include various changes intended to address concerns regarding barriers to entry, including standards allowing NRSROs to tailor particular requirements to their business models, size, and rating methodologies.⁸⁴

V. TRANSPARENCY

Congress described the Rating Agency Act as an act to improve ratings quality “by fostering accountability, transparency, and competition in the credit rating agency industry.”⁸⁵ Section 932 of the Dodd-Frank Act is entitled “Enhanced regulation, accountability, and transparency of NRSROs.” Both Acts contain various provisions designed to increase the

⁷⁸ For example, the rules for inclusion in the Bloomberg Barclays U.S. Aggregate Index specify that securities must be rated investment grade using the middle rating of Moody’s, S&P, and Fitch. See US Aggregate Index, available at: <https://www.bbhub.io/indices/sites/2/2016/08/2017-02-08-Factsheet-US-Aggregate.pdf>.

⁷⁹ Rating Firms Seek Changes to Index, Asset-Backed Alert, May 26, 2017.

⁸⁰ See, e.g., Section IV.C. of the March 2012 Annual Report, available at: <https://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0312.pdf>.

⁸¹ See Nationally Recognized Statistical Rating Organizations, Release No. 34-72936 (Aug. 27, 2014), 79 FR 55077 (Sept. 15, 2014) (“Adopting Release”).

⁸² See Adopting Release, 79 FR at 55090, 55154, 55161, and 55254-55. See also comment letters received with respect to the NRSRO Amendments as proposed, available at: <http://www.sec.gov/comments/s7-18-11/s71811.shtml>.

⁸³ See Adopting Release, 79 FR at 55254.

⁸⁴ See id. Section IV.C. of the December 2015 Annual Report, available at: <https://www.sec.gov/ocr/reportspubs/annual-reports/2015-annual-report-on-nrsros.pdf>.

⁸⁵ See the preamble to the Rating Agency Act.

transparency—through clear disclosure open to public scrutiny—of, among other things, NRSROs’ credit rating procedures and methodologies, business practices, and credit ratings performance.

The NRSRO Amendments improved and expanded the disclosure requirements applicable to NRSROs. Additional sources of information that can be beneficial to investors and others are required to be made publicly available under the NRSRO Amendments. These requirements are designed to enhance the transparency of NRSRO credit ratings by reducing information asymmetries that may adversely affect users of credit ratings.⁸⁶ Specifically, under the NRSRO Amendments, NRSROs must disclose:

- (1) standardized performance statistics;⁸⁷
- (2) consolidated and increased information about credit rating histories;⁸⁸
- (3) information about material changes and significant errors in the procedures and methodologies used to determine credit ratings;⁸⁹
- (4) information about specific rating actions;⁹⁰ and
- (5) clear definitions of each symbol, number, or score in the rating scale used by the NRSRO.⁹¹

An objective of these requirements is to improve the information provided to users of credit ratings in order to facilitate external scrutiny of NRSRO activities, enable ratings users to make more informed investment and credit-related decisions and allow users to compare the performance of credit ratings by different NRSROs.⁹²

In accordance with the NRSRO Amendments, each NRSRO must disclose certain information in connection with each rating action it takes.⁹³ Such information includes, among other things, the version of the procedure or methodology used to determine the credit rating, a description of the types of data that were relied upon for purposes of determining the credit rating, an assessment of the quality of information available and considered in determining the credit rating, and information on the sensitivity of the credit ratings to assumptions made by the NRSRO.⁹⁴ These requirements are designed to promote transparency of the process for determining credit rating actions, allowing users of credit ratings to better understand how credit ratings are produced and the information content of credit ratings, including how these factors vary across NRSROs.⁹⁵

⁸⁶ See Adopting Release, 79 FR at 55091.

⁸⁷ See Instructions for Exhibit 1 to Form NRSRO; Adopting Release, 79 FR at 55295-302.

⁸⁸ See Rule 17g-7(b); Adopting Release, 79 FR at 55266-67.

⁸⁹ See Rule 17g-8(a)(4); Adopting Release, 79 FR at 55267-68.

⁹⁰ See Rule 17g-7(a); Adopting Release, 79 FR at 55264-66.

⁹¹ See Rule 17g-8(b)(2); Adopting Release, 79 FR at 55268.

⁹² See Adopting Release, 79 FR at 55091.

⁹³ See Rule 17g-7(a).

⁹⁴ See Rule 17g-7(a)(1)(ii).

⁹⁵ See Adopting Release, 79 FR at 55180.

In addition to the disclosures required by rule, NRSROs often issue press releases and reports at the time of a rating action to describe the rationale behind such rating action,⁹⁶ and make versions of the methodologies for determining credit ratings available on their websites. The availability of the underlying methodologies, together with a report discussing the analysis supporting a rating action, provides additional transparency into the credit rating process.

Some NRSROs also offer access on a subscription basis to tools that may provide further insight into their credit ratings. For example, during the Report Period, Fitch announced the launch of its Resi Investor tool, which allows investors to conduct analysis on the underlying loans in rated RMBS transactions, such as by calculating their own expected losses and model-implied ratings outcomes.⁹⁷ Fitch noted in its announcement that this product “provides detailed insight into the factors behind the rating and allows investors to better understand how Fitch determines its ratings.”⁹⁸ A.M. Best sells access to the model it uses to calculate a capital adequacy ratio, allowing subscribers to make their own assumptions and assess the impact of various scenarios using the same tool utilized by A.M. Best’s credit analysts.⁹⁹ Other NRSROs may offer similar tools.

Beyond the disclosures required under Section 15E and the related Commission rules, and information otherwise made available by NRSROs with respect to their credit ratings, transparency may be increased if NRSROs that are not hired to rate a security publish their views of the credit quality of such a security, such as by issuing an unsolicited rating or publishing unsolicited commentaries.

During the Report Period, several NRSROs published commentaries and research in which they express their viewpoints on particular securities, ratings, or asset classes. For example, Moody’s published research comparing the characteristics of the subprime auto loans underlying asset-backed securities issued by the two largest issuers in this asset class.¹⁰⁰ The research utilized loan-by-loan data made available in accordance with Regulation AB under the Securities Act¹⁰¹ to identify a number of potential contributors to the higher historical losses in the loan pools of one such issuer.

⁹⁶ The reports accompanying a rating action are frequently available on a paid subscription basis, although some NRSROs provide access to such reports for free.

⁹⁷ Fitch Ratings Launches “Resi Investor” Toll for RMBS Market, Fitch Ratings, October 13, 2016, available at: <https://www.fitchratings.com/site/pr/1013050>.

⁹⁸ Id.

⁹⁹ See Best’s Capital Adequacy Ratio Model – Universal, A.M. Best, available at: <http://www.ambest.com/sales/bcaru/productbrochure.pdf>; Best’s Capital Adequacy Ratio Adjustment System, A.M. Best, available at: <http://www.ambest.com/sales/BCARSystem/brochure.pdf>.

¹⁰⁰ Announcement: Moody’s: Reg AB II data may shed light on differing performance of US subprime auto ABS issuers, Global Credit Research, Moody’s Investors Service, May 17, 2017, available at: https://www.moodys.com/research/Moodys-Reg-AB-II-data-may-shed-light-on-differing--PR_366915. See Matt Scully, Auto Lender Santander Checked Income on Just 8% in Subprime ABS, May 22, 2017, available at: <https://www.bloomberg.com/news/articles/2017-05-22/subprime-auto-giant-checked-income-on-just-8-of-loans-in-abs>.

¹⁰¹ 17 CFR 229.1100 et seq. Beginning on November 23, 2016, issuers of residential mortgage-backed securities, commercial mortgage-backed securities, auto loan asset-backed securities, auto lease asset-backed securities and debt security asset-backed securities (and securitizations of such asset-backed securities) were required to begin filing asset-level data with the Commission on EDGAR.

DBRS has also used data made available in accordance with Regulation AB to develop a monthly report that provides an aggregate overview and loan-level detail with respect to loans underlying public U.S. auto loan asset-backed securities.¹⁰² The report is designed to provide insight into the newly available loan-by-loan data and to make it easier for market participants to compare pools of auto loans.¹⁰³

NRSROs also published commentaries and research during the Report Period that highlighted differences of opinion they may have with other NRSROs. For instance, KBRA published a research piece regarding financial guarantors in which it expressed the view that “bond insurance financial strength ratings should be heavily focused on an assessment of the likelihood a financial guarantor will meet all its obligations to policyholders when claims come due.”¹⁰⁴ KBRA contrasted its approach with the “overly prescriptive criteria” of other rating agencies that, according to KBRA, may overemphasize the market position and future growth of the rated financial guarantors.¹⁰⁵

Another example from the Report Period is Morningstar’s commentary regarding CLO combination notes.¹⁰⁶ In that commentary, Morningstar expressed its view that refinancing risk does not present significant additional credit risk for typical CLO combination notes. Although Morningstar did not contrast its view on CLO combination notes with those of other NRSROs in the commentary, Moody’s, the NRSRO with the largest market share with respect to CLO ratings,¹⁰⁷ had recently updated its methodology for rating CLO combination notes to account for risks associated with potential refinancings.¹⁰⁸

Commentaries and research pieces such as those mentioned above may provide additional insight into the credit characteristics of certain securities or asset types and/or highlight differences in opinions and ratings criteria among NRSROs. This type of information can serve to enhance investors’ understanding of the differences in ratings approaches used by the NRSROs.

¹⁰² DBRS Releases Figures on Automotive Securitization Tapes Report for U.S. Auto Loans, DBRS, September 15, 2017, available at: <http://www.dbrs.com/research/316114/dbrs-releases-figures-on-automotive-securitization-tapes-report-for-u-s-auto-loans.html>.

¹⁰³ Id.

¹⁰⁴ Rating Risk and the Financial Guarantors: Déjà Vu All Over Again, Kroll Bond Rating Agency, Financial Guaranty Research, June 13, 2017, available at: https://www.krollbondratings.com/show_report/6996.

¹⁰⁵ Id.

¹⁰⁶ CLO Commentary, Refinancing Poses Limited Additional Credit Risk to CLO Combinations Notes, Morningstar, February 2017, available at: <https://ratingagency.morningstar.com/PublicDocDisplay.aspx?i=Css8DdoWLRM%3d&m=i0Pyc%2bx7qZZ4%2bsXnymazBA%3d%3d&s=LviRtUKXqs8kml5dHt7FTeE2SZmY0Fvqd4iX49Mk%2f9UapyiFTEO6TA%3d%3d>.

¹⁰⁷ According to the Asset-Backed Alert database, Moody’s rated 93.6% of rated CLO transactions during the Report Period.

¹⁰⁸ See Announcement: Moody’s publishes its updated methodology for rating securities backed by CLO secured debt and equity tranches, Moody’s Investors Service, October, 7, 2016, available at: https://www.moody.com/research/Moody-publishes-its-updated-methodology-for-rating-securities-backed-by-PR_355239.

VI. CONFLICTS OF INTEREST

NRSROs operate under a combination of two business models, and there are potential conflicts of interest inherent in both. Most of the NRSROs, including the largest NRSROs, primarily operate under the “issuer-pay” model, which is subject to a potential conflict in that the credit rating agency may be influenced to determine more favorable (i.e., higher) ratings than warranted in order to retain the obligors or issuers as clients.¹⁰⁹ This conflict could affect an entire asset class if, for example, an NRSRO becomes known for issuing higher credit ratings with respect to such class, resulting in that NRSRO’s retaining or attracting business from most or all issuers of securities in such class.¹¹⁰ The potential for such a conflict to influence the ratings process may be particularly acute with respect to structured finance products, where transactions are arranged by a relatively concentrated group of sponsors, underwriters, and managers, and rating fees are particularly lucrative.¹¹¹

The other business model is the “subscriber-pay” model which means that investors pay the rating agency a subscription fee to access its ratings. This model is also subject to potential conflicts of interest. For example, an NRSRO may be aware that an influential subscriber holds a securities position (long or short) that could be advantaged if a credit rating upgrade or downgrade causes the market value of the security to increase or decrease or that a subscriber invests in newly issued bonds and would obtain higher yields if the bonds were to have lower ratings.

Another example of a conflict in a “subscriber-pay” model is that the NRSRO may be aware that a subscriber wishes to acquire a particular security but is prevented from doing so because the credit rating of the security is lower than internal investment guidelines or an applicable contract permit. An upgrade of the credit rating of the security by the NRSRO could remove this impediment to investing in the security. These potential conflicts could be mitigated

¹⁰⁹ For example, during the Report Period, the U.S. Department of Justice and 21 states and the District of Columbia announced that they had entered into a settlement agreement with Moody’s to resolve certain allegations regarding Moody’s ratings on residential mortgage-backed securities and collateralized debt obligations. The conduct covered by the settlement agreement included statements made by Moody’s concerning the integrity, objectivity, independence, and lack of influence from business concerns in connection with the issuance and maintenance of credit ratings of structured finance instruments. See Justice Department and State Partners Secure Nearly \$864 Million Settlement With Moody’s From Conduct in the Lead up to the Financial Crisis, January 13, 2017, available at: <https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-nearly-864-million-settlement-moody-s-arising>. The U.S. Department of Justice and several states entered into a similar settlement agreement with S&P in 2015. See Justice Department and State Partners Secure \$1.375 Billion Settlement with S&P for Defrauding Investors in the Lead Up to the Financial Crisis, February 3, 2015, available at: <http://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors>.

¹¹⁰ Some authors, however, have written about the effect of reputational concerns on the motivation of rating agencies to provide accurate ratings. See, e.g., Steven L. Schwarcz, Private Ordering of Public Markets: The Rating Agency Paradox, 2002 U. ILL. L. REV. 1 (2002); Harold Cole and Thomas F. Cooley, Rating Agencies, NBER working paper No. 19972 (Mar. 2014).

¹¹¹ A Senate Report related to the Dodd-Frank Act noted, for instance, that conflicts of interest in the process of rating structured financial products contributed to the issuance of inaccurate ratings by rating agencies and, accordingly, to the mismanagement of risks by financial institutions and investors. See S. Report No. 111-176 (2010).

to the extent that an NRSRO has a wide subscriber base and subscribers have different interests with respect to an upgrade or downgrade of a particular security.

Section 15E and the related Commission rules contain provisions addressing conflicts of interest. For example, Rule 17g-5 identifies certain conflicts of interest that are prohibited under all circumstances¹¹² and other conflicts of interest that are prohibited unless an NRSRO has publicly disclosed the existence of the conflict and has implemented policies and procedures reasonably designed to address and manage such conflict.¹¹³ One such flatly prohibited conflict of interest is Rule 17g-5(c)(8), which was added by the NRSRO Amendments. In accordance with this rule, an NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the rating, or developing or approving procedures or methodologies used for determining the rating, also (a) participates in sales or marketing activities of the NRSRO or its affiliate or (b) is influenced by sales or marketing considerations.¹¹⁴

Other statutory provisions and Commission rules address potential conflicts of interest that may arise when a credit analyst seeks employment outside the NRSRO. Each NRSRO is required to have policies and procedures in place to provide for an internal “look-back” review process in order to determine whether any conflict of interest of a former employee influenced a credit rating in certain instances.¹¹⁵ During the Report Period, OCR Staff issued letters to the designated compliance officers of the NRSROs to provide the Staff’s view that an NRSRO’s policies and procedures should provide for a look-back review in those instances where a former analyst participated in determining credit ratings with respect to his or her new employer during the one-year period preceding the most recent rating action taken by the NRSRO prior to the analyst’s departure.¹¹⁶

The annual examinations conducted by Staff in accordance with Section 15E(p) are required to include, among other things, a review of the management of conflicts of interest by the NRSRO and the policies of the NRSRO governing post-employment activities of its former personnel.¹¹⁷ Information regarding the examinations, including any essential findings with respect to these review areas, is included in OCR’s annual examination reports.¹¹⁸

¹¹² See Rule 17g-5(c).

¹¹³ See Rule 17g-5(a)(1)-(2); Rule 17g-5(b); and Form NRSRO, Exhibits 6-7. Additional requirements apply to the “issuer-pay” conflict of interest in the context of credit ratings of asset-backed securities. See Rule 17g-5(a)(3).

¹¹⁴ See Rule 17g-5(c)(8).

¹¹⁵ See Section 15E(h)(4)(A).

¹¹⁶ The content of these letters was also published on the OCR page of the Commission’s website. See “Dear DCO” Letter, July 2016, available at <https://www.sec.gov/about/offices/ocr/dear-dco-letter-15eh4a-071816.pdf>.

¹¹⁷ See Section 15E(p)(3)(B).

¹¹⁸ The examination reports can be found under “Summary Examination Reports” in the “Reports and Studies” section of the OCR webpage, available at <http://www.sec.gov/ocr>.

VII. CONCLUSION

The Staff will continue to conduct its oversight function with respect to NRSROs, including the performance of Staff examinations, and engage in other initiatives with respect to NRSROs.