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**2015 SUMMARY REPORT OF COMMISSION STAFF'S EXAMINATIONS OF  
EACH NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION**

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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.**

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## I. REGULATORY AND NRSRO OVERVIEW

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

### A. Statutory Framework and Rules

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

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

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

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

<sup>3</sup> *See* Sections 17(a) and 17(b) of the Exchange Act.

<sup>4</sup> 15 U.S.C. § 78o-7(c)(2).

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

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

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

The Dodd-Frank Act directed the Commission to adopt rules to implement a number of provisions related to NRSROs. In January 2011, the Commission adopted new Rule 17g-7.<sup>8</sup> 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.<sup>9</sup> These new and amended rules concern NRSROs’ internal control structures, credit rating methodologies, conflicts of interest relating to sales and marketing activities, look-back reviews, disclosure forms and certifications to accompany each credit rating, public disclosures of NRSRO credit rating performance statistics and credit rating histories, Asset-Backed Securities (“ABS”) third-party due diligence providers, and NRSRO standards of training, experience, and competence.

New Rule 17g-2(b)(12), which requires an NRSRO to retain records related to its internal control structure, took effect in November 2014. The Staff’s 2015 examination activities reviewed NRSROs’ compliance with Rule 17g-2(b)(12). Since most of the other new and amended rules took effect on June 15, 2015 (which is after the time period generally covered by the 2015 examinations) the Staff’s 2015 examination activities did not review NRSROs’ compliance with such new and amended rules. However, the Staff did assess all of the NRSROs’ plans to implement the new and amended rules by the June 15, 2015 effective date. This assessment generally included interviewing relevant NRSRO personnel and reviewing action plans or other documentation concerning each NRSRO’s progress in implementing the new rules.

## B. Registered NRSROs

In 2007, following the adoption of its first set of NRSRO rules, the Commission began granting registrations to credit rating agencies that applied to be registered as an NRSRO. A credit rating agency may apply to be registered with respect to one or more of the following five classes of

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

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

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

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

credit ratings: (1) financial institutions, brokers, or dealers (“financial institutions”); (2) insurance companies; (3) corporate issuers; (4) issuers of ABS; and (5) issuers of government securities, municipal securities, or securities issued by a foreign government (“government securities”).<sup>10</sup>

The ten credit rating agencies registered as NRSROs as of December 1, 2015, and dates of their initial registrations are listed below:

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

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

## **II. OFFICE OF CREDIT RATINGS AND EXAMINATION OVERVIEW**

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

Generally, the purpose of NRSRO examinations is to monitor compliance with federal securities laws and rules, identify conduct or insufficient policies and procedures or internal controls that potentially violate such laws and rules, and encourage remedial action. Examinations also serve to inform the Commission and the NRSROs’ compliance personnel of regulatory obligations and

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<sup>10</sup> See Section 3(a)(62)(A) of the Exchange Act.

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

<sup>12</sup> Formerly known as LACE Financial Corp.

<sup>13</sup> Formerly known as Realpoint LLC.

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 ("Enforcement"), which is responsible for further investigation of these potential violations.

Section 15E(p)(3)(A) requires OCR to conduct an examination of each NRSRO at least annually. Section 15E(p)(3)(B) provides that the examination shall include a review of the following eight topic areas ("Section 15E Review Areas"): (i) whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest by the NRSRO; (iii) the implementation of ethics policies by the NRSRO; (iv) the internal supervisory controls of the NRSRO; (v) the governance of the NRSRO; (vi) the activities of the designated compliance officer ("DCO") of the NRSRO; (vii) the processing of complaints by the NRSRO; and (viii) the policies of the NRSRO governing the post-employment activities of its former personnel.

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

## B. Examination Overview

The 2015 examinations generally focused on the NRSROs' activities for the period covering January 1, 2014 through December 31, 2014 (the "Review Period"). The examinations also reviewed certain activities or credit rating actions from outside the Review Period.

The 2015 examinations reviewed the Section 15E Review Areas and examined how each NRSRO adhered to Section 15E and Rules 17g-1 through 17g-7. Each of the NRSRO examinations was based upon an individualized risk assessment by the Staff that determined areas of emphasis and issues of focus for that NRSRO within the Section 15E Review Areas. Thus, the 2015 examinations reviewed each of the Section 15E Review Areas while also being tailored to each NRSRO's specific risk profile. The individualized risk assessments took into account a number of factors, including the NRSRO's credit rating activities and operations, the Staff's findings, recommendations, and other observations from prior examinations, the impact of a potential or actual internal control or compliance failure by the NRSRO, recent industry developments affecting NRSROs and the asset classes in which the NRSRO is registered, the NRSRO's filings with the Commission and public disclosures, the NRSRO's self-identified weaknesses, and relevant tips, complaints, and referrals ("TCRs") received by the Commission. Several of the Staff's findings and recommendations from the 2015 examinations directly resulted from TCRs.

The 2015 examinations also focused on certain subjects and activities that the Staff identified as relevant to multiple NRSROs, as summarized in this paragraph. First, the Staff conducted in-depth reviews of multiple NRSROs' policies, procedures, and practices regarding quantitative models used in the rating process. The Staff assessed whether these NRSROs had sufficient policies and procedures, controls, and frameworks for the development, review, testing, and

validation of quantitative models. The Staff also assessed whether these NRSROs applied such quantitative models in the rating process consistently with their policies and procedures, methodologies, and criteria. Second, building on work performed during the 2014 exams, the Staff reviewed multiple NRSROs' policies and procedures, controls, and documentation related to Information Technology ("IT") and cybersecurity. Third, the Staff reviewed third-party vendors' and non-NRSRO affiliates' involvement in determining, issuing, or contributing to the NRSROs' credit ratings or credit rating process. Any findings by the Staff concerning models, IT and cybersecurity, and third-party vendors or non-NRSRO affiliates are addressed in this Report in the Sections concerning the relevant Review Areas.

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

### **III. SETTLED ADMINISTRATIVE ENFORCEMENT PROCEEDINGS**

In January 2015, the Commission issued three orders instituting settled administrative proceedings against S&P and making findings.<sup>14</sup> In the first settlement, the Commission charged S&P with making affirmative misrepresentations in its ratings publications for six conduit-fusion Commercial Mortgage-Backed Securities ("CMBS") concerning the methodology applied to determine the ratings for these securities. S&P consented to the entry of the Commission order and admitted to certain underlying facts in the Commission order, but neither admitted nor denied the findings therein. S&P also entered into similar settlements with two State Attorneys General concerning these securities. The second Commission settlement involved charges that S&P published an article that contained false and misleading statements concerning the conservative nature of its revised criteria for U.S. conduit-fusion CMBS, in an attempt by S&P to enhance its market share of U.S. conduit-fusion CMBS ratings. In the third settlement, the Commission charged that S&P improperly changed assumptions to its Residential Mortgage-Backed Securities ("RMBS") surveillance methodology, which had the effect of making S&P's RMBS surveillance ratings less conservative, without fully disclosing these changes. S&P consented to the entry of the Commission orders for the second and third settlements without admitting or denying the findings therein.

These orders found that S&P violated Section 17(a)(1) of the Securities Act, as well as Section 15E(c)(3)(A) and Rules 17g-2(a)(2)(iii) and 17g-2(a)(6) of the Exchange Act. The Commission obtained several types of relief as a result of these settlements. First, S&P paid the Commission more than \$58 million in civil money penalties, disgorgement, and pre-judgment interest. Second, S&P was censured. Third, the Commission obtained orders that S&P cease-and-desist from violating the aforementioned securities laws and regulations. Finally, S&P agreed to various undertakings. These undertakings include a one-year timeout from certain activities related to U.S. conduit-fusion CMBS, including marketing and rating of new issuances. The

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<sup>14</sup> *SEC Announces Charges Against Standard & Poor's for Fraudulent Ratings Misconduct*, Release No. 2015-10 (Jan. 21, 2015); *In the Matter of Standard & Poor's Rating Services*, Exchange Act Release Nos. 74102, 74103, and 74104 (Jan. 21, 2015).

undertakings also required S&P to withdraw and, where applicable, revise certain rating criteria and the article concerning U.S. conduit-fusion CMBS. S&P also agreed to extensive measures to improve its internal controls related to RMBS surveillance and rating criteria generally, and to adopt, implement, and maintain policies, procedures, practices, and internal controls that address all of the recommendations from OCR Staff's 2014 annual examination. As required by these settled orders, S&P provided to the Staff certifications and a report under penalty of perjury confirming that it completed these undertakings. OCR Staff worked closely with Enforcement on these matters, including monitoring S&P's compliance with these undertakings.

In October 2015, the Commission issued an order instituting settled administrative proceedings against DBRS and making findings.<sup>15</sup> The Commission charged that between April 2009 and early 2012, DBRS did not conduct surveillance of its outstanding ratings of U.S. RMBS and re-securitized real estate mortgage investment conduits ("Re-REMICs") consistent with its published methodology and Form NRSRO filings and did not disclose material changes to that surveillance methodology in its Form NRSRO filings. The Commission also charged that DBRS did not maintain adequate financial and managerial resources to conduct surveillance of U.S. RMBS and Re-REMIC ratings pursuant to its published methodology. Finally, the Commission charged that DBRS did not make and retain a record of the rationale for material differences between the ratings implied by its quantitative model and the final credit ratings it issued for a substantial number of its U.S. RMBS and Re-REMIC surveillance ratings. DBRS consented to the entry of the Commission order without admitting or denying the findings therein.

This order found that DBRS violated Sections 15E(b)(1), 15E(b)(2), 15E(c)(3)(A), 15E(d)(1)(E), and 17(a) of the Exchange Act, and Rules 17g-1(e), 17g-1(f), and 17g-2(a)(2)(iii) of the Exchange Act. The Commission obtained several types of relief as a result of this settlement. First, DBRS paid the Commission approximately \$5.8 million in civil money penalty, disgorgement, and pre-judgment interest. Second, DBRS was censured. Third, the Commission obtained an order that DBRS cease-and-desist from violating the aforementioned securities laws and regulations. Finally, DBRS agreed to certain undertakings, including a requirement that DBRS retain an independent consultant not unacceptable to OCR and Enforcement. The independent consultant will audit certain of DBRS's U.S. RMBS and ABS methodologies to determine whether DBRS is issuing ratings in accordance with those methodologies and will review DBRS's compliance program and other specified aspects of DBRS's operations and internal controls. Based on its audit and review, the independent consultant will make written recommendations for improvement to DBRS. DBRS must implement the independent consultant's recommendations or agreed-upon alternatives within a specified timeframe.

Enforcement initiated its investigation of DBRS following an annual examination of DBRS by the Staff. OCR Staff worked closely with Enforcement on this matter, and expects to continue to work with Enforcement to monitor DBRS's compliance with these undertakings.

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<sup>15</sup> *SEC Charges Credit Rating Agency With Misrepresenting Surveillance Methodology*, Release No. 2015-246 (Oct. 26, 2015); *In the Matter of DBRS, Inc.*, Exchange Act Release No. 76261 (Oct. 26, 2015).

#### **IV. SUMMARY OF RESPONSES TO RECOMMENDATIONS FROM PREVIOUS REPORTS**

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, checking 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 assessment of whether an NRSRO appropriately addressed a recommendation reflects solely the Staff's view and does not necessarily reflect the views of the Commission.

The Staff's assessment of whether an NRSRO has appropriately addressed a recommendation depends on the specific facts and circumstances of each recommendation, including the promptness of the NRSRO's response, the severity of the conduct at issue, and whether the remedial action undertaken by the NRSRO is expected to fully resolve the Staff's concerns. To assess whether NRSROs appropriately addressed findings from the 2014 examinations, the Staff reviewed each NRSRO's written submissions that responded to the Staff's findings and recommendations and described its planned remedial measures, and participated in follow-up calls in 2014 with each NRSRO to discuss its written submission. During the 2015 examinations, the Staff assessed each NRSRO's progress in implementing remedial measures and tested the existence and effectiveness of such measures where possible.

##### **A. Recommendations Not Appropriately Addressed**

Based on the Staff's 2015 examinations, the Staff has determined that one smaller NRSRO did not appropriately address certain recommendations from the Staff's previous examinations.

This smaller NRSRO did not appropriately address two recommendations from the Staff's 2014 examination. The first recommendation that this NRSRO did not appropriately address concerns rating committee members' application of its rating methodology. Notably, the Staff made another finding and certain recommendations in the 2015 examination concerning this NRSRO's rating committee members' unfamiliarity with and non-adherence to the relevant rating methodology. This finding and recommendation from the 2015 examination is discussed further in Section V.D.2 of this Report. Second, the Staff recommended during the 2014 examination that this NRSRO collect annual disclosures from its Board members concerning their outside business activities and potential conflicts of interest and inform the Board members of their obligations concerning outside business activities and potential conflicts. As discussed further in Section V.E.2 of this Report, in the 2015 examination, the Staff found that this NRSRO did not collect such annual disclosures and did not sufficiently inform certain Board members of these obligations, and made recommendations that this NRSRO take such measures.

Moreover, during the 2015 examination, the Staff determined this smaller NRSRO had not appropriately addressed certain recommendations that the Staff had made in connection with examinations conducted prior to 2014. The Staff had previously concluded that this NRSRO

appropriately addressed these recommendations from pre-2014 examinations because this NRSRO represented to the Staff that it would implement responsive remedial measures and took initial steps to implement them. The Staff planned to assess this NRSRO's progress in fully implementing these remedial measures and test the existence and effectiveness of these measures in future examinations.

Specifically, during the 2015 examination, the Staff determined that this smaller NRSRO had not made sufficient progress in implementing these remedial measures. In addition, the Staff found, in connection with its rating file reviews, focus on quantitative models, and other testing it conducted in connection with the 2015 examination, that certain remedial steps this NRSRO had previously taken had not been maintained or were ineffective. To illustrate, while this NRSRO wrote policies and procedures intended to respond to some of these pre-2014 recommendations, the Staff found significant instances of non-adherence to these policies and procedures and found that the NRSRO lacked sufficient controls to ensure such adherence. One pre-2014 recommendation that this NRSRO did not appropriately address concerned adhering to policies covering its management of conflicts of interest related to ancillary services that are offered by this NRSRO's affiliate, as discussed in Section V.B.4. of this Report. Other pre-2014 recommendations that this NRSRO did not appropriately address concerned this NRSRO's determining and documenting analytical justifications for changes to inputs of quantitative models that it uses in the rating process and differences between the ratings implied by such models and the final ratings assigned, as discussed in Section V.D.1. of this Report.

The Staff will follow-up concerning its recommendations from the 2014 examination and previous examinations that this NRSRO failed to appropriately address, as well as its related recommendations from the 2015 examination.

Regarding the other nine NRSROs, the Staff has determined that all recommendations from the 2014 exam have been appropriately addressed. The NRSROs addressed the 2014 recommendations by taking remedial measures such as adopting new or enhancing existing policies or procedures, enhancing or implementing new internal controls, implementing new systems and processes, and adding compliance personnel and resources.

#### B. Notable Improvements

Since the Section 15E examinations began in 2010, all of the NRSROs have taken measures intended to increase their understanding of their obligations as regulated entities. In addition, at many of the NRSROs, improvements that were initiated or implemented in previous years have been further integrated into their operations and culture or continue to be enhanced. For example, several NRSROs that previously implemented electronic systems to facilitate steps in the rating process or enhance recordkeeping and monitoring activities continue to evaluate the effectiveness of these systems and implement updates intended to improve their performance.

During the 2015 examinations, the Staff observed improvements at some of the NRSROs. A few NRSROs made adherence to their rating policies and procedures, code of conduct, and compliance rules a tangible component of their employees' performance evaluations, promotions, and compensation. Additionally, a few NRSROs displayed a greater awareness of risk-management issues and devoted additional personnel or other resources to risk-management

issues. Finally, some NRSROs self-reported certain incidents to the Staff, and a few NRSROs initiated remedial measures soon after the Staff first brought an issue to their attention during an examination rather than initiating responses only after receipt of the Staff's exam summary letter. Such self-reporting of incidents and greater activity in responding to issues raised by the Staff are indicative of improvements in these NRSROs' compliance cultures.

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

## **V. 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 2015 examinations that were included with one or more recommendations in an exam summary letter sent to an NRSRO. "Essential findings" do not include the Staff's general observations that are not included in an exam summary letter. In this Report, essential findings are organized by the applicable Section 15E Review Areas. This Report uses the phrases "substantial," "significant," "numerous," "multiple," "several," "some," and "a few" to describe and distinguish the frequency of conduct or instances underlying certain findings. The particular phrase used reflects directionally 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 full activities during the Review Period. The Commission has not determined whether any finding discussed in this Report constitutes a "material regulatory deficiency," but may do so in the future.

In the following Sections of this Report, the numbered headers identify in general terms the Staff's findings concerning one or more NRSROs, and the paragraph(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**

Section 15E and Commission rules require that NRSROs maintain and enforce various written policies and procedures. Section 15E(c)(3)(A) requires NRSROs to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. Rule 17g-2(a)(6) requires an NRSRO to make and retain a record documenting its established procedures and methodologies used to determine credit ratings. A general description of the procedures and methodologies the NRSRO uses to determine credit ratings must be included in Exhibit 2 to Form NRSRO.

Section 17(a) and Rule 17g-2(a) requires an NRSRO to make and retain, and Rule 17g-2(b) requires an NRSRO to retain, certain records, including information concerning each rating it issues. For example, Rule 17g-2(a)(2)(i) and (ii) require NRSROs to make and retain records of the identity of any analysts that participated in determining the credit rating and the identity of the persons that approved the credit rating before it was issued. Rule 17g-2(a)(2)(iii) requires, where a quantitative model is a substantial component in an NRSRO's process of determining ABS credit ratings, that the NRSRO make and retain a record of the rationale for any material difference between the rating implied by the model and the final credit rating issued. Rule 17g-2(b)(2) requires an NRSRO to retain internal records and work papers used to form the basis of a rating it issues. Rule 17g-2(b)(7) requires an NRSRO to retain its external and internal communications, including electronic communications, related to initiating, determining, maintaining, monitoring, changing, or withdrawing a rating.

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

The Staff's reviews of the Section 15E Review Areas included testing whether each NRSRO operated in accordance with its policies, procedures, and methodologies. The Staff's essential findings regarding NRSROs conducting ratings-related activities in accordance with their policies, procedures, methodologies, criteria, and models are discussed in this Section of this Report. The Staff's essential findings regarding NRSROs' adherence to policies and procedures related to other Review Areas are generally discussed in later Sections of this Report. Instances where policies, procedures, and methodologies 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. On numerous occasions, two larger NRSROs and one smaller NRSRO failed to adhere to their ratings policies and procedures, methodologies, or criteria, or to properly apply quantitative models.

One larger NRSRO did not code the quantitative model used for an initial rating of a structured finance transaction in a manner that reflected the actual terms of the transaction, and subsequent surveillance ratings of this transaction did not detect this coding mistake. When the mistake was detected, it resulted in a substantial downgrade of this transaction's rating. This NRSRO also failed to apply certain assumptions required by its RMBS criteria to numerous ratings, and it

mistakenly applied its methodology to surveillance ratings of certain other RMBS transactions, which resulted in several erroneous ratings. The Staff recommended that this NRSRO enhance its internal controls to ensure that it properly applies its methodologies. Also at this NRSRO, two ratings determinations made by rating committees were subsequently changed at the prompting of senior ratings personnel, which contravened this NRSRO's policies and procedures governing the rating process and rating appeals and resulted in the misapplication of its criteria. The Staff recommended that this NRSRO ensure that all of its analysts and supervisors be made aware of and be properly trained regarding its code of conduct, policies, and procedures concerning the determination of ratings and independence of the rating process, and rating criteria.

Another larger NRSRO did not adhere to its internal policies and procedures and Rule 17g-2(a)(2)(iii) by assigning several ratings that differed from the ratings implied by the quantitative model without properly documenting in rating committee materials the rationale for this difference. The Staff recommended that this NRSRO ensure it adheres to all applicable record retention requirements. In addition, when reviewing certain financial institutions ratings, this NRSRO did not adhere to its internal policies and procedures concerning withdrawals of ratings, the process for issuers to appeal ratings, and communicating with an issuer concerning the withdrawal and appeal processes. The Staff recommended that this NRSRO strengthen its internal controls over the rating appeal and withdrawal processes and ensure it adheres to its internal policies and procedures concerning rating publications.

At one smaller NRSRO, there were numerous instances where analysts did not process monthly data concerning particular transactions, in contravention of its surveillance criteria. The Staff recommended that this NRSRO take measures to ensure that its analysts adhere to its policies and procedures concerning the credit rating process.

2. Two larger NRSROs and one smaller NRSRO did not always adhere to some of their policies and procedures concerning review and revision of methodology, criteria, and models.

One larger NRSRO did not adequately disclose, consider, and document a material component of its revised methodology before it approved that methodology, as required by its policies and procedures. Another larger NRSRO did not review a substantial portion of its quantitative rating models on an annual basis as required by its policies and procedures. One smaller NRSRO did not prepare and retain the records required by its policies and procedures in connection with its approval of two rating methodologies. The Staff recommended that these three NRSROs ensure they adhere to all of their policies and procedures concerning the development, review, revision, and/or approval of methodologies, criteria, and models.

3. Two larger NRSROs and one smaller NRSRO did not adhere on multiple occasions to their policies and procedures for ratings publications or correction of errors in ratings publications.

Analysts at one larger NRSRO learned of errors in a substantial number of third-party models that it had used to determine outstanding ratings but did not analyze the impact of these errors on the ratings or inform appropriate personnel as required by its policies and procedures. Also at this NRSRO, the Staff found instances where substantive statements in its rating publications directly contradicted substantive statements in its internal rating records. The Staff recommended that this NRSRO ensure that its rating publications are accurate, adhere to its error correction policies and procedures, and review the specific ratings where the Staff identified discrepancies and correct any errors.

Analytical personnel at another larger NRSRO noticed an error in calculations used to determine certain surveillance ratings, but subsequent rating publications did not disclose that error or its ratings implications. This NRSRO also made inaccurate disclosures regarding the methodology it used to determine some of its ratings. The Staff recommended that this larger NRSRO ensure that all analytical personnel be made aware of and adhere to its error correction policies and procedures and code of conduct provisions concerning transparent disclosure. The Staff also recommended that this larger NRSRO ensure that rating publications reference the actual published methodologies it applied. A substantial number of a smaller NRSRO's rating publications referenced unapproved methodologies or did not correctly reference all of the methodologies it applied to those ratings. The Staff recommended that this smaller NRSRO adhere to its policies and procedures and enhance its internal control structure concerning publication of ratings.

4. One larger NRSRO and one smaller NRSRO did not always adhere to their IT policies and procedures concerning access, updates, and use of third-party vendors.

A larger NRSRO updated one of its rating databases without obtaining the documentation or approval required by its IT policies and procedures, which resulted in a significant number of outstanding ratings being inadvertently withdrawn. Also, this NRSRO did not adhere to its policies and procedures concerning use of third-party vendors when attempting to update an IT program, which temporarily made that program inaccessible. The Staff recommended that this NRSRO ensure it adheres to its policies and procedures for updating its IT systems and enhance its oversight of third-party IT vendors that it has engaged.

A smaller NRSRO updated its IT policies and procedures without the approval of all required personnel. In addition, this NRSRO did not adhere to its policies and procedures concerning personnel's access to certain internet databases. The Staff recommended that this NRSRO ensure that it adheres to its approval process when updating its IT policies and procedures, and adhere to or modify its policies and procedures for accessing these internet databases.

5. Certain rating files and rating publications of two larger NRSROs and three smaller NRSROs did not adhere to document retention requirements and other operational policies and procedures related to determining or reviewing ratings.

At one larger NRSRO, several rating files were missing required documents and information or contained inaccurate information, including notifications to issuers, the purpose of the rating committee, and references to applicable policies, procedures, and criteria. At another larger NRSRO, some rating files were missing required documents, including communications with the issuer and the inputs to quantitative models used to determine the rating of structured finance securities. At one smaller NRSRO, several rating files were missing required documents and information concerning the analysis performed, documents referenced, or conflicts of interest checks. At another smaller NRSRO, multiple rating files did not contain a record of the personnel who participated in determining the rating or who approved the rating. At a third smaller NRSRO, some rating files were missing required documents, including rating committee minutes.

The Staff recommended that these five NRSROs take various remedial measures to ensure they comply with Rule 17g-2 and their internal policies and procedures concerning the creation and retention of records and other operational procedures related to their determination of ratings.

#### B. Review Area: Management of Conflicts of Interest

Section 15E(h)(1) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage conflicts of interest. Rule 17g-5(b) identifies certain types of conflicts that an NRSRO must disclose in Exhibit 6 to Form NRSRO and establish, maintain, and enforce written policies and procedures to address and manage such conflicts. The NRSRO's written policies and procedures to address and manage these conflicts must be disclosed in Exhibit 7 to Form NRSRO. For example, Rules 17g-5(b)(1) and (2) concern the conflicts related to being paid by issuers, underwriters, or obligors to determine ratings with respect to securities that they issue or underwrite or on which they are the obligor. Similarly, Rule 17g-5(b)(9) concerns the conflict related to issuing or maintaining a rating for certain securities or instruments that was paid for by the security's issuer, sponsor, or underwriter. Rule 17g-5(c) lists certain conflicts that are strictly prohibited. For example, Rule 17g-5(c)(6) prohibits an NRSRO from issuing a rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who had responsibility for determining ratings or for developing or approving procedures, methodologies, or models used to determine ratings.

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

1. One larger NRSRO and three smaller NRSROs did not have sufficient policies, procedures, and controls to manage the issuer-paid conflict or to prevent analytical personnel's access to fee or market-share information.

One larger NRSRO had written policies and procedures requiring the periodic rotation of analysts responsible for working on the ratings of particular issuers in order to manage the issuer-paid conflict of interest. Although exemptions to these policies and procedures were required to be authorized in writing by a specified senior officer, an analytical supervisor (who was not authorized to grant such an exemption) at this NRSRO suspended analyst rotation for

several months for a substantial number of ratings in an asset-class without obtaining the required written exemption. The Staff recommended that this NRSRO enhance its internal controls to ensure that all personnel adhere to this policy. In addition, a senior officer of this NRSRO violated its policies and procedures by sending emails to analytical and criteria-development personnel concerning an issuer's decision to terminate its rating in response to revisions by this NRSRO to its criteria. The Staff recommended that this NRSRO ensure that all of its personnel be made sufficiently aware of and comply with their responsibilities to manage conflicts of interest.

At one smaller NRSRO, there were several occasions where a senior analyst sent emails containing fee information to clients or potential clients, and some analytical personnel may have engaged in sales and marketing activities. At another smaller NRSRO, there were numerous instances where analytical personnel received fee information by email, and this smaller NRSRO did not have sufficient policies and procedures for handling instances of analysts' exposure to fee information. At a third smaller NRSRO, the workspace for one of the NRSRO's senior officers, whose responsibilities include the NRSRO's financial performance, was located in the analysts' work area. The Staff recommended that these three smaller NRSROs enhance their policies, procedures, and controls to separate the analytical function from the sales and marketing function and to prevent inappropriate access to fee information. The Staff also recommended that one of these smaller NRSROs review whether its analysts engaged in improper sales and marketing activity and report any such incidences to the Staff.

2. At one larger NRSRO, there were not sufficient policies and procedures to prevent prohibited unfair, coercive, or abusive practices, and this larger NRSRO's decision to issue an unsolicited rating of an issuer was motivated at least in part by market-share considerations.

Rules 17g-6(a)(1) through (a)(4) prohibit an NRSRO from engaging in certain unfair, coercive, or abusive practices. For example, Rule 17g-6(a)(2) prohibits an NRSRO from issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with its established procedures and methodologies, based on whether the entity that would be subject to the rating or an affiliate of this entity pays for or will pay for the credit rating or any other service by the NRSRO or an affiliate of the NRSRO.

One larger NRSRO lacked written policies and procedures to prevent the conduct prohibited by Rule 17g-6. This larger NRSRO also lacked sufficient written policies and procedures concerning the issuance of unsolicited credit ratings. The Staff reviewed this larger NRSRO's unsolicited rating of an issuer. The Staff's efforts included reviewing the NRSRO's rating file and emails concerning this rating, and interviewing analytical and sales personnel who were involved in the decision to rate this issuer or in determining this rating. During its review, the Staff identified emails among sales personnel suggesting that the NRSRO issue an unsolicited rating of this issuer for market-share considerations; these emails are inconsistent with this larger NRSRO's code of conduct, yet the personnel who received these emails did not report them as required by its code. The Staff also identified other emails between a sales employee and analytical managers and senior management related to this larger NRSRO's unsolicited rating of this issuer.

The Staff recommended that this larger NRSRO establish, maintain, enforce, and document written policies and procedures that govern its issuance of unsolicited ratings, and that prohibit all of the conduct covered by Rule 17g-6. The Staff also recommended that this NRSRO adequately enforce its code of conduct and ensure that analytical personnel's conduct is not influenced by commercial considerations. Finally, the Staff recommended that this NRSRO enhance its monitoring of internal communications for compliance with its policies and procedures and enhance training regarding its code of conduct and associated reporting requirements.

3. There were some weaknesses in one larger NRSRO's and one smaller NRSRO's monitoring, investigation, or disclosure of conflicts of interest.

There was more than one instance where one larger NRSRO did not timely investigate, evaluate the rating impact of, and disclose that an analyst who participated in determining certain credit ratings should have been recused due to a conflict of interest. Also, this larger NRSRO's log for tracking violations did not include all violations and was not sufficiently detailed concerning the review and resolution of violations. The Staff recommended that this larger NRSRO enhance and adhere to its policies and procedures for investigating and disclosing conflicts of interest, and that it ensure that its log for tracking violations contains accurate and complete information.

One smaller NRSRO lacked policies and procedures for the review of conflict of interest attestations submitted by its employees. The Staff recommended that this smaller NRSRO establish, maintain, enforce, and document policies and procedures and effective internal controls concerning the compilation, review, and retention of such attestation responses.

4. Four smaller NRSROs did not have sufficient policies, procedures, or controls regarding certain conflicts of interest or did not sufficiently disclose such conflicts of interest.

Pursuant to Rule 17g-5(b)(3), it is a conflict of interest for an NRSRO to be paid for other related services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a credit rating. Pursuant to Rule 17g-5(b)(7), it is a conflict of interest for persons within the NRSRO to have a business relationship that is more than an arm's length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the NRSRO.

One smaller NRSRO did not have sufficient policies and procedures and controls to manage the conflict of interest posed by ancillary services that were offered by this NRSRO's affiliate. The Staff identified several instances at this NRSRO where senior rating analysts participated in activities related to these ancillary services or received information concerning these ancillary services, in contravention of its code of conduct. The Staff recommended that this smaller NRSRO enhance its policies and procedures and controls to manage this conflict of interest.

Another smaller NRSRO did not have written policies and procedures to manage conflicts of interest related to its owners' other business interests. The Staff recommended that this NRSRO

establish, maintain, and enforce written policies and procedures to manage this conflict of interest. A third smaller NRSRO did not sufficiently disclose in Exhibit 6 of Form NRSRO the existence of the conflict that is covered by Rule 17g-5(b)(7), and the Staff recommended that this NRSRO amend its disclosure in Exhibit 6.

A fourth smaller NRSRO did not have or disclose sufficient policies and procedures to manage certain conflicts that it identified in Exhibit 6 of Form NRSRO, including the conflicts identified in Rule 17g-5(b)(4) and 17g-5(b)(5) related to being paid for subscriptions to receive or access its credit ratings. The Staff recommended that this smaller NRSRO establish policies and procedures to address and manage all of its conflicts and disclose such policies and procedures in Exhibit 7 of its Form NRSRO.

5. There were weaknesses in securities ownership policies and procedures and controls at one larger NRSRO and four smaller NRSROs.

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

At one larger NRSRO, one analyst participated in determining numerous ratings where that analyst should have been recused due to that analyst's securities holdings. The analyst reported these securities holdings to the NRSRO, but recusals were not created in the NRSRO's existing systems. The Staff recommended that this larger NRSRO enhance its internal controls concerning recusals, and ensure that all employees adhere to its securities ownership policies and procedures.

One smaller NRSRO did not timely update its list of securities or issuers that the NRSRO's personnel are restricted from owning, and did not have written policies and procedures concerning its review of securities holdings of non-U.S. personnel. Another smaller NRSRO did not update its securities ownership restrictions to manage conflicts of interest related to all types of securities that it rates. The Staff recommended that these smaller NRSROs ensure that their securities ownership policies and procedures and restricted lists are updated and complete.

A third smaller NRSRO did not monitor its analytical employees' securities holdings as required by its policies and procedures, and did not have sufficient policies and procedures concerning non-analytical employees' securities holdings. At a fourth smaller NRSRO, the scope of reporting and monitoring of employees' securities ownership was insufficient. The Staff recommended that these smaller NRSROs enhance their policies, procedures, and internal controls related to their employees' securities ownership.

C. Review Area: Implementation of Ethics Policies

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

Each NRSRO has implemented written ethics policies and procedures. During the 2015 examinations, the Staff reviewed each NRSRO's ethics policies and procedures, as well as a sample of each NRSRO's employee certifications or monitoring activities concerning 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

As discussed above, Section 15E(c)(3)(A) requires that each NRSRO establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. Also as discussed above, Rule 17g-2 requires an NRSRO to make and retain (in the case of Rule 17g-2(a)), or to retain (in the case of Rule 17g-2(b)), certain records relating to the determination of particular ratings. In addition, Rule 17g-2(b)(5) requires an NRSRO to retain internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the NRSRO's internal auditors as necessary to audit the NRSRO's credit rating business. The Staff reviewed each NRSRO's overall control structure, including the internal control structure related to determining credit ratings.

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

Section 15E(f)(2) prohibits any credit rating agency that is not registered as an NRSRO from stating that it is registered as an NRSRO.

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

1. All three larger NRSROs and two smaller NRSROs lacked certain policies, procedures, and internal controls concerning the development, review, or use of ratings methodologies, criteria, and models.

The Staff identified multiple weaknesses concerning one larger NRSRO's development, review, and testing of criteria and models. First, when revising one of its rating criteria, this NRSRO's personnel did not consider all relevant information and factors as required by its policies and procedures for criteria revision, and it was unclear how this NRSRO planned to apply the revised criteria to existing ratings. Due to these procedural weaknesses, this NRSRO rescinded the revised criteria soon after publishing it. Also at this NRSRO, the instructions for revising an RMBS model that were provided to the model development team were not consistent with the applicable criteria, which resulted in the model being revised in a manner that did not reflect the criteria. Furthermore, this NRSRO did not adequately test quantitative models after they were developed, which resulted in its use on multiple occasions of models that did not conform to the corresponding criteria or otherwise contained errors. This NRSRO also lacked sufficient internal controls regarding the permissible application of models which had not been validated, and lacked policies and procedures regarding single-use models, which are models that are used for single transactions and specific to an issue or issuer.

The Staff recommended that this larger NRSRO adopt and enforce internal controls to ensure that its criteria development processes consider all relevant information, and that it develop policies and procedures concerning the application of revised criteria. The Staff also recommended that this NRSRO establish and maintain effective internal controls, including policies and procedures, for the development, use, and testing of all quantitative models and for ensuring that quantitative models reflect the corresponding criteria.

One smaller NRSRO lacked sufficient policies and procedures concerning the analytical justification for changes it makes to inputs for quantitative rating models that it used for its ratings of multiple asset classes. This NRSRO did not adequately document such changes, and it appeared to lack analytical justification for such changes. Moreover, this NRSRO frequently assigned final ratings that differ from the rating implied by its rating models, and it typically did not disclose or internally document the rationale for the difference between the rating assigned and the model-implied rating. The Staff recommended that this NRSRO establish, maintain, and enforce effective internal controls, including written policies and procedures, concerning model inputs and documenting the rationale for differences between the rating implied by its model and the final assigned rating. In addition, this smaller NRSRO did not respond to its own recommendations resulting from its internal model testing. The Staff recommended that this NRSRO promptly take remedial action in response to these model testing recommendations and that it document its responses to such testing.

The Staff identified several weaknesses in another larger NRSRO's policies, procedures, and internal controls regarding, and oversight of, quantitative models used in the rating process. First, this NRSRO allowed models to be altered by a single model officer and did not require these alterations to be reviewed independently or by a rating committee. Second, this NRSRO allowed non-validated models to be used in the rating process with the sole approval of an analytical manager, and its internal controls for model version control, including logging of model alterations and versions, was insufficient. Third, this NRSRO did not have effective internal controls regarding the oversight of third parties that provide quantitative models it uses in the rating process. This NRSRO did not perform due diligence of, or request any information from, third-party model providers concerning their operations, quality assurance, or model verification, and did not have written policies and procedures to conduct such activities. Finally,

this NRSRO did not have written policies and procedures concerning the development, review, and oversight of quantitative model inputs that it determines by statistical calculations. The Staff recommended that this NRSRO establish, maintain, enforce, and document policies, procedures, and effective internal controls concerning models, model inputs, and oversight of third-party model providers. The Staff also recommended that this NRSRO enhance its model version control and model-related logs, and consider designating an independent employee or group to be responsible for model version control.

A third larger NRSRO lacked effective internal controls, including written policies and procedures, for the development and verification of reusable and single-use quantitative models, which were created by the analytical personnel responsible for determining or reviewing the rating and were not required to be reviewed by the NRSRO's model verification group. Over the past few years, this larger NRSRO identified a substantial number of rating errors or potential errors where single-use models were applied. The Staff recommended that this NRSRO establish, maintain, enforce, and document an effective internal control structure, including written policies and procedures, concerning the development and verification of reusable and single-use quantitative models used in the credit rating process.

Another smaller NRSRO did not have written policies and procedures for the annual certification of methodologies, criteria, models, and rating guidelines. The Staff recommended that this smaller NRSRO establish, maintain, enforce, and document written policies and procedures concerning such annual certifications and requiring the retention of documentation of the analysis conducted for each certification.

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

The rating committee of one smaller NRSRO did not exercise effective oversight over certain types of ratings issued by that NRSRO. This NRSRO had insufficient policies and procedures concerning rating committee review of certain rating actions. In addition, some of this NRSRO's rating committee members appeared to lack sufficient expertise and independence to effectively review the rating actions taken by this NRSRO, and did not appear to be familiar with or to apply the relevant methodology when reviewing rating actions. The Staff recommended that this NRSRO enhance its rating committee policies and procedures and ensure that its rating committee members have sufficient expertise, time, and independence to fulfill their responsibilities.

At another smaller NRSRO, weaknesses in its surveillance processes resulted in this NRSRO posting erroneous ratings for numerous CMBS tranches and erroneously withdrawing ratings for a significant number of outstanding CMBS tranches. The Staff recommended that this smaller NRSRO enhance its internal controls over its surveillance process.

Employees of one larger NRSRO did not obtain managerial pre-approval for multiple exceptions to its rating policies, procedures, and criteria. This NRSRO also did not sufficiently log, monitor, and internally report information concerning these exceptions. The Staff recommended that this NRSRO enhance and adhere to its policies and procedures concerning exceptions. A

third smaller NRSRO permitted analysts to deviate from its methodologies when determining a particular rating but did not require the rating publication to disclose methodology deviations. Such non-disclosure of methodology deviations may limit the ability of users of credit ratings to understand this NRSRO's ratings and assess whether it is adhering to its methodologies. The Staff recommended that this smaller NRSRO establish, maintain, enforce, and document policies and procedures for the disclosure of methodology deviations.

Another larger NRSRO did not clearly distinguish mandatory policies and procedures concerning the rating process from non-mandatory guidelines or best practices concerning the rating process, which is potentially confusing to its personnel. The Staff recommended that this NRSRO ensure that it clearly distinguishes mandatory responsibilities from non-mandatory guidelines, and that it enforce its mandatory policies and procedures. This NRSRO also did not sufficiently document its determination that a credit rating action is not necessary and that it can instead publish a credit opinion, which is only available to subscribers and did not involve the same processes as a rating action. In addition, this NRSRO did not appear to retain documentation related to its credit opinions as required by Rule 17g-2(b)(3). The Staff recommended that this NRSRO establish, maintain, and enforce written policies and procedures to document its determination whether or not a credit rating action is necessary and to retain records related to its credit opinions.

Another smaller NRSRO did not sufficiently document certain aspects of its handling of external or internal appeals, such as the circumstances where an appeal is appropriate and the timeframe for resolving an appeal. This smaller NRSRO also did not sufficiently distinguish methodologies, which must be applied when determining relevant ratings, from less formal rating guidelines. The Staff recommended that this smaller NRSRO enhance its policies and procedures for ratings appeals, and that it clarify internally and disclose the differences between methodologies and guidelines.

The methodology of another smaller NRSRO entailed base and stress case scenarios and financial projections, both of which used weighted averages of data. However, neither this methodology nor the publications for specific ratings where this methodology was applied stated the specific weighted averages used, and rating publications and rating committee presentations also did not state the analytical justifications for these weighted averages. Such non-disclosure or lack of documentation may make it difficult to understand the rating assigned and to assess whether this NRSRO followed its methodology. The Staff recommended that this NRSRO establish parameters for determining weighted averages of data, enhance disclosures in its published methodology and rating publications concerning weighted averages, and document in its internal records the analytical justification for weighted averages it applies for particular ratings.

3. There were weaknesses in one larger NRSRO's and five smaller NRSROs' policies, procedures, and internal controls concerning publication of ratings and correction of ratings errors.

One larger NRSRO's policies and procedures did not provide specific guidance to analysts regarding the extent of detail to include in rating publications. The Staff observed a substantial number of this NRSRO's rating publications where the rationale for rating changes was not clearly explained, including instances where ratings changes resulted from errors in models used to determine that rating and revisions to its criteria. In addition, this NRSRO's error-correction policies and procedures did not require the NRSRO to perform a root-cause analysis of the error and determine if the error resulted from a violation of law or its policies and procedures. The Staff recommended that this NRSRO enhance its internal controls, including establishing written policies and procedures, concerning the response to credit rating model errors, and ensure that its public disclosures are transparent and sufficiently detailed.

In a few instances, one smaller NRSRO issued ratings in an asset class in which it was not registered as an NRSRO without indicating in written materials provided to the issuer that it was not registered for this asset class. The Staff recommended that this NRSRO prominently disclose in writing its non-NRSRO status for any ratings it issues for an asset class in which it is not currently registered as an NRSRO. Another smaller NRSRO lacked written policies and procedures for correcting and disclosing errors in its ratings or rating publications and for fixing the root cause of such errors. This NRSRO also did not have written policies and procedures that address whether ratings which were determined with the participation of both NRSRO analysts and non-NRSRO analysts are deemed to be, and published as, NRSRO ratings. The Staff recommended that this NRSRO establish, maintain, document, and enforce policies and procedures for error correction, and for determining which of its ratings are deemed to be NRSRO ratings and published as such.

Another smaller NRSRO's policies and procedures concerning when it would issue rating publications were unclear and inconsistent. For example, these policies and procedures contained conflicting or ambiguous statements regarding its surveillance of outstanding ratings and the timing of its rating publications. In addition, this NRSRO's policies and procedures concerning when it must issue a press release to explain certain rating actions were not sufficiently transparent. For example, this NRSRO's policies and procedures did not require, when it changes certain outstanding ratings due to an error, that it publish a press release or otherwise provide notice that these rating changes resulted from an error. The Staff recommended that this NRSRO ensure that its policies and procedures for disseminating ratings are clear and consistent, and that it enhance such policies and procedures to ensure sufficient public dissemination of information and transparency.

Two other smaller NRSROs did not have sufficient policies, procedures, and internal controls concerning issuers' review of draft rating publications and issuers' appeal of a rating. One of these NRSRO's policies and procedures were unclear regarding the length of time an issuer has to appeal a rating and the timeframe for the NRSRO to publish a rating after it has been finalized. Moreover, this NRSRO did not have sufficient policies, procedures, and internal controls to ensure that issuers do not inappropriately influence the substance of a rating action or rating publication. Another smaller NRSRO's policies and procedures did not require approval by an analytical supervisor before it sends a draft rating publication to an issuer for review. The Staff recommended that these two NRSROs establish or enhance policies and procedures and processes for issuers to review draft rating publications and appeal a rating, and for these NRSROs to finalize ratings and rating publications, to ensure that MNPI is not misused or

inappropriately disseminated. The Staff also recommended that one of these NRSROs establish internal controls to ensure that issuers do not inappropriately influence the substance of its rating publications.

4. Three smaller NRSROs had some weaknesses in their IT systems or oversight of third-party IT vendors.

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

One smaller NRSRO's policies and procedures concerning granting analysts permission to access client information were inconsistent and differed from its actual practices. This NRSRO also did not review access permissions to ensure they are appropriate and did not have sufficient controls to protect against inappropriate dissemination of MNPI through web-based email systems or external storage devices. Another smaller NRSRO had a number of IT vulnerabilities, including outdated or unsupported applications and cybersecurity software, programs that unnecessarily connect to the internet, and insufficient IT policies and procedures. The Staff recommended that these two NRSROs establish or enhance written IT policies and procedures to address the weaknesses identified by the Staff and enhance their testing, monitoring, and review of IT systems and processes.

A third smaller NRSRO did not periodically assess whether third-party vendors that provide IT services, such as operating its data center and maintaining its website, are complying with applicable confidentiality agreements and service-level agreements. The Staff recommended that this NRSRO establish, maintain, enforce, and document effective internal controls to exercise adequate oversight of third-party vendors.

5. The policies and procedures or internal control frameworks of one larger NRSRO and three smaller NRSROs did not satisfy all applicable statutory and rule requirements.

One larger NRSRO's and one smaller NRSRO's policies and procedures did not satisfy all of the requirements of Section 15E and applicable Commission rules. For example, the larger NRSRO did not have a written policy and procedure to comply with Section 15E(u), which requires an NRSRO to report to appropriate law enforcement or regulatory authorities certain information that it finds credible alleging that an issuer of securities it rated has committed or is committing a material violation of law. The Staff recommended that these two NRSROs establish, maintain, and enforce written policies and procedures that fully reflect the requirements of Section 15E and Commission rules. This smaller NRSRO and another smaller NRSRO also did not sufficiently document their internal control structure as required by Rule 17g-2(b)(12). These two smaller

NRSROs' policies and procedures and internal control framework documents were insufficiently detailed or out-of-date. The Staff recommended that these smaller NRSROs enhance and maintain up-to-date documentation of their internal control structures.

A third smaller NRSRO lacked effective internal controls with respect to implementing new and amended Commission rules. This NRSRO did not establish an action plan to implement these rules and its key personnel appeared insufficiently informed of these rules or their effective date. The Staff recommended that this NRSRO establish, maintain, enforce, and document policies, procedures, and effective internal controls for its implementation of all Commission rules applicable to NRSROs.

6. There were some deficiencies or inaccuracies in three smaller NRSROs' and one larger NRSRO's Form NRSRO filings.

Section 15E(a)(1)(B) requires an application for NRSRO registration to disclose certain information, including information concerning the rating agency's performance measurement statistics and its procedures and methodologies to determine ratings. Section 15E(b) requires an NRSRO to file updates of, and an annual certification which includes a list of material changes related to, its Form NRSRO registration and the information therein. Rule 17g-1 also contains requirements concerning the initial application for NRSRO registration and updating NRSRO registration. Moreover, Section 15E(k) and Rule 17g-3 require an NRSRO to confidentially file with the Commission certified financial statements and certain other financial information.

One smaller NRSRO did not file its 2015 annual Form NRSRO certification directly with the Commission; rather, it sent its certification to a third party, which forwarded it to an office within the Commission. In addition, in its last two annual Form NRSRO certifications, this smaller NRSRO has not provided the required list of material changes and has not filed with the Commission certain required financial information and accountant's certification. The Staff recommended that this smaller NRSRO ensure that its annual Form NRSRO certifications are filed directly with the Commission, and that it establish, maintain, document, and enforce adequate internal controls, including written procedures, to ensure the completeness and accuracy of its Form NRSRO filings and related exhibits.

There were multiple deficiencies in the annual Form NRSRO certifications filed by one larger NRSRO in 2014 and 2015. Exhibit 1 of this larger NRSRO's Form NRSRO filing did not provide a clear explanation of its performance statistics, and Exhibit 2 did not adequately describe its rating process for one asset class and did not describe its policy for determining whether to initiate an unsolicited rating. Another smaller NRSRO did not disclose in Exhibit 3 of its Form NRSRO filings sufficient information regarding its policies and procedures for the protection of MNPI as required by the Form NRSRO Instructions. A third smaller NRSRO did not file its code of ethics and policies and procedures for managing conflicts of interest consistently with the Form NRSRO Instructions. The Staff recommended that these three NRSROs ensure that their Form NRSRO filings are complete, accurate, and consistent with applicable laws and Form NRSRO Instructions.

7. There were weaknesses in one larger NRSRO's and one smaller NRSRO's monitoring of the rating process or review of rating files.

Some NRSROs periodically review a sample of their rating files to check for conflicts of interest and adherence to policies and procedures. This is a positive practice, but there were weaknesses in the rating file review activities of one larger NRSRO and one smaller NRSRO.

One larger NRSRO did not have a systematic and independent method to evaluate whether rating policies and procedures and methodologies are adhered to and applied appropriately. The Staff recommended that this NRSRO conduct periodic independent reviews and testing to assess whether its personnel are adhering to all policies, procedures, and methodologies used in the rating process. In addition, this NRSRO did not sufficiently and timely resolve the majority of recommendations made in connection with its internal methodology reviews. The Staff recommended that this larger NRSRO establish, maintain, and enforce effective internal controls for monitoring and resolving concerns and findings identified in its methodology reviews.

One smaller NRSRO did not document a significant number of its rating file reviews. The Staff recommended that this NRSRO ensure that it produces and maintains sufficient documentation for all rating file reviews that it conducts.

#### E. Review Area: Governance

Section 15E(t) requires each NRSRO to have a board of directors or governing committee (hereinafter, collectively the "Board" or "Boards") and establishes certain requirements concerning the composition and conduct of each NRSRO's Board. Section 15E(t)(2)(A) requires that at least half of an NRSRO's Board, but no fewer than two such members, must be independent of the NRSRO.

Section 15E(t)(3)(A) through (D) identifies four areas over which an NRSRO's Board must exercise oversight. Section 15E(t)(3)(A) and (B) require an NRSRO's Board to oversee the establishment, maintenance, and enforcement of policies and procedures for, respectively: determining credit ratings, and addressing, managing, and disclosing conflicts of interest. Section 15E(t)(3)(D) requires an NRSRO's Board to oversee the NRSRO's compensation and promotion policies and practices.

During the 2015 examinations, the Staff interviewed each NRSRO's Board and reviewed minutes and other documentation related to the activities of each NRSRO's Board.

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

1. One larger NRSRO and two smaller NRSROs had one or more directors who were identified as independent but also served as directors of their non-NRSRO parent companies or affiliates.

Section 15E(t)(2)(B)(i)(II) states that for a director to be considered independent, that director cannot, other than in his capacity as a member of the board of directors, be a person associated with the NRSRO or any affiliated company of the NRSRO. Section 3(a)(63) defines person associated with an NRSRO to include a director.

At one larger NRSRO and two smaller NRSROs, one or more directors that the NRSROs identified as independent also served as directors of non-NRSRO parent companies or affiliates. By serving as directors on non-NRSRO parent companies or affiliates, these individuals constituted persons associated with the NRSRO and thus were not independent. The Staff recommended that these NRSROs ensure that their corporate governance structures meet the requirements of Section 15E(t), including that individuals serving as independent directors satisfy the independence requirements of Section 15E(t)(2).

2. Three smaller NRSROs did not have sufficient controls related to independent directors' outside activities and potential conflicts of interest.

One smaller NRSRO did not collect annual disclosures from its independent Board members concerning outside business activities and other potential conflicts of interest, and this NRSRO's independent directors did not appear to be sufficiently aware of their responsibilities to report such activities and potential conflicts of interest. Another smaller NRSRO did not obtain periodic updates concerning independent Board members' outside business activities, and thus cannot review such activities for conflicts of interest. Also, this NRSRO's Board rules did not sufficiently prohibit participation by a member in all Board activities where that member might have a conflict of interest. A third smaller NRSRO did not thoroughly and timely review questionnaire responses provided by independent directors.

The Staff recommended that these three NRSROs enhance their monitoring of independent Board members' outside business activities by receiving or thoroughly reviewing questionnaire responses provided by these members. The Staff also recommended that one of these NRSROs ensure that its independent Board members are aware of their obligation to report outside business activities and other potential conflicts of interest, and that another of these NRSROs enhance its policies and procedures to ensure that conflict of interest rules and practices concerning its Board members are sufficient.

3. Minutes of three smaller NRSROs' Board meetings were inaccurate or insufficiently detailed to demonstrate the Board members were fulfilling all of their oversight responsibilities.

One smaller NRSRO's Board minutes did not contain sufficient detail concerning information the Board received or discussion the Board members had regarding a revised methodology, thus it was unclear if this Board performed the oversight required by Section 15E(t)(3)(C). Another smaller NRSRO's Board minutes did not mention the NRSRO's promotion policies and practices, thus it was unclear if this Board fully performed the oversight required by Section 15E(t)(3)(D). At another smaller NRSRO, minutes of certain Board meetings did not

sufficiently document the Board's oversight related to conflicts of interest as required by Section 15E(t)(3)(B) and did not accurately reflect meeting attendees.

The Staff recommended that these three smaller NRSROs ensure that their Board minutes are accurate and demonstrate the Board's sufficient performance of all of its 15E(t)(3) oversight responsibilities.

#### F. Review Area: DCO Activities

Section 15E(j)(1) requires each NRSRO to designate an individual responsible for administering policies and procedures established to prevent the misuse of MNPI and to manage conflicts of interest, and for ensuring compliance with the securities laws. Under Section 15E(j)(5), the DCO must submit an annual report to the NRSRO on the compliance of the NRSRO with the securities laws and the NRSRO's policies and procedures, and the NRSRO must file the report with the Commission. Rule 17g-2(b)(4) requires an NRSRO to retain compliance reports and compliance exception reports. Sections 17(a) and 17(b) and Rule 17g-2(f) require an NRSRO to promptly furnish to the Commission or its representatives copies of required records, including English translations of those documents upon request.

Section 15E(j)(2)(A)(iii) prohibits an NRSRO's DCO from performing marketing or sales functions. Pursuant to Section 15E(j)(4), the DCO's compensation must not be linked to the NRSRO's financial performance and must be arranged to ensure the DCO's independence.

The DCO role is a critical element to ensure an NRSRO's compliance with securities laws. The DCO at each NRSRO should have sufficient resources, institutional support, and independence to effectively carry out the DCO's statutory obligations. During the 2015 examinations, the Staff reviewed the role and activities of each NRSRO's DCO and interviewed each DCO.

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

1. The DCOs and Compliance departments of two larger NRSROs and three smaller NRSROs did not fulfill their responsibilities related to SEC examinations and other regulatory compliance responsibilities, and some of these NRSROs' Compliance departments appeared to lack sufficient resources to fulfill these responsibilities.

One smaller NRSRO did not implement timely responses to two recommendations from the Staff's 2014 examination. The first recommendation was that this NRSRO enhance its policies, procedures, and internal controls to ensure the accuracy and completeness of its Form NRSRO filings. The second recommendation was that this NRSRO enhance its access controls to sufficiently protect MNPI. This NRSRO's written response to OCR Staff concerning the 2014 examination stated that it would take measures to respond to these recommendations. However, this NRSRO did not take any steps to respond to these recommendations until several months later, and then did so only after the Staff inquired about its responses during the 2015 examinations and after this NRSRO filed its 2015 annual Form NRSRO certification. The Staff recommended that this NRSRO dedicate adequate resources to respond to the Staff's

recommendations in a timely manner and track these recommendations and its responses to ensure its responses are timely and effective.

At another smaller NRSRO, the number of compliance personnel and amount of resources devoted to compliance were not sufficient to meet the requirements of Section 15E(j) in light of the types and volume of its ratings activities. Furthermore, this NRSRO's DCO appeared to have engaged in sales and marketing activities, which is prohibited by Section 15E(j)(2)(A)(iii). This NRSRO also repeatedly failed to make complete and timely productions in response to OCR Staff's document requests as required by Sections 17(a) and 17(b) and Rule 17g-2(f). The Staff recommended that this NRSRO ensure that its compliance resources are sufficient, that its DCO did not perform prohibited sales and marketing functions, and that it promptly provides all requested documents to the Staff.

Two larger NRSROs and one smaller NRSRO failed to make complete and timely productions of documents requested by OCR Staff. Such documents included policies and procedures for determining ratings and handling complaints as well as records related to compliance investigations and reviews. The smaller NRSRO's DCO did not appear to have the capacity to balance implementation of new and amended Commission rules with fulfilling exam-related responsibilities. The Staff recommended that these three NRSROs ensure that they fulfill all exam-related responsibilities, including the prompt production of complete records required by Sections 17(a) and 17(b) and Rule 17g-2(f).

2. Two smaller NRSROs and one larger NRSRO did not sufficiently monitor their personnel's business email accounts to check for compliance violations.

One smaller NRSRO reviewed a sample of its personnel's business emails only for inappropriate references to rating fees, but not for other conflicts of interest or for inappropriate dissemination of MNPI. The Staff found that at least one of this NRSRO's analysts transmitted MNPI from a business email account to a personal email account. Another smaller NRSRO lacked policies and procedures prohibiting personnel from transmitting MNPI to their personal email accounts and did not monitor employee's work email accounts for such conduct. The Staff found instances of this smaller NRSRO's personnel transmitting MNPI to their personal email accounts. A larger NRSRO's email monitoring system did not detect multiple emails that contained market-share information and were sent to analysts and personnel responsible for criteria development, which was prohibited by this NRSRO's policies and procedures. The Staff recommended that these three NRSROs ensure that their email review activities and other internal controls, including policies and procedures, are sufficient to monitor for conflicts of interest and inappropriate dissemination of MNPI.

3. The Staff identified other aspects of the compliance function that can be improved at three smaller NRSROs.

One smaller NRSRO did not provide annual compliance training for all employees and did not provide sufficient compliance training for new employees, as required by its policies and

procedures. The Staff recommended that this NRSRO conduct compliance training as required and keep a record of attendees to ensure all employees complete required compliance training.

Two smaller NRSROs did not perform audits of their compliance departments. Periodic independent internal or external audits or reviews of an NRSRO's compliance department may help NRSROs improve the effectiveness of their DCO and compliance department. The Staff recommended that these two NRSROs consider conducting periodic independent audits of their compliance department. One of these smaller NRSROs also did not have written policies, procedures, and schedules for its compliance monitoring activities. The Staff recommended that this NRSRO establish, maintain, enforce, and document such written policies, procedures, and schedules.

#### G. Review Area: Complaints

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

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

1. There were various weaknesses in one larger NRSRO's and four smaller NRSRO's complaint policies and procedures or handling of some complaints.

One smaller NRSRO did not have policies and procedures for complaints by employees as required by Section 15E(j)(3)(B). Also, this NRSRO's compliance personnel were not aware of the statutory requirements concerning complaints and the types of employee communications that should be treated as complaints. The definition of complaint in two other smaller NRSROs' policies and procedures did not include complaints regarding models and methodologies and complaints regarding compliance with the securities laws or their policies and procedures, as required by Section 15E(j)(3)(A). One of these two other NRSROs also did not provide a sufficient process for third parties to submit anonymous complaints. The Staff recommended that these three NRSROs revise their written complaints policies and procedures, including their definitions of complaints, to satisfy the requirements of Section 15E(j)(3).

One larger NRSRO did not have sufficient policies and procedures for handling oral communications that may constitute complaints and a sufficient process for a third-party to submit an anonymous email complaint. The Staff recommended that this NRSRO enhance its written policies and procedures and public website to address these weaknesses. Also, under this NRSRO's current practice for developing and revising policies and procedures, complaint policies and procedures may be changed without the DCO's approval. The Staff recommended that this larger NRSRO ensure the DCO's involvement in developing and reviewing complaint policies and procedures as required by Section 15E(j)(3).

The Staff identified weaknesses in another smaller NRSRO's retention of complaints, as well as its documentation of whether a communication constitutes a complaint and the resolution of complaints. The Staff recommended that this smaller NRSRO ensure that it documents and retains sufficient records of complaints.

#### H. Review Area: Post-Employment

Section 15E(h)(4)(A) requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to ensure that the NRSRO will conduct a review where an employee of an entity subject to a credit rating of the NRSRO or an issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the NRSRO was employed by the NRSRO and participated in determining the NRSRO's rating of that entity, issuer, underwriter, or sponsor during the one-year period preceding the date the NRSRO took an action with respect to the credit rating. Section 15E(h)(5) requires each NRSRO to report to the Commission any instance where the NRSRO knows or can reasonably be expected to know that certain specified persons who were associated with the NRSRO within the previous five years obtain employment with any obligor, issuer, underwriter, or sponsor of a security or money market instrument for which the organization issued a credit rating during the twelve-month period prior to such employment.

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

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

1. Two larger NRSROs and three smaller NRSROs did not adhere to their look-back policies and procedures or these NRSROs' look-back policies, procedures, and controls need improvement.

One larger NRSRO did not complete look-back reviews in all circumstances required by Section 15E(h)(4) because internal systems that it used to determine if a look-back review was necessary did not identify all ratings-related activities and entities that may have required a look-back

review. This NRSRO also did not have sufficient documented policies and procedures for receiving, processing, and retaining information concerning former employees' subsequent employers and did not take adequate proactive measures, such as social media searches, to identify the subsequent employer of former employees for the required five-year-period. The Staff recommended that this NRSRO ensure that its policies and procedures and systems are sufficient to satisfy the requirements of Sections 15E(h)(4) and 15E(h)(5).

One smaller NRSRO's policies and procedures permitted reliance solely on information provided by the departing analyst concerning whether that departing analyst previously participated in determining a rating for the new employer. Another smaller NRSRO's post-employment policies and procedures did not sufficiently explain when a look-back review is required, and the Staff observed instances of this NRSRO's non-adherence to or inconsistent application of such policies and procedures. A third smaller NRSRO did not adequately document some of its post-employment activities, and its policies and procedures did not establish a timeframe for completing a look-back review. The Staff recommended that these NRSROs enhance their look-back review policies and procedures to address these identified weaknesses and adhere to these policies and procedures.

One larger NRSRO did not consistently and sufficiently document its determination of whether a particular employee's departure requires a look-back and did not adequately train relevant personnel concerning its look-back review policies and procedures. The Staff recommended that this NRSRO enhance its documentation of look-back review determinations and consider providing mandatory training concerning its look-back policies and procedures.

2. One larger NRSRO's and two smaller NRSROs' post-employment policies and procedures did not meet all statutory requirements.

One larger NRSRO's policies and procedures as written may result in some instances where look-back reviews did not cover the entire required one-year time period. One smaller NRSRO's policies and procedures did not require a look-back review where a former analyst obtains employment with an underwriter or sponsor of rated securities. This smaller NRSRO also did not adhere to its look-back policies and procedures concerning the time period covered by its post-employment reviews. Another smaller NRSRO did not track the post-employment history of some former analysts for a five-year period for purposes of filing employee transition reports with the Commission as required by Section 15E(h)(5). The Staff recommended that these three NRSROs ensure that their look-back policies and procedures comply with the requirements of Section 15E(h)(4)(A) and Section 15E(h)(5), respectively, and that one of these smaller NRSROs ensure it adheres to its look-back policies and procedures.

## **VI. 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 2015 examinations and previous examinations and further utilize and refine its risk assessment to review compliance with laws and regulations and to examine emerging risk areas. In addition, the Staff will modify the scope of its future examinations to include the new and amended Commission rules concerning NRSROs.