

Rule 17g-3: Annual audited financial statements to be furnished by nationally recognized statistical rating organizations

SUPPORTING STATEMENT

A. Justification

1. Need For Information Collection

The Credit Rating Agency Reform Act of 2006¹ (“Rating Agency Act”), enacted on September 29, 2006, defines the term “nationally recognized statistical rating organization,” or “NRSRO,” provides authority for the Securities and Exchange Commission (“Commission”) to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue implementing rules no later than 270 days after its enactment.

The rules proposed under the Rating Agency Act contain recordkeeping and disclosure requirements. The collection of information obligations imposed by the proposed rules would be mandatory. The proposed rules, however, would apply only to credit rating agencies that are applying to register or are registered with the Commission as NRSROs, and registration is voluntary.

The Rating Agency Act added a new Section 15E, “Registration of Nationally Recognized Statistical Rating Organizations,”² to the Securities Exchange Act of 1934 (“Exchange Act”). Exchange Act Section 15E(k) requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.³ This section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant. Proposed Rule 17g-3 would implement this statutory provision by requiring an NRSRO to furnish annual audited financial statements, including schedules providing information concerning the NRSRO’s largest customers, certain revenue sources, and credit analyst compensation, certified by an independent public accountant.⁴

2. Purpose of, and Consequences of Not Requiring, the Information Collection

The collection of information included in proposed Rule 17g-3 is necessary for Commission oversight of NRSROs registered with the Commission. Specifically, this

¹ Pub. L. No. 109-291.

² 15 U.S.C. 78o-7.

³ 15 U.S.C. 78o-7(k).

⁴ See proposed Rule 17g-3. Release No. 34-55231 (Feb. 2, 2007), 72 FR 6378 (Feb. 9, 2007).

collection of information would aid the Commission in determining whether the initiation of a de-registration proceeding under Section 15E(d) of the Exchange Act would be appropriate. In addition, the audited financial statements would assist the Commission in identifying potential conflicts of interest.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

Proposed Rule 17g-3 is not designed to collect information through electronic submission. NRSROs would submit audited financial statements in paper format.

4. Efforts To Identify Duplication

No duplication is apparent.

5. Effects on Small Entities

Small entities may be affected by the proposed rule because all NRSROs, regardless of size, would be required to submit audited financial statements to the Commission on an annual basis.

6. Consequences of Less Frequent Collection

If this information were not collected as frequently, the Commission would be unable to ascertain, on an ongoing basis, whether a credit rating agency registered as an NRSRO “fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.”⁵

7. Inconsistencies With Guidelines In 5 CFR 1320.5(d)(2)

The collection of information would not be inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. The comment period for the release that discusses proposed Rule 17g-3⁶ is 30 days. This comment period will afford the public an opportunity to respond to the proposal.

9. Payment or Gift to Respondents

Not applicable.

⁵ 15 U.S.C. 15E(d).

⁶ Release No. 34-55231 (Feb. 2, 2007), 72 FR 6378 (Feb. 9, 2007).

10. Assurance of Confidentiality

Pursuant to section 15E(k) of the Rating Agency Act, financial statements submitted to the Commission are submitted on a “confidential basis.”

11. Sensitive Questions

Not applicable. Questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

The number of respondents that would be subject to the proposed rule would depend, in part, on the number of entities that would meet the statutory requirements for eligibility for registration. Further, registration is voluntary, and, consequently, the number of respondents would also depend on the number of entities that would choose to register with the Commission. The Commission estimates that approximately 30 credit rating agencies would register with the Commission as NRSROs under section 15E of the Exchange Act.

We estimate that each NRSRO that registers with the Commission would take, on average, approximately 200 hours to prepare for and submit annual audited financial statements.⁷ Consequently, we estimate the total annual burden for all 30 NRSROs to be approximately 6,000 hours.⁸

13. Estimate of Total Annualized Cost Burden

The cost of an audit by an independent public accountant would vary substantially with the size and complexity of the NRSRO. Based on staff experience, the annual audit costs of a small broker-dealer generally range from \$3,000 to \$5,000 a year. The Commission estimates that the annual audit costs for a small NRSRO would likely be comparable to the costs incurred by a small broker-dealer. The cost of an audit for a large NRSRO would be much greater. Although many of the large firms already are audited by an independent public accountant for other regulatory purposes, these firms may incur some additional audit costs because proposed Rule 17g-3 would require that the audited financial statements include certain supporting schedules. For these reasons, the Commission estimates that, on average, an NRSRO will pay an independent public accountant approximately \$15,000 per year to perform an audit or audit procedures that would be required by proposed Rule 17g-3. Therefore, the annual cost burden to the industry would be approximately \$450,000.⁹

⁷ 17 CFR 240.15c3-1 and 17i-5.

⁸ (200 hours) x 30 NRSROs = 6,000 hours. This estimate is based on the current PRA estimates used for consolidated supervised entities (“CSEs”) under Appendix G to Exchange Act Rule 15c3-1, as well as the PRA estimates for supervised investment bank holding companies under Exchange Act Rule 17i-5.

⁹ \$15,000 x 30 NRSROs = \$450,000.

In the proposing release, the Commission is seeking comment on the cost estimates of the proposed rule. Specifically, the Commission is seeking comment on any costs an NRSRO might incur to make changes to its accounting system in order to comply with proposed Rule 17g-3.

14. Estimate of Cost to Federal Government

Commission staff estimates that the review and processing of the annual audited financial statements of an NRSRO would take approximately 5 hours of staff time. We estimate that the hourly cost, including related overhead, is \$75 per hour. Therefore, the cost to the government to review and process the 30 annual audits we estimate we would receive from NRSROs would be approximately \$11,250 (5 hours x 30 annual audits x \$75 = \$11,250).

For purposes of this submission, our estimates regarding cost burdens have been computed according to the guidelines set forth in GSA, Guide to Estimating Reporting Costs (1973). Accordingly, the Commission has assumed that related overhead would be 35 percent of the salaries of Commission staff.

15. Explanation of Changes in Burden

Not applicable. Proposed Rule 17g-3 would be a new rule.

16. Information Collection Planned for Statistical Purposes

Not applicable. There is no intention to publish the information for any purpose.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor would the implementation of such methods reduce the burden or improve the accuracy of results.