

## **Text of Proposed Rules**

### **List of Subjects**

#### **17 CFR Parts 240 and 249b**

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

#### **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES**

##### **EXCHANGE ACT OF 1934**

1. The authority for Part 240 continues to read in part as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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2. Sections 240.17g-1 through 240.17g-6 are added to read as follows:

##### **Nationally Recognized Statistical Rating Organizations**

Sec.

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| 240.17g-1 | Application for registration as a nationally recognized statistical rating organization.                       |
| 240.17g-2 | Records to be made and retained by nationally recognized statistical rating organizations.                     |
| 240.17g-3 | Annual audited financial statements to be furnished by nationally recognized statistical rating organizations. |
| 240.17g-4 | Prevention of misuse of material nonpublic information.  |
| 240.17g-5 | Conflicts of interest.   |

240.17g-6 Prohibited acts and practices.

**§ 240.17g-1 Application for registration as a nationally recognized statistical rating organization.**

(a) Form of registration. A credit rating agency applying to the Commission to be registered under section 15E of the Act (15 U.S.C. 78o-7) as a nationally recognized statistical rating organization with respect to one or more of the categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) must furnish the Commission with an initial application on Form NRSRO (§249b.300 of this chapter) that follows all applicable instructions for the form.

(b) Furnishing and withdrawing initial application. (1) An initial application will be considered furnished to the Commission on the date the Commission receives a complete and properly executed initial application on Form NRSRO that follows all instructions for the form. Information submitted on a confidential basis will be accorded confidential treatment to the extent permitted by law.

(2) The applicant may withdraw an application prior to the date of a Commission order granting or denying the application. To withdraw the application, the applicant must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

(c) Updating application prior to final action by the Commission. The applicant must promptly furnish the Commission with a written notice if information submitted to the Commission on Form NRSRO, including exhibits and attachments, is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must describe the circumstances in which the

information was found to be inaccurate. The applicant must also update the application with accurate and complete information by promptly furnishing the Commission with an amended initial application on Form NRSRO that follows all applicable instructions for the form.

(d) Public availability of Form NRSRO. A credit rating agency registered as a nationally recognized statistical rating organization (“rating organization”) must make the current Form NRSRO and non-confidential exhibits publicly available by posting them on its Web site or by another comparable and readily accessible means within 5 business days of the date of the Commission order granting the application and, subsequently, within 5 business days of furnishing an amendment or an annual certification on Form NRSRO.

(e) Amending scope of registration. A rating organization that is registered for fewer than the five categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) may apply to be registered for an additional category by furnishing the Commission with an amendment on Form NRSRO indicating where appropriate on the Form the additional class for which registration is sought and following all applicable instructions for the Form. The application to amend the scope of the registration will be subject to the requirements of this section and section 15E(a)(2) of the Act (15 U.S.C. 78o-7(a)(2)) applicable to an initial application for registration, including with respect to the time periods and requirements for the Commission to grant or deny the application.

(f) Updating Form NRSRO after registration. A rating organization amending its application for registration pursuant to the requirements of section 15E(b)(1) of the

Act (15 U.S.C. 78o-7(b)(1)) must promptly furnish the Commission with the amendment on Form NRSRO that follows all applicable instructions for the Form.

(g) Annual certification. A rating organization submitting its annual certification pursuant to the requirements of section 15E(b)(2) of the Act (15 U.S.C. 78o-7(b)(2)) must furnish the Commission with the annual certification on Form NRSRO that follows all applicable instructions for the Form not later than 90 days after the end of each calendar year.

(h) Withdrawal of registration. A rating organization withdrawing its registration must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

**§ 240.17g-2 Records to be made and retained by nationally recognized statistical rating organizations.**

(a) Records required to be made and retained. Every credit rating agency registered with the Commission as a nationally recognized statistical rating organization (“rating organization”) must make and retain the following books and records, which must be complete and current:

(1) Records of original entry into the rating organization’s accounting system and records reflecting entries to and balances in all general ledger accounts of the rating organization for each fiscal year.

(2) Records with respect to each of the rating organization’s current credit ratings indicating (as applicable):

- (i) The identity of any credit analyst(s) that determined the rating;
- (ii) The identity of the person(s) who approved the rating before it was issued;
- (iii) The procedures and methodologies used to determine the rating;

(iv) The method by which the credit rating was made readily accessible;

(v) Whether the credit rating was solicited or unsolicited; and

(vi) The date the credit rating action was taken.

(3) A record for each person (for example, an obligor, issuer, underwriter, or other user) that solicits the rating organization to determine or maintain a credit rating indicating:

(i) The identity and principal business address of the person; and

(ii) The credit rating(s) determined for the person.

(4) A record for each subscriber to the credit ratings and/or credit analysis of the rating organization indicating the identity and principal business address of the subscriber and the compensation received from the subscriber.

(5) A record describing each type of service and product offered by the rating organization.

(b) Records required to be retained. A rating organization must retain the following books and records:

(1) All significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the rating organization's annual audited financial statements and schedules furnished to the Commission pursuant to §240.17g-3.

(2) Internal records, including non-public information and work papers, used to determine a credit rating.

(3) Credit analysis reports, credit assessment reports, and private rating reports and internal records, including non-public information and work papers, used to form the basis for the opinions expressed in these reports.

(4) All compliance reports and compliance exception reports that relate to its business as a credit rating agency.

(5) All internal audit plans, internal audit reports, documents relating to internal audit follow-up measures that relate to its business as a credit rating agency, and all records identified by the rating organization's internal auditors as necessary to perform the audit of an activity that relates to its business as a credit rating agency.

(6) All marketing materials that relate to its business as a credit rating agency.

(7) All external and internal communications, including electronic communications, received and sent by the rating organization and its employees relating to initiating, determining, maintaining, changing, or withdrawing a credit rating.

(8) All records made pursuant to paragraph (b) of §240.17g-6.

(9) All Form NRSROs (including information and documents in the exhibits thereto) furnished to the Commission.

(c) Record retention periods. (1) The records required to be retained pursuant to paragraphs (a)(1), (a)(2), and (a)(5) of this section must be retained for three years after the date the record is replaced with an updated record.

(2) The records required to be retained pursuant to paragraphs (a)(3) and (a)(4) of this section must be retained for three years after the date of the last receipt by the person in the record of a service or product of the rating organization.

(3) The records required to be retained pursuant to paragraphs (b)(1) through (b)(9) of this section must be retained for three years after the date the record is made or received by the NRSRO.

(d) Manner of retention. An original or true and complete copy of the original of each record required to be retained pursuant to paragraphs (a) and (b) of this section must be maintained in a manner that, for the applicable retention period specified in paragraph (c) of this section, makes the original record or copy easily accessible to the rating organization's principal office and to any other office that conducted activities causing the record to be made or received.

(e) Third-party record custodian. The records required to be retained pursuant to paragraphs (a) and (b) of this section may be made or retained by a third-party record custodian, provided the rating organization furnishes the Commission at its principal office in Washington, DC with a written undertaking of the custodian executed by a duly authorized person. The undertaking must acknowledge that the records are the property of the rating organization, will be surrendered promptly on request of the rating organization, and that the custodian will permit the Commission or its representatives to examine the records. The undertaking must be in substantially the following form:

The undersigned acknowledges that books and records it has made or is retaining for [the rating organization] are the exclusive property of [the rating organization] and the undersigned undertakes that upon the request of [the rating organization] it will promptly provide the books and records to [the rating organization] or the U.S. Securities and Exchange Commission ("Commission") and its representatives and that upon the request of the Commission it will promptly permit examination by the Commission and its representatives of the records at any time or from time to time during business hours, and promptly furnish to the Commission and its representatives a true and complete copy of any or all or any part of such books and records.

A rating organization that agrees with a third-party custodian to have the custodian make or retain any record specified in paragraphs (a) and (b) of this section remains responsible for complying with every provision in this section, notwithstanding the agreement.

(f) Non-resident undertaking. A non-resident rating organization, as defined in paragraph (h) of this section, must undertake to provide books and records to the Commission upon demand. The undertaking must be attached to the rating organization's initial application for registration as a nationally recognized statistical rating organization, signed by a duly authorized person, marked "Non-Resident Books and Records Undertaking," and in substantially the following form:

Upon a request by the U.S. Securities and Exchange Commission ("Commission") and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at its principal office in Washington, DC, an accurate copy of any book(s) and record(s) which [the rating organization] is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Securities Exchange Act of 1934 or any regulation under that Act. [The rating organization] will produce the requested copy of the book(s) or record(s), in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period.

(g) A rating organization must promptly furnish the Commission and its representatives with legible, complete, and current copies of those records of the rating organization required to be retained under this section, or any other records of the rating organization subject to examination under section 17(b) of the Act (15 U.S.C. 78q(b)) that are requested by the Commission and its representatives.

(h) Where used in this section non-resident rating organization means a rating organization that:

(1) If a corporation, is incorporated or has its principal office in a location outside the United States, its territories, or possessions; or



(2) If a partnership or other unincorporated organization or association, is organized under the laws of a jurisdiction or has its principal office in a location outside the United States, its territories, or possessions.

**§ 240.17g-3 Annual audited financial statements to be furnished by nationally recognized statistical rating organizations.**

(a) A credit rating agency registered with the Commission as a nationally recognized statistical rating organization (“rating organization”) annually must furnish the Commission, at its principal office in Washington, DC, with audited financial statements. The audited financial statements must be prepared in accordance with generally accepted accounting principles, must comply with applicable provisions of Regulation S-X (§210.1-01 - §210.12-29, of this chapter), must be as of the fiscal year end indicated on the rating organization’s current Form NRSRO, and must be furnished not more than 90 calendar days after the end of the fiscal year.

(b) The audited financial statements must include the following supporting schedules:

(1) A schedule separately itemizing the following aggregate revenues (as applicable):

(i) Revenue from determining and maintaining credit ratings;

(ii) Revenue from subscribers;

(iii) Revenue from granting licenses or rights to publish credit ratings;

(iv) Revenue from determining credit ratings that are not made readily accessible (private ratings); and

(v) Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue);

(2) A schedule providing the total aggregate and median annual compensation of the rating organization's credit analysts; and

(3) A schedule listing the 20 largest issuers and subscribers that used credit rating services provided by the rating organization by amount of net revenue received by the rating organization and its affiliates from the issuer or subscriber during the fiscal year. In addition, add to the list any obligor or underwriter that used credit rating services provided by the rating organization if the net revenue received by the rating organization and its affiliates from the obligor or underwriter during the fiscal year equaled or exceeded the net revenue received from the 20<sup>th</sup> largest issuer or subscriber. Include the net revenue amount for each customer.

Note to paragraph (b)(3): A customer would have used the "credit rating services" of the rating organization if the customer was any of the following: an obligor that is rated by the rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market

instruments rated by the rating organization (regardless of whether the issuer paid for the credit rating); any other person that has paid the rating organization to determine a credit rating with respect to a specific obligor, security, or money market instrument; or a subscriber to the credit ratings of the rating organization. In calculating net revenue received from a customer, the rating organization should include all fees, sales proceeds, commissions, and other revenue received by the rating organization and its affiliates for any type of service or product, regardless of whether related to credit rating services, and net of any fees, sales proceeds, rebates, and monies paid to the customer by the rating organization and its affiliates.

(c) The audited financial statements must be furnished in accordance with the following:

(1) They must be certified by an accountant who is qualified and independent in accordance with paragraphs (a) through (c) of §210.2-01 of this chapter, and the accountant must give an opinion on the financial statements and schedules in accordance with paragraphs (a) through (d) of §210.2-02 of this chapter; and

(2) The rating organization must attach to the financial statements a signed statement by a duly authorized person at the rating organization that the person has responsibility for the financial statements and, to the best knowledge of the person, the financial statements fairly present, in all material respects, the financial condition, results of operations, and cash flows of the rating organization for the period presented.

(d) The Commission may grant an extension of time from any requirements in this section either unconditionally or on specified terms and conditions on the written request of a rating organization if the Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

**§ 240.17g-4 Prevention of misuse of material nonpublic information.**

The written policies and procedures a nationally recognized statistical rating organization (“rating organization”) establishes, maintains, and enforces to prevent the

misuse of material nonpublic information in accordance with section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) must include:

(a) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of material nonpublic information obtained in connection with the performance of credit rating services;

(b) Procedures designed to prevent a person associated with the rating organization or any member of an associated person's household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments; and

(c) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of a pending credit rating action prior to making the action readily accessible.

**§ 240.17g-5 Conflicts of interest.**

(a) It shall be unlawful for a nationally recognized statistical rating organization ("rating organization") or a person associated with the rating organization to have a conflict of interest relating to the issuance of a credit rating identified in paragraph (b) of this section, unless:

(1) The rating organization has disclosed the type of conflict of interest on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)); and

(2) The rating organization has implemented policies and procedures to address and manage conflicts of interest in accordance with section 15E(h) of the Act (15 U.S.C. 78o-7(h)).

(b) Conflicts of interest. For purposes of this section, each of the following is a conflict of interest:

(1) Receiving compensation for any type of service or product from a person that is subject to a pending or issued credit rating of the rating organization.

(2) Owning securities or money market instruments of a person that is subject to a pending or issued credit rating of the rating organization.

(3) Receiving compensation from a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(4) Owning securities or money market instruments of, or having any other form of ownership interest in, a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(5) Having any other business, personal, or ownership relationship or affiliation with a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(6) Being an officer or director of a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(7) Any other type of conflict of interest identified by the rating organization on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)).

(c) Prohibited conflicts. It shall be unlawful for a rating organization to have a conflict of interest relating to the issuance of a credit rating in the following circumstances:

(1) The rating organization issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the rating organization and its affiliates with net revenue (as determined under §240.17g-3) equaling or exceeding 10% of the total net revenue of the rating organization and its affiliates for the year;

(2) The rating organization issues or maintains a credit rating with respect to a person where the rating organization, a credit analyst who participated in determining the credit rating, or a person associated with the rating organization responsible for approving the credit rating, owns securities of, or has any other ownership interest in, the rated person or is a borrower or lender with respect to the rated person;

(3) The rating organization issues or maintains a credit rating with respect to a person associated with the rating organization; or

(4) The rating organization issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person associated with the rating organization responsible for approving the credit rating, is also an officer or director of the person that is subject to the credit rating.

**§ 240.17g-6 Prohibited acts and practices.**

(a) Prohibitions. It shall be unlawful for a nationally recognized statistical rating organization (“rating organization”) to engage in any of the following unfair, coercive, or abusive practices:

(1) Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the rating organization or any person associated with the rating organization.

(2) Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the rating organization’s established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the rating organization or any person associated with the rating organization.

(3) Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the rating organization’s established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the rating organization or any person associated with the rating organization.

(4) Issuing or threatening to issue a lower credit rating, or lowering or threatening to lower an existing credit rating, or refusing to issue a credit rating or withdrawing a credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets which comprise the asset pool or the asset-backed or mortgaged-

backed securities also are rated by the rating organization. The prohibitions on refusing to issue a credit rating or withdrawing a credit rating shall not apply if the rating organization has rated less than 85% of the market value of the assets underlying the asset pool or the asset-backed or mortgage-backed securities.

(5) Issuing an unsolicited credit rating and communicating with the rated person to induce or attempt to induce the rated person to pay for the credit rating or any other service or product of the rating organization or a person associated with the rating organization.

(b) A rating organization refusing to issue a credit rating or withdrawing a credit rating with respect to an asset pool or the asset-backed or mortgaged-backed security must document in writing the reason for the refusal or withdrawal.

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#### **PART 249b– FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934**

3. The authority citation for Part 249b continues to read in part as follows.

Authority: 15 U.S.C. 78a et seq., unless otherwise noted;

\* \* \* \* \*

4. Section 249b.300 and Form NRSRO are added to read as follows:

#### **§249b.300 FORM NRSRO, application for registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 and §240.17g-1 of this chapter.**

This form shall be used for application for, and amendments to applications for, registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7) and §240.17g-1 of this chapter.



Note: The text of Form NRSRO will not appear in the Code of Federal Regulations.