

Rule 17g-7: Credit rating reports 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,” and 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. In 2007, the Commission adopted rules to implement specific provisions of the Rating Agency Act, as well as other registration, recordkeeping, financial reporting and oversight rules.²

The Commission is proposing rule amendments that would impose additional requirements on NRSROs in order to address concerns about the integrity of their credit rating procedures and methodologies in the light of the role they played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages.

Proposed Rule 17g-7 contains reporting and disclosure requirements. The collection of information obligations imposed by the proposed rule would be mandatory. Proposed Rule 17g-7, 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 amended Section 17(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) to add NRSROs to the list of entities required to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.³

Specifically, under proposed Rule 17g-7, each time an NRSRO publishes a credit rating for a structured finance product it also would be required to publish a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments such as corporate and municipal debt securities. As an alternative to publishing the report, an NRSRO would be allowed to use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities.

¹ Pub. L. No. 109-291.

² Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007).

³ See Section 5 of the Act and 15 U.S.C 78q(a)(1).

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

The Commission preliminarily believes these proposed amendments are necessary and appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act because they are designed to encourage investors to perform greater levels of internal risk assessment of structured finance products by putting them on notice that these products have different characteristics than other types of rated debt instruments.

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

Proposed Rule 17g-7 would require each time an NRSRO published a credit rating for a structured finance product that an NRSRO also publish a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments such as corporate and municipal debt securities. This report could be made and retained electronically. As an alternative to publishing the report, an NRSRO would be allowed to use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities.

The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens associated with proposed Rule 17g-7. NRSROs are not prevented by proposed Rule 17g-7 from using computers or other mechanical devices to generate the report or differentiated symbols required under the proposed rule.

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 each time an NRSRO published a credit rating for a structured finance product to also publish a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments such as corporate and municipal debt securities. As an alternative to publishing the report, an NRSRO would be allowed to use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities.

6. Consequences of Less Frequent Collection

If this information were not collected as frequently, the Commission preliminarily believes that investors will not be alerted that there are different rating methodologies and risk characteristics associated with structured finance products.

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-7⁴ 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.

10. Assurance of Confidentiality

The information collection under proposed Rule 17g-7 will not be confidential.

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.

The Commission expects that most NRSROs already have documented their methodologies and procedures in place to determine credit ratings for structured finance products and corporate debt securities, and have disclosed such policies and procedures if they have registered with the Commission as an NRSRO. The Commission expects, however, that an NRSRO would have to compile and/or modify these documents to comply with the specific reporting requirements that would be mandated by the proposed

⁴ Exchange Act Release No. 57967 (June 11, 2008), 73 FR 36212 (June 25, 2008).

rule. Based on staff information gained from the NRSRO examination process, the Commission estimates that it would take an NRSRO approximately 50 hours⁵ to draft the report required under the proposed rule for a total one-time hour burden of 1,500 hours.⁶

The Commission also estimates that it would take an NRSRO additional time to publish the report each time a credit rating for a structured finance product is published and to monitor the publications of structured finance credit ratings to ensure compliance with the proposed rule. Based on the average number of credit ratings of asset-backed securities outstanding as of the latest fiscal year of the three largest NRSROs, the Commission estimates that an NRSRO would publish approximately 128,000 asset-backed credit ratings per year.⁷ The Commission notes that this number may not include all structured finance ratings, since some may not fit within the statutory definition of asset-backed security. However, the Commission also notes that the issuance of RMBS has dropped dramatically off recent highs. Accordingly, the Commission believes the number of asset-backed ratings reported in Form NRSRO is a reasonable proxy for the number of structured finance ratings. The Commission also notes that, as discussed below, the burden estimate identifies 30 respondents. However, most of the structured finance ratings are concentrated in the largest 3 or 4 NRSROs. Accordingly, the average number of structured finance ratings issued per NRSRO each year may be considerably lower than 128,000. For these reasons, the Commission believes the estimate is fairly conservative.

The Commission estimates that an NRSRO would publish a rating action with respect to a particular structured finance rating approximately 4 times per year for a total of 512,000 publications.⁸ The Commission notes that this estimate would include publication of an initial rating, upgrades, downgrades and any affirmations published in a given year. Based on staff experience, the Commission estimates that an NRSRO would spend approximately 5 minutes ensuring that the required report was published along with the credit rating, for a total of 42,667 annual burden hours⁹ per respondent, and a total of 1,280,010 hours¹⁰ across 30 NRSROs. Finally, the Commission estimates, based on staff experience, that it would take an NRSRO approximately 10 hours per year to review and update the report to ensure that the disclosure was accurate and up-to-date for

⁵ The Commission based this estimate on the estimated number of hours it would take an NRSRO to comply with Rule 17g-4 to develop policies and procedures to prevent the misuse of material nonpublic information. See Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564, 33611 (June 18, 2007).

⁶ 50 hours x 30 NRSROs = 1,500 hours.

⁷ This estimate uses the average of the approximate number of credit ratings for asset-based securities as defined in 17 CFR 229.1101(c) that S&P, Moody's and Fitch had outstanding as of the most recent calendar year end as reported in their annual certifications. (S&P: 197,700; Moody's: 110,000; and Fitch: 75,278).

⁸ 128,000 x 4 = 512,000 ratings publications.

⁹ 512,000 x 5 minutes per report = 2,560,000 minutes/60 minutes per hour = 42,667 hours.

¹⁰ 42,667 hours x 30 NRSROs = 1,280,010 hours.

a total aggregate annual hour burden to the industry of 300 hours.¹¹ The Commission believes, therefore, that the aggregate one-time and annual burden hours under proposed Rule 17g-7(a) would be 1,280,010 and 1,800 hours,¹² respectively.

The Commission believes, however, that most, if not all, NRSROs would opt to differentiate their ratings under paragraph (b) of proposed Rule 17g-7,¹³ rather than publish a report. The Commission believes that an NRSRO would likely choose to use a specific credit rating symbol to indicate that the particular credit rating relates to a structured product as distinct from a credit rating for any other category of security or issuer. The Commission believes that an NRSRO would choose to employ this symbology approach because it would be more efficient and less burdensome than ensuring that the appropriate report was published along with the credit rating. The Commission believes that the implementation of a different rating symbol would entail a one-time burden of approximately 30 hours to develop the symbol for a total aggregate one-time burden to the industry of 900 hours.¹⁴

Because the Commission believes that NRSROs will choose to differentiate their ratings under paragraph (b) of proposed Rule 17g-7 rather than publish a report under paragraph (a) of the proposed new rule, the Commission believes that the appropriate estimate for the aggregate one-time burden to the industry under proposed Rule 17g-7(b) is 900 hours.

13. Estimate of Total Annualized Cost Burden

The Commission believes that there would be no reporting costs associated with the proposed rule.

14. Estimate of Cost to Federal Government

There would be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

Not applicable. Proposed Rule 17g-7 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.

¹¹ This estimate is based on the number of hours it would take an NRSRO to complete an annual certification on Form NRSRO. See Adopting Release at 33609 (June 18, 2007). 10 hours x 30 NRSROs = 300 hours.

¹² 1,500 + 300 hours.

¹³ See proposed Rule 17g-7(b).

¹⁴ 30 hours x 30 NRSROs.

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.