

Rule 17g-2: Records to be made and retained 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.

The Commission adopted rule amendments that impose additional requirements on NRSROs in order to address concerns about the integrity of their credit rating procedures and methodologies in light of the role they played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages.²

Rule 17g-2 contains recordkeeping and disclosure requirements. The collection of information obligations imposed by the rule is mandatory. The requirements of Rule 17g-2, however, 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 The inclusion of NRSROs on the list also provides the Commission with authority under Section 17(b)(1) of the Exchange Act to examine all the records of an NRSRO.⁴

Rule 17g-2, “Records to be made and retained by nationally recognized statistical rating organizations,” implements the Commission’s recordkeeping rulemaking authority under Section 17(a) of the Exchange Act.⁵ The rule requires an NRSRO to make and retain certain records relating to its business and to retain certain other business records, if such records are made. The rule also prescribes the time periods and manner in which all these records must be retained.

¹ Pub. L. No. 109-291.

² Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6456 (February 9, 2009).

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

⁴ See 15 U.S.C 78q(b)(1).

⁵ 15 U.S.C 78q.

The amendments to Rule 17g-2 require an NRSRO to make and retain two additional records; to retain a third type of record.⁶ The records to be made and retained are: (1) a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued, if a quantitative model is a substantial component in the process of determining a credit rating of a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction;⁷ and (2) a record showing the history and dates of all previous rating actions with respect to each outstanding credit rating.⁸ In addition, the amendments require an NRSRO to retain communications from persons not associated with the NRSRO that contain any complaints by an obligor, issuer, underwriter, or sponsor about the performance of a credit analyst.⁹

In addition to the rule changes described above, the amendments to Rule 17g-2 also require an NRSRO to make public, in XBRL format and with a six-month grace period, the ratings action information required under new paragraph (a)(8) for a random sample of 10% of the issuer paid credit ratings for each ratings class for which it has issued 500 or more issuer-paid credit ratings.¹⁰

The requirements of Rule 17g-2 are designed to ensure that an NRSRO makes and retains records that assist the Commission in monitoring, through its examination authority, whether an NRSRO continues to meet the requirements for registration as an NRSRO and whether the NRSRO is complying with applicable laws and regulations.

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

The collections of information in Rule 17g-2 are designed to allow the Commission to determine whether an NRSRO continues to meet the requirements for registration and is complying with applicable laws and regulations. In particular, the collections of information in Rule 17g-2 will assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E of the Exchange Act,¹¹ and applicable Exchange Act rules under the Rating Agency Act.

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

The records that the amendments to Rule 17g-2 require NRSROs to make and retain could be made and retained electronically. **The Commission believes that**

⁶ See Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6456 (February 9, 2009); see also Exchange Act Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008).

⁷ Paragraph (a)(2)(iii) of Rule 17g-2.

⁸ Paragraph (a)(8) of Rule 17g-2.

⁹ Paragraph (b)(8) of Rule 17g-2.

¹⁰ Amendment to Rule 17g-2(d).

¹¹ 15 U.S.C. 78o-7.

improvements in telecommunications and data processing technology may reduce any burdens associated with the amendments to Rule 17g-2. NRSROs are not prevented by Rule 17g-2 from using computers or other mechanical devices to generate the records required under the rule.

In addition, the amendments to Rule 17g-2 also require an NRSRO to make public, in XBRL format and with a six-month grace period, the ratings action information required under new paragraph (a)(8) for a random sample of 10% of the issuer paid credit ratings for each ratings class for which it has issued 500 or more issuer-paid credit ratings.¹²

4. Efforts To Identify Duplication

No duplication is apparent.

5. Effects on Small Entities

Small entities may be affected by the rule amendments because all credit rating agencies, regardless of size, that are registered as NRSROs will be required to make and retain records in accordance with Rule 17g-2.

6. Consequences of Less Frequent Collection

Up to date records are essential for the Commission to monitor whether an NRSRO continues to meet the requirements for registration as an NRSRO. If an NRSRO did not make these records, or if it made these records less frequently, the goals of the Rating Agency Act--including enhancing the information used by investors to make investment decisions--will be diminished.

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 discussed the amendments to Rule 17g-2 was 30 days.¹³ This comment period afforded the public an opportunity to respond to the proposal. The Commission received one comment on this burden estimate in the proposing release.

¹² Amendment to Rule 17g-2(d).

¹³ Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6456 (February 9, 2009).

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Rule 17g-2(d) will require certain information required to be made and retained by an NRSRO to be made publicly available. The rest of the information required to be made and maintained under the amendments will be available only to the examination staff of the Commission. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. 552 (“FOIA”) and the Commission’s rules under FOIA (17 CFR 200.80(b)(4) (iii)), the Commission generally does not publish or make available information contained in reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

11. Sensitive Questions

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

12. Estimate of Respondent Reporting Burden

The number of respondents that will be subject to Rule 17g-2 will depend, in part, on the number of entities that will meet the statutory requirements for eligibility for registration. Further, registration is voluntary, and, consequently, the number of respondents will also depend on the number of entities that will choose to register with the Commission. The Commission estimates that approximately 30 credit rating agencies will register with the Commission as NRSROs under section 15E of the Exchange Act.

As a result of the amendments to Rule 17g-2, the Commission estimates, based on staff information gained from the NRSRO examination process and in response to comments received, that the total one-time and annual recordkeeping burdens will increase approximately 15% and 10%, respectively. Therefore, the Commission estimates that the average one-time burden of implementing a recordkeeping system to comply with Rule 17g-2 will be approximately 345 hours,¹⁴ for a total one-time burden of 10,350 hours for 30 NRSROs.¹⁵ Additionally, the Commission estimates that an NRSRO will spend an average of 279 hours per year¹⁶ to make and retain records under Rule 17g-2 as amended, for a total annual hour burden under Rule 17g-2 of 8,370 hours.¹⁷

In addition, Rule 17g-2 requires an NRSRO to make publicly available on its Web site in XBRL format ratings action histories for a random sample of 10% of its outstanding issuer-paid credit ratings in each class of credit rating for which it is

¹⁴ 300 hours x 1.15 = 345 hours.

¹⁵ 345 hours x 30 respondents = 10,350 hours.

¹⁶ 254 hours x 1.10 = 279 hours.

¹⁷ 279 hours x 30 respondents = 8,370 hours.

registered and has determined 500 or more issuer-paid credit ratings.¹⁸ Based on information furnished on Form NRSRO, seven of the ten currently registered NRSROs issue 500 or more issuer-paid credit ratings in at least one of the classes of credit ratings for which they are registered. The Commission believes that even as the number of registered NRSROs expands to the 30 ultimately expected to register, this number will remain relatively constant, as new entrants are likely to predominantly determine subscriber-paid credit ratings, at least in the near future. In addition, the Commission believes that each of the NRSROs affected by this new requirement already has, or will have, an Internet Web site. The amendment, as adopted, specifies that in making the required information available on its Web site, an NRSRO will use the List of XBRL Tags for NRSROs as specified on the Commission's Web site, thus eliminating the need for an NRSRO to develop its own taxonomy and tags and significantly reducing the amount of time required to comply with the amendment.

Therefore, based on staff experience, the Commission estimates that, on average, an NRSRO subject to the requirement will spend approximately 30 hours to publicly disclose the required information in an XBRL format and, thereafter, 10 hours per year to update this information.¹⁹ Accordingly, the total aggregate one-time burden to the industry to make the history of rating actions publicly available in an XBRL format will be 210 hours,²⁰ and the total aggregate annual burden hours will be 70 hours.²¹

Rule 17g-2 also requires that an NRSRO that uses a third-party record custodian furnish the Commission with an undertaking from the custodian. Based on staff experience, the Commission estimates that approximately five NRSROs will file this undertaking on a one-time basis. The Commission estimates, based on staff experience, that it will take an NRSRO approximately 10 hours to complete an undertaking prior to furnishing it to the Commission.²² Therefore, the Commission estimates that the total one-time hour burden for this undertaking will be 50 hours.²³

Under the currently approved PRA collection for Rule 17g-2, the Commission estimated that an NRSRO may need to purchase recordkeeping system software to establish a recordkeeping system in conformance with Rule 17g-2. The Commission estimated that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimated that some NRSROs would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission

¹⁸ See amendment to Rule 17g-2(d).

¹⁹ The Commission also bases this estimate on the current one-time and annual burden hours for an NRSRO to publicly disclose its Form NRSRO. No alternatives to these estimates as proposed were suggested by commenters. See June 5, 2007 Adopting Release, 72 FR at 33609.

²⁰ 30 hours x 7 NRSROs = 210 hours.

²¹ 10 hours x 7 NRSROs = 70 hours.

²² The estimated 10 hours includes drafting, legal review, and receiving corporate authorization to file the undertaking with the Commission.

²³ 10 hours x 5 NRSROs = 50 hours. This estimate is the same as the previous hours estimate to use a third-party record custodian.

estimated that the average cost for recordkeeping software across all NRSROs would be approximately \$1,000 per firm, with an aggregate one-time cost to the industry of \$30,000.

The Commission also estimates that the amendments to Rule 17g-2 will alter this \$30,000 estimate upward by approximately \$800 per firm.²⁴ For example, in the PRA for the proposed rules requiring the submission of risk/return summary information using interactive data, the Commission estimated that software and consulting services would be used by mutual funds for an increase of approximately \$803 per mutual fund.²⁵ The Commission believes that the requirement to publicly disclose certain ratings action histories in an XBRL format will result in a similar cost. Therefore, the Commission believes that the one-time cost to the industry discussed above will increase by \$5,600,²⁶ for a total one-time cost to the industry for Rule 17g-2 of \$35,600 (\$30,000 + \$5,600).

The Commission therefore estimates that the burden associated with Rule 17g-2 is 10,610 hours (10,350 + 210 + 50 = 10,610) on a one-time basis; 8,440 hours (8,370 + 70 = 8,440) on an annual basis; and a cost \$35,600 on a one-time basis. (For purposes of the 83-I only, the one time hour and cost burden are amortized over the three-year approval period, producing an annual hour burden of approximately 12,000 hours per year (10,610 / 3 plus 8,440) and an annual cost burden of \$11,850).

13. Estimate of Total Annualized Cost Burden

The Commission believes that there would be no additional reporting costs associated with Rule 17g-2, other than the costs described in Item 12 above.

14. Estimate of Cost to Federal Government

There would be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The new burden associated with Rule 17g-2 as a result of the final rule amendments is 10,610 hours (10,350 + 210 + 50) on a one-time basis, a decrease of 240 hours; 8,440 hours (8,370 + 70) on an annual basis, an increase of 130 hours; and a one-time cost of \$35,600, an increase of \$5,600.

In response to comments, the Commission estimated that the one-time burden that each NRSRO will spend implementing a recordkeeping system to comply with Rule 17g-2, as amended, will be 10,350 hours for 30 NRSROs (345 hours x 30 NRSROs), and the annual hour burden that an NRSRO will spend to make and retain records will be 8,370 hours (279 hours x 30 NRSROs). The Commission also estimated that the total

²⁴ See Interactive Data for Mutual Fund Risk/Return Summary, Securities Act Release No. 8929 (June 10, 2008), 73 FR 35442 (June 23, 2008).

²⁵ Id.

²⁶ \$800 x 7 = \$5,600.

aggregate one-time burden to the industry to make the history of rating actions publicly available in XBRL format will be 210 hours, and the total aggregate annual burden hours will be 70 hours.

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 will not employ statistical methods, nor will the implementation of such methods reduce the burden or improve the accuracy of results.