

Rule 17g-1: Application for registration as a nationally recognized statistical rating organization

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 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 the light of the role they played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages.³

Rule 17g-1 and Form NRSRO contain recordkeeping and disclosure requirements. The collection of information obligations imposed by Rule 17g-1 and Form NRSRO is mandatory. Rule 17g-1 and Form NRSRO, however, apply only to credit rating agencies that are applying to register or are registered with the Commission as NRSROs, and registration is voluntary.

Rule 17g-1 requires a credit rating agency to furnish an initial application on Form NRSRO.⁴ The rule also provides that if information on the application becomes materially inaccurate before the Commission has granted or denied the application, the credit rating agency must promptly notify the Commission and amend the application with accurate and complete information by submitting an amended initial application on Form NRSRO. Rule 17g-1 also provides that a credit rating agency could withdraw its application before the Commission takes final action on it by furnishing the Commission with a written notice of withdrawal executed by a duly authorized person. Once the application has been approved, Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend the application if any information or document provided as

¹ Pub. L. No. 109-291.

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

³ Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6456 (February 9, 2009).

⁴ This provision was implemented under the Commission’s authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o-7(a)(1)(A)); see also Release No. 34-55857 (June 5, 2007), 72 FR 33564 (June 18, 2007).

part of the application becomes materially inaccurate.⁵ Rule 17g-1 provides that an NRSRO is required to furnish the amendment to the Commission on Form NRSRO.

Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, must require an NRSRO, after registration, to make certain that the information submitted in its completed application and any amendments are made publicly available on its Web site or through another comparable, readily accessible means.⁶ It also permits the Commission to determine by rule the information that must be made publicly available.⁷ Rule 17g-1 requires that the information be made publicly available within 10 business days of the NRSRO being registered or furnishing an amendment to the application.

A credit rating agency may apply to be registered for fewer than all five categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act.⁸ Rule 17g-1 provides that an NRSRO registered for fewer than the five categories may apply to be registered with respect to an additional category by furnishing an amended Form NRSRO and indicating where appropriate on the Form the additional category for which it is applying to be registered.

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish the Commission with an amendment to its registration not later than 90 days after the end of each calendar year in a form prescribed by Commission rule (the “annual certification”).⁹ This section further provides that the amendment must (1) certify that the information and documents provided in the application for registration (except the QIB certifications) continue to be accurate and (2) list any material change to the information and documents that occurred during the previous calendar year. Rule 17g-1 implements these statutory provisions by requiring an NRSRO to furnish the annual certification on Form NRSRO.

Finally, Section 15E(e)(1) of the Exchange Act provides that an NRSRO may withdraw from registration, subject to terms and conditions the Commission may establish as necessary in the public interest or for the protection of investors, by furnishing the Commission with a written notice of withdrawal.¹⁰ Rule 17g-1 provides that an NRSRO must furnish the Commission with a withdrawal of registration on Form NRSRO.

The Commission proposed amendments to amend the instructions for Exhibit 6 to Form NRSRO to require a credit rating agency applying to be registered as an NRSRO or an NRSRO providing its annual update to Form NRSRO to publicly disclose: (1) the percentage of the net revenue of the applicant/NRSRO attributable to the 20 largest users

⁵ 15 U.S.C. 78o-7(b)(1).

⁶ 15 U.S.C. 78o-7(a)(3).

⁷ Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o-7(a)(3)).

⁸ Section 15E(a)(1)(B)(vii) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(vii)) provides that a credit rating agency must submit information with its application regarding the categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)) for which it “intends to apply for registration.”

⁹ 15 U.S.C. 78o-7(b)(2).

¹⁰ 15 U.S.C. 78o-7(e)(1).

of credit rating services of the applicant/NRSRO; and (2) the percentage of the revenue of the applicant/NRSRO attributable to other services and products of the applicant/NRSRO.

The proposed amendments to the Exhibit 6 Instructions to Form NRSRO would require additional disclosures and are designed to further increase transparency by allowing users of credit ratings to more effectively evaluate the integrity of an NRSRO's credit ratings and analyze whether the NRSRO is effectively managing its conflicts of interests.¹¹

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

Rule 17g-1, Form NRSRO, and the Instructions for Form NRSRO create a registration program for NRSROs. The collections of information in the rules are designed to allow the Commission to determine whether an entity should be registered as an NRSRO. Further, they 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 and Exchange Act rules.

These rules also are designed to assist users of credit ratings by requiring the disclosure of information with respect to an NRSRO that could be used to compare the credit ratings quality of different NRSROs. The information may include: methods for determining credit ratings; organizational structure; policies for managing material, non-public information; information regarding conflicts of interest; policies for managing conflicts of interest; credit analyst experience; and management experience. As noted in the Senate Report accompanying the Act, the information that NRSROs will have to make public "will facilitate informed decisions by giving investors the opportunity to compare ratings quality of different firms."¹²

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

Form NRSRO is designed to be downloadable from the Commission Web site, and information could be entered on the Form and stored electronically. The Form, however, is submitted in paper format.

4. Efforts To Identify Duplication

No duplication is apparent.

¹¹ Exchange Act Release No. 61051 (Nov. 23, 2009); 74 FR 63866 (Dec. 4, 2009).

¹² See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

5. Effects on Small Entities

Small entities may be affected by the rule because all credit rating agencies, regardless of size, that wish to apply for registration as an NRSRO, amend their applications, and submit annual certifications, will be required to do so in accordance with the rule.

6. Consequences of Less Frequent Collection

The information would be collected in accordance with the Credit Rating Agency Reform Act of 2006, which specifies when applications for registration, amendments to applications, and annual certifications must be collected.

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

The collection of information is 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-7 is 60 days.¹³ 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

Some of the information collection under Rule 17g-1 will be afforded confidential treatment to the extent permitted by law. The proposed amendments to Form NRSRO would be disclosed to the public.

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 the rule will depend, in part, on the number of entities that will meet the statutory requirement to be eligible 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

¹³ Exchange Act Release No. 61051 (Nov. 23, 2009); 74 FR 63866 (Dec. 4, 2009).

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.

The Commission estimates that the average time necessary to complete the initial Form NRSRO, and compile the various attachments, will be approximately 300 hours per applicant. This estimate is based on staff experience with the current NRSRO no-action letter process.¹⁴ The Commission therefore estimates that the total one-time burden to the industry as a result of this requirement will be approximately 9,000 hours.¹⁵

As noted, Rule 17g-1 requires a credit rating agency to provide the Commission with a written notice if it intends to withdraw its application prior to final Commission action. Based on staff experience, the Commission estimates that one credit rating agency per year will withdraw a Form NRSRO prior to final Commission action on the application and, consequently, will furnish a notice of its intent to withdraw the application. Based on the Commission's current estimates for a broker-dealer to file a notice with the Commission under Rule 17a-1, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal will be one hour.¹⁶ Thus, the Commission estimates that the aggregate annual burden to the industry of providing a notice of withdrawal prior to final Commission action will be one hour per year.¹⁷

Rule 17g-1 also provides that an NRSRO registered for fewer than the five categories of credit ratings listed in Section 3(a)(62)(B) of the Exchange Act could apply to be registered for an additional category by furnishing an amendment on Form NRSRO.¹⁸ The Commission estimates that it will take an NRSRO substantially less time to update the Form NRSRO for this purpose than to prepare the initial application. For example, much of the information on the Form and many of the exhibits will still be current and not have to be updated. Based on the Commission's estimate of the burden to complete a Form ADV, the Commission estimates that filing an amended Form NRSRO for this purpose will take an average of approximately 25 hours.¹⁹

The Commission further estimates based on staff experience that approximately five of the 30 credit rating agencies expected to register with the Commission will apply to register for additional categories of credit ratings within the first year. The Commission believes that almost all NRSROs will initially apply to register for the first

¹⁴ As a comparison, the Commission notes that Form ADV, the registration form for investment advisers, is estimated to take approximately 22.25 hours to complete. See Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004). The Commission estimates that the hour burden under Rule 17g-1 will be greater, given the substantially larger amount of information that will be required in Form NRSRO.

¹⁵ 300 hours x 30 entities = 9,000 hours.

¹⁶ See Exchange Act Release No. 49830 (June 8, 2004), at note 89; see also 17 CFR 240.17a-11.

¹⁷ 1 hour x 1 entity = 1 hour.

¹⁸ See Rule 17g-1(e).

¹⁹ As noted above, the Commission's burden estimate for Form ADV is approximately 22.25 hours to complete. See Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004).

three categories of credit ratings identified in the definition of NRSRO: (1) financial institutions, brokers, or dealers; (2) insurance companies; and (3) corporate issuers.²⁰ The Commission believes these are the most common types of credit ratings issued, particularly since some credit rating agencies limit their credit ratings to domestic companies. The Commission believes that, after these three categories, the next largest category of credit ratings for which most NRSROs will register will be credit ratings with respect to issuers of government securities, municipal securities, and foreign government securities.²¹ These types of credit ratings require expertise beyond that required for the first three categories of credit ratings. Finally, the Commission believes the category of credit ratings for which the least number of NRSROs will register will be credit ratings of issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)).²² This assumption is based on the fact that determining a credit rating for an asset-backed security takes specialized expertise beyond that required for determining credit ratings of corporate issuers and obligors. For example, it requires analysis of complex legal structures.

For these reasons, the Commission anticipates that a number of NRSROs may register for less than all five categories of credit ratings. Moreover, some of these NRSROs, in time, may develop their businesses to include issuing credit ratings for a category for which they are not initially registered. Based on staff experience, the Commission estimates that approximately five of the estimated 30 NRSROs will apply to add another category of credit ratings to their registration within the first year. Therefore, given the 25 hour average burden estimate, the total aggregate one-time burden to the industry for filing the amended Form NRSROs to change the scope of registration will be approximately 125 hours.²³

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate. Rule 17g-1 requires an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO. Based on staff experience, the Commission estimates that an NRSRO will file two amendments of its Form NRSRO per year on average. Furthermore, for the reasons discussed above, the Commission estimates that it will take an average of approximately 25 hours to prepare and furnish an amendment on Form NRSRO.²⁴ Therefore, the Commission estimates that the total aggregate annual burden to the industry to update Form NRSRO will be approximately 1,500 hours each year.²⁵

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.²⁶ Rule 17g-1 requires an NRSRO to furnish the annual certification on Form

²⁰ Section 3(a)(62)(B)(i)-(iii) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(i)-(iii)).

²¹ Section 3(a)(62)(B)(v) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(v)).

²² Section 3(a)(62)(B)(iv) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(iv)).

²³ 25 hours x 5 NRSROs = 125 hours.

²⁴ This estimate also is based on the estimates for the collection of information on Rule 17i-2 of the Exchange Act. See 17 CFR 240.17i-2.

²⁵ 25 hours per amendment x 2 amendments x 30 NRSROs = 1,500 hours.

²⁶ 15 U.S.C. 78o-7(b)(2).

NRSRO.²⁷ The Commission estimates that the annual certification, generally, will take less time than an amendment to Form NRSRO because it will be done on a regular basis (yearly) and, therefore, become routine over time. Consequently, the Commission estimates that the burden will be similar to that for broker-dealers filing the quarterly reports required under Rules 17h-1T and 17h-2T, which is approximately 10 hours per year for each respondent.²⁸ Therefore, the Commission estimates it will take an NRSRO approximately 10 hours to complete the annual certification, for a total aggregate annual hour burden to the industry of 300 hours.²⁹

Rule 17g-1 requires an NRSRO to furnish the Commission with a withdrawal of registration on Form NRSRO.³⁰ Based on staff experience, the Commission estimates that one NRSRO per year will withdraw its registration. Further, the instructions to Form NRSRO provide that only the items on the Form need be completed in the case of a withdrawal; an NRSRO will not need to update or attach any of the information required in the Exhibits. Based on current estimates for a broker-dealer to file a notice under Rule 17a-11, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal will be one hour.³¹ Thus, the Commission estimates that the aggregate annual burden to the industry of providing a notice of withdrawal prior to final Commission action will be one hour per year.³²

Section 15E(a)(3) of the Exchange Act requires an NRSRO to make the information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.³³ Rule 17g-1 requires that this be done within 10 business days of the granting of an NRSRO's registration or the furnishing of an amendment or an annual certification.³⁴ The Commission assumes that each NRSRO already will have a Web site and will choose to use its Web site to comply with Section 15E(a)(3). Therefore, based on staff experience, the Commission estimates that, on average, an NRSRO will spend 30 hours to disclose the information in its initial application on its Web site and, thereafter, 10 hours per year to disclose updated information. Accordingly, the total aggregate one-time burden to the industry to make Form NRSRO publicly available will be 900 hours³⁵ and the total aggregate annual burden will be 300 hours.³⁶

The Commission estimates that the average time necessary for an applicant or NRSRO to gather the information on a one-time basis in order to complete the additional

²⁷ See Rule 17g-1(g).

²⁸ See 17 CFR 240.17h-1T and 2T.

²⁹ 10 hours x 30 NRSROs = 300 hours.

³⁰ See paragraph (g) of Rule 17g-1.

³¹ See Exchange Act Release No. 49830 (June 8, 2004); see also 17 CFR 240.17a-11.

³² 1 hour x 1 entity = 1 hour.

³³ 15 U.S.C. 78o-7(a)(3).

³⁴ See Rule 17g-1(f).

³⁵ 30 hours x 30 NRSROs.

³⁶ 10 hours x 30 NRSROs.

disclosures required by the amendments to Exhibit 2 to Form NRSRO will be 100 hours per NRSRO, which will be a one-time hour burden to the industry of 3,000 hours.³⁷

Based on staff experience, the Commission estimates that the average time necessary for an applicant or NRSRO to gather the information for the first time in order to complete the additional disclosures that would be required by the proposed amendments to Exhibit 6 to Form NRSRO would be 25 hours per NRSRO, which would be a one-time hour burden to the industry of 750 hours.³⁸ In addition, the Commission estimates that the additional disclosures proposed to be contained in Instructions to Exhibit 6 to Form NRSRO, the annual hour burden for each NRSRO to complete the annual certification would increase 2 hours per year, from 10 to 12 hours, for a total aggregate annual hour burden of 360 hours, resulting in an increase to the estimated annual hour burden for Rule 17g-1 and Form NRSRO of 60 hours.³⁹

The Commission therefore estimates that the total one-time burden as a result of Rule 17g-1 and Form NRSRO will be 13,775 hours (9,000 + 125 + 900 + 3,000 + 750 = 13,775).⁴⁰ The Commission also estimates that the total annual burden will be 2,162 hours (1 + 1,500 + 300 + 1 + 300 + 60 = 2,162, rounded to 2,160).

13. Estimate of Total Annualized Cost Burden

The Commission also anticipates that an NRSRO likely will engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney will spend on this work will depend on the size and complexity of the NRSRO. The Commission estimates that, on average, an outside counsel will spend approximately 40 hours assisting an NRSRO in preparing its application for registration, for a one-time aggregate burden to the industry of 1,200 hours. The Commission further estimates that this work will be split between a partner and an associate, with an associate performing a majority of the work. The Commission estimates that the average hourly cost for an outside counsel will be approximately \$400

³⁷ 100 hours x 30 NRSROs = 3,000 hours. See supra note 3.

³⁸ 30 NRSROs x 25 hours = 750 hours. The Commission also notes that the currently approved PRA collection for Rule 17g-1 and Form NRSRO includes an estimate that an outside counsel would spend approximately 40 hours assisting a credit rating agency in the process of completing and furnishing a Form NRSRO to the Commission. June 2007 Adopting Release, 72 FR at 33608. The Commission believes that any outside counsel review of the amendments to Exhibit 6 to Form NRSRO would de minimis and therefore the current estimate remains accurate.

³⁹ 12 hours x 30 NRSROs = 360 hours. The Commission also based this estimate, in part, on the time it would take an NRSRO to furnish a withdrawal of registration on Form NRSRO of 1 hour. June 2007 Proposing Release, 72 FR at 33608-33609. However, because the NRSRO would have to update information for calculations with respect to its revenues, the Commission believes it would take an NRSRO longer than 1 hour. Therefore, the Commission preliminarily believes that it would take an NRSRO approximately 2 hours each year to update the proposed information.

⁴⁰ For the purposes of the PRA submission, this one-time cost will be amortized over the three year approval period prior to the expiration and renewal of this collection of information.

per hour. The Commission therefore estimates that the average one-time cost to an NRSRO will be \$16,000⁴¹ and the one-time cost to the industry will be \$480,000.⁴² For the purposes of the PRA submission, this one-time cost will be amortized over the three year approval period prior to the expiration and renewal of this collection of information $\$480,000/3=\$160,000$.

14. Estimate of Cost to Federal Government

There will be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The changes to the one-time and annual hour burdens are due to the proposed amendment to Exhibit 6 to Form NRSRO, as discussed in Item 12 above. In addition, the prior PRA submission annualized the one-time hours over the three year approval period. This PRA submission does not annualize the one-time costs. Therefore, there is an overall decrease in the annual hours reflected on the Form 83I.

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 will the implementation of such methods reduce the burden or improve the accuracy of results.

⁴¹ \$400 per hour x 40 hours = \$16,000.

⁴² \$16,000 x 30 NRSROs = \$480,000.