

Rule 17g-7: Reports to be made public by nationally recognized statistical rating organizations about persons that paid the nationally recognized statistical rating organization for the issuance or maintenance of a credit rating.

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

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.⁴

Specifically, under proposed Rule 17g-7, each NRSRO, on an annual basis, would make publicly available on its Internet Web site a consolidated report that shows three items of information with respect to each person that paid the NRSRO to issue or maintain a credit rating. First, the NRSRO must disclose the percent of the net revenue attributable to the person that were earned by the NRSRO for that fiscal year from providing services and products other than credit rating services. Second, the NRSRO must indicate the relative standing of the person in terms of the person’s contribution to

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

the revenue of the NRSRO for the fiscal year as compared with other persons who provided the NRSRO with revenue. Third, the NRSRO must identify all outstanding credit ratings paid for by the person.

Proposed Rule 17g-7 consists of three main paragraphs: (a), (b), and (c). Proposed paragraph (a)(1) would require the NRSRO to include in the report: (1) the percent of the net revenue attributable to the person that paid the NRSRO that were earned by the NRSRO during the most recently ended fiscal year from providing services and products other than credit rating services to the person; (2) the relative standing of the person in terms of the person's contribution to the NRSRO's net revenue as compared with other persons that contributed to the NRSRO's net revenues; and (3) the identity of all outstanding credit ratings issued by the NRSRO and paid for by the person. Paragraph (a)(2) of proposed Rule 17g-7 would exempt an NRSRO from publishing the reports if, as of the end of the fiscal year, the NRSRO had no credit ratings outstanding that the NRSRO issued or maintained as a result of a person paying the NRSRO for the issuance or maintenance of the credit ratings. Paragraph (b) of proposed Rule 17g-7 would provide that the NRSRO must prominently include a generic disclosure statement each time the NRSRO publishes a credit rating or credit ratings indicating where on its Internet Web site the consolidated report required pursuant to paragraph (a) is located. Paragraph (c) of proposed Rule 17g-7 would contain definitions applicable to the section. Specifically, paragraph (c)(1) would define the term "credit rating services" and paragraph (c)(2) would define the term "net revenue."

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

The proposed rule seeks to further the goals of the Commission's current oversight program for NRSROs, including increasing transparency and disclosure, diminishing conflicts, and strengthening oversight, as well as, furthering the goals of the Rating Agency Act "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."⁵

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

Proposed Rule 17g-7 would require an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. This report would need to be updated annually. The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens associated with proposed Rule 17g-7.

⁵ 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) ("Senate Report"), p. 2.

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 publicly available on its Internet Web site the consolidated report, showing information with respect to each person that paid the NRSRO to issue or maintain a credit rating. Paragraph (a) of Rule 0-10 provides that for purposes of the Regulatory Flexibility Act, a small entity “[w]hen used with reference to an ‘issuer’ or a ‘person’ other than an investment company” means “an ‘issuer’ or ‘person’ that, on the last day of its most recent fiscal year, had total assets of \$5 million or less.”⁶ The Commission believes that an NRSRO with total assets of \$5 million or less would qualify as a “small” entity for purposes of the Regulatory Flexibility Act. Currently, there are two NRSROs that are classified as “small” entities for purposes of the Regulatory Flexibility Act.

6. Consequences of Less Frequent Collection

If this information were not collected as frequently, the Commission believes that investors and other users of credit ratings will not be able to benefit from the enhanced transparency provided by these disclosures with respect to an NRSRO’s management of its conflicts of interest by providing users of credit ratings with information about the potential risks of undue influence that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

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-7 is 60 days.⁷ This comment period will afford the public an opportunity to respond to the proposal.

9. Payment or Gift to Respondents

Not applicable.

⁶ 17 CFR 240.0-10(a).

⁷ Exchange Act Release No. 61051 (Nov. 23, 2009); 74 FR 63866 (Dec. 4, 2009).

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 report to be required under proposed Rule 17g-7 would be more complex and comprehensive to complete than a typical amendment to Form NRSRO because the new proposed rule would require an NRSRO to calculate percents for every person that paid the NRSRO for the issuance or maintenance of a credit rating. In contrast, however, the Commission preliminarily does not believe that the one-time hour burden to comply with the new Rule 17g-7 would be as extensive and time consuming as the time necessary to complete the initial Form NRSRO. Therefore, the estimate of 100 one-time hours per respondent is a conservative and reasonable given the significant variance in size between the largest NRSROs and the smallest NRSROs. Thus, based on staff experience, the Commission preliminarily estimates that the aggregate initial one-time hour burden to complete the report required by proposed Rule 17g-7 would be 3,000 hours for 30 NRSROs.⁸

In addition to the one-time hour burden, proposed new Rule 17g-7 also would result in an annual hour burden for an NRSRO to generate the percents required under the proposed report and to populate the proposed report with the required data once a year. The Commission notes that an NRSRO would have already developed the equations necessary to generate the percents in order to comply with the new Rule 17g-7 in the first year. Additionally, the Commission believes that once an NRSRO complies with Rule 17g-7 in the first year, that preparation of the new annual report would become more routine. Therefore, based on staff experience, the Commission estimates that it would take an NRSRO approximately 50 hours per year to generate the percents required under the proposed report, as well as to generate the report itself.⁹ Thus, the Commission

⁸ 100 hours x 30 NRSROs = 3,000 hours.

⁹ The Commission based this estimate, in part, on the number of estimated hours it would take an NRSRO to file an amendment to Form NRSRO of 25 hours. The Commission, however, preliminarily believes that it would take an NRSRO substantially more time to generate the information once a year to complete the proposed report under proposed Rule 17g-7. Therefore, the Commission preliminarily estimates that the average time necessary to complete the report

preliminarily estimates that this would result in a total annual hour burden of 1,500 hours for 30 NRSROs.¹⁰

Proposed Rule 17g-7 also would require an NRSRO to make publicly available on its Internet Web site the report required under paragraph (a)(1).¹¹ The Commission estimates that it would take an NRSRO approximately 30 hours to disclose the initial information in its Web site for a total one-time burden of 900 hours,¹² and thereafter 10 hours per year to disclose updated information for a total annual burden of 300 hours.¹³ This one-time hour burden is estimated in part on the current one-time and annual burden hours for an NRSRO to publicly disclose its Form NRSRO.¹⁴ Accordingly, the Commission estimates that implementation of proposed new Rule 17g-7 would result in a total one-time hour burden of 3,900¹⁵ hours and a total annual hour burden of 1,800 hours.¹⁶

13. Estimate of Total Annualized Cost Burden

The Commission also believes that an NRSRO may need to purchase and/or modify its software and operating systems in order to generate and publish the information proposed to be required in the report in proposed new Rule 17g-7. The Commission estimates that the cost of any software incurred in connection with its systems modifications would vary based on the size and complexity of the NRSRO. The Commission estimates that some NRSROs would not need such software because they may already have such systems in place to generate the proposed report, or given their small size, other NRSROs may find the purchase of additional software unnecessary. The Commission preliminarily believes that an NRSRO would be able to generate and compile the information for the reports using the NRSRO's own personnel. Therefore, based on staff experience, the Commission estimates that the average cost of software across all NRSROs would be approximately \$4,000 per firm, with an aggregate one-time cost to the industry of \$120,000.¹⁷

¹⁰ under proposed Rule 17g-7 would be more comparable to the time it would take an NRSRO to file two amendments to Form NRSRO, or 50 hours (2 x 25 hours).

¹¹ 50 hours x 30 NRSROs = 1,500 hours.

¹² See proposed Rule 17g-7(a)(1).

¹³ 30 hours x 30 NRSROs = 900 hours.

¹⁴ 10 hours x 30 NRSROs = 300 hours.

¹⁵ June 2007 Adopting Release, 71 FR at 33609.

¹⁶ 3,000 hours + 900 hours = 3,900 total hours for one-time burden.

¹⁷ 1,500 hours + 300 hours = 1,800 total annual hours.

¹⁷ \$4,000 x 30 NRSROs = \$120,000. As a means of comparison, the Commission notes that the average cost of recordkeeping software across all NRSROs under Rule 17g-2 is estimated to be \$1,800 per respondent. See February 2009 Adopting Release, 74 FR, at 6472. The Commission preliminarily believes that the one-time cost of purchasing software in order to comply with proposed new Rule 17g-7 would be greater than \$1,800 because the proposed rule would require the publication of two new reports not previously required by any 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

The proposed disclosures that would be required under proposed Rule 17g-7 would be public.

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.