

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission for**  
**Rule 17g-3: Annual financial reports to be furnished by nationally recognized statistical**  
**rating organizations**

A. JUSTIFICATION

1. Necessity of Information Collection

The Credit Rating Agency Reform Act of 2006<sup>1</sup> (“Rating Agency Act”), enacted on September 29, 2006, defined the term “nationally recognized statistical rating organization” (“NRSRO”) and provided authority for the Securities and Exchange Commission (“Commission”) to implement registration, recordkeeping, financial reporting, and oversight rules with respect to credit rating agencies registered with the Commission as NRSROs. The Rating Agency Act added new Section 15E, “Registration of Nationally Recognized Statistical Rating Organizations,”<sup>2</sup> to the Securities Exchange Act of 1934 (“Exchange Act”). 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.<sup>3</sup>

The Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>4</sup> (“Dodd-Frank Act”) was enacted on July 21, 2010. Title IX, Subtitle C of the Dodd-Frank, “Improvements to the Regulation of Credit Rating Agencies,” among other things, established new self-executing requirements applicable to NRSROs, required certain studies, and required that the Commission adopt rules applicable to NRSROs, providers of due diligence services, and issuers and underwriters of asset-backed securities in a number of areas. The Commission proposed rules and rule amendments to implement certain of these provisions, including proposed amendments to Rule 17g-3.<sup>5</sup>

Exchange Act Section 15E(k), as added by the Rating Agency Act, required an NRSRO to “furnish” to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Commission adopted paragraphs (a)(1) through (a)(5) of Rule 17g-3 under Section 15E(k). These paragraphs require NRSROs to furnish annual reports to the Commission, including audited financial statements and certain unaudited financial reports. Rule 17g-3(a)(6), which was adopted under Section 17(a)(1) of the Exchange Act, requires NRSROs to furnish the Commission with an unaudited report of certain rating transitions.<sup>6</sup>

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<sup>1</sup> Pub. L. No. 109-291.

<sup>2</sup> 15 U.S.C. 78o-7.

<sup>3</sup> Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007).

<sup>4</sup> Pub. L. No. 111-203, 124 Stat. 1376, H.R. 4173.

<sup>5</sup> Exchange Act Release No. 64514 (May 18, 2011), 76 FR 33420 (June 8, 2011).

<sup>6</sup> See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, 74 FR at 6464-65 (Feb. 9, 2009). Section 17(a)(1) of the Exchange Act provides that any report an NRSRO “is required by Commission rules under this paragraph to make and disseminate to the Commission shall be deemed furnished to the Commission.”

The Commission is proposing amending paragraphs (a) and (b) of Rule 17g-3 to implement the rulemaking mandated by Section 15E(c)(3)(B) of the Exchange Act, added by the Dodd-Frank Act. The proposed amendment would add a new paragraph (a)(7) to require an NRSRO to include an unaudited report on the NRSRO's internal control structure with its annual submission of reports pursuant to Rule 17g-3. The proposed amendment to paragraph (b) of Rule 17g-3 would implement Section 15E(c)(3)(B)(iii) of the Exchange Act, added by the Dodd-Frank Act, to require that the NRSRO's chief executive officer ("CEO") or equivalent individual provide a signed statement that would be attached to the report.

Section 15E(j)(5)(A) of the Exchange Act, added by the Dodd-Frank Act, requires the designated compliance officer of an NRSRO to submit to the NRSRO a report on the compliance of the NRSRO with the securities laws and the policies and procedures of the NRSRO, and Section 15E(j)(5)(B) provides that the NRSRO "shall file" this report with the financial report required to be submitted to the Commission under Section 15E of the Exchange Act (that is, the Rule 17g-3 annual reports). Proposed paragraph (a)(8) to Rule 17g-3 would identify this report as a report NRSROs must file with the other annual reports required under Rule 17g-3. The Commission preliminary believes this requirement would not result in a Commission collection of information requirement because the requirement to file the report with the other annual reports required under Rule 17g-3 derives exclusively from Section 15E(j)(5)(B) of the Exchange Act (not from Commission rulemaking).

The Dodd-Frank Act amended Section 15E(k) by changing the words "furnish to" to the words "file with." The Commission is therefore proposing amendments to paragraphs (a)(1) through (a)(5) to require that these reports be "filed" with rather than "furnished" to the Commission. In addition, the reports identified in proposed paragraphs (a) (7) and (8) of Rule 17g-3 would be required to be "filed" with the Commission. The report identified in paragraph (a)(6) would continue to be required to be "furnished" to the Commission.

The Commission is proposing that all the annual reports required to be submitted to the Commission pursuant to Rule 17g-3 be submitted through the Commission's EDGAR system. To implement this requirement, the Commission proposes to add new paragraph (d) to Rule 17g-3. Proposed new paragraph (d) would provide that the reports required by the rule must be submitted electronically with the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

In addition, as a technical amendment, the Commission proposes to amend the title of Rule 17g-3 to replace the words "financial reports" with the words "financial and other reports." The report required by paragraph (a)(6) of Rule 17g-3, the proposed paragraph (a)(7) internal control report, and the proposed paragraph (a)(8) compliance report are not financial in nature. The Commission also proposes adding the word "filed" in the title of Rule 17g-3. The proposed amended title of Rule 17g-3 would therefore be changed from "Annual financial reports to be furnished by nationally recognized statistical rating organizations" to "Annual financial and other reports to be filed or furnished by nationally recognized statistical rating organizations."

The collection of information obligations imposed by Rule 17g-3 are mandatory. The rule, however, applies only to credit rating agencies that are registered with the Commission as NRSROs, and registration is voluntary.

## 2. Purpose and Use of the Information Collection

The collection of information included in Rule 17g-3 is necessary for Commission oversight of NRSROs registered with the Commission. This collection of information will aid the Commission in determining whether the initiation of a de-registration proceeding under Section 15E(d) of the Exchange Act would be appropriate.

## 3. Consideration Given to Information Technology

Currently, the reports required to be submitted to the Commission annually under Rule 17g-3 must be submitted in paper format. The proposed amendments would require that the reports be submitted through the Commission's EDGAR system. To implement this requirement, the Commission proposes to add new paragraph (d) to Rule 17g-3. Proposed new paragraph (d) would provide that the reports required by the rule must be submitted electronically with the Commission in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

## 4. Duplication

No duplication is apparent.

## 5. Effect on Small Entities

Small entities may be affected by Rule 17g-3 because all NRSROs, regardless of size, will be required to submit the reports to the Commission on an annual basis. The Commission solicited comment on whether small entities would be affected by the proposal.

## 6. Consequences of Not Conducting Collection

If this information were not collected as frequently, the Commission would be unable to ascertain, on an ongoing basis, whether a credit rating agency registered as an NRSRO "fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity."<sup>7</sup>

## 7. Inconsistencies with Guidelines in 5 CFR 1320.8(d)

The Commission has reviewed its collection responsibilities and does not believe there are any inconsistencies with 5 CFR 1320.8(d).

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<sup>7</sup> 15 U.S.C. 15E(d)(1)(E). Under 15 U.S.C. 15E(d), "Censure, Denial, or Suspension or Registration; Notice and Hearing," the Commission shall impose sanctions on an NRSRO, which may include revoking its registration, if, among other things, it fails to maintain such resources.

## 8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. The comment period for the proposing release is 60 days. This comment period will afford the public an opportunity to respond to the proposal. The proposing release solicits comment on the amended collection of information” requirements and associated paperwork burdens. A copy of the release is attached. Comments on Commission releases are generally received from registrants, investors, and other market participants. In addition, the Commission and staff participate in ongoing dialogue with representatives of various market participants through public conferences, meetings and informal exchanges. Any comments received on this proposal will be posted on the Commission’s public website, and made available through <http://www.sec.gov/rules/proposed.shtml>. The Commission will consider all comments received prior to adopting the proposal and will explain in any adopting release how the final rule responds to such comments, in accordance with 5 C.F.R. 1320.11(f).

## 9. Payment or Gift

The Commission did not provide any payment or gift to respondents in connection with the proposed rulemaking.

## 10. Confidentiality

Section 15E(k) of the Exchange Act provides that NRSROs “shall, on a confidential basis” file such statements of financial condition with the Commission as the Commission may prescribe. Therefore, the reports filed under paragraphs (a)(1) through (a)(5) of Rule 17g-3 are filed on a confidential basis. The reports submitted under paragraph (a)(6) of Rule 17g-3 and proposed paragraphs (a)(7) and (a)(8) of Rule 17g-3 will be protected only to the extent permitted by FOIA.

## 11. Sensitive Questions

To the extent that the Commission receives information that is sensitive to an NRSRO, the Commission will keep the information confidential upon request to the extent permitted by law.

## 12. Burden of Information Collection

The number of respondents subject to the rule depends, in part, on the number of entities that 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 choose to register with the Commission.

In adopting the first rules under the Rating Agency Act, the Commission estimated that approximately 30 credit rating agencies ultimately would be registered as NRSROs.<sup>8</sup> Since that

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<sup>8</sup> See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR at 33607 (June 18, 2007).

time, 10 credit rating agencies have registered with the Commission as NRSROs.<sup>9</sup> This number has remained the same for several years. Consequently, while the Commission expects several more credit rating agencies will become registered as NRSROs over the next few years, the Commission believes the number of NRSROs now registered should be used for purposes of the PRA.

Because the Commission is changing the number of respondents from 30 to 10 to reflect the actual number of NRSRO-respondents that are subject to the collection, the Commission is also adjusting the other burden estimates to reflect 10 instead of 30 NRSROs.

The Commission previously estimated that each NRSRO registered with the Commission will take, on average, approximately 200 hours to prepare for and submit annual audited financial statements for a total of 6,000 hours (200 hours x 30 NRSROs) per year. The new estimate, due to a change in the estimate of the number of respondents from 30 to 10 is approximately 2,000 hours (200 hours x 10 NRSROs) of reporting burden per year.

The Commission previously estimated that the average time necessary for an applicant or NRSRO to establish an internal process to conform its systems to generate a report in compliance with Rule 17g-3(a)(6) will be 100 hours per NRSRO, for a total one-time hour reporting burden to the industry of 3,000 hours,<sup>10</sup> which it averaged over the three year approval period, for an annual burden of 1000 hours. The new estimate, due to a change in the estimate of the number of respondents from 30 to 10 is approximately 333 hours (100 hours x 10 NRSROs / 3 years= 333 hours) of reporting burden per year.

Proposed new paragraph (a)(7) would require an NRSRO to include an additional report – a report on the NRSRO’s internal control structure – with its annual submission of reports pursuant to Rule 17g-3. The proposed amendment to paragraph (b) of Rule 17g-3 would require the NRSRO’s chief executive officer (“CEO”) or, if the firm does not have a CEO, an individual performing similar functions, to provide a signed statement that would be attached to the report. The Commission believes that NRSROs already should have developed processes and protocols to prepare the annual reports required by Rule 17g-3. Consequently, the Commission preliminarily estimates that the internal hour burden associated with the first submission of the report would not be materially different than the hour burden associated with submitting subsequent reports, although the time required to prepare subsequent reports could decrease incrementally over time as the NRSRO gains experience with the requirement.

The Commission preliminarily estimates, based on staff experience, that each NRSRO would spend on average approximately 150 hours preparing the internal control report to be included with the other annual reports filed with the Commission, resulting in an industry-wide

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<sup>9</sup> A.M. Best Company, Inc., DBRS Ltd., Egan-Jones Rating Company, Fitch, Inc., Japan Credit Rating Agency, Ltd., Kroll Bond Rating Agency, Inc. (formerly LACE Financial Corp.); Moody's Investors Service, Inc., Rating and Investment Information, Inc., Realpoint LLC, and Standard & Poor's Ratings Services.

<sup>10</sup> 100 hours x 30 NRSROs = 3,000 hours.

annual reporting burden of approximately 1,500 hours (10 NRSROs x 150 hours = 1,500 hours).<sup>11</sup>

The Commission does not believe that changing the method of submitting the annual reports from a paper submission to an electronic submission would increase the current hour burden for Rule 17g-3. For example, the Commission does not believe the amount of time it currently takes an NRSRO to gather these materials and send them to the Commission's headquarters by mail, messenger, or hand-delivery would be less than the time it would take to submit them electronically through the EDGAR system.

For purposes of this PRA submission, Commission therefore estimates that the annual industry-wide reporting burden would be 3,833 hours per year (2,000 annual hours plus 333 annualized one-time hours plus 1,500 annual hours).

### 13. Costs to Respondents

The cost of an audit by an independent public accountant varies substantially with the size and complexity of the NRSRO. The current OMB estimate is that, on average, an NRSRO will pay an independent public accountant approximately \$15,000 per year to perform an audit or audit procedures that are required by Rule 17g-3.<sup>12</sup> Therefore, the annual external reporting cost to the industry was estimated to be approximately \$450,000.<sup>13</sup> The new estimate due to the change in the estimate of the number of respondents from 30 to 10 is \$150,000 (\$15,000 x 10 NRSROs = \$150,000) external reporting cost per year.

The Commission preliminarily believes that an NRSRO likely would engage outside counsel to analyze the requirements for the report required by proposed Rule 17g-3(a)(7) and assist in drafting and reviewing the first report, given that it must be signed by the NRSRO's CEO or an individual performing a similar function. The time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. The Commission preliminarily estimates that an attorney would spend an average of approximately 100 hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the first report, resulting in an industry-wide external one-time hour burden of approximately 1,000 hours (10 NRSROs x 100 hours = 1,000 hours). Based on industry sources, the Commission estimates that the cost of an outside counsel would be approximately \$400 per hour.<sup>14</sup> For these reasons,

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<sup>11</sup> The amendments also would require that the Rule 17g-3 annual reports be submitted electronically on the Commission's EDGAR system. The Commission preliminarily estimates each NRSRO would spend 5 hours becoming familiar with how to use the EDGAR system and to complete Form ID for the purposes of submitting Form NRSRO (and Exhibits 1 through 9) and the Rule 17g-3 annual reports. For the purposes of this PRA the Commission is allocating that time to Rule 17g-1 and Form ID.

<sup>12</sup> Based on staff experience, it is estimated that the cost of the annual audit for a small NRSRO will range from \$3,000 - \$5,000 while the cost of the annual audit for a large NRSRO would be substantially greater.  
<sup>13</sup> \$15,000 x 30 NRSROs = \$450,000.

<sup>14</sup> See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506 (Jan. 26, 2011) (providing an estimate of \$400 an hour to engage outside professionals) and Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63889 (Dec. 4, 2009) (providing an estimate of \$400 per hour to engage an outside attorney).

the Commission estimates that the average one-time cost to an NRSRO would be approximately \$40,000 (100 hours x \$400 per hour = \$40,000), resulting in an industry-wide one-time cost of approximately \$400,000 (10 NRSROs x \$40,000 = \$400,000). Annualized over three years, the cost per year would be approximately \$133,000 of reporting cost per year.

The Commission preliminarily estimates that an NRSRO likely would continue to engage outside counsel to assist in preparing the report required by proposed Rule 17g-3(a)(7). The time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. In addition, the Commission preliminarily estimates that the time an outside attorney would spend assisting in the preparation of subsequent reports would be less than the time spent on preparing the first report since the counsel's work would not need to include an initial analysis of the new requirements. Consequently, the Commission estimates that an attorney would spend an average of approximately 50 hours assisting an NRSRO and its CEO or other qualified individual in drafting and reviewing the report, resulting in an industry-wide annual hour burden of approximately 500 hours (10 NRSROs x 50 hours = 500 hours). Based on industry sources, the Commission estimates that the cost of an outside counsel would be approximately \$400 per hour.<sup>15</sup> For these reasons, the Commission estimates that the average annual external cost to an NRSRO to comply with this requirement would be approximately \$20,000 (50 hours x \$400 per hour = \$20,000), resulting in an industry-wide annual reporting external cost of approximately \$200,000 (10 NRSROs x \$20,000 = \$200,000).

For purposes of this PRA submission, the Commission estimates that the annual industry-wide external reporting cost of complying with Rule 17g-3 is approximately \$483,000 (\$150,000 annual cost plus \$133,000 annualized one-time cost plus \$200,000 annual cost).

#### 14. Cost to Federal Government

There are no costs to the Federal Government associated with the information collections related to the Rule.

#### 15. Changes in Burden

The changes in burden are a result of proposed new Rule 17g-3(a)(7) and the change in the Commission's estimate of the number of respondents from 30 to 10.

The previous annual hour burden was 7,000 hours (6,000 + 1,000). The new annual hour burden is 3,833 hours (2,000 + 333 + 1,500). The change is due to an increase of 1,500 hours attributable to proposed new Rule 17g-3(a)(7) and decreases of 4,000 hours and 667 hours attributable to the change in the estimate of the number of respondents.

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<sup>15</sup> See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR at 4507-4506 (Jan. 26, 2011) (providing an estimate of \$400 an hour to engage outside professionals) and Proposed Rules for Nationally Recognized Statistical Rating Organizations, 74 FR 63889 (Dec. 4, 2009) (providing an estimate of \$400 per hour to engage an outside attorney).

The previous annual cost burden was \$450,000. The new annual cost burden is \$483,000 (\$150,000 + \$133,000 + \$200,000). The change is due to an increase of \$333,000 attributable to proposed new Rule 17g-3(a)(7) and a decrease of \$300,000 due to a change in the estimate of the number of respondents.

16. Information Collection Planned for Statistical Purposes

The Commission does not anticipate any complex analytical techniques to be used in connection with the proposal.

17. Display of OMB Approval Date

The Commission is not seeking approval to not display the expiration date for OMB approval.

18. Exceptions to Certifications for Paperwork Reduction Act Submissions

No exceptions to certification are contained in the proposal.

B. Collections of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor does it analyze the information for the Commission.