

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission for**  
**Rule 17g-3: Annual Financial and Other Reports to be Filed or 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 Act, “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.<sup>5</sup> On August 27, 2014, the Commission adopted rules and rule amendments to implement certain of these provisions, including amendments to Rule 17g-3, as discussed below.<sup>6</sup>

*Overview of Rule 17g-3 Prior to the Amendments*

Rule 17-3 under the Exchange Act (17 CFR 240.17g-3) contains reporting requirements for NRSROs.<sup>7</sup> Exchange Act Section 15E(k), as added by the Rating Agency Act, required an

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<sup>1</sup> Pub. L. No. 109-291 (2006).

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

<sup>3</sup> Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 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 (2010).

<sup>5</sup> See Pub. L. No. 111-203, 939, 939D-939F.

<sup>6</sup> Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 72936 (August 27, 2014).

<sup>7</sup> The Office of Management and Budget (“OMB”) Control Number for Rule 17g-3 is 3235-0626.

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).<sup>8</sup> 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>9</sup>

### *Amendments to Rule 17g-3*

The Commission amended 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 amendments added 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.<sup>10</sup> The amendment to paragraph (b) of Rule 17g-3 implemented 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.<sup>11</sup>

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). New paragraph (a)(8) to Rule 17g-3 requires that this report be filed with the other annual reports required under Rule 17g-3.<sup>12</sup> This requirement does 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).<sup>13</sup>

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<sup>8</sup> See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 FR 33564.

<sup>9</sup> See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (Feb. 2, 2009), 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.”

<sup>10</sup> 17 CFR 240.17g-3(a)(7).

<sup>11</sup> 17 CFR 240.17g-3(b)(2).

<sup>12</sup> 17 CFR 240.17g-3(a)(8).

<sup>13</sup> See 15 U.S.C. 78o-7(j)(5)(B).

The Dodd-Frank Act amended Section 15E(k) by changing the words “furnish to” to the words “file with.” The Commission therefore amended 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 paragraphs (a) (7) and (8) of Rule 17g-3 are required to be “filed” with the Commission. The report identified in paragraph (a)(6) continues to be required to be “furnished” to the Commission.

The Commission added new paragraph (d) to Rule 17g-3 to require that all the annual reports that are required to be provided to the Commission pursuant to Rule 17g-3 be submitted through the Commission’s EDGAR system.<sup>14</sup> Paragraph (d) provides 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 amended 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 paragraph (a)(7) internal controls report, and the paragraph (a)(8) compliance report are not financial in nature. The Commission also added the word “filed” in the title of Rule 17g-3. The title of Rule 17g-3 was therefore 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**

### *Rule 17g-3 in general*

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.

### *Amendments to Rule 17g-3*

The amendments to Rule 17g-3 requiring an NRSRO to submit to the Commission an annual internal controls report will be used by the Commission to perform its NRSRO oversight function. For example, section 15E(c)(3)(A) of the Exchange Act requires an NRSRO to “establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.” Paragraph (a)(7) of Rule 17g-3 requires that the report describe material weaknesses identified in the internal control structure and how they were addressed and that it

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<sup>14</sup> 17 CFR 240.17g-3(d).

state whether the internal control structure was effective as of the end of the NRSRO's fiscal year.<sup>15</sup> Consequently, the Commission can use the information provided in the report as part of reviewing whether the NRSRO is complying with the requirement in section 15E(c)(3)(A) of the Exchange Act. An NRSRO also can use the report to evaluate the effectiveness of its internal control structure.

The amendment to Rule 17g-3 requiring that NRSROs use the Commission's EDGAR system to file the annual reports as PDF documents will assist the Commission in performing its oversight function. For example, Commission examiners will be able to more easily retrieve the reports of an NRSRO to prepare for an examination. Moreover, having these reports submitted and stored through the EDGAR system will assist the Commission from a records management perspective by establishing a more automated storage process and reducing the volume of paper submissions that must be manually processed and stored.

### **3. Consideration Given to Information Technology**

The Commission added new paragraph (d) to Rule 17g-3 to require that the reports that are provided to the Commission pursuant to Rule 17g-3 be submitted through the Commission's EDGAR system. Paragraph (d) of Rule 17g-3 provides 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**

The Commission has not identified any duplication with respect to the information required by Rule 17g-3.

### **5. Effect on Small Entities**

Small entities will 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 in the proposing release regarding the proposal's burden on small entities and considered potential alternatives to minimize the burden of the collection of information requirements on those who are required to respond.

### **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>16</sup>

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<sup>15</sup> 17 CFR 240.17g-3(a)(7).

<sup>16</sup> See 15 U.S.C. 78o-7(d)(1)(E). Under 15 U.S.C. 78o-7(d), "Censure, Denial, or Suspension or Registration; Notice and Hearing," the Commission shall impose sanctions on an NRSRO, which may include revoking

## **7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)**

There are no special circumstances. This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

## **8. Consultations Outside the Agency**

The Commission issued a proposing release that solicited comment on the Paperwork Reduction Act (“PRA”) analysis with respect to the new “collection of information” requirements and associated paperwork burdens.<sup>17</sup> Comments on the proposing release were 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. The comments received on the proposing release are posted on the Commission’s public website, and made available through <http://www.sec.gov/rules/proposed.shtml>. The Commission considered all comments received prior to adopting the proposal and explained in the adopting release how the final rule responded to such comments, in accordance with 5 C.F.R. 1320.11(f). The Commission received comments regarding the hourly rate for retaining outside counsel. Specifically, in connection with the amendments to Rule 17g-7, an NRSRO stated that the Commission underestimated the hourly rate for retaining outside counsel.<sup>18</sup> The commenter, however, did not provide alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate for purposes of this PRA submission without revision.<sup>19</sup>

## **9. Payment or Gift**

The Commission did not provide any payment or gift to respondents in connection with the amendments to Rule 17g-3.

## **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

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its registration, if, among other things, it fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.

<sup>17</sup> See Proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 64514 (May 18, 2011), 76 FR 33420 (June 8, 2011).

<sup>18</sup> See letter from Daniel Curry, President, and Mary Keogh, Managing Director, Regulatory Affairs, DBRS, Inc., dated Aug. 8, 2011 (“DBRS Letter”).

<sup>19</sup> See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (“Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately \$400 per hour”).

paragraphs (a)(7) and (a)(8) of Rule 17g-3 will be protected only to the extent permitted by FOIA.

## **11. Sensitive Questions**

Not applicable. No inquiries of a sensitive nature were made. The information collection does not collect any Personally Identifiable Information (PII). The Systems of Record Notice may be reviewed at the following site, <http://www.sec.gov/about/privacy/sorn/secsorn6.pdf>. The Privacy Impact Assessment document for EDGAR is attached as a supplemental document.

## **12. Burden of Information Collection**

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 2,000 hours (200 hours x 10 NRSROs) reporting burden for the industry per year.

The Commission amended paragraphs (a) and (b) of Rule 17g-3. The amendment to paragraph (a) added paragraph (a)(7) requiring an NRSRO to include an additional report – a report on the NRSRO’s internal control structure – with its annual submission of reports to the Commission pursuant to Rule 17g-3.<sup>20</sup> The amendment to paragraph (b) of Rule 17g-3 requires that the NRSRO’s CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report.<sup>21</sup>

In the proposing release, the Commission stated that because NRSROs already should have developed processes and protocols to prepare the annual reports required by Rule 17g-3, the hour burden associated with the first submission of the report on the NRSRO’s internal control structure 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.<sup>22</sup>

In terms of the annual burden relating to the submission of the reports, the Commission estimated, based on staff experience, that each NRSRO would spend on average approximately 150 hours preparing the internal controls report, resulting in an industry-wide annual reporting burden of approximately 1,500 hours.<sup>23</sup> Paragraph (a)(7) of Rule 17g-3 requires that the internal controls report contain a description of the responsibility of management in establishing and maintaining an effective control structure and an assessment of the effectiveness of the internal control structure. In response to comment, paragraph (a)(7), as adopted, has been modified from

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<sup>20</sup> 17 CFR 240.17g-3(a)(7).

<sup>21</sup> 17 CFR 240.17g-3(b)(2).

<sup>22</sup> See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 76 FR at 33504.

<sup>23</sup> See id. (10 NRSROs x 150 hours = 1,500 hours).

the proposal to require that the report describe material weaknesses identified in the internal control structure during the fiscal year and how they were addressed and to state whether the internal control structure was effective as of the end of the fiscal year. In order to include an assessment of the effectiveness of the NRSRO's internal control structure in the annual internal controls report, the NRSRO will need to identify any material weaknesses in the internal control structure. In addition, since the statute requires that the internal control structure be "effective," the NRSRO will have to remediate any such weaknesses to comply with the statutory requirement.<sup>24</sup> Therefore, the Commission does not believe the modifications discussed above necessitate adjusting the burdens from those that were proposed.

However, the modifications to the amendment from the proposal also require that the internal controls report include a description of material weaknesses identified during the fiscal year and how they were remediated. The Commission believes that documenting these items for inclusion in the internal controls report will take NRSROs an average of approximately fifteen extra hours per year, resulting in an annual total internal burden of approximately 165 hours per NRSRO per year for preparing the internal controls report, resulting in a total industry-wide annual reporting burden of approximately 1,650 hours.<sup>25</sup>

As discussed above, the amendments to Rule 17g-3 also require that the annual reports be submitted electronically on the Commission's EDGAR system. The Commission estimates there will be burdens to complete Form ID for purposes of submitting Form NRSRO (and Exhibits 1 through 9) and the Rule 17g-3 annual reports electronically through EDGAR. However, the Commission is allocating these burdens to Rule 17g-1 and Form ID. For purposes of this PRA submission, the Commission therefore estimates that the annual industry-wide reporting burden would be 3,650 hours per year (2,000 annual hours plus 1,650 annual hours). The previous annual hour burden was 2,000 hours per year. The change is due to an increase of 1,650 annual hours attributable to new Rule 17g-3(a)(7).

### **13. Costs to Respondents**

Rule 17g-3 requires that an NRSRO provide audited financial statements that are certified by an independent public accountant.<sup>26</sup> 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>27</sup> Therefore, the annual external reporting cost to the industry is estimated to be approximately \$150,000.<sup>28</sup>

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<sup>24</sup> See 15 U.S.C. 78o-7(c)(3)(A).

<sup>25</sup> 150 hours + 15 hours = 165 hours; 165 hours x 10 NRSROs = 1,650 hours.

<sup>26</sup> 17 CFR 240.17g-3(a)(1)(iii).

<sup>27</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>28</sup> \$15,000 x 10 NRSROs = \$150,000.

As discussed above, the amendment to paragraph (a) added paragraph (a)(7) requiring an NRSRO to include an additional report – a report on the NRSRO’s internal control structure – with its annual submission of reports to the Commission pursuant to Rule 17g-3. The amendment to paragraph (b) of Rule 17g-3 requires that the NRSRO’s CEO or, if the firm does not have a CEO, an individual performing similar functions, must provide a signed statement attesting to information in the report that must be attached to the report. The Commission stated that an NRSRO likely would engage outside counsel to analyze the requirements for the report and to assist in drafting and reviewing the first report, that the time outside counsel would spend on this work would depend on the size and complexity of the NRSRO, and 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.<sup>29</sup> Based on industry sources, the Commission estimated that the cost of outside counsel would be approximately \$400 per hour<sup>30</sup>, and that the average one-time cost to an NRSRO would be approximately \$40,000<sup>31</sup>, resulting in an industry-wide one-time cost of approximately \$400,000.<sup>32</sup> In connection with the proposed amendments to Rule 17g-7, an NRSRO stated that the Commission underestimated the hourly rate for retaining outside counsel.<sup>33</sup> The commenter, however, did not provide alternative estimate of the hourly rate. Based on staff experience, the Commission is retaining the hourly rate without revision.<sup>34</sup> Annualized over the three year approval period, the cost per year would be approximately \$133,333 per year (\$400,000/3).

In addition, the Commission stated that an NRSRO likely would continue to engage outside counsel to assist in preparing the reports (after filing the first report) and that the time outside counsel 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 will not need to include an initial analysis of the new requirements. Consequently, the Commission estimated that an attorney would spend an average of approximately fifty 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.<sup>35</sup> As stated above, the Commission estimated

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<sup>29</sup> See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (10 NRSROs x 100 hours = 1,000 hours).

<sup>30</sup> See id. (providing an estimate of \$400 per hour to engage outside counsel).

<sup>31</sup> 100 hours x \$400 = \$40,000.

<sup>32</sup> 10 NRSROs x \$40,000 = \$400,000.

<sup>33</sup> See DBRS Letter.

<sup>34</sup> See Proposed Rules for Nationally Recognized Statistical Rating Organizations, 76 FR at 33504 (“Based on industry sources, the Commission estimates that the cost of outside counsel would be approximately \$400 per hour”).

<sup>35</sup> See id. (10 NRSROs x 50 hours = 500 hours). The Commission adopted paragraph (a)(7) of Rule 17g-3 as proposed. Accordingly, this estimate remains unchanged from the Commission’s preliminary estimate in the proposing release.

that the cost of outside counsel would be approximately \$400 per hour. For these reasons, the Commission estimated that the average annual cost to an NRSRO to comply with this requirement would be approximately \$20,000<sup>36</sup>, resulting in an industry-wide annual cost of approximately \$200,000.<sup>37</sup> The Commission did not receive comment on the hour estimates. For purposes of this PRA submission, the one-time cost and annual cost burden are amortized over the three year approval period.

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 \$483,333 (\$150,000 annual cost plus \$133,333 annualized one-time cost plus \$200,000 annual cost). The previous annual cost burden was \$150,000. The change is due to an increase of \$333,333 attributable to new Rule 17g-3(a)(7).

#### **14. Cost to Federal Government**

The Commission does not anticipate any 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 new Rule 17g-3(a)(7).

#### **16. Information Collection Planned for Statistical Purposes**

Not applicable. The information collection is not used for statistical purposes.

#### **17. Approval to Omit OMB Expiration Date**

We request authorization to omit the expiration date on the electronic version of the form, although the OMB control number will be displayed. Including the expiration date on the electronic version of this form will result in increased costs, because the need to make changes to the form may not follow the application's scheduled version release dates.

#### **18. Exceptions to Certifications for Paperwork Reduction Act Submissions**

This collection complies with the requirements in 5 CFR 1320.9.

### **B. Collections of Information Employing Statistical Methods**

The collection of information does not employ statistical methods, or analyze the information for the Commission.

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<sup>36</sup> See *id.* (50 hours x \$400 = \$20,000).

<sup>37</sup> See *id.* (10 NRSROs x \$20,000 = \$200,000).