COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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TECHNICAL ADVICE

Technical Advice to the European Commission on the Equivalence between the US Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies

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Securities and Exchange Act of 1934		Securities and Exchange Act
Credit Rating Agency Reform Act of 2006		Rating Agency Act
Rules and regulations under the Securities and Exchange Act of 1934 - Nationally Recognised Statistical Rating Organisation		Rules, or SEC Rules

Section I. Executive Summary

This document sets out the technical advice of CESR in relation to the equivalence between the US legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 12th June 2009.

CESR concludes that, overall, the US legal and supervisory framework is broadly equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what CESR considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

However, there are a number of differences between the US legal and supervisory framework and the EU regulatory regime as set out below and explained in detail in this advice, that mainly relate to the issue of disclosure of credit ratings and the quality of credit ratings and credit rating methodologies.

CESR recommends the identified differences be addressed to allow for further convergence between both regimes and considers that reducing the difference may be achieved by future regulatory amendments to the Securities and Exchange Commission's (SEC) rules.

In coming to this conclusion, CESR has grouped the requirements of the EU Regulation into seven areas, in relation to each of which CESR has assessed the ability of the US legal and supervisory framework to achieve the main objectives of the relevant EU requirements. CESR considers the US system to be stronger in some areas and weaker in others in terms of ability to achieve the relevant objectives.

In accordance with the mandate, CESR has not taken into account any consideration of a political nature.

These seven areas are:

1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

US philosophy and approach to the regulation and supervision of credit rating agencies

Before going into the specific details of the basis upon which CESR has arrived at its conclusions, CESR considers it important to highlight that there are fundamental differences in terms of the philosophy that the US has in relation to their regulation and supervision of credit ratings and credit rating agencies.

The approach in the US relies very heavily on upfront and detailed disclosure being made during the application process demonstrating substantive policies that the applicant is required to adopt, which has to be kept updated and whose accuracy has to be certified on an annual basis.

Once the information is in the public domain, the US system relies on the Securities and Exchange Commission which has the power to determine through their examination process whether or not the described policies and procedures are reasonably designed and the ability of the market at large to exercise its own judgment regarding the credibility of the NRSRO itself, the robustness of the processes and procedures it has in place in order to carry out its credit rating activities and the reliability of the ratings it produces.

The SEC carries out supervision on an ex-post basis and, in case of failure by the NRSRO to adhere to its disclosure, the NRSRO may be subject to liability under the federal securities laws and rules thereunder.

For further information regarding the US philosophy and approach to the regulation and supervision of credit rating agencies see paragraphs **224 to 312** below Section IV "US Assessment".

1) Scope of the regulatory and supervisory framework

CESR considers that the scope of the regulatory and supervisory framework for credit rating agencies is equivalent to that of the EU Regulation.

For a detailed explanation regarding how CESR has arrived at this conclusion, please see Box 2 – paragraphs **344 to 349 below** and paragraphs **317 to 343 below** of Section IV "US assessment".

2) Corporate Governance

CESR considers that, overall, the US legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to corporate governance.

However, CESR points out that the US legal and supervisory requirements in this area are heavily dependent on the role that a designated compliance officer plays in ensuring that the NRSRO meets its legal requirements, and whose independence is not legally required, but where the potential consequences of this are mitigated through other requirements and the supervisory and enforcement powers of the SEC.

For a detailed explanation regarding how CESR has arrived at this conclusion, please see Box 3 paragraphs **402** to **408 below** and paragraphs **350 to 399 below** of Section IV "US Assessment".

3) Conflicts of interest management

CESR considers that, overall, the US legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to conflicts of interest management.

CESR considers this to be an area of strength of the US legal and regulatory framework, but points out that there are some differences in how the objectives of the EU requirements in this area are met, as discussed in detail in this advice.

In particular, CESR highlights that an NRSRO is not prohibited from providing advisory or consultancy services, but it is required to manage and disclose conflicts of interest arising from being paid for services in addition to determining credit ratings by those who have paid the NRSRO to provide a credit rating, and any other type of conflict of interest that the NRSRO considers to be material.

For a detailed explanation on how CESR has arrived at its conclusion in relation to conflicts of interest management, please see Box 14 paragraphs **525 to 530** below and paragraphs **409 to 524** below of Section IV "US Assessment".

4) Organisational requirements

CESR considers that, overall, the US legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to organisational requirements, including outsourcing, recording keeping and confidentiality.

CESR points out that certain specific organisational requirements are not embedded in the US Exchange Act or SEC Rules but, as discussed in detail in the advice, it considers that the absence of these requirements is mitigated by the extensive disclosure to the public of certain NRSROs' policies and procedures, the specific legal obligations of the designated compliance officer and CESR's understanding of how the SEC supervise these entities.

For a detailed explanation on how CESR has arrived at its conclusion in relation to organisational requirements, please see Box 15 paragraphs **567 to 570**, and paragraphs **531 to 566** below, Box 16 paragraphs **580 to 581**, and paragraphs **571 to 579** below, Box 17 paragraph **588** and paragraphs **582 to 587** below, and Box 18 paragraphs **597 to 598** and paragraphs **589 to 596** below of Section IV "US Assessment".

5) Quality of methodologies and quality of ratings

CESR considers that, overall, the US legal and supervisory framework does not achieve the objectives of the EU regulatory requirements in relation to the quality of methodologies and of credit ratings.

CESR points out that, out of the five broad areas these requirements relate to – namely, *(i)* reviewing credit ratings, methodologies, models and key rating assumptions; *(ii)* quality of credit ratings and analysis of information used in assigning credit ratings; *(iii)* quality of methodologies and changes to them; *(iv)* knowledge and experience of employees directly involved in credit rating activities; *(v)* competition - **CESR has identified weaknesses in respect of the first three areas.**

In particular, CESR highlights that:

-There are no specific legal requirements to monitor methodologies and to have a review function. There is also no requirement to monitor credit ratings on an ongoing basis and at least annually. CESR considers that a way of bridging the gap between this difference is, for example, to introduce a requirement dealing with the ongoing monitoring of methodologies and credit ratings and the frequency within which their review should take place.

- There is no requirement that the NRSRO has to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information on which to base its ratings. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" concerning the quality of information used by the NRSRO to determine credit ratings, could make a significant change in meeting the objective of this EU requirement.

- There is no specific requirement to use credit rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience and back testing.

- There is no specific requirement to apply changes to methodologies and models consistently to existing ratings. CESR notes that the bill of "Restoring American Financial Stability Act 2010" and the bill of "Wall Street Reform and Consumer Protection Act of 2009" could direct the SEC to prescribe rules to ensure that ratings are produced in accordance with procedures and methodologies that have been approved by the NRSRO senior management. The potential rules shall also require that material changes to a rating procedure or methodology be applied in a consistent manner to all ratings where the changes apply, and be applied to existing ratings within a reasonable period of time.

- There is no specific requirement to immediately disclose the likely scope of credit ratings to be

affected by changes in the methodologies used to determine them. CESR notes that potential amendments to the US regulatory framework through the bill of "Restoring the American Financial Stability Act 2010" and the bill of "Wall Street Reform and Consumer Protection Act of 2009" could make a significant change in the right direction to meet the objectives of this requirement.

CESR understands the reasons for these differences to be linked to the US approach taken in relation to the prohibition to interfere with the substance of credit ratings and methodologies to determine credit ratings. The US system relies heavily on the ability of the market to make its own judgment about the quality of the credit ratings and of the methodologies used to determine them, as well as the powers of the SEC to supervise and address any issue that may arise on an ex-post basis.

For a detailed explanation on how CESR has arrived at its conclusion in relation to quality of methodologies and quality of credit ratings, please see Box 26 paragraphs **701 to 708** below and paragraphs **599 to 700** below of Section IV "US Assessment"

6) Disclosure

There are two distinct types of disclosure requirements in the EU Regulation: (i) those relating to the disclosure that a credit rating agency needs to make on a rating by rating basis, and (ii) those relating to the credit rating agency itself.

(a) Disclosure of credit ratings

CESR considers that the US legal and supervisory framework, overall, does not achieve the objectives of the EU requirements that relate to disclosure of credit ratings.

CESR has identified weaknesses in five of the thirteen areas in which the requirements relating to disclosure of credit ratings have been divided. Namely:

1. There is no specific requirement for unsolicited credit ratings to be clearly identified as such, the information is only available to the SEC. In addition, there is no requirement for an NRSRO to disclose on a rating by rating basis whether or not a rated entity participated in the process for determining an unsolicited credit rating or if a credit rating agency had access to the rated entity's books and records;

2. There is no specific requirement to explain the key elements underlying the credit rating when announcing it;

3. There is no specific requirement to disclose information about the specific sources that were substantially material in the determination of a particular credit rating;

4. There is no specific requirement to disclose limitations and attributes of individual credit ratings;

5. There is no specific requirement to disclose on a rating by rating basis information about the level of assessment conducted by the NRSRO on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments.

CESR has pointed out in its advice that a possible way of bridging the gap between the differences in the EU and the US in these five areas could be to require an NRSRO to disclose the above information on a rating-by-rating basis. In addition, CESR considers that an NRSRO must always indicate in its Form NRSRO the location on its website where additional information about the procedures and methodologies to determine credit ratings is included.

CESR notes that the potential amendments under the bill of Restoring American Financial Stability Act of 2010, and the bill of "Wall Street Reform and Consumer Protection Act of 2009" direct the SEC to prescribe rules requiring NRSROs to publish information on a rating by rating basis, which could

make a significant change in the right direction to meet the objectives the EU requirements.

CESR has identified a number of differences on how the US legal and regulatory framework achieves the objectives of EU requirements relating to the remaining eight areas, which relate to:

1. Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner;

2. Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings;

3. Disclosure of historical performance data;

4. Disclosure in the credit rating of the lead rating analyst and the person primarily responsible for approving the rating;

5. Indication in the credit rating of the principal methodology or methodology version used;

6. Disclosure of the meaning of each rating category, the definition of default or recovery and any appropriate risk warning;

7. Indication of the date of first release of the credit rating for publication as well as of its last update;

8. Information on whether the credit rating concerns a newly financial instrument and whether the credit rating agency is rating it for the first time.

As discussed in detail in the advice, in lieu of rating-by-rating disclosure requirements, the US legal and regulatory framework is based on upfront disclosure regarding how credit ratings are published and about the methodologies and procedures used to determine credit ratings, as well as on extensive record-keeping requirements.

CESR acknowledges that, as a matter of practice, the differences between the EU and the US approach may, in reality, be mitigated by the credit rating agencies themselves on a voluntary basis, but points out that voluntary disclosures that NRSROs make on their own accord cannot be taken into account, because the mandate relates to an assessment of legal and supervisory requirements.

For a detailed explanation on how CESR has arrived at its conclusion in relation to disclosure of credit ratings, please see Box 39 paragraphs **882 to 901** below and paragraphs **709 to 881** below of Section IVUS Assessment".

(b) Disclosure concerning the credit rating agency and its activities

CESR considers that, irrespective of some differences discussed in detail in the advice, the US legal and supervisory framework, overall, achieves the objectives of the EU requirements that relate to disclosure regarding the credit rating agency and its activities.

For a detailed explanation on how CESR has arrived at its conclusion in relation to disclosure concerning the credit rating agency and its activities, please see Box 55 paragraphs **1000 to 1009** below and paragraphs **902 to 999** below of Section IV "US Assessment".

7) Effective Supervision and enforcement

CESR considers that the US legal and supervisory framework ensures that the SEC is entrusted with sufficient powers to enable effective supervision and enforcement over NRSROs, and points out that it considers this to be an area of strength.

For a detailed explanation on how CESR has arrived at its conclusion in relation to effective

supervision and enforcement, please see Box 56 paragraphs **1062 to 1068** below and paragraphs **1010 to 1060** below of Section IV "US Assessment".

Section II. Introduction

1. The European Commission mandated CESR in 12th June 2009 to provide it with technical advice on the equivalence between the US, Canadian and Japanese legal and supervisory frameworks and the EU regulatory regime for credit rating agencies (Regulation (EC) No. 1060/2009 of the European Parliament and the Council on credit rating agencies[1]).

2. An additional mandate relating to the equivalence of the Australian legal and supervisory framework followed in 17th November 2009.

3. This report sets out CESR's advice to the European Commission in respect of the equivalence between the US legal and supervisory framework and the EU regulatory regime for credit rating agencies.

4. In contrast to CESR's normal process when delivering its advice to the European Commission, CESR has not conducted a consultation with the market at large, given the nature of this particular advice that CESR has been asked to give and the very tight timeframe.

5. CESR therefore is using this report to not only provide its advice but to also explain in detail its approach and methodology in assessing the equivalence between 3rd country legal and supervisory frameworks, and the EU regulatory regime for credit rating agencies, in order to be completely transparent and to ensure that those reading this advice can fully understand the thinking behind it.

6. Details of the EU Commission's mandate are set out in Annex I, and references to various aspects of the mandate are made throughout this advice. CESR highlights that it has been asked to:

   a) undertake a global and holistic assessment of the third country regulatory regime from a technical point of view, based on the entirety of the third country regulatory framework;

   b) describe the supervisory arrangements provided for in the third country which ensure that the regulatory framework applicable to credit rating agencies registered/authorised there is respected;

   c) identify areas where significant discrepancies exist and suggest any solutions which could be considered by the European Commission to overcome such discrepancies;

   d) focus on the differences and give its judgment on the material importance of such differences; and

   e) advise on an early warning mechanism in case of significant changes to the third country regulatory framework.

7. Section IV of this report sets out CESR's advice in relation to the points in paragraph 6 a, b and aspects of c above, and Section V deals with points 6 c and d of paragraph 6 above.

8. CESR reiterates as reflected in the European Commission's mandate, that it has been requested to focus on the differences between the third country legal and supervisory framework and the EU

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1 Hereinafter, "the Regulation".

regulatory regime for credit rating agencies, evaluating and giving its judgment on the material importance of such differences, and in doing so, focusing on "***technical criteria"*** and "***not taking into account any considerations of a political nature"***.

9. Following CESR's advice, the European Commission will make a final decision regarding the determination of the equivalence between a third country legal and supervisory framework and the EU regulatory regime for credit rating agencies.

10. At the time of writing, it is anticipated that the decision in relation to the equivalence between the US legal and supervisory framework and the EU regulatory regime for credit rating agencies will be made by the end of 2010 in order to enable the credit rating agencies to start making applications accordingly.

Purpose and use of the European Commission's equivalence decision

11. Once an equivalence decision has been made by the European Commission, it will enable certain aspects of the EU Regulation, relating to the use of credit ratings issued[2] outside the EU, to become operational, provided other conditions are met.

12. There are two methods in the EU Regulation through which credit ratings issued outside the EU can be used in the EU for regulatory purposes.[3]

13. The first method is referred to as ***certification*** and is set out in Article 5 of the EU Regulation. It will allow a third country credit rating agency, whose activities are not considered to be of systemic importance[4] to the financial stability or integrity of the financial markets of one or more Member States, to enable its credit ratings which are not considered to be of systemic importance to the financial stability or integrity of the financial markets of one of more Member States to be used in the EU for regulatory purposes.

14. A positive equivalence determination is required to enable a third country credit rating agency to apply for certification, however CESR reiterates that a determination of equivalence is one of a number of criteria that have to be met as set out in Article 5(1) of the EU Regulation. A positive

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2 For an explanation of how the location of where a credit rating is issued from is to be determined see CESR Guidance on the Registration Process which will be published before the 7th of June, 2010.

3 According to Article 3(1)(g) of the Regulation, "regulatory purposes" means the use of credit ratings for the specific purpose of complying with Community law, as implemented by the national legislation of the Member States. Article 4(1) of the Regulation refers to the use of credit ratings for regulatory purposes by "credit institutions as defined in Directive 2006/48/EC, investments firms as defined in Directive 2004/39/EC, insurance undertakings subject to the First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance1, assurance undertakings as defined in Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance2, reinsurance undertakings as defined in Directive 2005/68/EC of the European Parliament and the Council of 16 November 2005 on reinsurance, undertakings for collective investment in transferable securities (UCITS) as defined in Directive 85/611/EEC and institutions for occupational retirement provision as defined in Directive 2003/41/EC".

4 For an explanation of how systemic importance is to be assessed please see CESR Guidance on the Registration Process which will be published before the 7th of June, 2010

equivalence determination should not be understood as meaning that a third country credit rating agency **will automatically** be granted certification and as such its credit ratings issued from such a third country may be used in the EU for regulatory purposes.

15. Only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification.

16. These conditions are that:

    a) the credit rating agency is authorised or registered in and is subject to supervision in that third country;

    b) the cooperation arrangements are operational;

    c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

17. Cooperation arrangements, as set out in Article 5(7) of the EU Regulation are necessary in order to enable home competent authorities in the EU and the relevant third country competent authority to (i) exchange information; (ii) coordinate supervision.

18. CESR points out that these coordination arrangements are in the process of being negotiated, but if there are no such arrangements in place with the relevant third country competent authority, then the conditions for certification will not legally be met and as such certification will not be possible until such arrangements are in place.

19. The second method is ***endorsement,*** through which an EU registered credit rating agency will be able to endorse credit ratings issued in a third country through the endorsement process set out in Article 4(3)-(6) of the EU Regulation.

20. This method includes a number of tests, including, among other things, that the credit rating agency has verified and is able to demonstrate on an ongoing basis to the competent authority of the home Member State that the conduct of credit rating activities by the third country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are "as stringent as" the requirements set out in Articles 6-12 of the EU Regulation. This is known as the "as stringent as" test.

21. A positive equivalence decision by the European Commission will enable an EU registered credit rating agency to endorse credit ratings without needing to verify or demonstrate that the regulatory regime in that third country, prevents interference by the competent authorities and other public authorities of that third country with the content of credit ratings and methodologies provided that the cooperation arrangements discussed in paragraph 17 above are operational.

22. In addition, in light of the "as stringent as" test that is set out in Article 4(3)(b), explained in paragraph 20 above, the assessment according to Article 5 of the EU Regulation of the equivalence between a third country legal and supervisory framework and the EU regulatory regime for credit rating agencies will be used for the purposes of Article 4 (3)(b) for those credit rating agencies making use of the endorsement procedure for ratings used after the transition period that will end on the 7th of June 2011.

Section III. CESR's Approach To Assessing Equivalence

23. The EU Regulation has established a prescriptive and strict EU legal and supervisory framework for credit rating agencies in order to ensure that credit ratings are independent, objective, and of adequate quality in order to underpin confidence and stability in the financial markets and contribute to the protection of investors.

24. CESR recognises that, in contrast to legal and supervisory frameworks in some third countries, the EU regulatory framework for credit rating agencies is very prescriptive and detailed.

25. The philosophy and approach of the EU Regulation is front loaded and rigorous. The Regulation prescribes in great detail:

    a) how a credit rating agency should organise itself and the types of procedures and processes it needs to have in place,
    b) what corporate governance needs to be in place,
    c) the skills and knowledge base of the people it should employ,
    d) the presentation and method of publishing its ratings,
    e) information about the credit rating agency and its activities, in order for such credit rating agency to be eligible for consideration of suitability for issuing ratings for use in the EU.

26. The EU Regulation is directly applicable in Member States. This means that the ability of member states at a national level to exercise individual decisions is limited. For example, competent authorities cannot impose requirements regarding registration which are not imposed in the EU Regulation, however each Member State can establish the penalties and registration and or supervisory fees that will be applied by each competent authority.

27. The EU Regulation also seeks to ensure that all Member States adopt the same supervisory approach in respect of credit rating agencies. It has introduced a concept of group decision making in the form of colleges of competent authorities.

28. Applications for registration are to be examined by the home Member State competent authority jointly with the other authorities that are members of the college.

29. In addition, where the home Member State competent authority has established that a credit rating agency breaches the obligations arising from the EU Regulation, such competent authority is expected to consult the members of the relevant college before taking supervisory measures against the credit rating agencies. It is only in respect of the supervisory measures that can be imposed on a credit rating agency for breaching the obligations arising from the EU Regulation, that decisions at a national level can be taken in the absence of agreement with either the college or CESR and even then these require initial consultation with the college, and then with CESR in the absence of agreement with the college.

30. The unified approach to supervision will be reinforced once CESR becomes a European agency and is formally empowered to take over the supervisory responsibility for credit rating agencies.

31. Against this background, CESR has been tasked with assessing the equivalence of legal and supervisory frameworks – where the philosophy of how best to regulate and supervise these entities may be very different, against that of the EU Regulation.

32. As such, CESR's approach to assessing equivalence is not to expect the EU regime to be adopted in an identical manner – this is clearly unrealistic and does not reflect the principle that the same outcome can be achieved through different means.

33. The approach adopted is to take a high level and overall look at the legal and supervisory framework that is in place, the powers of those entrusted to enforce it, and their overall approach to supervision.

34. CESR has also taken into to account a number of objectives that the European Commission set out in section 2.3 of its mandate. The most notable of these being, that when assessing the equivalence of the legally binding requirements that a credit rating agency in a third country has to comply with, and the nature of the effectiveness of the supervision and enforcement to which it may be subjected to:

"the priority should lie in assuring that users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

35. This principle has driven the method that CESR has used in assessing overall equivalence, where CESR has asked itself - **does the third country legal and supervisory framework being assessed achieve this objective?**

36. In addition, when assessing the details of any provisions – CESR has asked itself - **does the requirement that is in place achieve the same objective of the EU requirement?**

37. The European Commission's mandate also included an indicative list of areas that CESR needs to consider in its assessment as well as the regulatory principles that need to be respected in the third country regime being assessed, CESR makes reference to these in Section IV.

38. The mandate also made it clear that CESR should:

a) conduct a technical "*global and holistic*" assessment of the regulatory framework based on "*the entirety of the third country regulatory framework in that country*";

b) "*not be limited to just assessing a commitment to any international convergence initiatives*" – such as the IOSCO code of conduct;

c) "focus on the differences between the regulatory regime established at EU level and the third country framework", and *"evaluate and give its judgment on the material importance of such differences*".

39. In light of the instructions set out in paragraph 38, in conducting its assessment CESR has not just looked at the relevant legal provisions that have been introduced for the purposes of regulating and supervising credit rating agencies in a third country, but has also looked at other areas, such as existing securities law or corporate law that may also be applicable.

40. As the assessment is global in nature and not limited to the legal requirements that may be in place, CESR has in accordance with the mandate also assessed the nature of supervision and enforcement to which a credit rating agency may be subjected to.

41. CESR also points out for completeness that the European Commission's mandate also made it clear that:

a) *"the regulatory framework of the third country must include mandatory requirements for the registered CRA's;* and

b) *voluntary regimes are not to be considered equivalent to the regulatory and supervisory framework introduced by the CRA Regulation."*

III.1 The steps adopted by CESR in assessing equivalence

42. Having discussed in detail above the approach that CESR has adopted in carrying out its assessment of the equivalence between a third country's legal and supervisory framework and the EU regulatory regime for credit rating agencies, this part of the advice explains the steps taken by CESR in assessing equivalence.

43. In light of the fact that the assessment is technical in nature, its scope is global, and the comparison is between prescriptive detailed provisions in a regulation and a whole regulatory and supervisory framework, CESR decided to undertake a detailed analysis ensuring that it is able to exercise its judgment objectively and that the information, it used in doing so, was fully comprehensive.

44. To do this, CESR used a step by step approach as set out below.

Step 1 – drafting a questionnaire for self assessment

45. The first step was to find out what the third country's framework is, and how it compares to the EU one.

46. CESR considered the EU Regulation and in light of its prescriptiveness and the global nature of the assessment that needs to be undertaken, drafted a questionnaire that covered all aspects of the EU Regulation, including those relating to supervision and enforcement.

47. As the third country authority responsible for the registration and supervision of credit rating agencies is clearly best placed to explain its legal and supervisory framework, the objective of the questionnaire was to enable the third country authority to assess itself against the requirements of the EU Regulation, and explain how it considers it meets the same objectives of the requirements in light of the inevitable differences in philosophy and approach that may be in place.

48. For full details of the US answers to the questionnaire – see Annex II.

Step 2 – establishing conditions for objectively assessing equivalence

49. In order to ensure that CESR adopted an objective approach to its assessment, it needed to establish a number of conditions that it considers have to be met by third country regulators and their regulatory and supervisory regimes:

a) Pure self regulatory regimes are insufficient for an equivalence assessment. Any assessment on the equivalence of a third country regulatory regime must be based on laws, draft laws and regulations that either are currently or will be legally binding;

b) For the successful assessment of a third country's regulatory regime it is not sufficient that the relevant rules are described in the abstract. CESR therefore required that the third country regulator provided it not only with the relevant rules and regulations itself, but also with accompanying translations into English as the functional language of CESR;

c) Unconditional assessments can only be made with regard to laws and regulations already in force. Where only draft regulations and laws exist an equivalence assessment can only be made under the condition that the draft regulations and laws will come into force as proposed. No assessment is possible until a legislative stage is reached in which, according to the third country regulator, the proposed legal texts that are being assessed will more likely than not come into force as proposed, before an equivalent decision by the European Commission is taken. If significant changes occur, the assessment will need to be revised;

d) There needs to be legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and these need to broadly cover what the EU Regulation covers, including those areas where exemptions are permissible according to the third country laws and regulations. Such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the EU Regulation.

50. In addition to the conditions set out in paragraph 49 above, CESR also needed to take into account what the EU Regulation states regarding the assessment of equivalence, and look at what, from a legal perspective, the text of the EU Regulation sets out.

51. Article 5(6) of the EU Regulation sets out the following requirements that need to be met cumulatively by a third country regulatory system in order for it to be able to be considered as equivalent:

a) credit rating agencies in the third country are subject to authorisation or registration;

b) the regulatory regime in the third country prevents interference with the content of credit ratings and methodologies by the supervisory authorities and other public authorities of that third country;

c) credit rating agencies in the third country are subject to legally binding rules which are equivalent to those set out in Articles 6 to 12 and Annex I of the EU Regulation;

d) credit rating agencies in the third country are subject to effective supervision and enforcement on an ongoing basis.

52. The conditions listed in paragraphs 51 a) and b) and d) above are narrowly defined in the EU Regulation itself and as such can be assessed with relative ease. If these conditions are not met by a third country regulatory system, CESR considers that such a system **cannot be considered as equivalent**.

53. This means that if:

a) in terms of scope there is no legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and the scope of coverage is not broadly speaking what is covered by the EU Regulation;

b) credit rating agencies in third countries are not subject to authorisation or registration; and

c) the regulatory regime in the third country does not prevent interference by the supervisory authorities and other public authorities of that third country with the content of credit ratings and methodologies;

54. **Then CESR will not consider the third country regulatory regime to be equivalent**.

55. Having established the core fundamental conditions that need to be satisfied, the next step was to consider what needs to be in place in order to assess the requirements of the condition set out in paragraph 51 c) above.

56. CESR considers that this condition requires that the third country regulatory regime is **equivalent with regard to the core substantive provisions of the EU-Regulation** concerning independence and the avoidance of conflicts of interest, rating analysts, employees and other persons involved in the issuing of credit ratings, methodologies, models and key rating assumptions, outsourcing, disclosure and presentation of credit ratings, general and periodic disclosures, and transparency reports.

57. This means that the third country regulatory systems that do not take the same kind of regulatory approach and do not have the same detailed requirements set out in their legal system as those set out in the EU Regulation with regard to these issues may nevertheless be considered as equivalent if the regulatory system achieves similar adequate regulatory effects.

58. In order to ensure an objective, fair and transparent process in assessing equivalence, CESR went through those provisions considered relevant for assessing equivalence as set out in the questionnaire created under step 1.

59. As explained in paragraph 36 above, when assessing the equivalence of these provisions, CESR asked itself - **does the requirement that is in place achieve the same objective of the EU requirement?**

60. This assessment is reflected in detail in Section IV below of this advice.

Step 3 assessing the third country's regulatory and supervisory framework against the conditions

61. Having established the conditions for assessing equivalence, CESR reviewed the responses to the questionnaire, ensuring that it fully understood the responses and how the relevant authority had explained its framework. A number of meetings and conference calls were held, with many additional questions, which were not set out in the original questionnaire, being asked.

62. Since the responses to the questionnaire are to be made public in order to ensure that there is complete transparency regarding the assessment that CESR has conducted, the relevant authority was given the opportunity to update its responses to the questionnaire, following further discussion and clarification regarding either the objective of what the EU regulatory requirement was, or what the requirement meant in practice.

63. An assessment table was created in order to compare each of the third country's requirements against:

a) the conditions for assessing equivalence;

b) the requirements as set out in the EU Regulation; and

c) the relevant legal provisions that had been provided by the authority.

64. This enabled CESR to do a detailed assessment of the framework in question, identifying the similarities and differences on a provision by provision basis, establishing how the objective of the provision was covered either by law or through supervisory practice or a combination of the two; and ensuring that where requirements were stated as being embedded in legislation, that the legislation in question covered the provision.

65. Once completed, the assessment of equivalence of each provision was established, with CESR asking itself the question as explained in paragraph 36 - **does the requirement that is in place achieve the same objective of the EU requirement?** and thereby establishing the basis of its conclusion in respect of each provision.

66. CESR then grouped the provisions into core areas establishing overall objectives for each area and then assessed whether or not the overall objectives of each of these areas were met.

67. In relation to those areas where CESR considers that there is no equivalence, CESR will highlight the differences and make suggestions regarding how the gap between these differences can be bridged.

68. For completeness, although it is not possible for the purposes of assessing the equivalence of an existing regime to take recent proposals that may or may not be adopted in the future into account, where such developments may shed light on the direction in which an existing framework may be going, reference to this will also be made.

69. For the detailed CESR assessment of the US regulatory and supervisory framework please see Section IV of this advice.

70. Although CESR has left it to each authority to check the accuracy of its response to the questionnaire which is annexed to this advice, CESR has ensured that both it and the third country authority have fully understood each other's framework and its requirements. Therefore, this advice is based on additional explanations and clarifications that have been provided to CESR by the staff of the SEC in addition to the information set out in the answer.

Step 4 – Establishing the global assessment of the equivalence between the third country's legal and supervisory framework and the EU Regulatory regime for credit rating agencies

71. Once the assessment of the regulatory and supervisory framework was completed, the framework was looked at as a whole and CESR made a global assessment of the equivalence between the third country's legal and supervisory framework and the EU Regulatory regime for credit rating agencies on that basis, asking itself the question whether the framework overall enables assurance that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

72. For CESR's global assessment of the equivalence between the US legal and supervisory framework and the EU Regulatory regime for credit rating agencies see paragraphs 1070 to 1072 and Box 57 below.

III.2 The conditions that CESR has established for each provision of the EU Regulation in order to assess equivalence

73. In establishing its advice, CESR has divided the EU Regulation into a number of different sections, based on the overall objective that the provision is seeking to address.

74. These sections are discussed below and the same sub divisioning is used in the discussion of the assessment of the US set out in the next Section IV US Assessment.

75. The sections are as follows:

(A) Scope of the regulatory and supervisory framework
(B) Corporate governance
(C) Conflicts of interest management
(D) Organisational requirements
General organisational requirements
Outsourcing
Confidentiality
Record Keeping
(E) Quality of ratings and quality of methodologies
Reviewing methodologies, credit ratings assumptions and information used in issuing rating
Knowledge and experience of employees directly involved in credit rating activities
Quality of ratings and information used in assigning credit ratings
Quality of methodologies and changes to them
Competition
(F) Disclosure
Presentation and disclosure of credit ratings
Structured finance products
Periodic disclosure
(G) Effective supervision and enforcement
Personnel
Powers of the authority
Penalties

(A) Scope of the Regulatory and supervisory framework

76. In assessing equivalence, as can be seen from Questions 1-8 and Questions 40-41 of the CESR questionnaire set out in Annex II and as discussed in paragraphs 49 - 54 above, ensuring that the nature of the legal and supervisory framework that is in place is able to meet the same overall objectives of the EU regulatory regime is key.

77. If CESR is not satisfied that the framework is able to do this, **then a positive equivalence recommendation cannot be made.**

78. As such, the following needs to be in place:

a) there has to be some form of legally binding regulatory and supervisory framework for credit ratings in place (Art 4.3.f and 5.6.a);

b) credit rating agencies have to be subject to what CESR considers to be effective ongoing supervision and enforcement (for what CESR considers this to be see sub-section (G) effective supervision and enforcement paragraphs 200 to 220 below (Art 4.3.f and 5.6.a);

c) credit rating agencies are subject to some form of registration or authorisation process (Art 4.3.f and 5.6.a);

d) the scope of the activities of a credit rating agency that are subject to the third country legal and supervisory framework includes the scope of activities that is included in the EU regime (Art 3.1(a)(b);

e) the relevant authority is prohibited from influencing the content of ratings and methodologies (Art 23.1).

79. In respect of the points above, see paragraphs 200 to 220 below for a discussion regarding what CESR considers needs to be in place for effective ongoing supervision and enforcement.

80. Of the other requirements, set out in paragraph 78 above, it is point d) that needs further elaboration. As explained in paragraphs 49 d) and 53 a) above, there needs to be legal clarity regarding what a credit rating agency is, or the activities that it conducts are, and these need to broadly cover what the EU Regulation covers.

81. Where exemptions are permissible according to the third country laws and regulations, such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the EU Regulation.

82. Looking at the requirements of the EU Regulation, this means that the definition of credit rating agency or the activities that it conducts **do not need to be identical**, but it needs to cover the same scope of what is covered by the EU Regulation, ensuring that the credit ratings that are subject to the oversight of the third country framework in question and that could be used in the EU are covered.

83. In assessing equivalence of this aspect, CESR looked at the legal definition of what a credit rating agency is, what activities of the agency are covered and also at the nature of the exemptions that can be applied.

84. In looking at the definition of a credit rating agency, CESR considered whether or not the definition meant that individuals as opposed to legal entities could be credit rating agencies, as this could have implications for the recourse of those relying on those ratings.

85. If for example the definition of credit rating agencies is broader in scope than the EU definition, then clearly there is equivalence in relation to this aspect.

86. CESR points out that a third country regulatory and supervisory framework may not require all credit rating agencies to be registered or authorised with the relevant authority, but only those who want to enable their ratings to be used for what CESR considers to be those circumstances covered by Article 4.1 (referred to as "use for regulatory purposes" in this advice) need to be registered or authorised.

87. CESR highlights that Articles 4 and 5 make specific reference to the use of credit ratings issued in a third country for regulatory purposes in the EU and require the credit rating agency in question to be registered or authorised in that third country.

88. In addition, CESR highlights that it does not expect the concept of "use for regulatory purposes" in a third country's legal and supervisory framework to be the same.

89. In cases where the third country and supervisory and regulatory framework is broad, although CESR has been mandated to assess the third country framework as a whole, for the purposes of assessing equivalence, CESR is only focusing on those aspects of the third country framework that relate to the use of credit ratings for "regulatory purposes".

Exemptions

90. In terms of assessing the exemptions that can be applied and how the authority in question exercises its discretion in respect of these exemptions, any exemptions need to be assessed for the reasons set out below in paragraph 92 below.

91. If there are no exemptions set out in the third courtly legal and regulatory framework, then this is acceptable for the purposes of assessing equivalence because, the exemptions allowed under the EU Regulation exist in order to facilitate competition, recognising that the nature, scale, and complexity of its business and the nature and range of its credit ratings, may in certain circumstances warrant that the agency can be exempted from complying with some of the EU Regulation's requirements.

92. Where exemptions are allowed, CESR has looked at what the nature of these exemptions are or can be, looking at whether or not other requirements of what CESR considers to be required of a credit rating agency in order to ensure that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities."

93. Only where CESR is satisfied that the exemptions do not prevent the achievement of this objective in practice, and there is legal clarity as to how the authority will exercise its discretion in respect of applying exemptions for attaining registered or authorisation status, is equivalence said to be in place.

(B) Corporate governance

94. Corporate governance is a core aspect of the EU Regulation, and its ability to achieve the objective set out in paragraph 23 above, and as such sets out a large number of detailed and prescriptive requirements in Annex I section A.

95. CESR considers that the key objectives of the EU Regulation's requirements with respect to corporate governance are to ensure that senior management is responsible and legally accountable for ensuring:

a) that credit ratings activities are independent;
b) that there is proper management of conflicts of interest; and
c) compliance with the legal requirements of the regulatory framework.

96. CESR points out that, as set out in recitals 28, 29 and 30 of the EU Regulation, corporate governance arrangements are necessary to ensure that credit ratings are independent, objective, and of adequate quality.

97. The EU Regulation sets out a number of corporate governance requirements that need to be in place in order to ensure that a credit rating is able to demonstrate its ability to meet these objectives, and its compliance with them.

98. In assessing the equivalence of a third country's legal and supervisory framework, CESR asked a number of questions in order to establish whether the requirements set out in Article 6.2 and Annex I Section A of the EU Regulation were in place.

99. These requirements involve the need for the credit rating agency to have:

a) an administrative or supervisory board ("board');
b) at least 2 independent members of the board tasked with monitoring the:
   I) credit rating policy ;
   II) effectiveness of the internal quality control system;
   III) internal controls and measures established to deal with conflicts of interest.

100. The need for the credit rating agency to ensure that:

a) the compensation of the independent members of the board is not linked to the business performance of the credit rating agency, and that their judgment can be exercised in an independent manner;
b) the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable;
c) a term limit for the independent member of the board is defined;
d) the majority of members of the board, including independent members have sufficient expertise in financial services;
e) if the CRA issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments;
f) in addition to the overall responsibility of the board, the independent members of the administrative or supervisory board have the specific task of monitoring:
   I) development of credit rating policy;
   II) development of the methodologies the CRA uses in credit rating activities;
   III) effectiveness of internal control mechanisms in relation to credit rating activities;
   IV) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed;
   V) compliance and governance processes including the efficiency of the review function.

101. CESR anticipates that there may be significant differences in the corporate governance requirements, and as such is not expecting all of the above requirements to be in place.

102. However, CESR considers that for the purposes of assessing equivalence, there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable.

103. In respect of the requirements relating to the independent directors that are tasked with monitoring certain activities, CESR considers that what is important and needs as a minimum to be in place is that there is a clear allocation of the following monitoring tasks in terms of overall responsibility to the senior management:

a) the development of credit rating policy and of the methodologies used by the CRA in its credit rating activities;
b) effectiveness of the internal quality control system;
c) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed;
d) compliance and governance processes.

104. CESR points out that it considers that these monitoring tasks do not need to be carried out by senior management per se, but in order for the objective of the EU requirement to be met, what is important is that these monitoring tasks are carried out by someone independent, who is not involved in credit rating activities, and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the CRA.

105. Considering the importance of the specific monitoring tasks and the overall responsibilities of senior management, these tasks and functions are to be ideally carried out by those who have sufficient expertise in financial services and, where relevant for the business of the CRA, an appropriate in-depth knowledge and experience of the markets in structured finance instruments.

106. For a discussion regarding how the US framework compares to these requirements see paragraphs 350 to 408 below.

(C) Conflicts of interest management

107. CESR points out that conflicts of interest management is a core requirement of the EU Regulation in order to ensure that it meets the overall objective as set out in paragraph 23 above.

108. CESR considers the objectives of the conflicts of interest management requirements of the EU Regulation are to ensure:

a) objectivity, independence, integrity, and quality of the credit ratings;
b) transparency about the credit ratings; and
c) to contribute to the protection of investors and financial markets.

109. The EU Regulation sets out a number of detailed requirements that have to be met by credit rating agencies in order to ensure that these objectives are achieved.

110. In assessing the equivalence of a third country's legal and supervisory framework, CESR asked a number of questions in order to establish whether the requirements set out in Article 6, Article 7 paragraphs 2-5, Annex I sections A, B, and C of the EU Regulation were in place in addition to those aspects of conflicts of interest covered in the corporate governance section above.

111. These requirements involve the need for credit rating agencies to:

a) identify and eliminate or alternatively manage and disclose conflicts of interest;
b) be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;
c) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate, or manage and disclose any conflicts of interest;
d) identify, eliminate, or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees, and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings;
e) publicly disclose the names of the rated entities or related 3rd parties from which it receives more than 5% of its annual revenue;
f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 section B paragraph 3 of the EU Regulation;

g) ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;
h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis;
i) ensure that compensation and performance evaluation of the rating analysts' and persons approving the credit ratings are not linked to the amount of revenue they generate;
j) disclose any actual and potential conflicts of interest;
k) have requirements whereby those who know of illegal conduct by others report it to the compliance officer without negative consequences ;
l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, the CRA is required to review the relevant work of the analyst preceding his departure;
m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

112. In addition to the above:

a) a credit rating agency is prohibited from providing consultancy or advisory services;
b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating; and
c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

113. In addition those persons referred to in Annex 1 Section C point 1 of the EU Regulation are prohibited from:

a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;
b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;
c) soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business;
d) from taking key management positions with the rated entity or its related third party within 6 months after the rating.

114. Overall, as can be seen from the above requirements the EU approach to conflicts of interest management is a combination of requirements relating to how:

♦ the credit rating agency needs to be organised so that conflicts of interest are managed,
♦ to disclose certain interests which are considered to be a potential conflict,
♦ to prohibit the credit rating agency itself and those who are involved in the credit rating process from conducting certain activities,
♦ to ensure that those who are key to determining the credit rating of credit rated entities and their instruments do not establish working relationships that may result in conflict, and
♦ to ensure that the compensation of those involved in credit rating activities ensures the independence of their judgment.

115. This is another area where CESR recognises that the approach to this may differ for example by setting out in the law a list of prohibited activities that are considered *de facto* to be conflicts of interest and are prohibited irrespective of the procedures and processes that a credit rating agency may have in place.

116. CESR recognises that the third country laws and regulations in this area may not be as detailed or specific as those set out in the EU Regulation.

117. However, CESR points out that conflicts of interest management is fundamental to the ability of the EU Regulation to achieve its objectives and does expect, for the purposes of making an equivalence assessment, that there are robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure.

118. As such, CESR considers that, in addition to those aspects of corporate governance set out in paragraphs 102 to 105 above, overall, the objectives of each individual conflict of interest management requirement described in paragraphs 111-113 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.

119. However, CESR can accept the following differences:

a) disclosure regarding the names of clients from whom the credit rating agency receives more than 5% of its annual revenue - can be made only to the regulator - so that it can monitor and supervise how the credit rating agency is managing the conflicts that may arise in respect of these clients;

b) requirements that relate to the need to review the work of the rating analyst prior to its departure to a rated entity do not need to be in place because this duplicates other requirements that would pick this issue up;

c) requirements prohibiting certain individuals from taking key management positions with the rated entity or its related third party within 6 months after the rating – do not need to be in place because the conflict that is being addressed would be captured by other requirements;

d) requirements relating to rotation of certain individuals.

120. CESR recognises that the requirements relating to the gradual rotation of rating analysts and persons approving is one of a number of ways in which a credit rating agency can achieve the objectives of the management of conflicts of interest requirements as set out in paragraph 108 above and the independence of rating analysts and persons approving ratings.

121. CESR also recognises that these requirements are controversial in that sense that some market players consider such requirements as having the effect of potentially damaging the quality of ratings by diluting expertise, as well as being in contradiction to those requirements relating to knowledge and experience.

122. Others, on the other hand, welcome it as they consider it a good discipline to have to ensure that knowledge and expertise is shared as well as the ensuring that the nature of the working relationship between the credit rating analysts and the rated entity remains impartial.

123. For the purposes of assessing equivalence, CESR does not consider it necessary that rotation requirements are in place in order to achieve the objective, but where there are no such

requirements will expect for example the legal requirements relating to conflicts of interest management to be very robust.

124. For a discussion regarding how the US framework compares to the conflicts of interest requirements see paragraphs 409 to 530 below.

(D) Organisational requirements

125. CESR considers that the overall objective of the organisational requirements is to contribute to ensuring the objectivity, independence, integrity, and quality of the credit rating activities.

126. The EU Regulation sets out a number of organisational requirements that credit rating agencies need to have in place in order to be able to demonstrate its ability to meet these objectives and compliance with them.

127. These requirements can be divided as follows:

I) General organisational requirements;
II) Outsourcing;
III) Confidentiality; and
IV) Record keeping.

D.I) General organisational requirements

128. Article 6.2 and Annex I Section A paragraph 3-6, 8, 10 of the EU Regulation requires the credit rating agency to:

a) establish adequate policies and procedures that ensure compliance of its obligations under the relevant regulation;
b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;
c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;
d) establish and maintain a permanent and effective compliance function which operates independently;
e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities;
f) monitor and evaluates the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies;

129. In respect of the above requirements, CESR considers that these are necessary to facilitate the credit rating agency's ability to achieve the objectives set out in paragraph 125 above, although it does not expect the identical requirements to be hard wired into a third country's regulatory framework.

130. CESR needs to take an in depth look at what organisational requirements are in place as a package, and in addition consider the nature and extent of the supervisory and enforcement powers and practices that are in place, as discussed in Section G below.

131. Having assessed what is in place as a package, CESR considers that the overall organisational requirements must objectively achieve the purposes discussed above in order to be assessed equivalent to the EU requirements.

132. As such, for example CESR can accept that there may not be an identical requirement set out in the law to have a permanent and effective compliance function which operates independently, but it does expect the objective of this requirement to be somehow in place.

133. For an explanation of CESR's view regarding how and if the US framework meets these requirements please see paragraphs 535 to 570 below.

D.II) Outsourcing

134. Article 9 of the EU Regulation prohibits outsourcing of important operational functions in such a way so as to impair materially the quality of the credit rating agency's internal control and the ability of the authorities to supervise the credit ratings agency's compliance under the EU Regulation.

135. In assessing the equivalence of this prohibition, CESR asked a number of questions to establish:

a) if any outsourcing of important operational functions is allowed;
b) if any restrictions in respect of outsourcing exist;
c) whether or not the regulatory framework ensures that:

I) none of the outsourced functions impair the quality of the credit rating agency's internal controls; and
II) that the outsourcing does not impair the ability of the relevant authority to supervise the credit rating agencies compliance with its regulatory obligations.

136. In respect of these requirements, CESR considers that, where outsourcing is allowed in the third country, for the purposes of a positive assessment of the equivalence, the third-country regulatory framework shall set out conditions for outsourcing aimed at ensuring that the following objectives are achieved:

a)none of the outsourced functions impair the quality of the CRA's internal controls, and

b)the ability of the authority to supervise the CRA's compliance with its legal obligations is not impaired.

137. In addition, CESR expects that if outsourcing is allowed:

a)there needs to be legal clarity regarding what can be outsourced; and

b)the legal responsibility for what is being outsourced shall remain with the credit rating agency.

138. For a discussion about what the US outsourcing requirements are, please see paragraphs 571 to 581 below.

D.III) Confidentiality

139. Requirements relating to confidentiality are important because of the nature of the information that the credit agency and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

140. The EU Regulation imposes a number of confidentiality obligations on rating analysts, employees of the credit rating agency as well individuals whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities as well as individuals closely associated with them as set out in Article 7.3 and Annex I Section C paragraph 3 of the EU Regulation as follows:

a) to take all reasonable measures to protect property and records in possession of the credit rating agency from fraud, theft or misuse;
b) to not disclose any information about credit ratings or future ones other than to the rated entity or its related third party;
c) to keep information entrusted to the credit rating agency confidential;
d) to not use or share confidential information for trading purposes or any other purpose other than credit rating activities;

141. CESR considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.

142. For a discussion regarding how the US framework compares to these confidentiality requirements see paragraphs 582 to 588 below.

D.IV) Record Keeping

143. Effective record keeping enables a credit rating agency to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

144. Article 6.2 and Annex I Sections 7 to 9 of the EU Regulation require credit rating agencies to keep adequate records and, where appropriate, audit trails of its credit rating activities for at least five years and make them available upon request to the competent authority.

145. CESR considers this requirement to be crucial for the purposes of establishing equivalence, but can accept that the period of time for which records need to be kept may differ from jurisdiction to jurisdiction, but whatever is in place has to be reasonable.

146. For a discussion regarding how the US framework compares to these record keeping requirements see paragraphs 589 to 598 below.

(E) Quality of Methodologies and Quality of Ratings

147. In addition to the general organisational requirements referred to above, the EU Regulation sets out a number of requirements aimed at ensuring the following objectives:

a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;
b) the adequate quality, integrity and thoroughness of the credit rating activities; and
c) as set out in recital 7 of the EU Regulation the protection of the stability of financial markets and of investors;

d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

148. These requirements are set out in Article 6.2 - Annex I Section A paragraph 9, Article 7.1, Article 8.2, 8.3, 8.4, 8.5, 8.6, Article 10.2 Annex I Section D.1 of the EU Regulation, and can be divided into the following areas:

I) Reviewing methodologies, credit ratings models and assumptions and information used in issuing ratings;
II) Knowledge and experience of credit rating employees;
III) Quality of ratings and analysis of information used in assigning credit ratings;
IV) Changes to methodologies;
V) Competition.

E.I) Reviewing methodologies, credit ratings models and assumptions and information used in issuing ratings.

149. The EU Regulation sets out a number of requirements dealing with the review of methodologies, models and assumptions as well as the need to review the information used in issuing ratings in Article 8.2 Article 8.5, Article 6 and Annex I Section A paragraph 9.

150. These requirements require a credit rating agency to:

a) have a review function devoted to the periodical review of methodologies, models, key rating assumptions;
b) monitor its ratings and methodologies on an on-going basis and at least annually; and
c) review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.

151. For the purposes of assessing equivalence CESR considers it important that methodologies are up-to-date and subject to a comprehensive review on a periodic basis.

152. CESR does not consider it necessary for there to be a separate review function per se for the purposes of equivalence, but that whatever requirements are in place, that these achieve a periodic review of methodologies, models, and key rating assumptions by those who are independent from those that are responsible for the development and use of these models, key rating assumptions, and models.

E.II) Knowledge and experience of employees directly involved in credit rating activities

153. The EU Regulation sets out requirements relating to the nature of the knowledge and experience of credit rating agency employees directly involved in credit rating activities in Article 7.1.

154. This requirement is that the credit rating agency ensures that rating analysts, employees of the credit rating agency, and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

155. CESR considers it important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities, and that this is an area that needs to be covered in the relevant third country framework.

156. CESR recognises that the EU requirement has embedded a test of appropriateness, which is subjective and is something that will need to be assessed on a case-by-case basis.

157. The question for the purposes of equivalence is therefore whether embedding the "appropriateness" requirement in law means that in practice those doing the job are appropriately qualified, and who is best placed to assess this?

158. CESR considers that for the purposes of assessing equivalence, the lack of an appropriateness test in a requirement can still result in the objective of the provision being met, provided there is disclosure regarding those individuals doing the job, and the ability to take legal action where it is clear in practice that those doing it are not appropriate.

E.III) Quality of ratings and analysis of information used in assigning credit ratings

159. The EU Regulation sets out a number of requirements dealing with the quality of ratings and the information that credit rating analysts have to use when assigning ratings, as well as ensuring that the information is up to date and accurate.

160. These requirements are set out in Articles 8.2, 8.3, 8.5, 8.7, 10.2, and Annex I.DI. of the EU Regulation.

161. These requirements are:

a) adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies ;
b) adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;
c) establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;
d) to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors;
e) refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on; and
f) to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

162. CESR considers these requirements are important for the purposes of achieving the objective of ensuring that the ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality.

163. In establishing the equivalence of these requirements with a third country's legal and supervisory framework, CESR would not expect to see identical requirements however it would expect to see requirements that are able to achieve this objective.

164. In respect of the requirement set out in paragraph 161c) above CESR does not consider that this needs to be addressed by a separate requirement as is the case in the EU Regulation because it expects this to be covered in the obligation to ensure that ratings are based on accurate and up to date information.

165. In respect of the requirement set out in paragraph 161f) above, and as discussed in paragraphs 120 to 123 above, CESR does not consider it necessary that there is a specific requirement that the credit rating agency establishes a gradual rotation mechanism.

E.IV) Quality of methodologies and changes to them

166. The EU Regulation sets out a number of requirements relating to the quality of methodologies and what needs to be done when models or key rating assumptions used in credit rating activities are changed, as set out in Article 8.3 and 8.6(a-c) of the EU Regulation.

167. These requirements impose an obligation on credit rating agencies to:

a) use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;
b) apply the changes in methodologies and models consistently to existing ratings; and
c) immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.

168. CESR considers that these requirements are significant in ensuring that the credit rating agency is able to achieve the overall objective of these requirements.

E.V) Competition

169. The EU Regulation has a number of requirements relating to the rating of structured finance products where the rating agency has not rated the underlying assets of the product.

170. These requirements are set out in Article 8.4 of the EU Regulation and they impose a prohibition on the credit rating agency to refuse:

a) to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another credit rating agency, where a credit rating agency is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or structured finance instruments;
b) to record all instances where in its credit rating process it departs from existing credit ratings prepared by another credit rating agency with respect to underlying assets or structured finance instruments providing a justification for the differing assessment.

171. CESR does not consider that these requirements need to be in place for the purposes of assessing equivalence.

172. For an explanation of CESR's view regarding how and if the US framework meets the quality of ratings and quality of methodologies requirements please see paragraphs 599 to 708 below.

(F) Disclosure

173. The information that has to be disclosed either to the public or the regulator in respect of credit ratings and the credit rating agency and its activities form another set of core prescriptive requirements.

174. For the purposes of assessing equivalence, CESR has subdivided the EU Regulation's disclosure requirements as follows:

I) Presentation and disclosure of credit ratings;
II) General and periodic disclosure about the credit rating agency.

F.I) Presentation and disclosure of ratings

175. In light of the number of presentation and disclosure of ratings requirements, for the purposes of this report, CESR has further categorized these requirements into:

a) General provisions; and
b) Additional requirements for structured finance instruments.

F.I)A) GENERAL PROVISIONS

176. The EU Regulation sets out a number of detailed requirements relating to the disclosure and presentation of ratings. CESR considers that the objectives of these requirements aim at ensuring that ratings are disclosed in a timely manner and in a non-selective basis, and that adequate information is provided to the users of credit ratings in order to allow them to conduct their own due diligence when assessing whether or not to rely on those credit ratings.

177. Namely, pursuant to Article 10.1,4,6, Article 11.2, and Annex I, Section D, paragraph 5, of the EU Regulation, credit rating agencies are required to:

a) disclose any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner;
b) refrain from using the name of the competent authority in such a way that would indicate endorsement or approval by that authority of the credit rating or any credit rating activities of the credit rating agency;
c) disclose its policies and procedures regarding unsolicited credit ratings and ensure that unsolicited credit ratings are identified as such;
d) in the case of an unsolicited credit rating, information on whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party;
e) when announcing a credit rating, to explain in their press releases or reports the key elements underlying the credit rating; and
f) make available information on its historical performance data, including the rating transition frequency and information about credit ratings issued in the past and their changes.

178. In addition, according to Article 10(2) and Annex I, Section D, paragraphs 1, 2, 4 of the EU Regulation, credit rating agencies are required to ensure that the following information is indicated in the credit ratings:

a) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating;
b) all substantially material sources used to prepare the credit rating, with an indication of whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure;
c) the principal methodology or methodology version that was used in determining the rating, with a reference to its comprehensive description;
d) the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitive analysis of the relevant key rating assumptions, accompanied by an explanation of the worst-case and best-case scenario credit ratings;
e) the date of first release of the credit rating for publication as well as of its last update;
f) information on whether the credit rating concerns a new financial instrument and whether the credit rating agency is rating it for the first time; and
g) any attributes and limitations of a credit rating, and in particular to what extent the credit rating agency has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on.

179. CESR considers that, for the purposes of assessing equivalence, overall, the objectives of each individual requirement described in paragraphs 177 to 178 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.

180. However, CESR can accept the following differences:

a) decisions to discontinue a credit rating are to be disclosed, but there is no requirement to indicate the reasons for such a decision;
b) the requirement, when announcing a credit rating, for press releases or reports to indicate the key elements underlying the credit rating, provided that it is ensured that such key elements are provided to investors when ratings are announced;
c) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating are not to be disclosed in the credit rating, provided that record of this information is kept;
d) credit ratings are not required to indicate whether the credit rating concerns a new financial instrument and whether the credit rating agency is rating it for the first time, since it is expects this requirement to be covered through the requirement to indicate the attributes and limitations of the credit ratings that are disclosed.

F.I)B)ADDITIONAL REQUIREMENTS FOR STRUCTURED FINANCE INSTRUMENTS

181. The EU Regulation imposes additional requirements in respect of the presentation of ratings related to structured financial instruments.

182. The aim of these requirements is to ensure that ratings for structured financial instruments are clearly identifiable as such, and that investors receive appropriate information to deal with the additional complexity of these products.

183. Namely, Article 10.3 and Annex I, Section D.II, paragraphs 3, 4 of the EU Regulation require credit rating agencies that rate structured finance instruments:

a) to ensure that credit categories attributed to those structured finance instruments are clearly differentiated by the use of a specific symbol;
b) to accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings;
c) to disclose on an on-going basis information about all structured finance products submitted to them for initial review or preliminary rating, regardless of whether a final rating has been issued.

184. In addition, credit rating agencies that rate structured financial instruments are required to provide in the relevant credit ratings the additional information set out in according to Annex I, Section D.II, paragraphs 1, 2 of the EU Regulation, as detailed below:

a) all information about loss and cash-flows analysis performed or relied upon by the credit rating agency as well as about expected changes in the credit rating;
b) information on whether the credit rating agency has performed any assessment concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments (specifying what level of assessment) or whether the credit rating agency has relied on a third party assessment.

185. Taking into account the complexity of structured finance products, CESR considers it important, for the purposes of assessing equivalence, that additional requirements are in place for the presentation of credit ratings related to these type of products.

186. Out of the requirements set out in paragraphs 183 to 184 above, CESR considers that it shall be, as a minimum, ensured that information is disclosed about the level of assessment, if any, conducted by the credit rating agency on the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments.

187. For a discussion regarding how the US framework compares to these presentation and disclosure of ratings requirements see paragraphs 715 to 901 below.

F.II) General and periodic disclosure about the credit rating agencies

188. In addition to the requirements on disclosure and presentation of credit ratings, the EU Regulation imposes a number of prescriptive disclosure requirements on credit rating agencies in relation to their organization and their activities, including the methodologies they use for determining and publishing credit ratings.

189. CESR considers that the objectives of the general and periodic disclosure requirements of the EU Regulation are aimed at ensuring transparency about credit rating activities, at making information available to the public to allow it to perform an assessment on whether to rely on certain credit ratings as well as at providing information to competent authorities for the purposes of on-going supervision.

190. For the purpose of this paper, a distinction is made between:

a) General additional disclosure requirements; and
b) Periodic additional disclosure requirements, which include the information expected to be provided in the transparency reports.

F.II)A) GENERAL ADDITIONAL DISCLOSURE REQUIREMENTS

191. According to Article 11.1 and Annex I, Section E.I of the EU Regulation, a credit rating agency is required to generally disclose to the public the following information:

a) the fact that it is registered;
b) a list of ancillary services;
c) the policy of the credit rating agency concerning the publication of credit ratings and other related communications;
d) the general nature of its compensation arrangements;
e) the methodologies, and descriptions of models and key rating assumptions as well as their material changes;
f) any material modification to its systems, resources or procedures; and
g) where relevant, its code of conduct.

192. CESR recognises the importance of the disclosure of such information for the purposes of achieving the objectives referred to in paragraph 189 above. CESR considers that, for the purposes of an equivalence assessment, it is necessary to assess, whether or not as a minimum, the information referred to under letters a), b), c), e), g) of paragraph 191 above is disclosed to the public. CESR can accept for the purposes of equivalence that the information referred to under letters d) and f) of paragraph 191 above is provided only to the competent authority.

F.II.B) PERIODIC ADDITIONAL DISCLOSURE REQUIREMENTS

193. Article 11.3 and Annex I, Section E.II paragraph 2 of the EU Regulation require credit rating agencies to provide, on an annual basis, to the competent authority:

a) a list of the 20 largest clients by revenue generated by them; and
b) a list of the clients whose contribution to the growth rate in the generation of the credit rating agency's revenue in the previous financial year exceeded the growth rate in the total revenue of the credit rating agency in that year by a factor of 1.5 times.

194. For the purposes of assessing equivalence, CESR expects the third country regulatory framework to impose some form of public disclosure requirement regarding revenue generation on the credit rating agency. However, for the purposes of assessing equivalence, CESR can accept that the requirement in paragraph 193a) above does not need to be identical to the one set out under the EU Regulation (e.g. not covering the 20 largest clients), and that the requirement in paragraph 193b) above does not need to be in place in the third country.

195. In addition to these requirements, the EU Regulation (Article 11.2 and Annex I, Section E.II paragraph 1) requires credit rating agencies to make available to the public, on a half-yearly basis, data about the historical default rates of their rating categories, distinguishing between geographical areas of the issuers and whether these default rates have changed over time.

196. CESR considers that, for the purposes of an equivalence assessment, the third country legal and regulatory framework shall require credit rating agencies to disclose to the public data about historical default rates of rating categories and their changes over time. However, CESR can accept that the frequency for publication may be different, as well as that no distinction is made between the geographical areas of the issuer.

197. In addition, under Article 12 and Annex I, Section E.III of the EU Regulation, credit rating agencies are required to make the following information available to the public on an annual basis in an annual report on their Internet website:

a) a detailed description of their legal structure, ownership and revenue streams;
b) a description of the internal control mechanisms ensuring quality of their credit rating activities;
c) a description of their record keeping policy;
d) a description of their management and rotation policy;
e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management; and
f) the outcome of the annual internal review of their independent compliance function.

198. Whilst according to the EU Regulation these requirements need to be disclosed to the public, CESR considers disclosure to the authority is adequate for the purposes of establishing equivalence. In addition, CESR considers that it can accept that credit rating agencies are not required to disclose the statistics referred to under letter e) in paragraph 197e) above.

199. For a discussion regarding how the US framework compares to these general and periodic disclosure about the credit rating agencies requirements see paragraphs 902 to 1009 below.

(G) Effective supervision and enforcement

200. Article 4.3(f) and 5.6 of the EU Regulation include as preconditions for ratings issued outside the EU to be endorsable or certifiable that:

a) credit rating agencies in the third country are subject to effective supervision and enforcement on an ongoing basis (Article 5.6); and
b) the credit rating agency established in the third country is authorised or registered, and is subject to supervision in that third country (Article 4.3(f)).

201. In addition, the coordination arrangements that need to be in place in accordance with Articles 4.3(h) and 5.1(c) have to include provisions relating to the *"coordination of supervisory activities…"*

202. As explained in paragraph 52 above, CESR has established a number of preconditions for the purposes of establishing whether or not equivalence exists, and in the event that it does not consider the objectives of these requirements to be met, then such a system cannot be considered to be equivalent.

203. In assessing the nature of equivalence in this area, CESR divided these requirements into the following areas:

I) The methods that the authority has in place to ensure that it is adequately staffed;
II) The powers of the relevant authority; and
III) The nature of the penalties that can be imposed.

204. CESR points out that it is not, for the purposes of assessing equivalence, making any judgments regarding the approach that the third country regulator adopts in relation to on going supervision, for example, whether a risk based approach is or is not a good or bad thing, but is overall looking to get comfort that the supervision that will or is being done can be or is in practice effective.

G.I) The methods that the Authority has in place to ensure that it is adequately staffed

205. The nature of supervision and enforcement that takes place in respect of monitoring and supervising the credit rating agencies adherence to their obligations and taking action where they do not, is heavily dependant upon the number of staff that the relevant authority charged with the legal responsibility of supervising these entities has in place.

206. Article 22.2 of the EU Regulation requires that competent authorities in the EU to be adequately staffed, with regard to capacity and expertise, in order to able to apply the EU Regulation.

207. In assessing equivalence in this area, CESR does not expect to find a similar legal provision but that there will be enough staff.

208. Even at an EU level there is no standardisation between Member States in terms of what "adequate" means and the minimum number of staff or their expertise for the purposes of applying the EU Regulation, as such there is no benchmark against which CESR can assess equivalence in this area.

209. However, without the necessary staff there cannot said to be "effective supervision", as such, CESR has, in assessing equivalence, sought to understand how the regulator in question either already does, or will, in the future be organising itself, and how many staff it has or will have.

210. CESR is conscious of the fact that this is an area that may change in respect of the third country that it is assessing, but clearly if there is no thought to how supervision will in practice be carried out – then irrespective of the powers that the supervisors may have at its disposable to use, CESR cannot say that the supervision is or will be effective.

G.II) The powers of the relevant authority

211. Article 23 of the EU Regulation sets out the details of the powers that the EU competent authorities need to have in order to be able to discharge their legal duties under Article 23.3 of the EU Regulation, as well as a description of how these powers are to be exercised Article 23.2.

212. The necessary powers that the authority need to have are the power to:

a) access to any document in any form and to receive or take a copy thereof;
b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;
c) carry out on-site inspections with or without announcement;
d) require records of telephone and data traffic;

213. In addition, as set out in Article 24 of the EU Regulation, the authority in question has to be able to take the following measures against a credit rating agency following the establishment of a breach by it in respect of its obligations under the EU Regulation:

a) withdraw the CRA's registration or authorisation;
b) prohibit the CRA from temporarily issuing credit ratings;
c) suspend the use of credit ratings issued by the CRA for regulatory purposes;
d) take appropriate measures to ensure that the CRA continues to comply with its legal requirements;
e) issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and
f) refer matters for criminal prosecution to the relevant national authorities.

214. For the purposes of assessing equivalence, CESR considers that all the above powers need to be firmly embedded in the relevant law in order to be able to classify the third country regime as having effective supervision which it considers to be equivalent to that of the EU's.

215. In addition, as set out in the final paragraph of Article 23.3 the authority needs to be able to exercise these powers in respect of:

"credit rating agencies, persons involved in credit rating activities, rated entities and related third parties, third parties to whom the credit rating agencies have outsourced certain functions or activities; and person otherwise related or connected to credit rating agencies or credit rating activities."

216. As such, when assessing equivalence in this area, CESR needs to assess not only the nature of the powers that can be exercised, but also against whom these powers can be exercised in assessing whether or not the supervision is or can be "effective."

G.III) Penalties

217. Article 36 of the EU Regulation sets out that the penalties that can be imposed by each national authority need to be: "effective, proportionate and dissuasive" – but leaves it to each authority to determine what these should be[5].

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5 CESR will in June be issuing some guidance regarding what the nature of these penalties may be.

218. In addition, the EU Regulation imposes an obligation on the national authorities to disclose to the public every penalty being imposed for infringements of the EU Regulation, unless such disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved.

219. For the purposes of assessing equivalence, CESR expects that the relevant third country framework has legal provisions setting out what the penalties that can be imposed for breaches of the relevant requirements are, but does not expect these penalties to be publishable for the purposes of equivalence.

220. For a discussion regarding the equivalence of the US's framework in respect of effective supervision and enforcement see paragraphs 1010 to 1068 below.

Section IV. US Assessment

221. This section of the advice explains how CESR has assessed the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

222. This section is divided as follows:

a)The US legal and supervisory framework;
b)The assessment of the equivalence of that framework to that of the EU.

223. This section of the advice outlines the general differences between the EU and the US approach on implementing a credit rating agency registration and oversight regime.

IV.1 Overall philosophy of approach

224. Before going into the specific details of the US legal and regulatory framework for credit rating agencies in the US, CESR considers it important to highlight that there is a fundamental difference in terms of the philosophy that the US has in relation to regulation and supervision of credit ratings and credit rating agencies.

225. The US legislative approach is to set out, at a relatively high level, what the overall objective the framework needs to achieve is, the issues that the Securities and Exchange Commission ("SEC") - as the authority empowered to apply the law and supervise the credit rating agencies - needs to have regard to, and setting out a number of provisions in the US Statute (see paragraphs 239 to 300 below) that apply directly to the US equivalent of registered credit rating agencies namely Nationally Recognised Statistical Rating Organisations ("NRSROs"), then leaving it to the SEC through its broad rule making and supervisory powers to put further "flesh on the bones" of the framework.

226. The approach is therefore aligned with a philosophy whereby the SEC relies very heavily on upfront disclosure being made during the application process, with rules detailing what needs to be disclosed, demonstrating the substantive policies that an applicant is required to adopt, as well as instructions about how the application form is to be completed, and what information has to be made public and what information is only to be provided to the SEC.

227. This application form and a lot of the information that has to be provided to support the application needs to be made public, and the framework prescribes how and by when this needs to be done, as well as for example highlighting that the detail to be provided regarding the description of procedures and methodologies used to determine credit ratings be *"sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the applicant…[6]".*

228. In contrast, other disclosure sets out to ensure that the disclosure made does not diminish the effectiveness of the policy or procedure being described by instructing the applicant not to *"include*

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6 Exhibit 2 of the Form NRSRO.

any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available."[7]

229. Once the information is in the public domain, the SEC has the power to determine through their examination process whether or not the described policies and procedures are reasonably designed. The market at large exercises its own judgment on issues where the EU Regulation has in contrast left it to competent authorities to make a "judgment call" upfront in terms of what is for example an "adequate", "sound", "appropriate", or "effective" procedure or process when assessing an application, which is then subsequently assessed by the market.

230. Once the disclosure has been made, the credit rating agency that has made that disclosure is legally responsible for the accuracy of the disclosure, and for which, if through the SEC's ongoing supervision processes turns out subsequently to be inaccurate or untrue, the NRSRO may be subject to liability under the federal securities laws and rules thereunder.

231. The instructions to the application form make it clear that: the principal purposes of the application form are to determine whether the applicant should be granted registration as an NRSRO, and whether it continues to meet the criteria for registration and to provide information to users of credit ratings about the NRSRO – *"intentional misstatements or omissions may constitute federal criminal violations.*"

232. This approach means that there is less of a need to prescribe in great detail all the procedures and processes that need to be in place and what they have to be, but rather to prescribe what the obligations of the credit rating agency are and what objectives processes and procedures they need to achieve.

233. What is prescribed in great detail is the disclosure that needs to be made upfront, the need to update the information to ensure that it is up to date and accurate, and to make a number of filings to the SEC during the course of the year.

234. In addition, the US takes (in contrast to the EU) a very rigid approach to the concept of non interference with credit rating methodologies and the content of credit ratings, which means that the SEC does not regulate the content of procedures and methodologies to determine credit ratings and as such does not evaluate the content of the disclosure that is made on an ex-ante basis in respect of, for example, methodologies, procedures by which methodologies or credit ratings are monitored or reviewed or prescribing how often they should be monitored or reviewed, leaving it to the market to make its own judgments about the quality of what the methodology or procedure for its review is, and where necessary being able to exercise their power on an ex-post basis to address any issues that may arise.

235. The philosophy of front loading disclosure in the application form and leaving it to the market to make its own judgments also extends to the content of credit ratings, so in contrast to the EU where there are a large number of rating by rating disclosure requirements, in the US this disclosure is done in the application form, leaving it to the investor to match the ex-ante disclosure with the ex-post credit rating.

236. The philosophy in the US is almost polarised to that of the EU, and the architecture of the resulting legal and supervisory framework is consistent with this philosophy.

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7 See instructions for Exhibits 3 and 7 of the NRSRO Form regarding policies and procedures adopted and implemented to prevent the misuse of material, non-public information and to address and manage conflicts of interest.

237. In the US there is a philosophy of:

- ♦ publicly disclosing the application form and its accompanying documentation;
- ♦ front loading the disclosure that is made on an ex-ante basis in the application form;
- ♦ not regulating the content of procedures and methodologies to determine credit ratings and as such does not reviewing the accuracy of the content of disclosure that is made in Form NRSRO on an ex-ante basis, but instead during subsequent examinations of NRSROs on an ex-post basis;
- ♦ leaving it to the market to make its own judgment as the regulator has not in advance determined what is and what is not adequate per se - as this is something that is to be determined in practice and on an ongoing basis through the supervision of the credit rating agency;
- ♦ relying on the threat of taking action if the NRSRO issues credit ratings in material contravention of the procedures that the NRSRO includes in its application for registration and makes and disseminates in reports pursuant to the SEC's Rules.

238. In the EU the philosophy is very different:

- ♦ no philosophy of publicly disclosing the application form and the information provided to support it,
- ♦ there is an expectation that the competent authority as well as the market make their own assessment of what is an "adequate" or "inadequate" procedure, so there is more ex-ante supervision and rating by rating disclosure requirements; and
- ♦ there is more reliance on ex-ante supervision and less reliance on ex-post supervision to identify potential problems than in the US.

IV.2 The US Legal and Regulatory framework for credit rating agencies

Legal framework

239. The US Congress passed the Credit Rating Agency Reform Act of 2006 ("Rating Agency Act") with the goals of improving ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.

240. By adding Section 15E[8] and amending Section 17[9] and Section 21B(a)[10] of the Securities Exchange Act ("Exchange Act"), the Rating Agency Act provided the SEC with rulemaking authority in a variety of areas.

241. In detail, the Rating Agency Act, among other things, amended Section 3 of the Exchange Act[11] to add certain definitions, added Section 15E to the Exchange Act to implement a registration and oversight program for Nationally Recognised Statistical Rating Organisations, amended Section 17 of the Exchange Act to provide the SEC with recordkeeping, reporting, and examination authority over NRSROs, and amended Section 21B(a) of the Exchange Act to provide the SEC with authority to assess money penalties against NRSROs in proceedings instituted under Section 15E of the Exchange Act.

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8 15 U.S.C.78o-7
9 15 U.S.C.78q
10 15 U.S.C.78u-2
11 15 U.S.C. 78c

242. The operative provisions of the Rating Agency Act became applicable upon the SEC's adoption in June 2007 of a series of rules implementing a registration and oversight program for credit rating agencies that register as NRSROs (hereafter referred to as "SEC Rules" or "Rules").

243. Since June 2008 several sets of amendments to the NRSRO Rules have been proposed, some of which were adopted in February and September 2009. The latter set of amendments will become effective on the 2nd of June this year and are discussed in detail in the latter parts of this section of the report, for example paragraphs 791 to 799 below.

244. The Rating Agency Act defined the term NRSRO and provided exclusive authority to the SEC to implement registration, recordkeeping, financial reporting and oversight rules with respect to NRSROs.

245. It also provided the SEC with authority to examine and take enforcement actions against NRSROs. The term NRSRO is used in US statutes and regulations.[12]

Application process

246. The application process for credit rating agencies to register with the SEC as NRSROs is prescribed in Section 15E(a) of the Exchange Act[13], Rule 17g-1[14], and SEC form "Form NRSRO".[15]

247. Rule 17g-1 prescribes, among other things, how a credit rating agency may apply to be registered with the SEC as an NRSRO and how a registered NRSRO is required to keep its registration up-to-date, and comply with the statutory requirement to furnish the SEC with an annual certification.[16] Specifically, all of these actions must be accomplished by furnishing the SEC with a Form NRSRO described in paragraphs 261 to 280 below.

248. To get registered, the entity must meet the definition of credit rating agency in Section 3 of the Exchange Act, which means, among other things, it must issue credit ratings. Furthermore, to be a registered credit rating agency, the entity must be engaged in the business of issuing credit ratings on the internet or through another readily accessible means, for free or for a reasonable fee. In addition, the entity must employ either a quantitative or qualitative model or both to determine credit ratings and receive fees from issuers, investors, or other market participants, or a combination thereof.

249. To register with the SEC, a credit rating agency must also meet the definition of NRSRO. For example, under the Rating Agency Act, the credit rating agency must have been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration with the SEC.[17] In addition, the credit rating agency must issue credit ratings with respect to one or more classes of specific types of obligors:

- financial institutions, brokers, or dealers,
- insurance companies,
- corporate issuers,
- issuers of asset-backed securities,

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12 Joint Forum - Stocktaking on the use of credit ratings - http://www.bis.org/publ/joint22.pdf.
13 15 U.S.C. 78o-7(a).
14 17 CFR 240.17g-1.
15 17 CFR 249b.300.
16 See 17 CFR 240.17g-1.
17 See Section 3 (a)(62)(A) of the Exchange Act.

- issuers of government securities, municipal securities, or securities issued by a foreign government.[18]

250. A credit rating agency that meets these statutory definitions can seek to be registered with the SEC as an NRSRO under Section 15E of the Exchange Act. This section, prescribes certain minimum information a credit rating agency must provide in its application for registration as an NRSRO, for example:[19]

- Credit ratings performance measurement statistics over short-, mid-, and long-term periods, as applicable,[20]
- The procedures and methodologies that the applicant uses in determining ratings,[21]
- Policies or procedures adopted and implemented by the applicant to prevent the misuse, in violation of the of the Exchange Act (or the rules and regulations hereunder) of material, non-public information,[22]
- The organisational structure of the applicant,[23]
- Whether or not the applicant has in effect a code of ethics, and if not, the reasons therefore,[24]
- Any conflict of interest relating to the issuance of credit ratings by the applicant.[25]

251. Overall, it can be seen that the Exchange Act and the SEC Rules are prescriptive and there is clarity regarding the basis upon which the application for registration has to be accepted, and the grounds upon which the SEC can reject it, Section 15E(a)(2)(C) of the Exchange Act:

"Grounds for decision. The Commission shall grant registration under this subsection--
(i) if the Commission finds that the requirements of this section are satisfied; and
(ii) unless the Commission finds (in which case the Commission shall deny such registration) that--
(I) the applicant does not have adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with the procedures and methodologies disclosed under paragraph (1)(B) and with subsections (g), (h), (i), and (j); or
(II) if the applicant were so registered, its registration would be subject to suspension or revocation under subsection (d)."

252. Section 15E(a)(2)(A) of the Exchange Act requires the SEC to grant an application for registration as an NRSRO or commence proceedings on whether to deny the application within 90 days from the date the application is furnished to the SEC or a longer period if the applicant consents.[26] Further, if proceedings are commenced, the SEC has to conclude them within 120 days of the date the application is furnished to the SEC.[27] The SEC will grant a credit rating agency NRSRO status if the requirements of Section 15E of the Exchange Act are satisfied.[28] The SEC shall deny the application if it finds that the applicant does not have adequate financial and managerial resources to consistently produce credit ratings with integrity and materially comply with the procedures and methodologies disclosed.

Regulatory framework once NRSROs are registered

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18 Section 3 (a)(62)(B)(i) – (v) of the Exchange Act.
19 Section 15E (a)(1)(B) of the Exchange Act.
20 Section 15 E(a)(1)(B)(i) of the Exchange Act.
21 Section15E(a)(1)(B)(ii) of the Exchange Act.
22 Section 15 E(a)(1)(B)(iii) of the Exchange Act.
23 Section 15 E(a)(1)(B)(iv) of the Exchange Act.
24 Section 15 E(a)(1)(B)(v) of the Exchange Act.
25 Section 15 E(a)(1)(B)(vi) of the Exchange Act.
26 15 U.S.C. 78o-7(a)(2)(A).
27 Under Section 15E(a)(2)(B)(iii) of the Exchange Act, the SEC can extend this period for an additional 90 days for good cause or for such other period as the applicant consents (15 U.S.C. 78o-7(a)(2)(B)(iii)).
28 Section 15E (a)(2)(C)(i) of the Exchange Act.

253. After registration, NRSROs are subject to, for example, requirements that an NRSRO has to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information, to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest, and to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of non-public information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.[29]

254. Moreover, the books and records of an NRSRO are subject to examination by the SEC.[30]

255. In CESR's view, the US regulatory system is based on the following two key principles:

a. Requirements on misuse of non-public information, and
b. The management of conflicts of interest.

256. Both principles combined with extensive disclosure requirements together with extensive powers, supports the philosophy of the approach in the US to the regulation and supervision of credit rating agencies, namely that after application the NRSRO may be subject to liability under the federal securities laws and rules thereunder.

Misuse of non-public information

257. NRSROs are required to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information in violation of the Exchange Act.[31] Therefore, Rule 17g-4 requires an NRSRO to establish procedures to address areas where material, non-public information could be inappropriately disclosed or used.[32] In particular, it requires that the written policies and procedures an NRSRO establishes, maintains, and enforces must include policies and procedures reasonably designed to prevent:

- The inappropriate dissemination within and outside the NRSRO of material non-public information obtained in connection with the performance of credit rating services,[33]

- A person within the NRSRO from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material non-public information obtained in connection with the performance of credit rating services that affects the securities or money market instruments,[34]

- The inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.[35]

Management of conflicts of interest

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29 Section 15E of the Exchange Act.
30 Section 17 of the Exchange Act.
31 Section 15E (g) of the Exchange Act.
32 17 CFR 240.17g-4.
33 Rule 17g-4(a)(1).
34 Rule 17g-4(a)(2).
35 Rule 17g-4(a)(3). The SEC stated in the Adopting Release that this provision recognizes that a credit rating action of an NRSRO may be material, non-public information. Consequently, an NRSRO must have policies designed to ensure that its pending credit rating actions are not selectively disclosed before the credit rating is issued on the Internet or through another readily accessible means. See Adopting Release, 72 FR at 33594-33595.

258. Rule 17g-5[36] prohibits a person within an NRSRO from having certain conflicts of interest relating to the issuance of a credit rating identified in this rule unless the NRSRO has disclosed the type of conflict of interest and has implemented policies and procedures to address and manage the type of conflict of interest. The list of "disclose-and-manage" conflicts identified in Rule 17g-5(b) are the following:

- Being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite,
- Being paid by obligors to determine credit ratings with respect to the obligors,
- Being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a credit rating,
- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons may use the credit ratings of the NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term NRSRO,
- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons also may own investments or have entered into transactions that could be favourably or adversely impacted by a credit rating issued by the NRSRO,
- Allowing persons within the NRSRO to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO,
- Allowing persons within the NRSRO to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the NRSRO,
- Having a person associated with the NRSRO that is a broker or dealer engaged in the business of underwriting securities or money market instruments,
- Issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument,
- Any other type of conflict of interest relating to the issuance of credit ratings by the NRSRO that is material to the NRSRO and that is identified by the NRSRO in Exhibit 6 to Form NRSRO.

259. Seven types of conflicts of interest are prohibited by Rule 17g-5(c). Consequently, an NRSRO would violate the rule regardless of whether it had disclosed them and established procedures reasonably designed to address them. The prohibited conflicts are:

- The NRSRO issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equalling or exceeding 10% of the total net revenue of the NRSRO for the fiscal year;

- The NRSRO issues or maintains a credit rating with respect to a person where the NRSRO, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating;

- The NRSRO issues or maintains a credit rating with respect to a person associated with the NRSRO;

- The NRSRO issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating;

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36 17 CFR 240.17g-5

- The NRSRO issues or maintains a credit rating with respect to an obligor or security where the NRSRO or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security;

- The NRSRO issues or maintains a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models;

- The NRSRO issues or maintains a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $25.

260. By and large, the US regulatory regime does not consist of many detailed requirements, but concentrates on the ones mentioned above. Due to explicit disclosure requirements NRSROs have to publish in detail what they are doing in Form NRSRO, of which some parts are public and parts are only submitted to the SEC. An NRSRO that did not adhere to its disclosed policies, procedures, and methodologies may be subject to liability under the federal securities laws and rules thereunder.

Disclosure

261. Form NRSRO elicits information about the credit rating agency applying for registration and, after registration about the NRSRO, including the information required under 15E(a)(1)(B) of the Exchange Act.[37] Rule 17g-1(i) requires an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 (described below) publicly available within 10 business days of being granted an initial registration or registration in an additional class of credit ratings and within 10 business days of furnishing an update to amend information on the form, to provide the annual certification, and to withdraw a registration.[38]

262. All documents disclosed on Form NRSRO as well as any other books and records form the basis of what the SEC may examine when conducting an examination of an NRSRO. Moreover, in case an NRSRO did not adhere to what was disclosed in these documents, it may be subject to liability under the federal securities laws and rules thereunder.

263. Form NRSRO contains 8 line items and 13 Exhibits. The line items elicit information about the applicant credit rating agency or NRSRO such as: its address; corporate form; credit rating affiliates that would be, or are, a part of its registration; the classes of credit ratings for which it is seeking, or is, registered as an NRSRO; the number of credit ratings it has issued in each class and the date it began issuing credit ratings in each class; and whether it or a person associated with it has committed or omitted any act, been convicted of any crime, or is subject to any order identified in Section 15(d) of the Exchange Act.

264. The 13 Exhibits to Form NRSRO elicit the information required under Sections 15E(a)(1)(B)(i) through (ix) of the Exchange Act and additional information the SEC prescribed under authority in Section 15E(a)(1)(B)(x) of the Exchange Act.[39]

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37 15 U.S.C. 78o-7(a)(1)(B).
38 See 17 CFR 240.17g-1(i).
39 15 U.S.C. 78o-7(a)(1)(B)(i) – (x).

265. An NRSRO must make Exhibits 1 through 9 publicly available after it is registered. Exhibits 10 through 13 do not need to be publicly disclosed but need to be submitted to the SEC when applying for registration. These Exhibits elicit financial information about the applicant credit rating agency that the SEC uses in making the finding that the applicant has adequate financial and managerial resources to consistently produce credit ratings with integrity and materially comply with the procedures and methodologies disclosed and established.[40]

266. After registration, an NRSRO is required to furnish financial information to the SEC in an annual report that is similar to the information elicited in Exhibits 10 through 13.[41]

267. **Exhibit 1** elicits the following information: credit ratings performance measurement statistics over one, three and ten year time periods within each class of credit rating for which the NRSRO is registered.[42] The instructions for the Exhibit provide that an applicant and NRSRO must include in the Exhibit definitions of the credit ratings (i.e., an explanation of each category and notch) and explanations of the performance measurement statistics, including the metrics used to derive the statistics.

268. **Exhibit 2** elicits information regarding the procedures and methodologies used by the credit rating agency to determine credit ratings.[43] The instructions for the Exhibit require a description of the procedures and methodologies (not the submission and disclosure of each actual procedure and methodology). The instructions further provide that the description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes the applicant or NRSRO employs to determine credit ratings. The instructions also identify a number of areas that must be addressed in the description to the extent they are applicable.[44]

269. **Exhibit 3** elicits policies or procedures adopted and implemented by the credit rating agency to prevent the misuse of material, non-public information in violation of Exchange Act provisions and

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40 Section 15E (g), (h), (i) and (j) of the Exchange Act.
41 See Rule 17g-3.
42 Section 15E (a)(1)(B)(i) of the Exchange Act.
43 Section 15E (a)(1)(B)(ii) of the Exchange Act.
44 Specifically, the instructions require an NRSRO to provide descriptions of the following areas (as applicable): policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings; the methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating.

rules.[45] The instructions for the Exhibit provide that the applicant or NRSRO is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information is disclosed.

270. **Exhibit 4** elicits information regarding the organisational structure of the credit rating agency.[46] The instructions for the Exhibit provide that the applicant or NRSRO must provide three different charts as applicable. The first required organisational chart is of the credit rating agency's ultimate and sub-holding companies, subsidiaries, and material affiliates, if applicable. The second organisational chart is of the credit rating agency's divisions, departments, and business units, if applicable. The third organisational chart is of the credit rating agency's management structure and senior management reporting lines and must include its designated compliance officer.[47]

271. **Exhibit 5** elicits whether the credit rating agency has a code of ethics in effect or an explanation of why the credit rating agency has not established a code of ethics.[48] The instructions for the Exhibit require the credit rating agency to attach a copy of any established code of ethics or an explanation of why it does not have a code of ethics.

272. **Exhibit 6** elicits information regarding any conflicts of interest relating to the issuance of credit ratings by the applicant and NRSRO.[49] The instructions to the Exhibit require the credit rating agency to provide a list describing in general terms the types of conflicts of interest that arise from its business activities. The instructions list 10 different generic conflicts of interest that may apply to a credit rating agency based on its business model and activities. These conflicts are included in the instructions as examples of conflicts. The instructions further provide that the credit rating agency can use the descriptions provided in the instructions to identify an applicable conflict of interest and is not required to provide any further information. Thus, the credit rating agency can review each item on the list and determine whether it describes an applicable conflict. A credit rating agency can choose to provide its own description of the conflict or further explanation to one of the descriptions in the instructions.

273. **Exhibit 7** requires the credit rating agency to furnish a copy of the written policies and procedures it establishes, maintains, and enforces to address and manage conflicts of interest.[50] The instructions for the Exhibit provide that the credit rating agency is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information were disclosed.

274. **Exhibit 8** requires the credit rating agency to furnish summary information about its credit analysts. Specifically, the Exhibit requires the following information:

- The total number of credit analysts;
- The total number of credit analyst supervisors;
- A general description of the minimum required qualifications of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts); and
- A general description of the minimum required qualifications of the credit analyst supervisors, including education level and work experience.

275. **Exhibit 9** requires an applicant and NRSRO to provide certain background information on the entity's designated compliance officer.

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45 Section 15E (a)(1)(B)(iii) of the Exchange Act.
46 Section 15E (a)(1)(B)(iv) of the Exchange Act.
47 Section 15E (j) of the Exchange Act.
48 Section 15 E (a)(1)(B)(v) of the Exchange Act.
49 Section 15E (a)(1)(B)(vi) of the Exchange Act.
50 Section 15E (h) of the Exchange Act.

276. **Exhibit 10** elicits a list of the 20 largest issuers and subscribers that use the credit rating services provided by the credit rating agency by amount of net revenue received by the credit rating agency in the fiscal year immediately preceding the date of submission of the application.[51] The instructions for the Exhibit provide that the credit rating agency must disclose in the list large obligors (i.e., persons who are rated as an entity as opposed to having their securities rated) and underwriters if they are determined to have provided at least as much net revenue as the 20th largest issuer or subscriber. Consequently, a credit rating agency is required to identify the 20 largest issuers and subscribers and include in the list any obligor and underwriter that meets the above criteria. An NRSRO does not need to publicly disclose this information.[52] Instead, Rule 17g-3(a)(5) requires an NRSRO to include similar information in an annual report furnished to the SEC.[53]

277. **Exhibit 11** requires the credit rating agency to furnish audited financial statements for the past three fiscal or calendar years immediately preceding the date of the application. To accommodate credit rating agencies that did obtain audits in the normal course prior to registration as NRSROs, the instructions for the Exhibit provide that the credit rating agency may furnish an audited financial statement for the fiscal year immediately preceding the date of the application and unaudited financial statements for the prior years. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i). Instead, Rule 17g-3(a)(1) requires an NRSRO to include audited financial statements in an annual report furnished to the SEC.[54]

278. **Exhibit 12** requires the credit rating agency to provide information as to the amount of revenue generated from various credit rating services and a separate computation of total revenue from all other services. Specifically, the instructions for the Exhibit require the following information:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings; and
- Revenue from all other services and products offered by the credit rating agency (include descriptions of any major sources of revenue).

279. The instructions provide that this information be supplied for the most recently completed fiscal or calendar year and is not required to be audited. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i) and may request that the SEC keep such information confidential to the extent permitted by law.[55] Instead, Rule 17g-3 requires an NRSRO to include similar information in an annual report furnished to the SEC.[56]

280. **Exhibit 13** requires the credit rating agency to furnish the SEC with the amount of total aggregate annual compensation paid to its credit analysts and the median compensation. The instructions provide that the information supplied must be for the most recently completed fiscal or calendar year and will not have to be audited. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i).[57] Instead, Rule 17g-3 (a)(4) requires an NRSRO to provide similar information in an annual report furnished to the SEC.[58]

281. In general, the US regime is set up to improve ratings quality for the protection of investors and in the public interest. Credit rating agencies have to fulfil certain requirements and are required to

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51 Section 15E (a)(1)(B)(viii) of the Exchange Act.
52 Rule.17g-1(i).
53 17 CFR 240.17g-3(a)(5).
54 17 CFR 240.17g-3(a)(1).
55 17 CFR 240.17g-1(i).
56 17 CFR 240.17g-3(a)(3).
57 17 CFR 240.17g-1(i).
58 17 CFR 240.17g-3(a)(4).

disclose certain internal policies and procedures. Once these are published, they become additional requirements for a credit rating agency as the SEC checks whether a credit rating agency organises its work along its own policies and procedures. An NRSRO that did not adhere to its disclosed policies, procedures, and methodologies may be subject to liability under the federal securities laws and rules thereunder.

Organisational design of the SEC in respect of the oversight of NRSROs

282. Oversight of NRSROs in the SEC is carried out in a number of different divisions and offices depending on the nature of what is being done.

283. The division of trading and markets deals with policy and rule making, assessment of NRSRO registration forms and the monitoring unit (within the division) deals with updates of Form NRSRO, annual certification and the on-going monitoring of the NRSROs, the division of enforcement where enforcement against NRSROs will be dealt with and the office of compliance, inspections and examinations, that conducts examinations in order to assess whether or not the NRSRO is complying with their legal requirements.

284. Further details of these divisions are set out in paragraphs 1017 to 1028 below.

285. By and large, the US regulatory regime relies to a large extent on ex post supervision. Therefore, the SEC introduced an NRSRO monitoring function into its division of trading and markets consisting of three employees dedicated to monitoring NRSROs in order to provide input on regulatory initiatives such as NRSRO rulemaking. This group is distinct from the SEC's NRSRO examiners who review NRSROs for compliance with statutory and regulatory requirements applicable to NRSROs.

286. The members of the NRSRO monitoring group meet periodically with NRSROs in order to establish an ongoing dialogue and discuss a variety of topics, which can include, among other things:
- NRSRO organisational developments,
- new issuance, surveillance and performance trends,
- updates to rating methodologies and practices,
- market share and competitiveness issues,
- financial results,
- compliance and internal audit activity,
- in-depth reviews of sectors.

287. On top of these key issues, other responsibilities of the group include:
- Prepare internal periodic profile reports of each NRSRO and industry theme reports.
- Prepare annual report to the US Congress on NRSROs.
- Analyse and prepare reports on topics of interest or potential concern.
- Provide input, as needed, on regulatory initiatives.

288. Moreover, the NRSRO monitoring function is involved in model validation and governance issues. In addition to the above mentioned issues, broader monitoring meetings, may be organised where members of this group will meet periodically with NRSROs to discuss issues specifically related to model development, validation and governance. The purpose is to gain an understanding of the models and the controls around the models.

289. The SEC's Office of Compliance, Inspections and Examinations conducts routine and cause examinations of NRSROs. Routine examinations are done on a regular cycle and are designed to review whether the NRSRO is complying with the US securities laws, which include the

requirements in Section 15E of the Exchange Act and SEC's rules thereunder (e.g., Rules 17g-1, 17g-2, 17g-3, 17g-4, 17g-5 and 17g-6[59]).

290. The examiners will for example inspect the books and records of the NRSRO to review whether it is adhering to its disclosed and internally documented procedures for issuing credit ratings and managing conflicts of interest.

291. These exams typically involve onsite inspections conducted on the premises of the NRSRO.

292. Cause exams are undertaken to review specific matters that raise questions of whether an NRSRO is complying with the US securities laws that come to the attention of SEC staff (e.g., through a whistleblower or tipster).

293. If the examiners find a lack of compliance with the US securities laws through either type of exam, they can refer the matter to the Enforcement Division.

294. The Enforcement Division can investigate the matter, including taking testimony and issuing subpoenas for documents. This can lead to a recommendation that the SEC takes action against the NRSRO.

295. The SEC commenced its first set of routine reviews. The cause exams and sweep reviews were already used in the past, for example the sweep review of structured finance CDOs and RMBS that led to a critical report in June 2008 on the issues identified in those examinations of NRSROs.

296. There are a number of differences between how the EU approaches the issue of non interference with methodologies and how the US approach it. However, Section 15E(c)(2) of the Exchange Act prohibits the SEC, or any State (or political subdivision thereof) from regulating the substance of credit ratings or the procedures and methodologies by which an NRSRO determines credit ratings.[60]

297. As mentioned in paragraph 243 above, since June 2008 several sets of amendments to the SEC Rules have been proposed, some of which were adopted in February and some in September 2009. The following are currently in effect:

- to provide enhanced disclosure of performance measurements statistics and the procedures and methodologies used by the NRSRO in determining credit ratings for structured finance products and other debt securities,
- to make, keep, and preserve additional records under Rule 17g-2[61],
- to make publicly available on its Internet Web site in XBRL format a random sample of 10% of the ratings histories of credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated ("issuer-paid credit ratings") in each class of credit ratings for which it is registered and has issued 500 or more issuer-paid credit ratings, with each new ratings action to be reflected in such histories no later than six months after they are taken,
- to furnish the SEC with an additional annual report.

298. The amendments adopted by the SEC in September 2009 will enter into force in June of this year and some NRSROs are already complying with these amendments, which were designed to address concerns about the integrity of the process by which NRSROs rate structured finance products.

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59 17 CFR 240.17g-6.
60 15 U.S.C. 78o-7(c)(2).
61 17 CFR 240. 17g-2.

These new requirements are designed to address practices identified, in part, by the SEC staff during its examination of the three largest NRSROs.[62] The rule amendments require an NRSRO:

- Require NRSROs to make publicly available in a machine/readable format ratings action histories for all credit ratings (regardless of the business model under which they are determined) initially determined on or after June 26, 2007 (the effective date of the SEC's regulations implementing the Act), with each new ratings action to be disclosed on a delayed basis (12 month for rating information related to issuer/paid credit ratings, and 24 month for rating information related to credit ratings not issuer/paid).

- Require NRSROs that are hired by issuers, sponsors, or underwriters ("arrangers") to determine an initial credit rating for a structured finance product to disclose to other NRSROs (and only other NRSROs) that it is in the process of determining such a credit rating and obtain representations from the arranger that the arranger will provide the information it provided to the hired NRSROs to those other NRSROs as well.

299. The SEC consulted on enhanced disclosure rules to further address concerns about the integrity of the credit rating procedures and methodologies at NRSROs.[63] This consultation ended on February the 2nd and consisted of amendments such as:

- An amendment that would require an NRSRO to submit an annual report from its designated compliance officer describing the steps taken by the compliance officer during the most recently ended fiscal year to carry out the compliance officer's responsibilities.

- An amendment that would require an NRSRO to publicly disclose the percentage of its total net revenues attributable to providing services to its 20 largest clients and the percentage of its total net revenue attributable to providing services other than credit rating services (e.g., ancillary services).

- A new rule that would require an NRSRO to publish and annually update a consolidated report showing the following information for each person that paid the NRSRO to determine or monitor a credit rating: (1) the percentage of the total net revenue attributable to the person that is derived from providing ancillary services to the person; (2) the relative standing of the person (e.g., top 10%, top 25% etc..) in terms of providing net revenues to the NRSRO; and (3) the credit ratings outstanding that were determined for the person.[64]

300. Although the US regime has effectively been in place since 2007, the paragraphs above show that the SEC tries to constantly improve existing rules through lessons learned in a changing environment over the last two years.

301. On December 11, 2009 the House of Representatives passed a bill of an Act ("Wall Street Reform and Consumer Protection Act of 2009") to provide for financial regulatory reform, to protect consumers and investors, to enhance Federal understanding of insurance issues, to regulate over-the-counter derivatives markets and for other purposes. As of April 6th 2010, the bill has been received in the Senate and read twice and referred to the Committee on Banking, Housing and Urban Affairs.

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62 See June 16, 2008 Proposing Release, 73 FR at 36213; Summary Report of Issues Identified in the Staff's Examinations of Select Credit Rating Agencies (July 2008). The report can be accessed at http://www.sec.gov/news/studies/2008/craexamination070808.pdf

63 www.sec.gov/rules/proposed/2009/34-61051.pdf

64 Rule 17g-7.

302. The bill contains proposals designed to amend the Securities Exchange Act of 1934 to revise requirements for regulation of NRSROs. The bill proposes, among other things:
   (i) to introduce requirements for independent directors with specific monitoring tasks;
   (ii) to further reinforce the provisions on conflicts of interest by (a) including advisory services or ancillary assistance among the prohibited activities, (ii) introducing look-back requirements and (c) requiring a reporting to the SEC and to the public on certain employment transitions;
   (iii) to reinforce the duties of the designated compliance officer and his independence;
   (iv) to introduce requirements designed to enhance the quality of the methodologies to determine credit ratings as well as of the credit ratings;
   (v) to introduce disclosure requirements on a rating-by-rating basis (covering among other the underlying assumptions, the risks, limitations and potential volatility of the credit ratings, the data relied upon and the due diligence conducted in the determination of a credit rating);
   (vi) to introduce additional requirements for credit ratings of structured products, including the use of differentiated symbols;
   (vii) to enhance the disclosure concerning the NRSRO's activities, by introducing a requirement to publish information concerning the main clients of the NRSRO, the fees billed for the credit rating and the net revenues received for services other than the credit rating services.

303. The bill also contains proposals relating to the supervision by the SEC of NRSROs. It directs, among other things , the SEC to: (a) create a dedicated office to administer the NRSRO rules, (b) establish a Credit Rating Agency Advisory Board, (c) conduct extensive reviews on the credit ratings and the NRSRO's policies and procedures on at least an annual basis. In addition, the bill reinforces the rulemaking powers attributed to the SEC and sets out proposals of amendments concerning the liability of NRSROs and enforcement.

304. CESR also points out that on 15th of March 2010, the Senate Banking Committee Chairman released the bill of Restoring American Financial Stability Act of 2010, which overhauls the regulation of financial products and services. The bill also includes a number of detailed proposals to enhance transparency and accountability for NRSROs that CESR makes reference to throughout this section of the advice.

305. The bill provides, among other things, that the SEC would be directed to issue rules under which NRSROs would have to (a) adopt procedures for the development, approval and oversight of credit ratings methodologies and (b) implement related internal controls and reporting to the SEC. The SEC would also be required to adopt rules mandating public disclosures by an NRSRO of (a) quantitative and qualitative information on assumptions, source data and other matters underlying each credit rating (to accompany the rating) and (b) information on the performance of ratings over time.

306. Although there are significant differences between the bills released in 2009 and 2010, they both reflect a desire to strengthen the requirements relating to the regulation of NRSROs, especially in the areas of quality of credit ratings and credit rating methodologies and disclosure of credit ratings. The proposed changes promote greater convergence between the EU and the US legal and regulatory framework for credit rating agencies.

Box 1

THE US LEGAL AND REGULATORY FRAMEWORK FOR CREDIT RATING AGENCIES

307. The US has had a legally binding regulatory and supervisory framework in place since June 2007.

308. Credit rating agencies in the US have to register as NRSROs if they want to enable their ratings to be used for regulatory purposes.

309. The SEC is prohibited by law from influencing the substance of credit ratings and methodologies.

310. CESR points out that clearly there are differences between the EU and the US approaches regarding the types of framework that have been put in place for the purposes of regulating and supervising credit rating agencies. Overall, it is clear that both the EU and US share the same overall objectives, namely to improve the quality of ratings for both the protection of investors and the public interest by fostering accountability, transparency, and competition in the credit rating industry, however the routes to achieving these objectives are different.

311. The US approach is heavily based on upfront disclosure, with heavy reliance on the market's ability to make its own assessment regarding the credit rating agency's credibility, accountability and the quality of the credit ratings it produces, – with the SEC taking less of an ex-ante and more of an ex-post approach to the regulation and supervision of NRSROs, using its discretion to decide how and when to use its extensive examination, supervision and enforcement powers.

312. In contrast, the EU approach is to set out very detailed requirements in the EU Regulation regarding both the type and the quality of the procedures and processes the credit rating agency needs to have in place, as well as the minimum content of the credit ratings themselves, which requires a more detailed assessment of the credit rating agency's robustness as a whole on an ex-ante basis, and the ability to rely on ex-post supervision and enforcement as and when required.

IV.3 The Assessment

313. Having explained the overall legal framework of the existing regulatory regime in the US, the objective of this chapter is to assess whether credit ratings agencies authorised or registered in the US (namely NRSROs) comply with legally binding requirements which are equivalent to the requirements resulting from the EU Regulation and whether they are subject to effective supervision and enforcement in the United States of America.

314. As explained in paragraph 71 above, in determining the overall equivalence of the US regulatory and supervisory frameworks to that of the EU regime, the overall objective is to assess whether or not the framework overall enables assurance that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRAs' integrity, transparency, good governance and reliability of the credit rating activities."

315. In order to establish whether or not the US framework achieves this objective, (as explained in paragraph 73 above), CESR divided the EU Regulation into seven different sections, and established for each of them what conditions need to be in place when assessing equivalence and the objectives that need to be met in order for equivalence to be said to be in place.

316. In discussing the equivalence of the US regime for ease of reference, this section is divided into the same order as set out in Chapter II as follows:

a. Scope of the US regulatory and supervisory framework;
b. Corporate governance in the US;
c. Conflicts of interest management;
d. Organisational requirements;
e. Quality of methodologies and ratings;
f. Disclosures; and
g. Effective supervision and enforcement

A. Scope of the US regulatory and supervisory framework

317. In establishing the equivalence of the scope of the US regulatory and supervisory framework, as explained in paragraph 78 above, the following needs to be assessed:

a. the legal definition of what a credit rating agency is and the activities a registered credit rating agency can conduct are;

b. the exemptions that can be granted; and

c. whether or not the authority in question is prohibited from influencing the content of ratings and methodologies.

a) the US legal definition of what a credit rating agency is and the activities that a registered CRA can conduct in the US.

318. The Exchange Act, Section 3(a)(61) defines "credit rating agency" to mean "any person

- engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
- employing either a quantitative or qualitative model, or both, to determine credit ratings; and
- receiving fees from either issuers, investors, or other market participants, or a combination thereof."[65]

319. The Exchange Act Section 3(a)(62) defines a "nationally recognized statistical rating organization" as a "credit rating agency that

- has been in the business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under Section 15E of the Exchange Act;
- issues credit rating ratings certified by qualified institutional buyers, in accordance with Section 15E(a)(1)(B)(ix) of the Exchange Act, with respect to
  (i) financial institutions, brokers, or dealers;
  (ii) insurance companies;
  (iii) corporate issuers;
  (iv) issuers of asset-backed securities;
  (v) issuers of government securities, municipal securities, or securities issued by a foreign government; or
  (vi) a combination of one or more categories of obligors described in any of the clauses (i) through (v); and
- is registered under Section 15E of the Exchange Act."

320. As can be seen, the definition of CRA in the US regulatory regime is very different to the one in the EU.

321. It embeds a number of eligibility requirements that do not exist in the EU which can be regarded as providing additional protections in terms of the credibility of the credit rating agency that is applying for NRSRO status by requiring the NRSRO:

- to issue credit ratings on the internet or some other readily accessible means,
- to have some form of track record prior to applying for registered status, and
- to have the ratings issued by the credit rating agency to be issued for one or more classes of specific obligors (and this needs to be certified by qualified investors).

322. In addition, part of the registration process includes the need for the credit rating agency to provide financial information so that the SEC can assess whether or not it has adequate financial and managerial resources in order to consistently produce credit ratings with integrity[66].

323. The scope of definition is broader and covers in theory also a natural person in contrast to the definition in the EU where a credit rating agency can only be a "legal person".

324. As explained in paragraph 84 above, if the definition includes the possibility of individuals to be registered this is of concern because it may have implications in respect of the legal recourse for those using or relying on the ratings.

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65 15 USCS §78c.

66 Through Section 15E(a)(2)(C)(ii) of the Exchange Act, the SEC is empowered to deny the application if it finds that the applicant does not have adequate financial and managerial resources to consistently provide credit ratings with integrity and materially comply with disclosed policies and procedures.

325. However, CESR sought additional clarification on this point and understands that it would not be feasible, nor would it be practical, for an individual to apply for NRSRO status. It is highly unlikely that they would manage to meet the NRSRO registration requirements outlined above. Moreover, the US regime would require an NRSRO to have at least 2 individuals in which case it would have to be a partnership - and these would have legal identity and the partners would be jointly and severally liable as individuals for all activities which would foster compliance.

326. Moreover, an NRSRO needs at least two different persons, because negotiating fees and producing the ratings have to be separated.

327. CESR has no concerns with respect to these legal definitions.

a) Registration

328. As can be seen from the answer to question 3, there is a registration process for credit rating agencies in the US.

329. In contrast to the mandatory requirement for all credit rating agencies operating in the EU to get registered, the US system requires all credit rating agencies that want to be treated as an NRSRO for the purpose described in the Exchange Act to be registered with the SEC.[67]

330. As explained in paragraph 86 above, when assessing the scope of what is covered in the third country legal framework CESR needs to make sure, that credit ratings which are used for regulatory purposes in other jurisdictions are subject to an equivalent set of legally binding rules, and to effective supervision and enforcement on an ongoing basis.

331. According to the Joint Forum stock take on the use of credit ratings (2008) the US legislation, regulation and guidance refers quite often to the use of credit ratings from NRSROs in various situations, CESR notes that the scope of use credit ratings issued by NRSROs is much broader than in the EU thereby reinforcing the importance of attaining NRSRO registered status in US.

Groups

332. In assessing the scope of the third country regime, it is also necessary to look at how group structures are regulated in that third country.

333. As can be seen from the answer to question 6 of Annex II, in the US, in order to take the global business of CRAs into account, part of the registration process requires an NRSRO to identify any affiliates that issue credit ratings on behalf of the NRSRO.

334. The information that an NRSRO submits and discloses in its registration form must incorporate information from all credit rating affiliates identified on the form. Once an affiliate is identified on the registration form, all credit ratings issued by these affiliates will be deemed to be credit ratings of the NRSRO and subject to the requirements applicable to NRSROs. The credit ratings of any affiliates not identified on the form will not be deemed to be credit ratings of the NRSRO and, therefore, could not be used in the US for regulatory purposes.

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67 A proposal to amend the registration requirements in Section 15E(a)(1)(A) of the Securities Exchange Act is included in the bill of "Wall Street Reform and Consumer Protection Act of 2009."

335. The SEC has the power to take enforcement action against an identified affiliate irrespective of where they are located. The SEC will request information about such affiliates via the NRSRO located in the US and in the event that the information cannot be provided it can threaten the NRSRO status in the US.

b) Exemptions that can be granted

336. As explained in paragraph 81 above, if exemptions are permissible, CESR needs to verify that such exemptions do not hamper compliance with the EU Regulation. As can be seen from the answer to question 7 in Annex II to the paper, the US regulatory regime does not offer any specific exemptions for CRAs seeking NRSRO status.

337. According to Section 36 of the Exchange Act, the SEC is empowered, by rule, regulation, or order, to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act (Title I) or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

338. CESR points out that the SEC has the statutory power to grant exemptions from its rules. In February and June 2008, the SEC granted an exemption to Rule 17g-5(c)(1) until January 2009 to two small credit rating agencies in order to register them. Based on the information provided in the application, both agencies indicated a conflict of interest relating to the 10% share of net revenues generated by one client. The agencies stated that they expect the percentage of net revenue attributable to the relevant client to decrease in their fiscal year 2008.

339. CESR has no concerns regarding this balanced use of statutory power which was clearly disclosed on the SEC website.

c) ***whether or not the authority in question is prohibited from influencing the content of ratings and methodologies***

340. As explained in paragraph 78 above, for equivalence to be said to be in place, the legal framework needs to explicitly prohibit interference by the authorities with the content of credit rating methodologies.

341. The Exchange Act Section 15E(c)(2) prohibits the SEC or any state (or political subdivision thereof) from regulating the substance of credit ratings or the procedures and methodologies by which any NRSRO determines credit ratings.

342. This prohibition is broader than the one in the EU as it prohibits the regulation of the substance of credit ratings or the procedures by which such ratings are determined as well as prohibiting the regulation of the substance of methodologies.

343. CESR points out that the philosophy to provide no grounds for interference with the content of methodologies by competent authorities is stricter in the sense that for example the "quality" of methodologies in the US will not be checked by the SEC who does not regulate the content of procedures and methodologies to determine credit ratings and as such does not examine their content, but by the market. Article 8.3 of the EU Regulation requires a CRA to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing. CESR sought additional clarification on this point and understands that this fact cannot be checked by the SEC, because it is considered to be an interference with the CRA's methodologies.

Box 2

SCOPE OF THE US REGULATORY AND SUPERVISORY FRAMEWORK

344. CESR considers that the objectives of the EU requirements referred to in this Section are met through the provisions on registration of NRSROs and the prohibition for the SEC to interfere with the substance of credit ratings or the methodologies to determine ratings.

345. There are however a number of notable differences namely:

346. The definition of an NRSRO differs in terms of the potential liability of individuals, but CESR considers that in practice this difference does not undermine the achievement of the objectives of the EU regulatory requirements.

347. The Exchange Act does not include exemptions in respect of NRSROs, however it does provide the SEC with the power to grant exemptions but only to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. This power has in the past been used but only in respect of two small NRSROs and only for a limited period of time.

348. Registration is only required for those credit rating agencies that want to attain NRSRO status in order to enable their credit ratings to be used for regulatory purposes.

349. There is also a difference in respect of the non interference with the content of credit ratings and methodologies requirements, where the US takes a very rigid approach in terms of how it applies this prohibition in practice, for example there is no prescription regarding what the content of the process and procedures that need to be in place for the determination of credit ratings should be.

B. Corporate Governance

350. The EU mandate on assessing the equivalence between certain third country legal and supervisory frameworks and the EU regulatory regime for credit rating agencies (CRAs) required CESR to check at least the following issues in this section:

Extract from the mandate

- Two independent directors on the CRA's administrative or supervisory board are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest.

351. In addition to the above, CESR's approach to assessing the equivalence of the EU Regulation's corporate governance requirements, as set out in paragraphs 94 -105 above, make it clear that this is an area where CESR anticipates there may be significant differences, and **as such is not expecting** all of the EU Regulation's requirements to be in place.

352. CESR considers the objectives of these requirements taken as a whole (as explained in paragraph 95 above), are to ensure that senior management is responsible and legally accountable for ensuring:

a. That credit rating activities are independent;
b. That there is proper management of conflicts of interest; and
c. Compliance with the legal requirements of the regulatory framework.

353. As explained (in paragraphs 102 - 105 above), when assessing equivalence in this area, CESR considers that it should assess whether or not the following requirements are in place:

a. there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable;
b. there needs to be a clear allocation of the following monitoring tasks in terms of ultimate responsibility to the independent members of senior management:
   a. the development of credit rating policy and of methodologies used by the credit rating agency in its credit rating activities;
   b. effectiveness of the internal quality control system;
   c. effectiveness of measures and procedures instituted to ensure that any conflicts of interest are indentified, eliminated, or managed and disclosed;
   d. compliance with governance processes.

354. As can be seen from the US answers to questions 10a – 10j, this is an area where the US have **answered in the negative**, as the US regulatory regime for CRAs does not cover corporate governance.

355. In their written answer, the staff of the SEC clarified this by explaining that there is a requirement to designate an individual who is responsible for administering certain procedures and for the credit agency's overall compliance with the law. They also highlighted that **corporations in the United Sates are chartered at the state level. As such, corporate governance including board composition, is generally regulated by the State, not Federal law.**

356. Given the substantial difference that exists between the EU and US in this area in respect of credit rating agencies, CESR has discussed this issue extensively with the staff of the SEC, seeking to ascertain whether or not there are any general corporate governance law requirements that are applicable, that should be taken into consideration when assessing equivalence (with a view to looking at these provisions and identifying requirements that we could get comfort from).

357. CESR sought additional clarification on this point and understands that as set out above, that, corporate governance in the United States including board composition is generally regulated by state law, and although each State does have corporate governance law requirements, each State has different requirements, and there is not even a common list of requirements that can be pointed to as the basis from which corporate governance of credit rating agencies in the US is governed.

358. CESR sought additional clarification on this point and understands that no assumptions about corporate governance on the basis of which State the CRA is registered can be made, and that it is not something that they have regard to at all for the purposes of eligibility for NRSRO status. In addition, CESR points out that although there are NRSROs that are listed and as such are subject

to corporate law requirements, listed status is not an NRSRO eligibility requirement - as such there is no comfort that can be drawn from this either.

359. It is clear from the above, that assessing the equivalence of the US in this area is not clear cut, and as CESR has been mandated to take a global and holistic approach in its assessment, in coming to a determination in this area, as explained below, **CESR has asked itself the question – what does the US have in place that meets the requirements and objectives set out in paragraphs 352 -353 above?**

360. Having discussed what the US does not have in terms of corporate governance, CESR sets out below what the US does have in place.

Compliance officer

361. As can be seen from the US answer, under Section 15E(j) of the Exchange Act, an NRSRO registered credit rating agency must:

"*designate an individual responsible for administering the policies and procedures that are required to be established pursuant to subsection (g) and (h)*[68]*, and for ensuring compliance with the securities laws and the regulations thereunder, including those promulgated by the Commission pursuant to this section*".

362. This individual is therefore responsible for administering a number of procedures and overall ensuring that the credit rating agency adheres to policies and procedures which are required to enable the credit rating agency to meet the requirements of the Exchange Act.

363. These requirements collectively require the credit rating agency to have procedures and controls around its operations namely:

a. to document their established procedures and methodologies for determining credit ratings;
b. to establish, maintain and enforce written policies and procedures to prevent the misuse of material non- public information;
c. to manage conflicts of interest; and
d. to ensure compliance with the securities laws and regulations.

364. The individual appointed to carry out these responsibilities has to be identified in the registration form in Exhibit 4 which is made available to the public[69].

Organisational Charts

365. In addition to the disclosure in this Exhibit regarding the identification of the designated compliance officer, the credit rating agency needs to include three types of organisational charts as applicable in terms of the size and nature of the NRSRO as follows:

a) the credit rating agencies management structure and senior management reporting lines which must include the designated compliance officer (chart 1);
b) the credit rating agencies divisions, departments, and business units (chart 2); and
c) a chart of the credit rating agency's ultimate and sub holding companies , subsidiaries and material affiliates (chart 3).

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68 These relate to prevention and misuse of non public information and management of conflicts of interest

69 Section 15E(j) of the Exchange Act and Rule 17g-1(i).

366. In terms of how to look at this requirement, chart number 1 is the minimum that any credit rating agency would have to have and therefore disclose, chart number 2 would also be expected in most cases and chart number 3 clearly would depend on the size and structure of the credit rating agency applying.

Identification of reporting lines

367. The credit rating agency is required to include an organisational chart which by law has to include reporting lines which must include the designated compliance officer.

368. Taking what the US framework does have in place, **the next question is to establish whether or not these requirements can be said to meet the objectives of the corporate governance requirements**?

Senior management responsibility and accountability

369. The first objective is that senior management is responsible and legally accountable for ensuring a number of things as set out in paragraphs 102 to 105 and paragraph 353 above.

370. In the case of the US, although there is no legal requirement that senior management is accountable for monitoring certain procedures and processes, the SEC staff has indicated in its answer that the senior management shares the responsibility with the designated compliance officer for ensuring compliance with relevant laws and regulations as well as the NRSRO's internal policies.

371. On this basis, CESR considers that this aspect of the objective has been achieved.

The tasks that the compliance officer is responsible for compared to the EU requirements

372. As set out above, the following needs to be monitored:

- the development of credit rating policy and of methodologies used by the credit rating agency in its credit rating activities;
- effectiveness of the internal quality control system;
- effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed; and
- compliance with governance processes.

(i) the development of credit rating policy and of methodologies used by the credit rating agency in its credit rating activities

373. Looking at what the compliance officer in the US is legally responsible for, there is no specific requirement that the compliance officer is responsible for monitoring the development of credit rating policies and methodologies, it is required to administer certain policies and procedures and overall ensure compliance of the credit rating agency with its legal obligations, and as there is no legal obligation that the "development" of these policies and methodologies needs to be monitored, CESR cannot say that this requirement is met per se.

374. CESR sought additional clarification on this point and understands that what is required is that the information about these policies and description of the credit rating methodology is required to

be updated in the registration form whenever they change to ensure that the disclosure is up to date, this is required by Section 15E(b) of the Exchange Act (see paragraph 426 below).

375. As such, although there is no legal requirement to monitor development – there is in practice a legal obligation to monitor any changes so that these can be correctly disclosed to the public – a failure to do so amounts to a breach of the law.

(ii) effectiveness of the internal quality control system

376. There is no such specific requirement in the US, however CESR sought additional clarification on this point and understands that the compliance officer would in practice be expected to monitor the effectiveness of the internal quality control system.

(iii) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed.

377. The compliance officer is legally responsible for administering the policies and procedures relating to conflicts of interest which are described in detail in paragraphs 409 to 530 below.

378. Conflicts of interest management is, as discussed below, an area of particular strength of the US legal and supervisory framework, and clearly there is a legal requirement that the compliance officer is responsible in the same manner as the same individual meeting the EU requirements.

(iii) compliance with governance processes

379. As discussed above, the designated compliance officer would be responsible for monitoring that the NRSRO is complying with its own governance processes, but - there are no specific legal requirements to monitor these processes.

380. Comparing what the compliance officer in the US is responsible for and what the independent members of the supervisory or administrative board in the EU are responsible for monitoring, clearly there are a number of differences.

381. The question then arises, **does CESR consider that these differences prevent the overall objectives of the corporate governance requirements from being met?**

382. CESR does not consider this to be the case because it does not consider it necessary that the identical policies and procedures get monitored, but that what is important is that senior management is responsible for and legally accountable for ensuring that:

a) credit rating activities are independent;
b) there is proper management of conflicts of interest;
c) there is compliance with the legal requirements of the regulatory framework.

383. Clearly when comparing these objectives with what the US has in place, CESR does consider that there are robust requirements that ensure that there is proper management of conflicts of interest as further discussed in paragraphs 409 to 530 below, in addition to which this is an area that the designated individual in the US is legally responsible for administering the procedures for.

384. In addition, the designated individual is responsible for ensuring the compliance of the credit rating agency with the legal requirements of the regulatory framework.

385. In terms of the objective, that credit rating activities are independent, taking into account the fact that EU regulatory requirements assume that this objective can be met through monitoring tasks that are imposed on independent members of the board, CESR also has to take into consideration that the monitoring tasks that the EU Regulation expects to be carried out by independent members of the supervisory or administrative board can be carried out by an individual who does not need to be a member of the supervisory or administrative board - but has to be independent from the day-to-day activities of the CRA that are being monitored and has to be accountable to senior management.

386. **In terms of accountability**, as mentioned in paragraph 370 above and indicated by the SEC staff, senior management shares the responsibility with the designated compliance officer for ensuring compliance with relevant laws and regulations as well as the NRSRO's internal policies. CESR understands that, although there is no legal requirement that a designated individual has to have a reporting line directly to management, as senior management is accountable for what the designated individual does, CESR considers this requirement to be met.

387. The "bill of Restoring American Financial Stability Act 2010" contains amendments designed to reinforce the senior management's accountability, by providing that:

- NRSRO CEOs must make an annual attestation as to the effectiveness of the internal controls (Section 932(1));
- Procedures and methodologies to determine credit ratings have to be approved by the NRSRO's board or the senior credit officer (Section 932(1)).

388. **In terms of independence** of the designated individual, as this role is designated to what the EU classifies as the compliance officer, CESR also needs to consider how the EU Regulation assess independence in order to assess whether or not the US framework achieves this objective.

389. Annex I, Section A paragraph 6 of the EU Regulation stipulates that in order to enable the compliance officer to discharge its responsibilities properly and independently, the compliance officer shall not be involved in the performance of the credit rating activities that are monitored, and that its compensation shall not be linked to the business performance of the CRA and shall be arranged as to ensure the independence of his judgment.

390. The compliance officer is also required to report regularly on the carrying out of his duties to the senior management and independent members of the administrative or supervisory board.

391. There are no such requirements relating to the independence of the designated individual in the US, and in terms of assessing the designated individuals compensation, there is no requirement for disclosure to be made about how this individual gets paid.

392. In light of the importance of the function of this individual in the US framework for credit rating agencies and the need for this individual to be independent from a CESR perspective, CESR sought additional explanations about this issue from the SEC on this point.

393. CESR understands that although there is no independence requirement set out by a rule, as highlighted above, what the credit rating agency needs to disclose is the organisational chart and what position the designated individual has in the organisation.

394. If there was a declaration on the form regarding the independence in terms of reporting lines of this individual, and this turns out not to be the case, then the credit rating agency is in breach of the law.

395. In addition, CESR understands that, if from the organisational chart the reporting line is not independent (for example this individual was reporting to the lead analyst), then this may constitute evidence that an NRSRO did not have reasonably designed procedures for managing conflicts of interest and preventing the misuse of non public material information – as those procedures, as explained above, are to be monitored by the designated individual.

396. CESR sought additional clarification on this point and understands that if the designated individual did not report to the appropriate level of seniority and had a weak reporting line, or its independence was questionable then they do not know if they could legally reject the application but this would be disclosable to the public who would know that there was a weak reporting line and that independence was questionable. This would also be a matter that would be flagged for the examination unit to look into on an ex-post basis.

397. Overall the independence of this individual is something that the examiners would look at closely on an ex-post basis irrespective of whether or not this was an issue of weakness that was highlighted during the application process.

398. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act 2010" both contain proposals that would further enhance the convergence between the EU and the US legal and regulatory framework in the field of corporate governance of credit rating agencies.

399. The "bill of Restoring American Financial Stability Act 2010" (Section 932(4)) provides that an NRSRO compliance officer may not perform credit ratings, take part in sales or marketing, develop ratings methodologies, or set compensation levels for NRSRO employees. An annual compliance report must be submitted to the SEC.

400. The bill of "Wall Street Reform and Consumer Protection Act of 2009" contains additional proposals designed to further enhance the independence and accountability of the designated compliance officer, including a requirement for the designated compliance officer: (i) to report directly to the board, (ii) to assess the risks of the internal control systems, (iii) to establish procedures for the receipt, treatment and remediation of complaints and for the consideration of all relevant information in the determination of credit ratings.

401. In addition, the amendments proposed under the bill of "Wall Street Reform and Consumer Protection Act of 2009" require each NRSRO to have a board of directors and a minimum number of independent directors entrusted with specific monitoring tasks.

Box 3

CORPORATE GOVERNANCE

402. The US requirements for NRSROs do not include provisions relating to corporate governance as this is an area that is governed by State law.

403. CESR considers that the requirements that are in place meet the objectives of this section in light of the following:

404. The senior management shares the responsibility with the designated compliance officer for ensuring compliance with relevant laws and regulations as well as the NRSRO's internal policies.

405. The designated compliance officer is responsible for administering the procedures in respect of the management of conflicts of interest and the prevention of the misuse of material confidential information, and overall for ensuring that the NRSRO adheres to the policies and procedures it has disclosed and complies with the requirements of the Exchange Act and the SEC Rules.

406. Although there are no requirements to have independent members of the board of directors or supervisory board, CESR understands that the designated compliance officer is responsible for the specific monitoring of tasks that the EU Regulation requires to be carried out by such independent members.

407. Although there is not an explicit requirement for the designated compliance officer to be independent, CESR understands, that the independence of this individual is something that the examination office would examine in due course, and that in the event that this individual reporting line was questionable, this would be flagged for the purposes of examination. In addition CESR understands that this may constitute evidence that an NRSRO did not have reasonably designed procedures for managing conflicts of interest and preventing the misuse of non - public material information.

408. Irrespective of the significant difference in the manner in which the independence of the designated compliance officer is dealt with in the US compared to the EU, CESR is satisfied that the potential negative consequences of this difference are sufficiently mitigated in the US through SEC supervision, given that in practice whether or not this individual is actually independent is something that will be determined on an ex-post basis.

C. Conflicts of Interest Management

409. The EU mandate required CESR to check at least the following issues in this section:

Extract from the mandate

- A CRA identifies and eliminates (or manages and discloses) conflicts of interest.
- A CRA ensures that business interest does not impair the independence and accuracy of ratings.
- A CRA does not provide consultancy or advisory services; an exhaustive and limited list of ancillary services, which may be provided by a CRA, is defined in the third country legal framework;
- A CRA refrains from issuing a rating when it has direct or indirect interest in the entity asking for a rating;
- Rating analysts cannot make proposals or recommendations on the design of structured finance products;
- Rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control;
- Rating analysts' compensation and performance evaluation is de-linked from the revenue they generate for the CRA;
- A stringent rotation policy is put in place (lead rating analysts to rotate client at least every 4 years)

410. As discussed (in paragraph 107 above), conflicts of interest management is a core requirement of the EU Regulation in order to ensure that it meets the overall objective as set out in paragraph 23 above.

411. The EU Regulation sets out a large number of detailed requirements in this area (set out in paragraphs 109 to 113 above) and in assessing equivalence, as discussed in paragraph 115 above, this is another area where CESR does not expect the third country laws and regulations in this area to be as detailed or specific as those set out in the EU Regulation.

412. **CESR does however expect there to be robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure**.

413. CESR considers the objectives of the EU Regulation's requirements in this area are to ensure:

a) objectivity, independence, integrity and quality of the credit ratings;
b) transparency about the credit ratings; and
c) to contribute to the protection of investors and financial markets.

414. In assessing the equivalence of the third country requirements against these objectives, of the requirements set out in the EU Regulation, CESR considers that in addition to the corporate governance requirements discussed in paragraph 372 above, (which as explained above CESR considers the objectives of which are met), overall the objectives of each of the individual requirements set out in paragraphs 111 -113 above should be met through provisions embedded in the law.

US approach to conflicts of interest management

415. Conflicts of interest management is one of the key principles embedded into the US's legal and supervisory framework in respect of credit rating agencies.

416. There are a number of approaches that the US uses to deal with the provisions in the EU Regulation relating to conflicts of interest management, there is a mixture of:

- specific provisions that deal with conflicts of interest,;
- specific provisions that deal with the prevention of misuse of material non-public information;
- aspects of record retention obligations;
- aspects of annual financial reporting requirements;
- information that needs to be disclosed as part of the registration process
- requirements obligating the NRSRO to update the accuracy of the information provided in the application form;
- SEC's power to withdraw the registration if the NRSRO does not have sufficient resources to ensure that credit ratings are issued with integrity and compliance with their rules.

417. The registration process and subsequent updating of that information work in tandem with certain aspects of the conflicts of interest provisions and those relating to the prevention and misuse of material non public information.

1) Provisions that deal specifically with Conflicts of Interest

418. There are two approaches that the US framework uses to deal with the issue, (i) the first is to set out legal requirements obliging the credit rating agency to disclose the conflicts of interest that it has and then manage these conflicts "disclose and manage", (ii), the second is to prohibit outright certain behaviour/activities which the credit rating agency can simply not engage in irrespective of whether or not the credit rating agency discloses and subsequently manages them.

(i) legal requirements obliging the credit rating agency to disclose and manage conflicts of interest

419. Section 15E(h)(1) of the Exchange Act sets out the legal requirements that an NRSRO has to abide by in respect of how it manages these conflicts:

"Each nationally recognized statistical rating organization shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such nationally recognized statistical rating organization and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business."

420. Therefore, as can be seen the first requirement is for the NRSRO to establish, maintain and enforce written policies and procedures reasonably designed to address and manage any conflicts of interest that can arise from such business.

421. Under Section 15E(a)(1)(B) of the Exchange the credit rating agency is required to include as part of its registration process certain information:

"(B) Required information. An application for registration under this section shall contain information regarding--
(i) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the applicant;
(ii) the procedures and methodologies that the applicant uses in determining credit ratings;

(iii) policies or procedures adopted and implemented by the applicant to prevent the misuse, in violation of this title [15 USCS §§ 78a et seq.] (or the rules and regulations hereunder), of material, non-public information;
(iv) the organizational structure of the applicant;
(v) whether or not the applicant has in effect a code of ethics, and if not, the reasons therefore;
(vi) any conflict of interest relating to the issuance of credit ratings by the applicant;
(vii) the categories described in any of clauses (i) through (v) of section 3(a)(62)(B) [15 USCS § 78c(a)(62)(B)] with respect to which the applicant intends to apply for registration under this section;
(viii) on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services of the applicant, by amount of net revenues received therefrom in the fiscal year immediately preceding the date of submission of the application;
(ix) on a confidential basis, as to each applicable category of obligor described in any of clauses (i) through (v) of section 3(a)(62)(B) [15 USCS § 78c(a)(62)(B)], written certifications described in subparagraph (C), except as provided in subparagraph (D); and
(x) any other information and documents concerning the applicant and any person associated with such applicant as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors"

422. As can be seen, this list includes a catch all provision that enables the SEC to require any information and documents that the SEC prescribes by rule as necessary or appropriate in the public interest or for the protection of investors.

423. The information that is required under this section of the Exchange Act is elicited by the SEC through a number of Exhibits (13 of them) that are discussed in paragraphs 267 to 280 above.

424. Exhibit 6 requires the credit rating agency to disclose its conflicts of interest and Exhibit 7 requires the credit rating agency to:

'to furnish a copy of the written policies and procedures it establishes, maintains, and enforces to address and manage conflicts of interest pursuant to Section 15E(h) of the Exchange Act……[70]"

425. As can be seen, the second requirement is to disclose (to the public) its conflicts of interest and its written policies and procedures designed in order to address and manage any conflicts of interest.

426. Section 15E(b) of the Exchange Act imposes:

a) an obligation on the NRSRO to update the information in the Form NRSRO or any document provided promptly if the information or any document provided becomes materially inaccurate (other than the information relating to credit rating performance measurement statistics – which has to be updated annually); and

b) to annually certify that the information is accurate and to list any material changes that occurred:

"(b) Update of registration.
(1) Update. Each nationally recognized statistical rating organization shall promptly amend its application for registration under this section if any information or document provided therein becomes materially inaccurate, except that a nationally recognized statistical rating organization is not required to amend--

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70 15 U.S.C. 78o-7(h).

(A) the information required to be furnished under subsection (a)(1)(B)(i) by furnishing information under this paragraph, but shall amend such information in the annual submission of the organization under paragraph (2) of this subsection; or

(B) the certifications required to be provided under subsection (a)(1)(B)(ix) by furnishing information under this paragraph.

(2) Certification. Not later than 90 days after the end of each calendar year, each nationally recognized statistical rating organization shall furnish to the Commission an amendment to its registration, in such form as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors:

(A) certifying that the information and documents in the application for registration of such nationally recognized statistical rating organization (other than the certifications required under subsection (a)(1)(B)(ix)) continue to be accurate; and

(B) listing any material change that occurred to such information or documents during the previous calendar year. "

427. As can be seen, the third requirement is to update the information that has been disclosed in the registration form.

428. Under Section 15E(h)(2) of the Exchange Act the SEC is empowered to[71]:

"issue final rules in accordance with subsection (n) to prohibit, or require the management and disclosure of, any conflicts of interest relating to the issuance of credit ratings by a nationally recognized statistical rating organization, including, without limitation, conflicts of interest relating to:

(A) the manner in which a nationally recognized statistical rating organization is compensated by the obligor, or any affiliate of the obligor, for issuing credit ratings or providing related services;

(B) the provision of consulting, advisory, or other services by a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, to the obligor, or any affiliate of the obligor;

(C) business relationships, ownership interests, or any other financial or personal interests between a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, and the obligor, or any affiliate of the obligor;

(D) any affiliation of a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, with any person that underwrites the securities or money market instruments that are the subject of a credit rating; and

(E) any other potential conflict of interest, as the Commission deems necessary or appropriate in the public interest or for the protection of investors."

429. As one can see, this is comprehensive and very broad in scope, enabling the SEC to issue final rules to either prohibit, or require management and disclosure of **any** conflicts of interest relating to the issuance of credit ratings, as it deems necessary or appropriate in the public interest or for the protection of investors.

430. CESR points out that NRSROs are bound by the legal obligations set out in Section 15E(h)(1) of the Exchange Act – irrespective of whether or not the SEC issues rules in accordance with Section 15E(h)(2) of the Exchange Act.

431. In terms of the number of conflicts of interest that this can relate to - this is "*without limitation*" and includes a list that the SEC has already identified as those activities that are considered to be classified as a conflict of interest – set out in Rule 17g-5.

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71 15 U.S.C. 78o-7(h)(2).

432. Looking at the SEC rule that implements this Exchange Act provision – namely Rule 17g-5:

> *"(a) A person within a nationally recognized statistical rating organization is prohibited from having a conflict of interest relating to the issuance or maintenance of a credit rating identified in paragraph (b) of this section, unless:*
>
> *(1) The nationally recognized statistical rating organization has disclosed the type of conflict of interest in Exhibit 6 to Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)) and § 240.17g-1; and*
>
> *(2) The nationally recognized statistical rating organization has established and is maintaining and enforcing written policies and procedures to address and manage conflicts of interest in accordance with section 15E(h) of the Act (15 U.S.C. 78o-7(h)).*"

433. It can be seen that a person within an NRSRO is legally prohibited from having a conflict of interest relating to the issuance of or maintenance of a credit rating identified in paragraph b of Rule 17g-5 unless it has:

a) disclosed the conflict on Exhibit 6 of the application form; and
b) has established, maintains and enforces written policies and procedures to address and manage these conflicts.

434. In terms of the list of those activities which are already classifiable as conflicts of interest, and set out in Rule 17g-5(2)(b) these are:

- Being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite;[72]
- Being paid by obligors to determine credit ratings with respect to the obligors;[73]
- Being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a credit rating;[74]
- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons may use the credit ratings of the NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term "NRSRO;"[75]
- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons also may own investments or have entered into transactions that could be favourably or adversely impacted by a credit rating issued by the NRSRO;[76]
- Allowing persons within the NRSRO to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO;[77]

435. This list of conflicts is something that the SEC can update, and the SEC is empowered by virtue of Section 15E(n)2(B) of the Exchange Act to:

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72 Rule 17g-5(b)(1).
73 Rule 17g-5(b)(2).
74 Rule 17g-5(b)(3).
75 Rule 17g-5(b)(4).
76 Rule 17g-5(b)(5).
77 Rule 17g-5(b)(6).

"amend or revise such rules and regulations in accordance with the purpose of this section as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors".

436. The final requirement, as discussed in paragraph 361 above, is the Exchange Act obligation under Section 15E(j) on the credit rating agency to appoint a designated individual who is legally responsible for administering the policies and procedures which the credit rating agency is required to establish, maintain and enforce under the requirements of Section 15E(h) of the Exchange Act relating to the management of conflicts of interest.

(ii) prohibit outright certain behaviour/activities which the registered credit rating agency (NRSRO) can simply not engage in

437. In relation to the second approach to conflicts of interest, the Exchange Act Section 15E(i) sets out a list of prohibited acts and practices about which the SEC is empowered to issue final rules as follows:

"(1) ….to prohibit any act or practice relating to the issuance of credit ratings by a nationally recognized statistical rating organization that the Commission determines to be unfair, coercive, or abusive, including any act or practice relating to--

(A) conditioning or threatening to condition the issuance of a credit rating on the purchase by the obligor or an affiliate thereof of other services or products, including pre-credit rating assessment products, of the nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization;

(B) lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the nationally recognized statistical rating organization; or

(C) modifying or threatening to modify a credit rating or otherwise departing from its adopted systematic procedures and methodologies in determining credit ratings, based on whether the obligor, or an affiliate of the obligor, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with such organization."

438. As can be seen, these are very broad rule making powers where the SEC can issue rules to prohibit any act or practice relating to the issuance of credit ratings by an NRSRO that the SEC determines to be unfair, coercive or abusive, including any act or practice relating to those set out in Section 15E(i)(1)(A-C) of the Exchange Act above.

439. In terms of the rules that the SEC has made in relation to these requirements, these are set out in Rule 17g-5(c), and Rule 17g-6(a).

440. Rule 17g-5(c) sets out 7 prohibited conflicts as follows:

(c) Prohibited conflicts. A nationally recognized statistical rating organization is prohibited from having the following conflicts of interest relating to the issuance or maintenance of a credit rating as a credit rating agency:

(1) The nationally recognized statistical rating organization issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the nationally recognized statistical rating organization with net revenue (as reported under § 240.17g-3) equaling or exceeding 10% of the total net revenue of the nationally recognized statistical rating organization for the fiscal year;

(2) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to a person (excluding a sovereign nation or an agency of a sovereign nation) where the

nationally recognized statistical rating organization, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating;

(3) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to a person associated with the nationally recognized statistical rating organization;

(4) The nationally recognized statistical rating organization issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating;

(5) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to an obligor or security where the nationally recognized statistical rating organization or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security;

(6) The nationally recognized statistical rating organization issues or maintains a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the nationally recognized statistical rating organization who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models; or

(7) The nationally recognized statistical rating organization issues or maintains a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $ 25.

(d) For the purposes of this section, the term person within a nationally recognized statistical rating organization means a nationally recognized statistical rating organization, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the nationally recognized statistical rating organization or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

441. Rule 17g-6(a) sets out four prohibitions as follows:

".....prohibited from engaging in any of the following unfair, coercive, or abusive practices:

(1) Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(2) Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the nationally recognized statistical rating organization's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(3) Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the nationally recognized statistical rating organization's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(4) Issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw a

credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the nationally recognized statistical rating organization, where such practice is engaged in by the nationally recognized statistical rating organization for an anticompetitive purpose."

442. As such, in the event that the credit rating agency engaged in any of these activities, it may be subject to liability under the federal securities laws and rules thereunder.

443. The US approach to the disclosure and management of conflicts of interest combined with a list of prohibited acts, means that a credit rating agency **must** when filling in its registration form, have regard to the lists of prohibited acts – and is also required to disclose any other conflicts that is not in the list, with any of the prohibited acts simply being prohibited.

444. For further details of the kind of information that the NRSRO is required to set out in their application form, see the instructions to Exhibit 6 set out in paragraph 272 above.

2) Requirements relating to prevention of misuse of non-public information

445. In addition to the specific requirements relating explicitly to conflicts of interest management, Section 15E(g) of the Exchange Act and Rule 17g-4 require the credit rating agency to establish, maintain and enforce written policies and procedures reasonable designed to prevent the misuse of non public information in violation of the Exchange Act.

"(1) Organisation policies and procedures. Each nationally recognised statistical rating organisation shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such nationally recognised statistical rating organisation, to prevent the misuse in violation of this title [15 USCS §§ 78a et seq.], or the rules or regulations hereunder, of material, non-public information by such nationally recognised statistical rating organisation or any person associated with such nationally recognised statistical rating organisation.

(2) Commission authority. The Commission shall issue final rules in accordance with subsection (n) to require specific policies or procedures that are reasonably designed to prevent misuse in violation of this title [15 USCS §§ 78a et seq.](or the rules or regulations hereunder) of material, non-public information".

446. This rule has been implemented through the SEC Rule 17g-4 which among other provisions contains a provision that imposes an obligation on the credit rating agency to design these policies and procedures so that:

"The inappropriate dissemination within and outside the nationally recognized statistical rating organization of material non public information obtained in connection with the performance of credit rating services."[78]

447. Collectively these requirements ensure that confidential information both within and outside the credit rating agency is managed in such a way that its use in a manner that may result in a conflict of interest is prohibited.

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78 Rule 17g-4(a)(1)

3. Requirements relating to record retention

448. The US framework has a number of detailed provisions set out in Rule 17g-2 obliging the NRSRO to make and retain certain records relating to its business and to retain certain other records made in the normal course of its business operations.

449. This rule implements Section 17(a)(1) of the Exchange Act which imposes obligations on credit rating agencies to:

450. "*make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title [15 USCS §§ 78a et seq.]. Any report that a nationally recognized statistical rating organization is required by Commission rules under this paragraph to make and disseminate to the Commission shall be deemed furnished to the Commission.*"

451. Rule 17g-2 includes a long list of documents and records that need to be retained, which includes detailing on a credit rating by credit rating basis:

- details of credit analysts that participated in determining the rating;
- the identity of those that approved the rating;
- a record of the rationale for any material difference between the credit rating implied by a model and final credit rating issued in respect of structured finance products;
- whether or not the rating was solicited or unsolicited;
- an account record for each person that paid the NRSRO for the issuance or maintenance of a credit rating;
- a record documenting the established procedures and methodologies used by the NRSRO to determine credit ratings; and
- a record listing the general types of services and products offered by the NRSRO

4) Requirements relating to annual financial reports

452. Rule 17g-3 sets out the NRSROs annual financial reporting requirements to the SEC. These requirements overall require the credit rating agency to submit four and in some case five financial reports on an annual basis.

453. Of these reports, 17g-3(a)(5) requires that the NRSRO files with the SEC:

"(5) An unaudited financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the nationally recognized statistical rating organization by amount of net revenue attributable to the issuer or subscriber during the fiscal year. Additionally, include on the list any obligor or underwriter that used the credit rating services provided by the nationally recognized statistical rating organization if the net revenue attributable to the obligor or underwriter during the fiscal year equalled or exceeded the net revenue attributable to the 20th largest issuer or subscriber. Include the net revenue amount for each person on the list.

Note to paragraph (a)(5): A person is deemed to have "used the credit rating services" of the nationally recognized statistical rating organization if the person is any of the following: an obligor that is rated by the nationally recognized statistical rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market instruments subject to a credit rating of the nationally recognized statistical rating organization (regardless of

whether the issuer paid for the credit rating); any other person that has paid the nationally recognized statistical rating organization to determine a credit rating with respect to a specific obligor, security, or money market instrument; or a subscriber to the credit ratings, credit ratings data, or credit analysis of the nationally recognized statistical rating organization. In calculating net revenue attributable to a person, the nationally recognized statistical rating organization should include all revenue earned by the nationally recognized statistical rating organization for any type of service or product, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person by the nationally recognized statistical rating organization."

454. This requirement thus ensures that there is reporting to the SEC regarding the 20 largest clients as determined by revenues received on an annual basis not later than 90 calendar days after the end of the fiscal year.

5) General power of the SEC

455. In addition to all of the above, as discussed in paragraph 251 above the SEC has a general power under Section 15E(d)(5) of the Exchange Act to withdraw the registration of an NRSRO if it does not have sufficient resources to ensure that the credit ratings are issued with integrity and compliance with their rules.

456. Overall there are a number of requirements that relate to conflicts of interest as follows:

a) The Exchange Act Section 15E(i) sets out a list of prohibited acts and practices.

b) The Exchange Act Section 15E(h)(1) requires a credit rating agency to establish maintain and enforce written policies and procedures reasonably designed to address and manage any conflict that can arise in its business as a credit rating agency

c) A copy of these written policies and procedures have to be disclosed to the public in Exhibit 7 of Form NRSRO, and includes instructions about how this disclosure is to be made.

d) the Exchange Act 15E(a)(1)(vi) requires the credit rating agency to disclose all its conflicts of interest in its application form in Exhibit 6 of From NRSRO as part of the registration process .

e) The Exchange Act Section 15E(b) requires that the registration form is promptly amended if any information relating to the disclosure about conflicts of interest or the policies and procedures reasonably designed to manage them becomes materially inaccurate, and that the accuracy of this information is certified on an annual basis as continuing to be accurate, and requires the NRSRO to list any material changes that occurred.

f) As discussed in paragraph 361 above, Section 15E (j) of the Exchange Act imposes an obligation on the credit rating agency to appoint a designated individual who is legally responsible for administering the policies and procedures which the credit rating agency is required to establish, maintain and enforce under the requirements of Section 15E(h) of the Exchange Act relating to the management of conflicts of interest.

g) As discussed in paragraph 445 above, the Exchange Act includes provisions relating to the prevention of misuse of non-public information.

h) As discussed in paragraph 448 above there are record keeping requirements that enable the SEC through its examination powers to identify how the conflicts are in practice being managed, and identify any that are not.

i) As discussed in paragraph 452 above there are annual filling requirements that also enable the SEC to check that the NRSRO has disclosed and managed its conflicts, and is not conducting any activities that are prohibited.

j) In addition, as discussed in paragraph 455 above the SEC has a general power under Section 15E(d)(5) of the Exchange Act to withdraw the registration of an NRSRO if it does not have sufficient resources to ensure that the credit ratings are issued with integrity and compliance with their rules.

How these requirements compare to those required for the objectives to be met.

457. As set out in paragraph 414, for the purposes of equivalence, CESR considers that overall the objectives of the individual requirements set out in paragraphs 111 to 113 above need to be met.

458. CESR considers that the objectives of the EU Regulation's conflicts of interest requirements are:

- Objectivity, independence, integrity and quality of the credit ratings;
- Transparency about the credit ratings; and
- To contribute to the protection of investors and financial markets.

Requirements of paragraph 111

459. These requirements involve the need for credit rating agencies to:

a) identify and eliminate or alternatively manage and disclose conflicts of interest;
b) be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;
c) required to establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest;
d) identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings;
e) publicly disclose the names of the rated entities or related 3rd parties from which it receives more than 5% of its annual revenue;
f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in annex 1 section B paragraph 3 of the EU Regulation;
g) ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party(Q11f);
h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis ;
i) ensure that compensation and performance evaluation of the rating analysts' and persons approving the credit ratings are not liked to the amount of revenue they generate;
j) disclose any actual and potential conflicts of interest;

k) have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences;
l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, the CRA is required to review the relevant work of the analyst preceding his departure;
m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

460. Of these requirements, it is clear that the US requirements meet in terms of the objectives that CESR considers they seek to achieve, the following EU requirements as discussed in the paragraphs below.

461. The requirements relating to the identification or management and disclosure of conflicts of interest and the organisational procedures to achieve this, namely:

- identify and eliminate or alternatively manage and disclose conflicts of interest;
- required to establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest;
- identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees and other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings; and
- disclose any actual and potential conflicts of interest.

462. The requirement for the credit rating agency to design its reporting and communication channels to ensure independence of rated entities set out in paragraph 459 (h) above, is achieved by the extensive requirements[79] relating to the establishment, maintenance and enforcement of written policies and procedures reasonably designed to prevent the misuse of material non public information in violation of the Exchange Act this is further discussed in section 2.F. disclosure below.

463. The requirement to ensure that the compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate set out in paragraph 459 (i) above, although there is no specific requirement to this effect, CESR considers that the conflicts of interest of management section discussed above would cover this as through the requirement in Section 15E(h)(1) of the Exchange Act for an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest.

464. An NRSRO that linked analysts' compensation and performance evaluations to revenue generated by the analyst in a manner that caused the analyst to be unduly influenced in the performance of determining credit ratings would not have reasonably designed procedures for managing this conflict.

Differences between the EU requirements and the US

79 Section 15E(g) of the Exchange Act and Rule 17g-4.

465. Of these requirements, there are however a number or differences, which essentially reflect the difference in approach between the prescriptive nature of the EU Regulation, and the disclosure and subsequent ex-post supervisory approach that the US has adopted as follows:

a) be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;
b) publicly disclose the names of the rated entities or related thirds parties from which it receives more than 5% of its revenue;
c) not issue a credit rating or in the case of an existing credit rating immediately disclose that the credit rating is potentially affected in the circumstances set out in annex 1 section B paragraph 3 of the EU Regulation;
d) ensure that the provision of ancillary services does not present conflicts of interest wit its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;
e) have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences;
f) require that when a rating analyst terminates his or her employment and joins a rated entity there is a review of the relevant work of that analyst;
g) establish an appropriate gradual rotation mechanism.

a) Be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities

466. Annex I, Section A, 2 of the EU Regulation requires a CRA to be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities.

467. CESR points out that there is no explicit requirement in the US framework that deals with this provision, and as such sought additional clarification on this point from the SEC staff and it is CESR's understanding that the compliance officer and senior management would be held responsible for this.

Box 4

Be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities

468. CESR is therefore comfortable that the objective of this requirement is met through the US's overall approach to conflicts of interest management.

b) Publicly disclose the names of the rated entities or related thirds parties from which it receives more than 5% of its revenue

469. Annex I, Section B.2 requires a CRA to publicly disclose the names of the rated entities or related third parties from which it receives more than 5 % of its annual revenue.

470. As explained in paragraph 119 above this information does not have to be disclosed to the public for the purposes of assessing equivalence provided that there is some disclosure to the supervisor.

471. As indicated in their answer, the SEC requires an NRSRO to provide it with an unaudited report of the 20 largest clients of the NRSRO as determined by revenues received on an annual basis, not later than 90 calendar days after the end of the fiscal year. An NRSRO is not required to make this report public, and may request that the SEC keep the report confidential, to the extent permitted by law.

472. As such, depending on the number of clients, the requirement in the US may be actually stricter then the EU one. Moreover, an NRSRO is prohibited to issue or maintain a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equally or exceeding 10% of the total net revenue of the NRSRO for the fiscal year.

473. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" contains proposals to enhance disclosure concerning the clients of an NRSRO vis-à-vis the public. Each NRSRO would be required to disclose, on an annual basis, information on the relative standing of each person who paid for a credit rating in terms of the amount of net revenue earned by an NRSRO attributable to each such person and classified by the highest 5, 10, 25, and 50 percentiles and lowest 50 and 25 percentiles.

474. In addition, a disclosure requirement is proposed on a rating-by-rating basis, covering (i) the type and number of credit ratings provided by the NRSRO to the person being rated or affiliates of such person, (ii) the fees that the NRSRO has billed for the credit rating, and (iii) the aggregate amount of net revenue earned by the NRSRO in the preceding 2 fiscal years attributable to the person being rated and its affiliates.

Box 5

Publicly disclose the names of the rated entities or related thirds parties from which it receives more than 5% of its revenue

475. CESR concludes that despite the difference in requirements, the objectives of the EU disclosure requirement to publicly disclose the names of the rated entities or related third parties from which the credit rating agency received more than 5% of its revenues is met through the US requirement for NRSROs to submit to the SEC an unaudited report of the 20 largest clients .

c) not issue a credit rating or in the case of an existing credit rating immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 section B.3 of the EU Regulation.

476. Annex I, Section B.3 of the EU Regulation provides for a list of circumstances where a CRA shall not issue a credit rating or shall, in the case of an existing credit rating, immediately disclose where the credit rating is potentially affected as follows:

- the credit rating agency or related persons, directly or indirectly owns financial instruments of the rated entity or any related third party or has any other direct or indirect ownership interest in that entity or party other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance,
- the credit ratings is issued with respect to a rated entity or any related third party directly or indirectly linked to the credit rating agency by control,

- a related person is a member of the administrative or supervisory boards of the rated entity or any related third party.
- an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interest.

477. In the US this requirement is met in part through the list of prohibited conflicts set out in paragraphs 433 to 444 above (which is not identical to that of EU Regulation) and, for the rest, through the general requirement to manage and disclose conflicts of interest.

Box 6

Not issue a credit rating or in the case of an existing credit rating immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex I(B)(3) of the EU Regulation

478. On the basis of the US requirements to disclose and manage conflicts of interest and the prohibited conflicts, CESR considers that the objective of this EU requirement is met.

(d) ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party

479. CESR points out that, unlike in the EU, there is no requirement to list ancillary services per se in relation to this provision, but there are a number of other requirements that meet the same objective of this requirements namely:

a) the provision in Rule 17g-5(2)(b)(3) that makes it clear that being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a credit rating; and
b) the requirement under Rule 17g-1 and Exhibit 12 to Form NRSRO to provide the SEC with information regarding revenue that the NSRO derives from the provision of all other services and products offered besides credit rating services. As indicated by the SEC staff in their answer, an NRSRO is not required to publicly disclose the information required under Exhibit 12;
c) the Rule 17g-5(c)(5), that prohibits an NRSRO from issuing or maintaining a credit rating where the NRSRO or an affiliate of the NRSRO from making recommendations to the issuer, obligor or arranger about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security.

480. In addition - when the provision of ancillary services are considered by the NRSRO to give rise to a potential conflict of interest this is to be disclosed – but this disclosure would not be made in the final rating report, but in Exhibit 6 of the Form NRSRO – and this required by the NRSRO.

481. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes to prohibit an NRSRO that provides a credit rating for an issuer, underwriter, or placement agent of a security to provide any non-rating service to that issuer, underwriter, or placement agent in determining a credit rating, including ancillary assistance.

Box 7

Ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party

482. CESR concludes that the objectives of this provision are met through the classification by the NRSRO of the provision of ancillary services as a conflict of interest, irrespective of the difference in timing in terms of when the disclosure has to be made (not on a rating by rating basis but upfront in the application form) and the channel used to make this disclosure.

(e) have requirements whereby those who know of others illegal conduct report it to the compliance officer without negative consequences

483. The US does not have a specific requirement that deals with this per se, and the SEC staff responded negatively to this question.

484. CESR notes that the amendments proposed under the bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes that the designated compliance officer establishes procedures for the receipt, retention, and treatment of: (i) complaints regarding compliance with applicable NRSRO laws, policies and procedures, or credit ratings, models, methodologies, and (iii) other confidential, anonymous complaints by employees, obligors, issuers, and investors.

Box 8

Reporting illegal conduct to the compliance officer without negative consequences

485. CESR points out that despite the lack of the provision, it considers that the objective of this requirement is met through the conflicts of interest management provisions, the role of the compliance officer and the authority that the SEC can exercise through the examination office.

(f) require that when a rating analyst terminates his or her employment and joins a rated entity there is a review of the relevant work of that analyst; & (g) establish an appropriate gradual rotation mechanism

486. Article 7.4 of the EU Regulation provides that CRAs are required to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

487. Annex I, Section C.6 of the EU Regulation requires that, where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, the CRA is required to review the relevant work of the analyst preceding his departure.

488. In respect of both these requirements, as set out in paragraphs 116 to 119 above the lack of explicit requirements would be acceptable for the purposes of assessing equivalence provided that provisions on conflicts of interest exist. However, CESR considers it important to point out the fact that there are no such requirements in the US framework.

489. The US legislation and rules requiring NRSROs to disclose and manage certain conflicts of interest inherent in their business activities while prohibiting others outright are meant to detect and prevent the undue influence issues raised in these questions.

490. In addition, as indicated by the SEC staff in their answer, the SEC's examination authority over NRSROs is designed to uncover any instances of undue influence. The SEC could initiate

enforcement action were examiners to determine that a rating was influenced by the conflicts referred to in these questions in violation of federal securities laws and SEC rules.

491. Rule 17g-5 includes prohibitions on an NRSRO issuing or maintaining a credit rating where:

- ♦ the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models[80]; or
- ♦ a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $25[81].

492. Moreover, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest. As indicated by the SEC staff in their answer, linking analysts' compensation and performance evaluations to revenue generated by the analyst in a manner that caused the analyst to be unduly influenced in the performance of determining credit ratings may constitute evidence that an NRSRO did not have reasonably designed procedures for managing this conflict.

493. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes to introduce look-back requirements for an NRSRO to review, and revise as appropriate, the credit ratings in the case that an employee of the rated entity was employed by the NRSRO and participated to the credit rating activity for the rated entity during the 1 year period preceding the date of the rating action.

494. The bill of "Wall Street Reform and Consumer Protection Act of 2009" also proposes to introduce a requirement to disclose to the SEC and to the public certain employment transition for persons employed with the NRSRO within the previous 5 years that have obtained employments with a rated entity for which the NRSRO issued a credit rating during the 12 month period prior to such employment.

495. In addition, the bill proposes to direct the SEC to undertake a study on creating a system whereby NRSROs are assigned on a rotating basis to issuers and obligors seeking a credit rating.

Box 9

Establishing a gradual rotation mechanism

496. CESR clearly points out that this is an area of a different approach, but that the US has very robust conflicts of interest management requirements.

497. On the issue of rotation policy, CESR understands that the SEC will be looking to see how this requirement is met in the EU.

80 Rule 17g-5(c)(6).
81 Rule 17g-5(c)(7).

498. CESR can accept for the purposes of assessing equivalence, the lack of this specific requirement being embedded into the legislation, provided there is overall a robust set of conflicts of management requirements, which is clearly the case in respect of the US.

Requirements of paragraph 112.

499. There are three requirements in paragraph 112 above, and in relation to each of these there are differences in how the US requirements meet the objectives, but overall CESR consider that the objectives are met.

500. These requirements are:

a) a credit rating agency is prohibited from providing consultancy or advisory services;
b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating; and
c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

a) a credit rating agency is prohibited from providing consultancy or advisory services (11(d))

501. In order to avoid potential conflicts of interest from the issuing of credit ratings, Annex I, Section B.4 of the EU Regulation states that CRAs are prohibited from providing **consultancy or advisory services**.

502. In the US there are no such specific requirements, but CESR considers for the purposes of assessing equivalence, provided there are other conflict of management provisions that are robust and can be said to achieve the same objective in practice, the lack of a specific provision that corresponds to this one is acceptable.

503. CESR sought further clarification of this issue from the SEC staff, and it is CESR's understanding that advisory services are not considered to be a credit rating activity and as such the provision of such services are **disclosable but not prohibited**.

504. As discussed above, one of the provisions of Rule 17g-3 is to provide the SEC with a number of reports one of which is:

"An unaudited financial report providing information concerning the revenue of the NRSRO in each of the following categories (as applicable) for the fiscal year: (i) Revenue from determining and maintaining credit ratings; (ii) Revenue from subscribers; (iii) Revenue from granting licenses or rights to publish credit ratings; and (iv) Revenue from all other services and products (include descriptions of any major sources of revenue)."[82]

505. On September 17, 2009 the SEC voted to propose an amendment to Exhibit 6 to Form NRSRO, pursuant to which an NRSRO is required to publicly disclose the percentage of its total net revenue attributable to providing services other than credit rating services. The proposed amendment has not been adopted yet.

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82 Rule 17g-3(a)(3).

506. CESR does however consider it important to reiterate as set out in paragraph 434 above that the SEC requires the NRSRO to publicly disclose and implement procedures to manage and address the conflicts that arise from being paid to provide a service other than credit rating services, as such there is no prohibition per se – but when the provision of consultancy services gives rise to a conflict of interest - this would need to be disclosed and managed.

507. In addition, as explained in paragraph 479 above there are also a number of other requirements that deal with the objectives of the EU requirement relating to ensuring that the provision of ancillary services does not present conflicts of interest.

508. The bill of Restoring American Financial Stability Act of 2010 directs the SEC to evaluate the potential impact of rules prohibiting an NRSRO that provided a rating to an issuer from providing other services to the issuer.

509. In addition, CESR points out that the bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes to introduce an express prohibition for an NRSRO to provide any non rating service to an issuer, underwriter, or placement agent of a security for which the NRSRO provides a credit rating, including advisory or consultancy services.

Box 10

Prohibition to provide consultancy or advisory services

510. CESR highlights that this is an area of difference between the EU and the US in that the EU Regulation prohibits the provision of consultancy or advisory services, and in the US an NRSRO is required to manage and disclose a conflict in Exhibit 6 of Form NRSRO arising from being paid for services in addition to determining credit ratings by those who have paid the NRSRO to provide a credit rating, and any other type of conflict of interest that the NRSRO considers to be material.

b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating (11(g)

511. As set out in paragraph 440 above, Rule 17g-5(c)(5) the NRSRO is prohibited from issuing or maintaining a credit rating with respect to an obligor or security where the NRSRO or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security;[83].

Box 11

Prohibition to make proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating

512. CESR therefore considers that the objective of this EU provision is met by the US requirement.

83 17 CFR 240.17g-5(c)(5).

c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

513. As set out in paragraph 440 above, Rule 17g-5(c)(6) prohibits the NRSRO from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.[84]

514. The bill of Restoring American Financial Stability Act 2010 (Section 932(3)) requires the SEC to issue rules to prevent sales and marketing considerations from influencing the production of NRSRO ratings.

Box 12

Prohibition to be involved in the negotiation of fees or payments

515. CESR therefore considers that the objective of this EU provision is met by the US requirement.

Requirements of paragraph 113

516. These requirements are that: those persons referred to in Annex 1 Section C points 1, 2, 4, 6 of the EU Regulation are prohibited from:

a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;
b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;
c) soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business;
d) from taking key management positions with the rated entity or its related third party within 6 months after the rating.

(a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity

517. This EU requirement is covered by the US prohibition set out in Rule 17g-5 (c)(2) and the provisions of Article 17g-5(b)(6) that prohibits a credit rating agency to allow persons within an NRSRO to directly own securities or money market instruments of, or having any other direct interest or ownership in the rated entity unless the NRSRO has implemented policies and procedures to address and manage this conflict of interest and disclosed this type of conflict of interest.

84 17 CFR 240.17g-5(c)(6).

(b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity (q15b(i)&(ii) or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest

518. In relation to the EU Regulation prohibition set out in paragraph 516b) above relating to question 15b(i) and the rated entity, this prohibition is covered in Rule 17g-5(b)(6), where persons within the NRSRO are prohibited from directly owning securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO[85], unless the NRSRO has implemented policies and procedures to address and manage this conflict of interest and disclosed this type of conflict of interest.

519. In relation to the EU prohibition set out in paragraph 516b) above relating to questions 15b(ii)&(iii) these requirements are not covered by an identical prohibition but overall through the conflicts of interest management provisions discussed above.

520. As indicated by the SEC staff in its answer, in relation to the EU prohibition set out in paragraph 516b) above relating to having recent employment or other business relationships with the rated entity that may cause a conflict of interest, this is considered to be covered by:

a) the prohibition on the NRSRO to issue or maintain a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating;[86]

b) the obligation on the NRSRO to disclose and implement procedures to address and manage the conflict arising from allowing persons within the NRSRO to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the NRSRO[87]; and

c) the obligation on the NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest[88]. Allowing its analysts to have employment, business, or other relationships with rated entities that could cause the analyst to be unduly influenced in the performance of determining credit ratings may constitute evidence that an NRSRO did not have reasonably designed procedures for managing this conflict.

521. In relation to the EU prohibition set out in paragraph 516b) above, the objective of this requirement is achieved by Rule 17g-5(b)(6) so that if persons within the NRSRO are allowed to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO;[89] then the NRSRO must have policies and procedures to manage such conflicts and to disclose them.

(c) soliciting or accepting monies, gifts or favours from anyone with whom the credit rating agency does business;

522. This is prohibited by the prohibition in Rule 17g-5(c)(7) to issue or maintain a credit rating where:

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85 17 CFR 240.17g-5(b)(6).

86 Rule 17g-5(c)(4).
87 Rules 17g-5(a) and (b).
88 Section 15E(h)(1) of the Exchange Act.
89 17 CFR 240.17g-5(b)(6).

"a credit analyst who participated in determining or monitoring the credit rating or person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of $25."

(d) - prohibition from taking key management positions with the rated entity or its related third party within 6 months after the rating

523. There is no specific US provision per se that covers this, but CESR considers that the objective of the requirement would need to be managed by the NRSRO through policies and procedures that would have to be in place by virtue of the general conflicts of interest management requirements set out in Section 15E (h) of the Exchange Act, Rules 17g-5(a) and 17g-5(b).

Box 13

Prohibitions under Annex I(C)(1)(2)(4)(6) of the EU Regulation

524. CESR considers that the objectives of these EU requirements are overall achieved, either through outright prohibitions or through the management and disclosure of conflict of interests requirements.

Box 14

CONFLICTS OF INTEREST MANAGEMENT

525. CESR considers the US requirements in terms of conflicts of interest management, to be particularly strong and robust, and overall meet the objectives of the EU requirements irrespective of the notable differences highlighted below.

526. There is a list of those behaviours/activities that are considered to be conflicts of interest and CRAs are explicitly prohibited from doing, regardless of whether it had disclosed them and established procedures reasonably designed to address them. Moreover, there are additional circumstances where a person within an NRSRO is prohibited from having a conflict of interest relating to the issuance of a credit rating unless the NRSRO has disclosed the type of conflict of interest and has implemented policies and procedures reasonably designed to address and manage this type of conflict of interest. NRSROs must disclose the policies and procedures to manage conflicts of interest and update the disclosure in case of changes.

527. CESR understands that if the SEC could not bring a case under one of the prohibited conflicts, it could come under the general requirements to have procedures to manage and disclose conflicts of interest. Similarly, the case of ownership of securities of an entity related to a rated entity, which may cause a conflict of interest, would not be considered as a prohibited conflict, but would be covered by the general obligations to manage and disclose conflicts of interest.

528. Other notable differences are:

- **That information regarding the 20 largest clients of the NRSRO is provided to the SEC; the NRSRO may require that the SEC keep the report confidential, to the extent permitted by law;**
- **there is no requirement to list ancillary services in the final rating report,**
- **there is no requirement to have a gradual rotation policy for the NRSRO's rating analysts.**

529. In addition, in relation to the provision of advisory or consultancy services CESR highlights that this is an area of difference between the EU and the US in that the EU Regulation prohibits the provision of consultancy or advisory services, and in the US an NRSRO is required to manage and disclose a conflict in Exhibit 6 of Form NRSRO arising from being paid for services in addition to determining credit ratings by those who have paid the NRSRO to provide a credit rating, and any other type of conflict of interest that the NRSRO considers to be material.

530. Despite the differences outlined above, CESR considers that overall, the way in which the SEC deals with the management of conflicts of interest meets the objectives of the corresponding EU requirements.

D. Organisational requirements

531. The EU mandate required CESR to check at least the following issues in this section:

Extract from the mandate

- A CRA keeps records and audit trails of all its activities;
- A CRA has a compliance function, which operates independently

532. In addition to the above, CESR's approach to assessing the equivalence of the EU Regulation's organisational requirements, as set out in paragraphs 125 to 145 makes it clear that this is an area where CESR anticipates there may be differences and as such is not expecting all of the EU Regulation's requirements to be in place in a third country.

533. The organisational requirements set out in the EU Regulation can be divided into the following four areas:

- General organisational requirements
- Outsourcing
- Confidentiality
- Record keeping

534. The overall objective of the organisational requirements is that they contribute to ensuring the objectivity, independence, integrity and quality of the credit rating activities.

GENERAL ORGANISATIONAL REQUIREMENTS

535. As described in paragraph 128 for the purposes of assessing equivalence, CESR expects that the requirements in place in the third country, as a package, ensure that the objectives of the six requirements listed below are met have, namely that credit rating agencies are required to:

a) establish adequate policies and procedures that ensure compliance of the credit rating agency's obligations under the relevant regulation;
b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;
c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;
d) establish and maintain a permanent and effective compliance function which operates independently;
e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of the credit rating agency's credit rating activities;
f) monitor and evaluate the adequacy and effectiveness of the credit rating agency's systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take approraite measures to address any deficiencies.

a) Establish adequate policies and procedures that ensure compliance of the credit rating agency's obligations under the relevant regulation

536. Section 15E(j) of the Exchange Act requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO, including policies and procedures to prevent the misuse of material non-public information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws ("designated compliance officer"). Paragraph 361 discusses this requirement in detail.

537. In addition, SEC Rule 17g-1 requires an NRSRO to provide information about certain written policies and procedures they establish, maintain and enforce. A detailed explanation of the content of Rule 17g-1 is outlined in paragraphs 261 to 281. These include policies and procedures reasonably designed to manage conflicts of interest and to prevent the misuse of material, non-public information in violation of the Exchange Act. The SEC created Rule 17g-4 and Rule 17g-5 the prevention of the misuse of material, non-public information and to deal with conflicts of interest. A detailed explanation of the US conflicts of interest management approach is described in paragraphs 409 et seq., and paragraphs 445 et seq. deal with the misuse of material, non-public information.

538. An NRSRO must disclose a description of these policies, as well as other information including its procedures and methodologies for determining credit ratings and its code of ethics (or explanation as to why it does not have a code of ethics), on Form NRSRO.

539. As indicated by the SEC staff in their answer, failing to adhere to disclosed methodologies, procedures, and policies may subject the NRSRO to liability under federal securities laws and rules thereunder. An NRSRO must have a control environment that is designed to ensure that it adheres to its disclosed methodologies, procedures, and policies. The designated compliance officer reporting directly to senior management is a critical success factor of such a control environment.

b) Have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems.

540. The US regulatory regime does not contain an explicit requirement for an NRSRO to establish administrative and accounting procedures nor for these procedures to be "sound".

541. The SEC leaves this matter to the market to assess through disclosure of what these procedures are. Rule 17g-1 contains the relevant disclosure requirements explained in detail in paragraphs 261 to 281.

542. Theoretically, the SEC can exercise its discretion and use its power to deny the application on the basis that the NRSRO does not have sufficient managerial and financial resources to determine credit ratings with integrity pursuant to Section 15E(a)(2)(C)(ii)(1) of the Exchange Act. CESR understands that in practice the SEC would check compliance with the statutory and regulatory requirements and adherence with the disclosure on an ex-post basis through its cycles of inspections.

543. The US regulatory regime contains:

- extensive disclosure to the public of the policies and procedures adopted to address and manage conflicts of interest[90] and to prevent the misuse of material, non-public information,[91]

90 see paragraphs 409 et seq.

- a legal requirement to adhere to what is disclosed,
- a legal requirement to appoint a designated compliance officer that has to ensure that procedures are adhered to,[92] and
- both the designated compliance officer and senior management are responsible for this, and as stated above, all of this can be checked by the SEC on an ex-post basis through its cycles of inspections.

544. The US regulatory regime does not contain specific requirements to have effective procedures for risk assessment. However, CESR understands that the SEC would expect that NRSROs, and especially large organisations, have effective risk assessment procedures in place, as the absence of this may raise concerns about the ability of the compliance officer to carry out its tasks of ensuring compliance with the securities laws and regulations.

545. CESR sought additional clarification on this point and understands that "risks" is taken to mean legal and reputational risks considering that these as the greatest risks which cover also operational risk.

546. CESR understands that risks such as credit risk, liquidity risk, market risk, counterparty risk are considered by the SEC to be less relevant for an NRSRO.

547. CESR sought additional clarification on this point and understands that there is no general requirement for an NRSRO to have effective control and safeguard arrangements for information processing systems. The law requires NRSROs to have policies to handle material non-public information.[93] The policies put in place for this purpose are those disclosed in Exhibit 3 in Form NRSRO. The content of this Exhibit is described in paragraph 269.

548. CESR sought additional clarification on this point and understands that it is impossible for NRSROs to operate without effective controls and safeguards - and in terms of their models – NRSROs have to ensure that the information that they say they use going into the model is the information that they use. However, it does not mean that there have to be adequate back-up facilities in place (no specific IT requirements).

549. The bill of Restoring American Financial Stability Act 2010 indicates that a potential change could require each NRSRO to establish, maintain, enforce, and document an effective internal control structure governing adherence to policies, procedures, and methodologies for determining credit ratings. In addition, NRSRO CEOs could be required to make an annual attestation as to the effectiveness of the internal controls.

550. Also the bill of "Wall Street Reform and Consumer Protection Act of 2009" contains proposals designed to strengthen internal controls over the processes for determining credit ratings, and the periodical review of those internal controls by the SEC.

c) Implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities

551. As stated in paragraph 270 Exhibit 4 of Form NRSRO requires an NRSRO to publicly disclose information about its organisational structure, including, as applicable, an organisational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the NRSRO; an organisational chart showing the divisions, departments, and business

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91 see paragraphs 445 et seq.
92 see paragraphs 361 et seq.
93 Rule 17g-4

units of the NRSRO, and an organisational chart showing the managerial structure of the NRSRO which includes the senior management reporting lines and must include the designated compliance officer.

d) Establish and maintain a permanent and effective compliance function which operates independently

552. As stated in paragraph 361, NRSROs have to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of non-public information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.

553. The US regulatory regime does not explicitly require that this designated individual has to operate independently.

554. Independence in the context of the EU Regulation means not receiving for example any benefits (see Annex I section A paragraph 6 (c) (d) and 3rd sentence of same paragraph).

555. The SEC assesses independence by checking how the compliance function is integrated into the organisational structure and whether the compliance officer reports to senior management.

556. Although the information will be provided in Exhibit 4 of Form NRSRO, CESR understands that if the compliance officer did not report to senior management, concerns may be raised regarding whether or not the NRSRO has adopted policies and procedures reasonably designed to manage conflicts of interest and to prevent the misuse of material, non confidential information.

557. In the registration form, an NRSRO is not required to provide information about the compliance officer's compensation. A qualitative assessment about compliance officer's independence would happen after registration in the context of an NRSRO examination.

558. The bill of Restoring American Financial Stability Act 2010 indicates that a potential change could require an NRSRO to prohibit its compliance officer to perform credit ratings, take part in sales or marketing, develop ratings methodologies, or set compensation levels for NRSRO employees. In addition, an annual compliance report could be requested to be submitted to the SEC by this act.

559. The changes proposed under the bill of "Wall Street Reform and Consumer Protection Act of 2009" are designed to further reinforce the independence and duties of the designated compliance officer, as discussed in paragraph 398 above.

e) Employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities

560. The US regulatory regime does not contain specific requirements for an NRSRO to employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities.

561. NRSROs must include descriptions of their procedures and methodologies used in determining credit ratings in Exhibit 2 of their Form NRSRO disclosures.[94] There is only a requirement for the NRSRO to disclose certain procedures, including the procedures to determine ratings, and to update the disclosure in case of changes. In the context of an examination, the SEC checks whether the disclosed procedures are complied with.

562. This disclosure must be promptly amended if the information or documents provided in a previously furnished Form NRSRO become materially inaccurate.

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94 See paragraph 268

563. In addition, a registered NRSRO is required to provide an annual certification on Form NRSRO certifying that the information provided, including the description of its procedures and methodologies used in determining credit ratings, is accurate in all significant respects. NRSROs are also required to designate a compliance officer to ensure compliance with applicable securities laws, rules, and regulations. As indicated by the SEC staff in their answer, an NRSRO that did not adhere to its disclosed procedures and methodologies may be subject to liability under the federal securities laws and rules thereunder.

564. In addition, there is a separate office in New York tasked with ongoing monitoring of CRA's activities (see paragraphs 286 to 287 above) to ensure to identify any activity that would disrupt continuity and regularity in the performance of NRSRO's credit rating activities.

f) *Monitor and evaluates the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies*

565. The designated compliance officer adheres to the role of monitoring and evaluating the adequacy and effectiveness of an NRSRO's systems. The SEC staff has indicated in their answer that, notwithstanding this designation, senior management shares the responsibility for ensuring compliance with relevant laws and regulations as well as the internal policies disclosed by the NRSRO.

566. In assessing the extent to which this requirement is being met in practice, the function of the monitoring unit in New York has to be taken into account.

Box 15

GENERAL ORGANISATIONAL REQUIREMENTS

567. CESR concludes that overall the objectives of the general organisational requirements set out in the EU Regulation are met even though the US regulatory regime does not contain specific requirements in relation to:

- **procedures for risk assessment,**
- **control and safeguard arrangements for information processing systems and administrative procedures,**
- **decision making procedures**
- **independence of the compliance function,**
- **employing appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities.**

568. CESR considers the objectives of the EU requirements to be met because (i) there is extensive disclosure to the public of the policies and procedures adopted to address and manage conflicts of interest and to prevent the misuse of material, non-public

information, (ii) a legal requirement to adhere to what is disclosed, (iii) procedures and methodologies to determine credit ratings have to be made public and updated whenever they are changed, and aspects of this are monitored by the SEC's monitoring unit (iv) a designated compliance officer that has to ensure that procedures are adhered to, (v) both the compliance officer and senior management are responsible for this, and (vi) all of this can be checked by the SEC on an ex-post basis through its cycles of inspections.

569. With regard to the organisational structure CESR highlights that NRSROs are required to implement and maintain decision making procedures and organisational structures in order to comply with the disclosure requirement of Exhibit 2 of Form NRSRO.

570. CESR reiterates there is no specific requirement for the designated compliance officer to be independent but as discussed in paragraph 407 above this issue would be dealt with on an ex post basis.

OUTSOURCING

571. The requirements with regard to the outsourcing section are set in paragraphs 135 to 137 above.

572. The US regulatory regime generally permits outsourcing. An NRSRO can practically outsource any activity except the compliance function which has to be performed by someone within the NRSRO.

573. Taking this into account an NRSRO can theoretically outsource any activity without informing the SEC beforehand.

574. CESR understands that any outsourcing will only be identified by the SEC through conducting an examination, because Form NRSRO does not contain any information on rating activities outsourced to any other service provider.

575. However, in case of outsourcing the NRSRO remains fully responsible and liable for the activities that it has outsourced.

576. The US legal framework requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of non-public information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws. In addition to the compliance officer function, an NRSRO is not allowed to outsource this position.

577. An NRSRO is required to retain records, but can outsource the making or retaining to a third-party record custodian, provided the NRSRO furnished the SEC with a written undertaking of the custodian executed by a duly authorised person. This undertaking is required to specify that the third-party signatory acknowledges that any books and records it has made or is retaining for the NRSRO are the exclusive property of the NRSRO. The custodian is further required to undertake that upon the request of the NRSRO, it has to provide the books and records to the NRSRO or the SEC, and that upon the request of the SEC it has to permit examination of the records at any time and promptly provide to the SEC with a true and complete copy of any or all or any part of such books and records.

578. CESR understands, that although an NRSRO can outsource many activities, it still will be considered by the SEC as the single point of contact for the supervisory authority. It is not possible to outsource legal responsibility, because the NRSRO may be subject to liability under the federal securities laws and rules thereunder.

579. Although outsourcing is not prohibited by the US regulatory system, SEC supervision ensures that outsourcing of important operational functions does not impair materially the quality of the credit rating agency's internal control and the ability of the SEC to supervise the credit ratings agency's compliance under the Exchange Act and the SEC Rules.

Box 16

OUTSOURCING

580. CESR concludes that although the approach towards outsourcing in the US legal system is different, it considers the system to meet the objectives of the EU Regulation due to the fact that an NRSRO is still directly responsible for maintaining all internal controls mandated by law or regulation. Moreover, it remains fully liable for all outsourced activities.

581. In addition CESR understands that the SEC supervises on an ex post basis that outsourcing does not impair the ability of the NRSRO to issue ratings with integrity and to be in compliance with the US requirements.

CONFIDENTIALITY

582. Paragraph 140 above sets out the requirements relating to confidentiality. They are important because the nature of the information that the credit agency and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

583. As discussed in paragraph 445 above SEC Rule 17g-4 deals with prevention of misuse of material non-public information.

584. The US regulatory system requires an NRSRO to have written policies and procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of material non-public information obtained in connection with the performance of credit rating activities.

585. In addition, it requires an NRSRO to establish written policies and procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.

586. It furthermore, requires an NRSRO to have written policies and procedures reasonably designed to prevent a person within the NRSRO from purchasing, selling otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material non-public information obtained in connection with the performance of credit rating activities that affects the securities or money market instruments.

587. The US regulatory system does not explicitly deal with fraud and theft, but misuse and inappropriate use of information covers CESR's understanding of dealing with fraud and theft.

Box 17

CONFIDENTIALITY

588. CESR considers this area is well covered in the US regulatory regime, and as such the objectives of the EU confidentiality requirements for the purposes of assessing equivalence are met.

RECORD KEEPING

589. Paragraph 144 above sets out the requirements for effective record keeping which enables a credit rating agency to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

590. SEC Rule 17g-2 deals with records that need to be made and retained by NRSROs. Altogether, the rule requires an NRSRO to make and retain certain records for a period of three years.

Additionally, NRSROs have to provide the SEC with legible, complete, and current copies of those records that the NRSRO has to maintain pursuant to Rule 17g-2(a) and (b) and the SEC has the power to request English translations of any of these documents.

591. The three year retention period is designed to require the NRSRO to retain the records for a sufficiently long period of time so that they will be available to SEC examiners for at least one examination cycle, and available to the NRSRO's internal auditors and compliance personnel for at least one internal audit or compliance review cycle.

592. The records that must be retained, include documenting the identities of the credit analysts who determined a rating action and persons who approved the rating action, records documenting the identities of the issuers that have paid for ratings and the ratings determined for them, and records documenting all ratings methodologies.

593. The rule also requires NRSROs to retain records such as compliance reports and compliance exception reports, internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the internal auditors of the NRSRO as necessary to perform the audit of an activity that relates to its business as a credit rating agency.

594. In addition, an NRSRO must retain marketing materials and communications (e.g., emails) relating to determining ratings actions, including communications received from persons not associated with the NRSRO (e.g., individuals that are not employees) that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

595. If a quantitative model was a substantial component in the process of determining a credit rating for a structured finance product, an NRSRO is required to make a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued.

596. In addition, for each outstanding credit rating, an NRSRO is required to make a record showing all rating activities and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor.

Box 18

RECORD KEEPING

597. Overall, CESR considers the US record keeping requirements to be adequate in achieving the objective set out in paragraph 143 above, and points out that the record requirements in relation to how credit ratings are determined are particularly detailed compared to other US requirements.

598. In addition, CESR points out that it considers the requirements set in Rule 17g-2 in combination with the SEC's supervision enables CESR to accept the reduced time period of keeping records for only 3 years.

E. Quality of methodologies and quality of ratings

599. Within this section the EU Commission required CESR to assess at least the following criteria:

Extract from the mandate

- Competent authorities do not interfere with the content of ratings or the CRAs methodologies.
- A CRA has a function devoted to the periodical review of methodologies and models (review function).
- A CRA applies consistently the changes in methodologies and models to existing ratings.
- A CRA monitors its ratings and methodologies on an on-going basis and at least annually
- A stringent rotation policy is in put in place (lead rating analysts to rotate client at least every 4 years).

600. In addition to the above, CESR's approach to assessing the equivalence of the quality of rating and of methodologies requirements in the EU Regulation is as set out in paragraphs 147 to 172 above and for the purposes of discussion has grouped these requirements into the following sections as follows:

a) Reviewing methodologies models and assumptions and information used in issuing ratings;
b) Knowledge and experience of credit rating employees;
c) Quality and analysis of information used in assigning credit ratings;
d) Changes to methodologies; and
e) Competition.

601. As explained in paragraph 147 above, CESR considers that these requirements support achieving the following objectives:

a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;
b) the adequate quality, integrity and thoroughness of the credit rating activities;
c) as set out in recital 7 of the EU Regulation, the protection of the stability of financial markets and of investors;
d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

US approach to quality of methodologies and quality ratings

602. The overall approach in the US towards quality of methodologies and credit ratings differs from the EU approach. The US regulatory systems definition of interference with the quality of methodologies and credit ratings is stricter than the EU one. CESR understands that the SEC staff construes the prohibition of interference with the quality of ratings and methodologies in such a manner that they do not set out requirements that in any way interfere with this prohibition.

603. Overall, the SEC does not regulate the content of procedures and methodologies to determine credit ratings and as such does not review the content of the disclosure that is made in Form NRSRO on

an ex ante basis, but can do so on an ex post basis during subsequent examinations. Therefore, the market at large exercises its own judgement regarding the quality of methodologies and credit ratings.

604. As such, in comparison to the EU Regulation, there are not many specific provisions that deal with these requirements.

605. The requirements that the US does have in relation to these provisions of the EU Regulation are as follows:

a) The requirements in Section 15E of the Exchange Act relating to the registration process – namely the requirement set out in Section 15E(a)(1)(B)(ii);

b) The requirements of Rule 17g-1, which as discussed above prescribe how a credit rating agency must apply to be registered with the SEC and the information that is needs to supply upon registration.

c) The requirements of Rule 17g-2, which requires an NRSRO to make and retain certain other records made in the normal course of business operations. The rules also prescribe the time periods and manner in which all these records must be retained.

d) The Requirements of Rule 17g-6 – that implements the Section 15E(i)(1) of the Exchange Act.

e) The Requirements of Exhibit 2 and 8 which are used in order to comply with the information requirements that NRSROs need to comply with when filling in form NRSRO and complying with certain of the requirements in Rule 17g-6 and 17g-2.

606. As discussed above, Section 15E of the Exchange Act sets out a number of requirements that relates to the registration process – and the information that needs to be included in the registration form – of these requirements the 15E (a)(1)(B)(ii) applies in relation to methodologies disclosure that needs to be included :

"An application for registration under this section shall contain information regarding:
(i) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the applicant;
(ii) the procedures and methodologies that the applicant uses in determining credit ratings"

607. The SEC introduced Rule 17g-1 prescribing:

"(…) how an NRSRO must apply to be registered with the SEC, keep its registration up-to-date, and comply with the statutory requirement to furnish the Commission with an annual certification. Specifically, all of these actions must be accomplished by furnishing the SEC with a Form NRSRO. (…) The Form NRSRO elicits information about the credit rating agency applying for registration and, after registration about the NRSRO, including the information required under 15E(a)(1)(B) of the Exchange Act."

608. In addition to the above mentioned Rule, the SEC introduced Rule 17g-2 which requires an NRSRO to make and retain certain other records made in the normal course of business operations. The rule also prescribes the time periods and manner in which all these records must be retained.[95]

95 See paragraph 589 for more detail on Rule 17g-2.

609. Looking at the SEC Rule that implements the Section 15E(i)(1) of the Exchange Act , CESR notes that Rule 17g-6 prohibits "any act or practice by an NRSRO that the SEC determines is unfair, abusive, or coercive" and more specifically the following practices:

"- *Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO;*

- Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO;

- Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the NRSRO's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO; and

- Issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw a credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the NRSRO, where such practice is engaged in by the NRSRO for an anticompetitive purpose".

610. Pursuant the above mentioned Rules 17g-1, 2 and 6, an NRSRO must keep its Form NRSRO current and furnish relevant information in Exhibits 2 and 8. The content of the two Exhibits is explained in paragraphs 268 and 274 above.

How the US requirements meet the objectives of these requirements

611. Overall, this is an area where there are more differences between the EU requirements and the US requirements than similarities on a provision by provision basis in this area, CESR sets out the differences below.

(1) Reviewing credit ratings, methodologies models and assumptions and information used in issuing ratings

612. The EU requirements in respect of reviewing credit ratings, methodologies and assumption and information used in issuing ratings are as set out in paragraph 150 above:

a) have a review function devoted to the periodical review of methodologies, models, key rating assumptions
b) monitor its ratings and methodologies on an on-going basis and at least annually; and
c) review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.

613. For the purposes of assessing equivalence in relation to this set of requirements, CESR considers as set out in paragraph 151 above, that what is important to achieve in terms of objectives is that that methodologies and credit ratings are up to date and subject to a comprehensive review on a periodic basis.

a) Review function

614. CESR understands that there is no explicit requirement for an NRSRO to have a function devoted to the periodical review of methodologies, models and key rating assumptions – but that the SEC staff would nonetheless expect this to be done as a matter of course, in order to ensure that the requirement for updating the disclosure of methodologies in case of changes etc are being met, there is also the legal obligation imposed on the compliance officer to ensure that the US laws are being met.

615. In order for the compliance officer to be able to meet its statutory obligations, he or she would in essence have to be monitoring this on an ongoing basis.

616. As CESR explained in paragraph 152 above, for the purposes of equivalence, CESR does not consider it necessary that there is a separate review function provided that there are other requirements within the third country legal and regulatory framework that ensure that methodologies, models and key rating assumptions are periodically reviewed.

b) Monitoring of ratings and methodologies on an ongoing basis and at least annually

617. The US regulatory framework does not provide for an explicit legal requirement with regard to the requirement that ratings and methodologies need to be monitored on an ongoing basis and at least annually.

618. An NRSRO is required to disclose its procedures for monitoring credit ratings, including how frequently credit ratings are reviewed, but there is no specific requirement relating to the period during which an NRSRO has to carry out its monitoring of its credit ratings. An NRSRO which did not comply with their requirement may be subject to liability under the federal securities laws and rules thereunder.

619. There is no explicit requirement relating to the need to either disclose the procedure for, or to monitor methodologies.

620. CESR's understanding is that the reason there are no specific requirements relating to the monitoring and reviewing of methodologies or the time frame within which the monitoring of credit ratings has to take place is because this could be construed as interfering with the methodologies and credit ratings. In line with the difference in philosophy as explained above in paragraphs 224 to 238 above, this issue is tackled through the need for the NRSRO to make full disclosure about how the procedures and processes it has in place following which it is then left to the market to make its own judgment about this.

621. In addition, CESR points out that it understands that although there is a requirement to have a procedure to monitor credit ratings, having a similar requirement relating to methodologies is tantamount to telling the NRSRO how often it should be updating its methodologies – which CESR understands the SEC staff consider as interfering with the methodologies.

622. As the approach in the US to these issues is different to the EU approach, in determining the equivalence of these requirements, it is necessary to consider what the objectives of the EU requirements are, and to see if the objectives are being met.

623. CESR considers the objectives of these requirements to be:

- to ensure the adequate quality and thoroughness of the credit rating activities
- to protect the stability of financial markets and investors (recital 7).

624. In order to achieve these objectives, CESR considers robust methodologies subject to validation including by appropriate historical experience and back-testing as necessary. In addition, methodologies need to be properly maintained, up-to-date and subject to a comprehensive review on a periodic basis, to be able to properly reflect the changing conditions in the underlying asset markets.

625. As indicated in the SEC's staff answer, NRSROs are required to disclose their methodologies for monitoring credit ratings, including whether different models are used for surveillance and whether changes to initial rating or surveillance models are applied retrospectively to existing ratings. An NRSRO may be subject to liability under the federal securities laws and rules thereunder if it did not adhere to its disclosures.

c) Review affected ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation

626. In the US regulatory framework, NRSROs must according to Exhibit 2 of Form NRSRO have and disclose procedures for monitoring, reviewing, including whether different models are used for surveillance and whether changes to initial rating or surveillance models are applied retrospectively to existing ratings. An NRSRO that did not provide the required disclosures may be subject to liability under the federal securities laws and rules thereunder.

627. Again, the SEC leaves it to the market to decide on the details for reviewing credit ratings, as CESR understands that the prescription of details is considered as interfering with NRSROs methodologies.

628. The bill of Restoring American Financial Stability Act 2010 (Section 932) could direct the SEC to prescribe rules to ensure that ratings are produced in accordance with procedures and methodologies that have been approved by the NRSRO board or the senior credit officer. The potential rules could also require that material changes to a rating procedure or methodology be applied in a consistent manner to all ratings where the changes apply, and be applied to existing ratings within a reasonable period of time.

629. Similar proposals are contained in the bill of "Wall Street Reform and Consumer Protection Act of 2009" with the aim of strengthening the quality of credit ratings and methodologies to determine credit ratings.

Box 19

Reviewing credit ratings, methodologies, models and key rating assumptions

630. The US regulatory framework has no legal requirements to monitor the methodologies and to have a review function.

631. In addition, there is no legal requirement to monitor ratings on an ongoing basis and at least annually – but there is a requirement to describe the procedures in Exhibit 2 of Form NRSRO for monitoring and reviewing credit ratings. CESR points out that if you have to disclose how you monitor ratings you have to have a process in place to monitor them, as such this requirement is met. However, it is up to the NRSRO to decide on the frequency of the monitoring.

632. CESR understands that the SEC considers that imposing the frequency with which methodologies and credit ratings need to be reviewed interferes with the prohibition to regulate the substance of credit ratings or the procedures and methodologies through which an NRSRO determines credit ratings.

633. CESR considers that the objective of these requirements namely to ensure that methodologies and credit ratings are up to date and subject to comprehensive review on a periodical basis, are not fully met through the disclosure that has to be done in Exhibit 2 of Form NRSRO.

634. CESR considers that a way of bridging the gap between the differences in the EU and the US requirements, is for example to introduce a requirement dealing with the ongoing monitoring of methodologies and credit ratings, and the frequency within which their review should take place.

(2) *Knowledge and experience of employees directly involved in credit rating activities*

635. The EU requirements in relation to this section, as discussed in paragraph 154 above are that the credit rating agency ensures that rating analysts, employees of the credit rating agency and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

636. As set out in paragraph 155 above, in relation to this set of requirements, CESR considers for the purpose of equivalence that it is important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities and that this is an area that needs to be covered in the relevant third country regulatory framework.

637. NRSROs are required to disclose the information outlined in paragraph 274 above regarding credit analysts and the persons who supervise credit analysts in Exhibit 8 of Form NRSRO.

638. As indicated by the SEC staff in their answer, an NRSRO whose analysts and supervisors did not conform to this disclosed information may be subject to liability under the federal securities laws and rules thereunder. In addition, NRSROs are required to document their established procedures and methodologies for determining credit ratings. An NRSRO must follow its documented procedures when determining credit ratings or may be subject to liability under the federal securities laws and rules thereunder. Therefore, an NRSRO must have analysts with the expertise to determine credit ratings in the manner documented by the NRSRO.

639. The SEC requires some disclosure regarding the minimum qualification required for credit analysts – distinguishing between their seniority.

640. Section 936 of the bill of Restoring American Financial Stability directs the SEC to issue rules to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience, and competence necessary to produce accurate ratings, and is tested for knowledge of the credit rating process.

Box 20

<u>Knowledge and experience of employees directly involved in credit rating activities</u>

641. CESR points out that having minimum legal requirements in this area does not necessarily indicate that these individuals are adequately qualified for their jobs, because the EU requirement

includes the test of appropriateness which is very subjective. Furthermore, the EU framework, does not clearly define the qualifications required.

642. Overall, CESR considers that the US requirements achieve the objectives of the EU provisions.

(3) *Quality of credit ratings and analysis of information used in assigning credit ratings*

643. As set out in paragraph 161 above the EU requirements in relation to the quality of credit ratings and analysis of information used in assigning credit ratings are:

a) adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies;
b) adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;
c) establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;
d) to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors;
e) refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on;
f) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

644. As set out in paragraph 163 above, in relation to this set of requirements, CESR considers that for the purpose of achieving the objective of ensuring that the ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality, it does not expect to see identical requirements, but does expect to see requirements that it considers are able to achieve this objective.

a) Adopt, implement and enforce measures to ensure that credit ratings issued are based on a thorough analysis of all information that is available, and is relevant to their analysis according to rating methodologies

645. NRSROs are not specifically required to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a through analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies. Moreover, there is no explicit requirement for ratings to be accurate.

646. CESR understands that the SEC expects that the market will do the analysis on accuracy of ratings and come to its own judgment. Moreover, it is left to the market to assess what is and what is not accurate. The SEC does not maintain a database. Overall the market has the information about how 3rd party information has been used.

647. CESR understands that in terms of the robustness and accuracy, the SEC cannot tell the NRSRO what information is relevant or not - as that would be an interference with their methodologies, and is in essence a matter for the NRSROs and their methodologies.

648. NRSROs are required to disclose their methodologies, and to ensure that they comply with what they have disclosed. In addition, the expectation is that the market does its own analysis, come to its own judgment and assess what is and what is not accurate – the market has the information regarding how 3rd party information is intended to be used.

649. CESR notes that, according to the amendments of the Securities Exchange Act proposed under the bill of "Wall Street Reform and Consumer Protection Act of 2009", the designated compliance officer shall establish procedures designed so that ratings that the NRSRO disseminates reflect consideration of all information in a manner generally consistent with the NRSRO's published rating methodology, including information which is provided, received, or otherwise obtained from obligor, issuer an non-issuer sources, such as investors, the media, and other interested or informed parties.

b) Adopt measures so that the information used in assigning a credit rating is of sufficient quality and from a reliable source

650. The US legal system has no specific requirements relating to this EU requirement. CESR understands that NRSROs are required to disclose performance statistics.

651. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009", as well as the bill of "Restoring American Financial Stability Act 2010", propose to introduce a requirement to disclose, on a rating-by-rating basis, a statement containing an overall assessment of the quality of information available and considered in producing a credit rating for a security in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments. They also propose to introduce a requirement to disclose, on a rating-by-rating basis, information on the reliability, accuracy and quality of the data relied on in determining a credit rating.

c) Establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings

652. The US regulatory framework does not contain either a requirement to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings, or a requirement to disclose such arrangements in the registration form. Again, such a requirement to monitor the impact of the said changes could be seen as an interference with the NRSRO's methodologies and therefore is not part of the rules in the USA. However, in case a methodology states that an NRSRO monitors this issue, a failure to comply with the information disclosed may subject the NRSRO to liability under the federal securities laws and rules thereunder. As explained above, this would be checked after the event.

d) Inform the entity subject to the rating at least 12 hours before publication of the credit rating of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors

653. Although, there is no specific requirement to inform the rated entity before publication of the credit rating, the objective seems to be met through a requirement to disclose the manner in which the management of a rated obligor or issuer of rated securities etc should interact with the credit rating agency and procedures for informing rated obligors and issuers about credit rating decisions and for appeals for final and pending credit rating decisions in Exhibit 2 of Form NRSRO.

e) Refrain from issue a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on

654. As shown by the SEC staff in their answer, there is no such requirement in the US regulatory framework.

655. Pursuant to Rule 17g-1 and Exhibit 2 of Form NRSRO, an NRSRO must include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure and pursuant to Rule 17g-2(a)(6) an NRSRO must internally document its procedures. An NRSRO whose practices did not conform to this disclosed and internally documented information may be subject to liability under the federal securities laws and rules thereunder.

656. As such, if there is a procedure it has to be disclosed and adhered to, and if there is no such procedure, the market will know and make its own judgment about the credibility of the ratings where there are no such procedures.

657. Section 935 of the bill of Restoring American Financial Stability provides that, in producing a credit rating, an NRSRO shall consider information from a source other than an issuer that the NRSRO finds credible and potentially significant to a rating decision. In addition, Section 932(5) of the bill directs the SEC to prescribe rules to require NRSROs to indicate, in each credit rating, among other things, information about the NRSROs assessment of the quality of data available and considered. A similar provision is included in the bill of "Wall Street Reform and Consumer Protection Act of 2009". In addition, as mentioned above, the two bills propose to introduce requirements to disclose information on a rating-by-rating basis, information on the reliability, accuracy and quality of the data relied on in determining the credit rating.

(f) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings

658. As explained in paragraph 165 above, CESR does not think it necessary for the purposes of achieving the objective that this EU requirement is trying to achieve for a similar requirement to be embedded into the third country legislation.

Box 21

Quality of credit ratings and analysis of information used in assigning credit ratings

659. In relation to this set of requirements, the US has no specific requirements.

660. The SEC does not interfere with the substance of credit ratings and the methodologies to determine credit ratings and considers that it is up to the market to evaluate the quality of credit ratings and methodologies.

661. NRSROs are required to the disclose credit rating histories.

662. There is no requirement in the US that the NRSRO has to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information on which to base its ratings, but there is a requirement that the NRSRO discloses upfront a description of its procedures and methodologies to determine credit ratings, which may or may not cover this issue.

663. CESR points out that there is clearly a difference in approach between the EU and the US in relation to this issue and CESR understands that this difference in approach is inextricably linked to the US's approach to non interference with methodologies and credit ratings.

664. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" concerning the quality of information used by the NRSRO to determine credit ratings could make a significant change in meeting the objective of the EU requirement.

(4) Quality of methodologies and Changes to them

665. This set of EU requirements, as set out in paragraph 167 above impose obligations on a credit rating agency to:

a) use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;
b) apply the changes in methodologies and models consistently to existing ratings; and
c) immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.

666. As set out in paragraph 168 above, in relation to this set of requirements, CESR considers that for that these are significant in ensuring that the credit rating agency is able to achieve the overall objective of these requirements.

a) Use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing

667. Article 8.3 of the EU Regulation requires a credit rating agency to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing.

668. The US regulation has no such requirements, and the CESR understands that there are no similar requirements.

669. The US regulatory framework contains requirements that NRSROs are requested to include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure. This disclosure must be promptly amended if the information or documents provided in a previously furnished Form NRSRO become materially inaccurate. In addition, a registered NRSRO is required to provide an annual certification on Form NRSRO certifying that the information provided, including the description of its procedures and methodologies used in determining credit ratings, is accurate in all significant respects.

670. NRSROs are also required to designate a compliance officer to ensure compliance with applicable securities laws, rules, and regulations. An NRSRO that did not adhere to its disclosed procedures and methodologies may be subject to liability under the federal securities laws and rules thereunder.

671. It is then left to the market to make an assessment of what these methodologies are and how they have been developed.

672. The development of credit rating policies of methodologies that the credit rating agency uses in credit rating activities, need to be monitored and the monitoring of these tasks needs to be carried out by someone independent.

673. As can be seen, the CESR understands that there are no such mandatory requirements embedded into legislation in the US for these provisions.

674. Periodical review of methodologies, models and key rating assumptions are needed, even if not through a separate function.

Box 22

Using rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience and back testing

675. There are no specific requirements in the US that deal with this set of EU requirements.

676. This is related to the general approach in the US to the non interference with methodologies.

677. However there are broad disclosure requirements relating to the methodologies to determine credit ratings and therefore it is left to the market to make its own assessment regarding the quality of these methodologies.

678. CESR does not consider that the objectives of the EU requirements in this area are met by the US requirements.

b) Apply changes to methodologies and models consistently to existing ratings

679. In case methodologies, models or key rating assumptions used in credit ratings activities are changed the NRSROs are not explicitly required to apply the changes in methodologies and models consistently to existing ratings.

680. CESR understands that there is no requirement to apply changes in methodologies, models or key rating assumptions consistently to existing ratings, or to disclose the likely scope of credit ratings to be affected by changes to methodologies or models, and there is no requirement regarding the timing within which the affected ratings need to be reviewed.

681. NRSROs are only required to describe the methodologies for determining and monitoring credit rating and update the disclosure in case of changes.

682. Only if an NRSRO's methodology states that they do need to apply changes in methodologies, models or key rating assumptions consistently to existing ratings etc, a failure to do so may subject the NRSRO to liability under the federal securities laws and rules thereunder.

683. The bill of Restoring American Financial Stability Act 2010 (Section 932) directs the SEC to prescribe rules requiring material changes to a rating procedure or methodology to be applied in a consistent manner to all ratings where the changes apply, within a reasonable period of time. Similar proposals are contained in the bill of "Wall Street Reform and Consumer Protection Act of 2009."

Box 23

Apply changes to methodologies and models consistently to existing ratings

684. CESR notes that there is a clear difference in how the above mentioned issues are approached. Only if an NRSRO created or established a procedure to apply changes to methodologies and models consistently to existing ratings, would it be disclosable, and changes to methodologies and models would be applied to existing ratings in accordance with the disclosed procedure.

685. If no procedure exists, then the market has to analyse the situation and has to draw its own conclusions.

686. CESR does not consider that the objectives of the EU requirements are met by the US's approach to these requirements.

687. CESR points out that the proposed amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" could direct the SEC to prescribe rules to ensure that ratings are produced in accordance with procedures and methodologies that have been approved by the NRSRO's senior management. The potential rules may also require that material changes to a rating procedure or methodology be applied in a consistent manner to all ratings where the changes apply, within a time limit to be established in the SEC's rules.

c) Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings

688. There is no explicit US requirement that request to disclose this fact, but the bill of Restoring American Financial Stability Act 2010 (Section 932) could direct the SEC to prescribe rules to require an NRSRO to apply material changes to a rating procedure or methodology in a consistent manner to all ratings where the changes apply, within a reasonable period of time, and to notify users of credit ratings when a material change was made – or a material error was identified – in a rating procedure or methodology. Similar proposals of amendment are included in the bill of "Wall Street Reform and Consumer Protection Act of 2009".

Box 24

Immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings.

689. CESR notes that there is no specific requirement in the US regulatory framework.

690. In Exhibit 2 of Form NRSRO an NRSRO is required to make available to the public a description of its procedures for reviewing credit ratings. Thus, compliance with this objective will depend on the procedures that the NRSROs have and disclose.

691. On this basis CESR does not consider that the objectives of the EU requirement met but notes that potential changes to the US regulatory framework through the bill of Restoring American Financial Stability Act 2010 and the bill of Wall Street Reform and Consumer Protection Act of 2009 as outlined in paragraph 688 above could make a significant change in the right direction to meet the objectives of this requirement.

(5) Competition

692. The EU requirements in this area are set out in paragraph 170 above. As set out in paragraph 171 above, CESR does not consider that these requirements need to be in place for the purposes of assessing equivalence.

a) Not to refuse to issue a credit rating of an entity or a financial instrument because a position of the entity or the financial instrument had been previously rated by another CRA where a CRA is using an

existing credit rating prepared by another CRA with respect to the underlying assets or structured finance instruments

693. As indicated by the SEC staff in their answer, Rule 17g-6(a)(4), set out in paragraph 441 above prohibits refusing to issue a credit rating with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the NRSRO, where such practice is engaged in by the NRSRO for an anticompetitive purpose.

694. In addition, pursuant to Rule 17g-1 and Exhibit 2 of Form NRSRO, an NRSRO must include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure and pursuant to Rule 17g-2(a)(6) an NRSRO must internally document its procedures. An NRSRO whose practices did not conform to this disclosed and internally documented information may be subject to liability under the federal securities laws and rules thereunder.

695. Note that although the scope of the provisions is not identical CESR considers that overall the objectives are met.

b) Record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to the underlying assets or structured finance instruments providing a justification for the differing assessment

696. The US regulatory framework does not explicitly require NRSROs to record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to underlying assets or structured finance instruments providing a justification for the differing assessment.

697. Rule 17g-2(a)(7), which sets forth the record keeping requirements applicable to credit ratings for structured finance products, requires an NRSRO to make a record any time it takes into consideration credit ratings for the pool assets determined by another NRSRO (whether or not it uses such ratings). Rule 17g-2(b)(10) requires the NRSRO to retain the record about how the assests were traded.

698. CESR understands that an NRSRO has to have a procedure and methodology how to handle such issues and therefore has to record a file when producing the credit rating without explicitly recording all the mentioned instances. On top of that, NRSROs would need to explain their approach in their methodologies.

Box 25

Competition

699. The provision in the SEC rules are not identical to those of the EU requirements as they are limited to credit ratings issued with respect to securities or money market instruments issued by an asset pool or a part of any asset backed or mortgage backed securities transactions, whilst the EU requirements refer to structured finance products in general.

700. However, CESR considers that overall the objectives of the EU requirements are met.

Box 26

QUALITY OF METHODOLOGIES AND QUALITY OF RATINGS

701. Overall, this is an area of major difference between the EU and the US requirements which is related to the manner in which the US approaches the issue of non interference with the substance of credit ratings and the methodologies used to determine them.

702. In respect of this set of EU requirements CESR considers that overall the US requirements do not meet the objectives of the EU requirements for the reasons set out under the following headings:

1) Requirements relating to the review of credit ratings, methodologies, models and assumptions and information used in issuing ratings

- The US regulatory framework has no legal requirements to monitor methodologies and to have a review function.
- There is also no requirement to monitor ratings on an ongoing basis and at least annually, even if there is a requirement to monitor and describe in Exhibit 2 of Form NRSRO the procedures for monitoring and reviewing credit ratings.

703. CESR considers that a way of bridging the gap between the differences in the EU and the US requirements, is for example to introduce a requirement dealing with the ongoing monitoring of methodologies and credit ratings and the frequency within which their review of should take place.

2) Requirements relating to the quality of credit ratings and analysis of information used in assigning credit ratings

- There is no requirement in the US that the NRSRO has to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information on which to base its ratings, but there is a requirement that the NRSRO discloses upfront a description of its procedures and methodologies to determine credit ratings, which may or may not cover this issue.

- CESR notes that potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability" concerning the quality of information used by the NRSRO to determine credit ratings, could make a significant change in meeting the objective of the EU requirement.

3) Requirements in relation to the quality of methodologies and changes to them

704. There are no specific requirements in the US that deal with the requirement to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience and back testing, even if the description of the methodologies is to be disclosed and adhered to by the NRSRO.

705. Only if an NRSRO created or established a procedure to apply changes to methodologies and models consistently to existing ratings, would it be disclosable, and changes to methodologies and models would be applied to existing ratings in accordance with the disclosed procedure.

706. CESR points out that the proposed amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" direct the SEC to prescribe rules to ensure that ratings are produced in accordance with procedures and methodologies that have been approved by the NRSRO senior management. The potential rules may also require that material changes to a rating procedure or methodology be applied in a consistent manner to all ratings where the changes apply, within a time limit to be established by the SEC by rules.

707. There is no specific requirement in the US regulatory framework to immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distribution of the affected credit ratings, even if an NRSRO may commit to do so in the description disclosed in Exhibit 2 of Form NRSRO.

708. CESR notes that potential changes to the US regulatory framework through the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act 2010 as outlined in paragraph 688 above could make a significant change in the right direction to meet the objectives of this requirement.

F. Disclosure

709. According to the EU mandate, CESR is required to assess at least the following issues regarding the presentation of credit ratings and the disclosure about the credit rating agency and its activities:

Extract from the mandate

- A CRA discloses to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on. It will not be allowed to rate financial instruments if it does not have sufficient quality information to base ratings on.
- A CRA discloses the models, methodologies and key assumptions on which it bases its ratings.
- A CRA differentiates the ratings of structured products by adding a specific symbol.
- A CRA has a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such.
- A CRA collects and provides on a regular basis historical performance data (default and transition studies), in accordance with commonly agreed standards.
- A CRA ensures on an on-going basis general disclosure of key information relating to its activity (i.e. on managing conflicts of interest, ancillary services provided, compensation arrangements for its staff, policy on the publication of credit ratings, etc.)
- A CRA makes periodical disclosures (i.e. data on the historical default rates, the 20 largest clients by revenue)
- A CRA makes public an annual transparency report with information on the ownership of the agency, staff allocation, description of the quality control system, outcome of the internal review of independence compliance, financial information regarding the revenue streams, etc.

710. As discussed in paragraphs 173 to 198 above the EU Regulation sets out core prescriptive disclosure requirements on credit rating agencies.

711. For the purposes of this paper, CESR has divided the said requirements into the following two categories:

(i) presentation and disclosure of credit ratings, and
(ii) general and periodic disclosure about the credit rating agency.

712. The requirements under point *(i)* have in turn been divided between:

a) general provisions on the presentation and disclosure of any credit ratings, and
b) additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products.

713. The requirements under point *(ii)* have been divided between:

a. general additional disclosure requirements, and
b. periodic additional disclosure requirements.

714. The same order will be followed in the present section in assessing the US regulatory framework.

Presentation and disclosure of ratings

General provisions on the presentation and disclosure of any credit ratings

715. As outlined in paragraph 176, the EU requirements on the presentation and disclosure of credit ratings aim at ensuring a timely and non-selective disclosure of credit ratings and the provision of adequate information to investors in order to enable them to conduct their own due diligence regarding whether to rely on a credit rating.

716. In assessing equivalence, as discussed in paragraph 179, CESR expects that, overall, the objectives of each individual EU requirement described in paragraphs 177 to 178 above to be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision, although it considers that the differences highlighted in paragraph 180 can be accepted.

US approach to disclosure and presentation of credit ratings

717. Section 3(a)(61) of the Exchange Act defines "credit rating agency" to mean:

"*any person (A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, ….*".

718. In light of this provision, CESR understands that a credit rating agency that does not disclose each credit rating on the Internet or through another readily accessible means cannot meet the statutory definition of credit rating agency and, therefore, cannot seek to be registered with the SEC as an NRSRO.

719. Neither the Exchange Act nor the SEC's NRSRO Rules set out specific requirements concerning the specific contents of credit ratings.

720. This is one area of difference in the approach adopted by the EU and the US framework.

721. Whilst the EU Regulation sets out detailed requirements concerning the disclosure of each individual credit rating to ensure that credit rating users receive information that enable them to assess reliance on a credit rating, in the US the same objective is intended to be pursued through upfront disclosure requirements of the methodologies used to determine credit ratings.

722. Section 15E(a)(1)(B)(ii) of the Exchange Act and Rule 17g-1 require a credit rating agency to provide in its Form NRSRO (Exhibit 2) a description of the procedures and methodologies used in determining credit ratings. The list of information to be included in Exhibit 2 is discussed in paragraph 268 above.

723. As indicated in paragraphs 602 to 605 above, the SEC refrains from regulating the substance of the procedures and methodologies to determine credit ratings. The detailed contents of such policies and procedures are not set out in the laws and regulations, but are remitted to the NRSRO.

724. This description is required to be sufficiently detailed so as to provide users of credit ratings with an understanding of the processes the NRSRO employs to determine credit ratings. CESR understands that, if methodologies and procedures used by the NRSRO to determine credit ratings differ depending on the type of product or class of rating, then such differences are to be highlighted by the NRSRO in Exhibit 2 of its Form NRSRO. If the disclosure about the procedures

and methodologies used by the applicant to determine credit rating is not sufficiently detailed, then the application is not complete.

725. In addition, an NRSRO is required to provide in its Form NRSRO (Exhibit 3) a description of the policies and procedures adopted and implemented to reasonably prevent the misuse of material, non-public information in accordance with Section 15E(g) of the Exchange Act.

726. NRSROs must comply with the information disclosed and promptly update such information if, after registration, such information becomes materially inaccurate (Section 15E(b)(1) of the Exchange Act). The information is to be made publicly available on the NRSRO's website. In addition, no later than 90 days after the end of each calendar year, NRSROs must certify that information and documents provided in the application for registration continue to be accurate and list any material change (Section 15E(b)(2) of the Exchange Act).

727. If the NRSRO issues credit ratings in material contravention of those procedures disclosed by the NRSRO, the NRSRO may be subject to liability under the federal securities laws and rules thereunder (Section 15E(c)(1) of the Exchange Act).

728. Rule 17g-2 requires an NRSRO to make and maintain for 3 years certain records with respect to each credit rating of the NRSRO, as outlined in paragraph 590 above. These include, among other things, the established procedures to determine credit ratings, internal records used to form the basis of a credit rating issued by NRSRO, all rating actions from the initial credit rating and the identity of those who participated in determining or approved the credit rating. Furthermore, specific record-keeping requirements apply in relation to credit ratings for structured finance products as detailed in paragraphs 851 to 881 below. All records must be made available to the SEC upon request.

729. CESR understands the SEC staff would remain open to the introduction of possible specific disclosure requirements where such requirements proved to be useful and helpful, also taking account the experience about application of similar requirements in the EU ("learning-by-doing" approach).

730. As discussed in paragraph 855 below, in November 2009, the SEC has solicited comments on possible alternative measures concerning credit ratings for structured finance products, which may include for instance further disclosure requirements.

731. The bill of Restoring American Financial Stability Act of 2010 – that is currently under discussion at the Congress – proposes to introduce a new rule (Section 932) that:

a) provides that the SEC shall, by rule, require each NRSRO to disclose information on initial credit ratings and subsequent changes to those ratings, in a format that allows users of ratings to compare the performance of ratings across NRSROs;

b) directs the SEC to prescribe rules to require NRSROs to publish with each rating a form (in paper or electronic format) disclosing information about (1) the assumptions behind the rating, (2) the data relied upon, (3) whether servicer or remittance reports are used to monitor the rating, and (4) other information to allow investors and users of credit ratings to better understand the rating. The form must discuss (1) the main assumptions underlying the rating, (2) potential limitations of the rating, (3) information on the uncertainty of ratings, (4) whether third-party due diligence reports have been used, (5) data about the issuer used in determining the rating, (6) the NRSRO's assessment of the quality of data available and considered, (7) information related to conflicts of interest, and (8) other information that the SEC may require.

732. In addition, the proposed Section 938 requires NRSROs to clearly define any symbols used to denote a credit rating, and apply any such symbols in a consistent manner to all types of securities and money market instruments to which they are applied. An NRSRO may use distinct sets of symbols to denote credit ratings for different types of securities.

733. Additional rating-by-rating disclosure requirements are proposed to be inserted in relation to credit ratings of structured finance products, as detailed in paragraph 867 below.

734. CESR also notes that several proposals on disclosure of individual credit ratings are contained in the bill of "Wall Street Reform and Consumer Protection Act of 2009". Among other proposals, the bill proposes the following information to be disclosed on a rating-by-rating basis:

- the expected default probability and the loss given default;
- the sensitivity of the rating to assumptions made by the NRSRO;
- an explanation or measure of the potential volatility for the credit rating, including any factors that might lead to a change in the credit rating, and the extent of the change that might be anticipated under different conditions;
- where applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating;
- the certainty of the rating, including information on the reliability, accuracy, and quality of the data relied on in determining the ultimate credit rating;
- a statement on the extent to which key data inputs for the credit rating were reliable or limited, including any limits on the reach of historical data, limits in accessibility to certain documents or other forms of information that would have better informed the credit rating, and the completeness of certain information considered;
- whether and to what extent third party due diligence services have been utilised, and a description of the information that such third party reviewed in conducting due diligence services;
- a description of relevant data about any obligor, issuer, security, or money market instrument that was used and relied on for the purpose of determining the credit rating;
- a statement containing an overall assessment of the quality of information available and considered in producing a credit rating for a security in relation to the quality of information available to the NRSRO in rating similar obligors, securities, or money market instruments.

How do these requirements compare to those required for the objectives to be met – go through each of them in details

735. For the purposes of assessing the equivalence, CESR needs to asses whether or not, despite the differences in the approach and philosophy as discussed above, the objectives of the EU requirements set out in paragraphs 177 to 178 above are met. As mentioned above, CESR may accept the differences highlighted in paragraph 180.

(i) Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner

736. There are differences regarding how the EU and the US ensure that the objective of timely and non-selective disclosure of credit ratings and decisions to discontinue credit ratings is met.

737. An NRSRO is required to disclose credit ratings on the Internet or through another readily accessible means to meet the statutory definition of "credit rating agency" set out in Section 3(a)(61) of the Exchange Act. CESR understands that this applies to each and every credit rating issued by the NRSRO.

738. If an NRSRO were to stop "issuing credit ratings on the Internet or through another readily accessible means, for free or a reasonable fee", the SEC has the power to cancel its registration under Section 15E(e)(2) of the Exchange Act on the grounds that it had "ceased to do business as a credit rating agency".

739. In item 6B of the Form NRSRO, an NRSRO is required to briefly describe how it makes the credit ratings readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the NRSRO, the NRSRO must indicate a fee schedule or the price(s) charged.

740. In addition, as indicated by the SEC in the answer to:

a) Section 15E(g)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration its business, to prevent the misuse of material, non-public information in violation of the Exchange Act and the SEC's Rules;

b) Rule 17g-4(a)(3) requires an NRSRO to establish, maintain and enforce written policies and procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.

741. CESR understands that credit ratings are, in practice, disclosed by NRSROs to the public as fast as technically possible to reduce the risk of misuse and inappropriate dissemination of material, non-public information.

742. The SEC recognises that a decision to discontinue credit ratings may be a material non-public information. Consequently, an NRSRO must have written policies reasonably designed: (i) to ensure that a pending decision regarding the discontinuance of a credit rating is not selectively disclosed and *(ii)* to prevent inappropriate dissemination of material non-public information obtained in connection with the performance of credit rating services, in accordance with Rule 17g-4(a)(1)(3).

743. In light of the above, CESR understands that decisions to discontinue credit ratings are, in practice, disclosed by NRSROs to the public as fast as technically possible to reduce the above mentioned risks.

744. In addition, it is noted that an NRSRO must provide a description of the procedures to withdraw, or suspend the maintenance of, credit ratings in their Form NRSRO (Exhibit 2).

745. An NRSRO is also required to retain a record showing for all outstanding credit ratings all rating actions and the date of such actions and any external and internal communications that relate to initiating, determining, changing or withdrawing a credit rating in accordance with Rule 17g-2. The NRSRO must promptly furnish to the SEC any records that are requested by it (Rule 17g-2).

746. In the US there is no requirement to disclose the reasons for a decision to discontinue a credit rating. However, as indicated in paragraph 180 above, CESR considers that it can accept such a difference in assessing the equivalence of a third country regulatory framework, provided that, at a minimum, there is a requirement to disclose the decision to discontinue credit rating itself.

747. CESR points out that the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 both direct the SEC to require each

NRSRO to publicly disclose information on initial ratings and subsequent changes to such ratings. The disclosures would be required to be clear and informative and would need to be published and made freely available by the NRSRO on an easily accessible portion of its website and in written form when requested by investors.

Box 27

Disclosure of any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner

748. In the US, an NRSRO is required to disclose credit ratings on the Internet or through another readily accessible means to meet the statutory definition of "credit rating agency".

749. There is no requirement for credit ratings and decisions to discontinue credit ratings to be disclosed to the public in a timely and non-selective manner.

750. CESR considers that, despite the lack of the aforesaid specific legal requirement in the US, the objective of the relevant EU requirement is achieved, in practice, in a different way, through the provisions imposed on an NRSRO to have written procedures reasonably designed to prevent the misuse of material, non-public information and the inappropriate dissemination within and outside the NRSRO of a pending credit rating action.

Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings

751. The US regulatory framework ensures that a NRSRO does not use the name of any relevant authority in such a way that it would indicate or suggest endorsement for approval by that authority of the credit ratings or any credit rating activities of the CRA by a prohibition in the Exchange Act.

752. As indicated by the SEC staff in their answer, Section 15E(f) of the Exchange Act states that it shall be unlawful for any NRSRO to represent or imply in any manner whatsoever that such NRSRO has been designated, sponsored, recommended, or approved, or that the abilities or qualifications thereof have in any respect been passed upon, by the United States or any agency, officer, or employee thereof.

Box 28

Ban to use the name of the competent authority in a way to indicate endorsement or approval of credit ratings

753. CESR considers that the objective of the relevant EU requirement is met, since an NRSRO is prohibited to represent or imply that such NRSRO has been designated, sponsored, recommended, or approved, or that the abilities or qualifications thereof have in any respect been passed upon, by the SEC.

Unsolicited credit ratings

754. The EU Regulation provides that credit rating agencies shall have a clear and fair policy in relation to the determination of unsolicited credit ratings. In addition, the EU Regulation prescribes that unsolicited credit ratings must be differentiated as such. When issuing an unsolicited credit rating,

a CRA is required to prominently state in the credit rating whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party.

755. CESR considers that the above information is of relevance for investors to make their own assessment regarding the quality of credit ratings. In fact, while for solicited credit ratings it is likely that a rated entity participated in the determination of the credit rating and the credit rating agency had access to the books and records of the rated entity, in the case of unsolicited credit ratings it may depend on a case-by-case basis. It is therefore relevant for credit rating users to know whether, for that particular credit rating, the rated entity participated in the rating process and the credit rating agency had access to the books and records of the rated entity.

756. CESR recognises that most of the ratings issued under the subscription-based model are unsolicited. However, CESR points out that no assumption can be made that the quality and quantity of information available for the determination of credit ratings is wider in the case of credit ratings initiated upon request of the rated entity than in case of unsolicited credit ratings. In any case, the users of credit ratings should not rely blindly on credit ratings but should take utmost care to perform their own analysis and conduct appropriate due diligence at all times regarding their reliance on such credit ratings.

757. CESR anticipates that differentiation of unsolicited ratings as such and rating-by-rating disclosure requirements in relation to this type of credit ratings is an area of difference between the EU and the US regulatory systems.

758. As shown by the SEC staff in their answer, an NRSRO must have a clear and fair policy in relation to unsolicited credit ratings. Rule 17g-6 prohibits an NRSRO from conditioning or threatening to condition issuing a credit rating, issuing or threatening to issue a credit rating not in accordance with its established procedures or methodologies, or modifying or threatening to modify a rating based on whether the rated person, or affiliate of the person, purchases the credit rating or any other service or product of the NRSRO. An NRSRO that uses the threat of an unsolicited rating to influence an issuer in any manner may be subject to liability under the federal securities laws and rules thereunder.

759. As shown by the SEC staff in their answer, a specific requirement to differentiate unsolicited credit ratings and to include specific information in the disclosure of this type of ratings does not exist in the US.

760. In lieu of a rating-by-rating disclosure requirement, there is a requirement to disclose upfront, through the Form NRSRO (Exhibit 2), a sufficiently detailed description of the procedures and methodologies used to determine credit ratings within the classes of credit ratings for which the NRSRO is registered, including unsolicited credit ratings.

761. This disclosure must include, as applicable, a description of the NRSRO's policies for determining whether to initiate a credit rating and a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors. This disclosure must also include a description of the procedures for interacting with the management of the rated entity and for informing the rated entity about credit rating decisions and for appeal.

762. According to the NRSRO Instructions, "*an NRSRO may provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is located*".

763. CESR understands that, where applicable, the disclosure should provide sufficient details of the differences of procedures and methodologies to determine credit ratings for different types of products and classes of ratings.

764. Where the information disclosed in Exhibit 2 provides that, for issuing any unsolicited credit rating for a particular type of product or class of rating, the rated entity must always (or never) participate in the credit rating process and the credit rating agency must always (or never) have access to the rated entity's books and records, this should theoretically ensure that credit rating users are informed upfront about the procedures that are applied in the determination of credit ratings for that type of product or class of rating. If the NRSRO did not adhere with its disclosure, it may be subject to liability under the federal securities laws and rules thereunder.

765. As Exhibit 2 is required to be published on each NRSRO's website, in order to ensure that CESR's understanding of the extent of disclosure that is actually required to be made is correct, CESR looked at a number of NRSRO websites to get a better idea of the type of disclosure that is actually made on Exhibit 2, and it is on this basis concluding that the disclosure that is made on Exhibit 2 may not by itself be enough to enable an investor to in effect match the credit rating being published to the disclosure that had been made in Exhibit 2, and on that basis understand the process used by the NRSRO to determine that rating.

766. Credit rating users may need to look at information that is published on the NRSRO's website on a voluntary basis that is not incorporated in Exhibit 2 of the Form NRSRO.

767. In addition, it is noted that, if the disclosure in Exhibit 2 gives enough flexibility to the NRSRO to decide on a case-by-case basis on the participation of the rated entity in the credit rating process and on the need for the NRSRO to access to the rated entity's books and records, then, in the absence of a specific rating-by-rating disclosure requirement, it would be impossible for credit rating users to be informed about whether the credit rating agency had access to the rated entity's books and records or whether the rated entity itself was determined in the process for determining that particular credit rating.

768. The above information would instead be available to the SEC. As discussed above, according to Rule 17g-2, an NRSRO must make, keep, and provide to the SEC upon request, among other things: (i) records in respect of each current credit rating of the NRSRO indicating whether the credit rating was solicited or unsolicited; (ii) external and internal communications received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining changing or withdrawing a credit rating.

769. CESR points out that, on September 17, 2009, the SEC adopted an amendment to Rule 17g-5 to facilitate unsolicited credit ratings from NRSROs that were not hired by issuers, sponsors, or underwriters to rate particular asset-backed securities (ABS) and other structured finance products by enabling these "non-hired NRSROs" to access the same rating-related information as "hired NRSROs". The amendment entered into force on February 2, 2010 with a compliance date on June 2, 2010.

770. CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 direct the SEC to issue rules requiring each NRSRO to disclose information on the data used and relied upon in the determination of the credit rating, on a rating by rating basis.

Box 29

Unsolicited credit ratings

771. CESR considers that the objective of the EU requirement to enable credit rating users to identify unsolicited credit ratings is not met.

772. There is no requirement for unsolicited credit ratings to be clearly identified as such. The information is only available to the SEC.

773. As it is impossible for credit rating users to identify whether a credit rating is solicited or unsolicited without a specific disclosure requirement on a rating-by-rating basis, CESR considers that one way of bridging the gap between the differences in the EU and the US is to require that an NRSRO makes a differentiation between solicited and unsolicited ratings, on a rating by rating basis.

774. This requirement will make it easier for a credit rating user to match the description of the process and methodology that was used to determine the credit rating with the credit rating itself.

775. CESR considers that the objective of the EU requirement to enable credit rating users to be informed about whether a rated entity participated in the process for determining an unsolicited credit rating or if a credit rating agency had access to the rated entity's books and records is not fully met.

776. There is no requirement to disclose this information on a rating-by-rating basis. Instead, there is upfront disclosure of a description of the methodologies for determining unsolicited credit ratings, which must be sufficiently detailed and cover a description of the public and non-public sources of information used in determining credit ratings and the procedures for interacting with the management of the rated entity.

777. In those cases where the disclosure about the methodologies provides that participation of the rated entity and access to the rated entity's books and records may vary on a case-by-case basis, depending on the discretion of the NRSRO itself. CESR does not consider disclosure to be sufficient in meeting the objective of the EU requirement.

778. CESR considers that a way of bridging the gap between the US and the EU in respect of this requirement in these cases is to require the NRSRO to include a statement, on a rating by rating basis, about whether or not the rated entity participated in the process for determining the credit rating and whether or not the credit rating agency had access to the rated entity's books and records.

779. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010, that directs the SEC to prescribe rules to require NRSROs to publish information on a rating by rating basis, could make a significant change in the right direction to meet the objectives of this requirement.

780. CESR notes that according to the instructions to Exhibit 2 of the Form NRSRO that an applicant "may" provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is included, CESR considers that it should always be the case that such reference is made in order to ensure that users of the NRSRO's credit ratings can always match the rating to the specific methodology used to determine it.

Explanation of the key elements underlying the credit rating in the press releases or reports

781. As shown by the SEC staff in their answer, the US regulatory framework does not contain a specific rule requiring NRSROs to explain in its press releases or reports the key elements underlying the credit rating when announcing a credit rating.

782. As indicated in paragraph 180 above, CESR considers that the third country legal and regulatory framework shall ensure that the public receives information about the key elements of the credit ratings, but can accept that the third country rules do not prescribe that these elements are to be provided in the press releases or reports.

783. In the US, there are no rating-by-rating disclosure requirements, but a requirement to disclose upfront a description of the procedures and methodologies used to determine credit ratings in Exhibit 2 of the Form NRSRO. The disclosure must be sufficiently detailed and contain the information listed in paragraph 268 above.

784. In addition, an NRSRO is required to disclose to define, as part of Exhibit 1 of the Form NRSRO, the credit rating categories, notches, grades, and rankings used by the NRSRO and explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics.

785. CESR highlights that the bill of Restoring American Financial Stability Act of 2010 contains a proposal to entrust the SEC with rule-making powers to direct the contents of disclosure of each credit rating, including the main assumptions underlying the rating, information on the uncertainty of ratings, information related to conflicts of interest and other information to allow investors and users of credit ratings to better understand the rating. The details of the proposal are provided in paragraphs 731 to 732 above and paragraph 867.

786. The bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes to direct the SEC to require similar information to be disclosed by NRSRO on a rating-by-rating basis.

Box 30

Explanation of the key elements underlying the credit rating in the press releases or reports

787. CESR considers that the objective of the EU requirement to enable credit rating users to be informed about the key elements underlying each credit rating is not met.

788. There is no requirement in the US to explain the key elements underlying the credit rating when announcing a credit rating.

789. Instead of a rating-by-rating disclosure requirement, there is upfront disclosure in Form NRSRO of: (i) a sufficiently detailed description of the procedures and methodologies used to determine credit ratings, (ii) the definitions of credit rating categories, notches, grades, and rankings used by the NRSRO; (iii) an explanation of the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics.

790. CESR considers that a way of bridging the gap between the differences in the US and EU in relation to this set of requirements, is to require an NRSRO to disclose the assumptions underlying the credit rating on a rating by rating basis. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring

American Financial Stability Act of 2010 could make a significant change in the right direction to meet the objectives of this requirement.

Historical performance data

791. According to the EU Regulation, a credit rating agency is required to disclose information on its historical performance data, including the ratings transition frequency and information about credit ratings issued in the past and on their changes.

792. The disclosure requirement is intended to allow interested parties to understand the historical performance of each rating category and if and how rating categories have changed.

793. An NRSRO is required to disclose in Form NRSRO credit rating performance measurement statistics over short-, mid-, and long perm periods, as applicable (Section 15E(a)(1)(B)(i) Exchange Act).

794. In particular, Rule 17g-1 and Form NRSRO (Exhibit 1) require the disclosure of the NRSRO's ratings performance statistics for each class of credit ratings for which the NRSRO is registered. The performance measurement statistics must at a minimum show the performance of credit ratings in each class over 1 year, 3 year, and 10 year periods (as applicable) through the most recent calendar year-end, including, as applicable: historical ratings transition and default rates within each of the credit rating categories, notches, grades, or rankings used by the NRSRO as an indicator of the assessment of the creditworthiness of an obligor, security, or money market instrument in each class of credit rating. The default statistics must include defaults relative to the initial rating. The information in Exhibit 1 is made available to the public on the NRSRO's website.

795. In addition, Rule 17g-2(d) requires NRSROs with 500 or more issuer-paid credit ratings in a class of credit rating to publicly disclose on their website the ratings action information for 10% of the current credit ratings in that class ("10% requirement"). The disclosure needs not to be made public less than six months from the date such rating action is disclosed.

796. Pursuant to an amendment to that rule adopted on September 17, 2009 that entered into effect on February 2, 2010 with a compliance date on June 2, 2010, NRSRO must publicly disclose on their website the ratings history information for all current credit ratings initially determined by the NRSRO on or after June 26, 2007 ("100% requirement"). The requirement applies to all credit ratings regardless of the business model under which they are determined, not only to issuer-paid credit ratings.

797. Also in this case there is a grace period between the time the rating action occurs and the requirement to disclose the information. In the case of issuer-paid credit ratings, each new rating action will be required to be reflected in such publicly disclosed histories no later than twelve months after it is taken, while in the case of rating actions that are not issuer-paid, each new rating action will be required to be reflected no later than twenty-four months after it is taken. The delay is intended to address the concerns regarding the potentially disproportionate negative effects such a disclosure requirement could have on NRSRO's operating under the subscriber-paid business model in the absence of a sufficiently long delay between the time a ratings action is taken - and made available to paid subscribers - and the time that ratings action must be made public.

798. The new "100% requirement" is designed to facilitate individual comparisons of NRSRO rating performances and to allow market observers to generate statistics about NRSRO performances by

compiling and processing the information in the aggregate, by fostering greater accountability and transparency of credit rating agencies and increasing competition.

799. In addition, Rule 17g-3(a)(6) requires an NRSRO to furnish to the SEC (but does not require it to disclose) an unaudited report indicating, for each class of credit rating for which the NRSRO is registered, the number of upgrades, downgrades, placements on watch, or withdrawals taken during the year.

800. CESR points out that the bill of "Wall Street Reform and Consumer Protection Act of 2009" directs the SEC to require each NRSRO to establish and maintain, on a publicly accessible Internet site, a facility to disclose, in a central database, the historical default rates of all classed of financial products rated by the NRSRO.

801. In addition, the proposed amendments under the bill of Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 direct the SEC to require each NRSRO to disclose, on a rating-by-rating basis, information on the historical performance of the rating.

Box 31

Historical performance data

802. CESR considers that the objective of the EU requirement to enable credit rating users to be informed about historical performance data is met.

803. NRSROs are required to disclose credit ratings performance statistics for each class of credit ratings for which they are registered over 1 year, 3 year, and 10 year periods.

804. In addition, CESR highlights that recent amendments to the SEC Rules have reinforced the requirement to disclose credit rating actions, regardless of the business model adopted by the NRSRO.

Details of the lead rating analyst and the person primarily responsible for approving the rating

805. According to the EU Regulation, credit rating agencies are required to indicate in their credit ratings the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating.

806. As indicated in paragraph 180 above, for the purposes of assessing the equivalence of a third country legal and regulatory framework, CESR can accept that this information is not to be disclosed in the credit rating, provided at a minimum that the credit rating agency keeps appropriate records of this information.

807. In the US, there is no requirement for the NRSRO to provide this information in the disclosure of credit ratings. Nonetheless, the SEC is in the position to get all relevant information.

808. According to Rule 17g-2(a)(2), the NRSRO has to make and keep records with respect to each current credit rating of the NRSRO, indicating, among other things: (i) the identity of any credit analyst(s) who participated in determining the credit rating, and (ii) the identity of the person(s) that approved the credit rating before it was issued.

Box 32

Details of the lead rating analyst and the person primarily responsible for approving the rating

809. CESR considers that, although the information is available to the SEC only, and not disclosed in individual credit ratings, the objective of the EU requirement to identify the lead rating analyst and the person primarily responsible for approving each credit rating is met.

810. An NRSRO is required to make and keep records of this information with respect to each of its current credit ratings.

Indication of all substantially material sources

811. The EU Regulation requires credit rating agencies to indicate in the credit ratings all substantive material sources used to prepare the rating, and whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure.

812. As shown by the SEC staff in their answer, NRSROs are not specifically required to ensure that individual credit ratings contain such information.

813. Instead of a rating-by-rating disclosure requirement, there is an upfront disclosure of a description in the Form NRSRO (Exhibit 2) of the procedures and methodologies used in determining credit ratings. This disclosure must include, among other things, a sufficiently detailed description of the public and non-public sources used in determining credit ratings, including information and analysis provided by third-party vendors. The disclosure must also include a description of the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments. CESR understands that the disclosure should provide details of the differences that may apply depending on the type of products and class of ratings.

814. As indicated in paragraphs 731 to 732 above, the bill of Restoring American Financial Stability Act of 2010 contains a proposal to entrust the SEC with rule-making powers to direct the contents of disclosure of each credit rating, including disclosure about the data about the issuer used in determining the rating, whether third-party due diligence reports have been used and other information to allow investors and users of credit ratings to better understand the rating.

815. CESR highlights that the bill of "Wall Street Reform and Consumer Protection Act of 2009" contains similar proposals designed to ensure disclosure, on a rating-by-rating basis, of the data relied on by the NRSRO in the determination of the credit rating.

Box 33

Indication of all substantially material sources

816. CESR considers that the objective of the EU requirement to enable credit rating users to be informed about all material sources used to determine an individual credit rating is not met.

817. There is a requirement to make publicly available, in Exhibit 2 of the Form NRSRO, a description of the public and non-public sources used in determining credit ratings.

818. However, there is no requirement to disclose information about the specific sources that were substantially material in the determination of a particular credit rating.

819. CESR considers that a way of bridging the gap between the differences in the EU and the US is to require an NRSRO on a rating by rating basis, to indicate all substantial material sources of information used to prepare the rating. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 could make a significant change in the right direction to meet the objectives of this requirement.

Indication of the principal methodology or methodology version used

820. According to the EU Regulation, credit rating agencies are required to clearly indicate the principal methodology or version of methodology that was used in determining the credit rating, with a reference to its comprehensive description. Where the credit rating is based on more than one methodology, or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, the credit rating agency shall explain this fact in the credit rating and indicate how the different methodologies or these other aspects are taken into account in the credit rating.

821. The information on the specific methodology used in determining a specific credit rating is necessary for credit rating users to make their own assessment on the reliance on such credit rating.

822. As shown by the SEC staff in their answer, NRSROs are not specifically required to ensure that the above information is included in the disclosure of individual credit ratings.

823. Instead of a rating-by-rating disclosure requirement, there is an upfront disclosure of the methodologies used in determining credit ratings in the Form NRSRO. Namely, Rule 17g-1 and Form NRSRO require an NRSRO to include in Exhibit 2 of Form NRSRO a description of the quantitative and qualitative models and metrics used to determine credit rating.

824. The disclosure must be sufficiently detailed. Therefore, CESR understands that such disclosure must give evidence of differences, if any, in the methodologies used to determine credit ratings for different classes of rating or different types of product. The NRSRO must adhere to the disclosure. In case of non-adherence, it may be subject to liability under the federal securities laws and rules thereunder.

825. However, where it is disclosed that more than one methodology can be used to determine a class of rating or a rating for a particular product, or when only the principal methodology is disclosed, it is not ensured that credit ratings users receive information about how the different methodologies or other important aspects apart from the principal methodology are taken into account by the NRSRO in determining a particular credit rating.

826. Rule 17g-2(a)(6) requires an NRSRO to make and retain a record documenting the established procedures and methodologies used by the NRSRO to determine credit ratings.

827. CESR highlights that the proposed amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" direct the SEC to require an NRSRO to notify persons who have access to the credit rating of

the NRSRO about the procedure or methodology used with respect to a particular credit rating as well as about changes made to that procedure or methodology.

Box 34

Indication of the principal methodology or methodology version used

828. There is no requirement to disclose the principal methodology or version of methodology used on a rating-by-rating basis. However, there is an upfront disclosure in Exhibit 2 of the Form NRSRO of the methodologies used in determining credit ratings. CESR understands that, where applicable, this disclosure must highlight differences in methodologies used for different classes of rating or types of products.

829. CESR highlights that, where an NRSRO discloses in Exhibit 2 that only one methodology may be used in relation to a particular class of rating or type of product, that credit rating users are informed upfront about the methodology used for determining each credit rating of that particular class or type of product.

830. CESR notes that, where an NRSRO discloses upfront that more than one methodology can be used to determine a class of rating or a rating for a particular product, or when only the principal methodology is disclosed, it is not ensured that credit ratings users receive information about how the different methodologies or other important aspects apart from the principal methodology have been taken into account by the NRSRO in determining a particular credit rating.

831. However, CESR considers that this case would be mostly of relevance for credit ratings of structured finance products. CESR's conclusions in relation to the requirements for disclosure of ratings of structured finance products are set out in Box 38.

832. In light of the above, CESR considers the objective of the EU requirement to be broadly met.

Meaning of each rating category, the definition of default or recovery and any appropriate risk warning

833. The EU Regulation requires credit rating agencies to explain the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings.

834. Rule 17g-1 and Form NRSRO require an NRSRO to define, as part of Exhibit 1, the credit rating categories, notches, grades, and rankings used by the NRSRO and explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics.

835. CESR highlights that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 direct the SEC to require an extensive disclosure of risk warnings on a rating-by-rating basis. The disclosure would cover, among other things, information on the certainty/uncertainty and potential volatility of the credit rating and on the types of risks that are not measured by the credit rating.

Box 35

Meaning of each rating category, the definition of default or recovery and any appropriate risk warning

836. CESR considers the objective of this EU requirement to allow credit rating users to be informed about the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, to be met.

837. There is an upfront requirement to disclose credit rating categories, notches, grades, and rankings used by the NRSRO and explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics.

Date of first release of the credit rating for publication as well as of its last update

838. The EU Regulation requires credit rating agencies to indicate clearly and prominently the date at which the credit rating was first released for distribution and when it was last updated.

839. As shown by the SEC staff in their answer, in the US there is no such requirement. Rule 17g-1 and Form NRSRO require an NRSRO to disclose the date the NRSRO began to issuing credit ratings in each class, not the date when a specific credit rating was first released for distribution or lastly updated.

840. Rule 17g-2(a)(8) requires an NRSRO to make and retain a record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor.

841. In addition, the 100% requirement discussed in paragraph 796 above provides that an NRSRO must publicly disclose the ratings history information for all current credit ratings - issuer-paid, subscriber-paid, or unsolicited credit ratings - initially determined by the NRSRO on or after June 26, 2007.

Box 36

Date of first release of the credit rating for publication as well as of its last update

842. There is no specific requirement to indicate in each credit rating the date at which the credit rating was first released for distribution and when it was last updated

843. However, information about all rating actions and the date of such actions is to be recorded and made available upon request to the SEC. In addition, the SEC reinforced public disclosure about credit rating history by introducing the "100% requirement" referred to in paragraph 796 above.

Information on whether the credit rating concerns a newly financial instrument and whether the credit rating agency is rating it for the first time

844. As shown by the SEC staff in their answer, NRSROs are not specifically required to provide information on whether a credit rating concerns a newly issued financial instrument and whether the credit rating agency is rating the financial instrument for the first time.

845. As indicated in paragraph 180 above, for the purposes of assessing the equivalence of a third country legal and regulatory framework, CESR can accept that credit rating agencies in a third country are not specifically required to disclose such information, provided that, at a minimum, it is ensured that attributes and limitations of the credit ratings are disclosed.

Attributes and limitation of credit ratings

846. As shown by the SEC staff in their answer, an NRSRO is not required to state clearly and prominently any attributes and limitations of the credit rating when disclosing credit ratings.

847. CESR highlights that the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 contain a proposal to entrust the SEC with rule-making powers to direct the contents of disclosure of each credit rating, including potential limitations of the credit ratings, information on the uncertainty of ratings and the NRSRO's assessment of the quality of data available and considered. The details of the proposal are provided in paragraph 731 to 732 above.

Box 37

Attributes and limitation of credit ratings

848. In the US, there is no requirement to disclose limitations and attributes of individual credit ratings. In addition, as indicated in Box 26 above, there is not a requirement for an NRSRO to refrain from issuing credit ratings if it does not have sufficient quality information to base its rating on.

849. CESR therefore considers the objective of this EU requirement not to be met.

850. CESR considers that the gap between the differences in the EU and the US requirements can be bridged by requiring an NRSRO to disclose on a rating by rating basis information regarding the attributes and limitation of each credit rating. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 could make a significant change in the right direction to meet the objectives of this requirement.

Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products

851. As indicated in paragraphs 183 to 184 above, taking into account the complexity of structure finance products, the EU Regulation contains a number of requirements on the disclosure of credit ratings for structured finance products, additional to those generally related to the presentation of any credit ratings.

852. Those additional requirements are designed to ensure that credit rating users may receive appropriate information regarding credit ratings for such type of products, in view of their complexity.

853. CESR can accept that the third country legal and regulatory framework does not include identical additional requirements for ratings of structured finance products. However, as stated in paragraph 186 above, CESR considers that, at a minimum, information is to be disclosed about the level of assessment, if any, conducted by the credit rating agency on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments.

How do these requirements compare to those required for the objectives to be met

854. As shown by the SEC staff in their response, currently, the US regulatory framework does not require a differentiation between the labelling of ratings for structured products and credit ratings for other types of financial instruments by for example adding a specific symbol.

855. On November 23, 2009, the SEC announced that it is deferring consideration of action with respect to a proposed rule that would have required an NRSRO to include, each time it published a credit rating for a structured finance product, a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments, or, alternatively, to use distinct ratings symbols for structured finance products that differentiated them from the credit ratings for other types of financial instruments.

856. The SEC staff expressed concerns that the proposal, if adopted, could have limited utility in achieving the goal of promoting independent analysis and understanding of the distinct risks of structured finance products. Furthermore, the SEC staff expressed concerns that mandating a distinct symbology could create the inaccurate impression that the SEC staff believes other types of debt instruments are less risky. The SEC staff indicated that they believe a more effective way to differentiate credit ratings for structured finance products may be by enhancing investor understanding of the distinct risk characteristics of these debt instruments and their credit ratings.

857. On the same date (November 23, 2009), the SEC solicited comments regarding alternative measures that could be taken to differentiate structured finance credit ratings and the risks relating to structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example enhanced disclosures of information.

858. Specifically, the SEC requested market participants and others to provide their views in the following four areas: (1) the differences between structured finance products and other debt instruments; (2) the differences between credit ratings for structured finance products and credit ratings for other types of debt instruments; (3) potential measures to communicate differences in structured finance products to investors; and (4) potential measures to communicate differences in structured finance credit ratings to investors.

859. Respondents were invited, among other things, to comment on the following types of information that NRSRO might be required to disclose:

a) *"The diligence that is performed by or provided to the NRSRO about the underlying assets, and quality control of numerical data provided to the NRSRO;*
b) *The characteristics and sensitivities of models used or relied upon by the NRSRO in assessing the likely performance of the structured finance product or the underlying assets;*
c) *The extent to which the NRSRO relies on representations and warranties made by transaction participants;*
d) *The assumptions as to future events and economic conditions that are embedded in the analytical models used by the NRSRO in arriving at a given rating;*

e) *Publishing "what if" scenario analyses that address the ratings implications of changes in the underlying assumptions upon which ratings are based and provide insight into ratings tolerance to changing economic or risk circumstances;*

f) *Providing additional information relating to default probability, loss sensitivity, severity of loss given default, short-tail and long-tail risk and similar risk metrics associated with each class of credit ratings".*

860. The public consultation ended on February 2, 2010. The SEC has not submitted proposals concerning these alternative measures to differentiate structured finance credit ratings yet.

861. The bill of Restoring American Financial Stability Act of 2010 (Section 938) and the bill of "Wall Street Reform and Consumer Protection Act of 2009" direct the SEC to issue rules requiring each NRSRO to clearly define any symbols used to denote a credit rating and apply any such symbols in consistent manner to all types of securities and money market instruments to which they are applied.

862. In addition, the bill of "Wall Street Reform and Consumer Protection Act of 2009" proposes that the SEC may prescribe rules that require NRSROs to establish credit rating symbols that distinguish credit ratings for structured products from credit ratings for other products that the SEC determines appropriate or necessary in the public interest and for the protection of investors.

863. In the US there are no specific requirements on a rating-by-rating basis regarding disclosure of credit ratings for structured products. As shown by the SEC staff in their answer, an NRSRO is not required to disclose whether it has undertaken any assessment of the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments or whether it has relied on a third-party assessment and to indicating how the outcome of such assessment impacts the credit rating.

864. However, there are upfront requirements to disclose in the Form NRSRO a sufficiently detailed description of the methodologies used in determining credit ratings, as well as some specific record-keeping requirements concerning credit ratings for security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, as detailed below.

865. Pursuant to Rule 17g-1 and Exhibit 2 to Form NRSRO, the description to be disclosed regarding the methodologies and procedures used in determining credit ratings must include, among other things: (i) a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; (ii) whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; (iii) the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings. An NRSRO that did not adhere to its disclosures may be subject to liability under the federal securities laws and rules thereunder.

866. In this respect, it is noted that the bill of Restoring American Financial Stability Act of 2010 contains proposals designed to enhance rating-by-rating disclosure requirements. As stated above, under the proposed Section 932(5), the SEC would be empowered to require NRSROs to publish with each rating a form which discusses, among other things, (i) whether third-party due diligence reports have been used, (ii) the NRSRO's assessment of the quality of data available and

considered, (iii) other information that the SEC may require. Similar provisions are contained in the bill of "Wall Street Reform and Consumer Protection Act of 2009."

867. In addition, the proposed amendments under the bill of Restoring American Financial Stability Act of 2010 (Section 932) would require third-party due diligence services to certify (in a form and content to be established by the SEC) that they have conducted a thorough review of data, documentation, and other relevant information necessary for the NRSRO to provide an accurate rating. NRSROs shall make such certifications public, in order to allow the public to determine the adequacy of third-party due diligence services. A similar rule is proposed to be included (for all credit ratings) in the bill of "Wall Street Reform and Consumer Protection Act of 2009".

868. Rule 17g-2(a)(2)(iii) provides that, if a quantitative model was 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, an NRSRO is required to make a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued.

869. In addition, Rule 17g-2(a)(7) requires an NRSRO to keep a record that lists each security and money market instrument and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the NRSRO, in determining the credit rating for the security or money market instrument, treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the NRSRO by any or a combination of the following methods: (1) determining credit ratings for the unrated assets; (2) performing credit assessments or determining private credit ratings for the unrated assets; (3) determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration the internal credit analysis of another person; or (4) determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration (but not necessarily adopting) the credit ratings of another NRSRO.

870. According to Rule 17g-2(a)(9), an NRSRO is required to keep internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another NRSRO for the purpose of determining a credit rating for a security or money market instrument issued by an asset pool or part of any asset-backed or mortgage-backed securities transaction. Moreover, under Rule 17g-2(a)(10), for each of those securities or money market instruments, an NRSRO must keep any document that contains a description of how assets within such pool or as a part of such transaction not rated by the NRSRO but rated by another NRSRO were treated for the purpose of determining the credit rating of the security or money market instrument.

871. The current provisions do not require an NRSRO to disclose, on an ongoing basis, information about all structured finance products submitted to it for their initial review or for preliminary rating, even when an issuer does not contract with the credit rating agency for a final rating. However, on September 17, 2009, the SEC proposed rule amendments that would require disclosure of credit ratings and related information in registration statements when ratings are used in connection with selling registered securities. The proposed information to be disclosed would include whether any "preliminary ratings" were obtained from other rating agencies, regardless of whether the issuer contracted with the credit rating agency for a final rating. The proposal has not been adopted yet.

872. CESR notes that, according to the amendments of the SEC's Rules adopted on September 17, 2009 – that entered into force on February 2, 2010 with a compliance date on June 2, 2010 - an NRSRO issuing or maintaining a credit rating for a security or money market instrument issued by an

asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument, must maintain a password-protected Internet Web site containing a list of each structured finance security or money market instrument for which it currently is in the process of determining an initial credit rating. The list must be made in chronological order and identify the type of security or money market instrument, the name of the issuer, and the date the rating process was initiated. An NRSRO must provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification stating it is accessing the Web site solely for the purpose of determining or monitoring credit ratings.

873. The NRSRO must grant access to other NRSROs that either (1) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to Rule 17g-5(a)(3) in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (2) has not accessed information pursuant to Rule 17g-5(a)(3) as amended 10 or more times in the calendar year prior to the year covered by the certification.

874. Lastly, an NRSRO required to maintain such a Web site also must obtain a written representation from the issuer, sponsor, or underwriter of the security or money market instrument (or "arranger"). Through the representation, the arranger agrees to also maintain a password-protected Internet Web site to make available to other NRSROs (and only other NRSROs) the same information it provides to the hired NRSROs, whether provided for the purpose of determining an initial rating or for monitoring a rating. Making this information available creates a mechanism requiring NRSROs hired to rate structured finance products to alert other NRSROs that an arranger has initiated the rating process and to promptly inform the other NRSROs where information being provided by the arranger to the hired NRSRO to determine the credit rating may be obtained.

Box 38

Additional disclosure requirements in respect of structured finance products

875. CESR points out that there is no requirement for a distinct labelling of ratings for structured finance products. In November 2009, the SEC announced to defer consideration of action in relation to this issue.

876. CESR considers that, despite the amendments recently introduced in the Rules, the US legal and regulatory framework does not achieve the objective of the EU requirements to enable credit rating users to be informed, for each credit rating, about the level of assessment conducted by the NRSRO on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments and about whether the NRSRO has relied on a third-party assessment and how the outcome of such assessment impacts the credit rating.

877. There are no specific requirements on a rating-by-rating basis regarding disclosure of credit ratings for structured products.

878. There is an upfront requirement to disclose publicly in the Form NRSRO a sufficiently detailed description of the methodologies used in determining credit ratings, that must include a description of whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any

asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings. CESR considers this ex-ante information not to be equivalent to the ex-post information about the effective extent of assessment conducted for each specific credit rating imposed under the EU Regulation.

879. CESR considers that a way of bridging the gap between the EU and the US in respect of these requirements is to require an NRSRO to disclosure on a rating by rating basis in respect of structured finance products the extent of due diligence that it has conducted in respect of the underlying instruments of that instrument. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010, that direct the SEC to prescribe rules to require NRSROs to publish with each rating information that the SEC may require, could make a significant change in the right direction to meet the objectives of this requirement.

880. NRSROs are subject to record-keeping requirements specifically related to the determination of credit ratings for structured finance products.

881. CESR acknowledges that, in November 2009, the SEC solicited comments on possible alternative measures for structured finance products, which may include for instance further disclosure requirements.

Box 39

DISCLOSURE OF CREDIT RATINGS

882. Overall CESR considers that this is an area where significant differences exist between the EU and the US requirements adopted to achieve the overall objectives of these requirements.

883. CESR recognises that the different approach adopted in the US, is related to the manner in which the US approaches the issue of non interference with the substance of credit ratings and the methodologies used to determine them.

884. In respect of the this set of EU requirements CESR considers that overall the US requirements do not meet the objectives of the EU requirements in relation to the areas covered by the EU requirements discussed above:

1) Unsolicited credit ratings

885. There is no requirement for unsolicited credit ratings to be clearly identified as such, the information is only available to the SEC.

886. As it is impossible for credit rating users to identify whether a credit rating is solicited or unsolicited without a specific disclosure requirement on a rating-by-rating basis, CESR considers that one way of bridging the gap between the differences in the EU and the US is to require that an NRSRO makes a differentiation between solicited and unsolicited ratings, on a rating by rating basis.

887. There is no requirement for an NRSRO to disclose on a rating by rating basis whether or not a rated entity participated in the process for determining an unsolicited credit rating or if a credit rating agency had access to the rated entity's books and records.

888. **There is an upfront disclosure requirement to provide a description of the methodologies for determining unsolicited credit ratings, which must be sufficiently detailed and cover a description of the public and non-public sources of information used in determining credit ratings and the procedures for interacting with the management of the rated entity.**

889. **CESR does not consider this requirement to be adequate in meeting the objective of the EU requirement in those cases where the disclosure about the methodologies provides that participation of the rated entity and access to the rated entity's books and records may vary on a case-by-case basis, depending on the discretion of the NRSRO itself.**

890. **CESR considers that a way of bridging the gap between the differences in US and the EU in respect of this requirement in these cases is to require the NRSRO to include a statement on a rating by rating basis about whether or not the rated entity participated in the process for determining the credit rating and whether or not the credit rating agency had access to the rated entity's books and records.**

891. **CESR notes that according to the instructions to Exhibit 2 of the Form NRSRO, that an applicant may provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is included, CESR considers that it should always be the case that such reference is made in order to ensure that users of the NRSRO's credit ratings can always match the rating to the specific methodology used to determine it.**

2) Key elements

892. **There is no requirement in the US to explain the key elements underlying the credit rating when announcing a credit rating.**

893. **CESR considers that a way of bridging the gap between the differences in the US and EU in relation to this set of requirements is to require an NRSRO to disclose the assumptions underlying the credit rating on a rating by rating basis.**

3) Indication of material sources of information

894. **There is no requirement to disclose information about the specific sources that were substantially material in the determination of a particular credit rating.**

895. **CESR considers that a way of bridging the gap between the differences in the EU and the US in respect of this requirement is to require an NRSRO on a rating by rating basis, to indicate all substantial material sources of information used to prepare the rating.**

4) Attributes and limitation of credit ratings

896. **In the US, there is no requirement to disclose limitations and attributes of individual credit ratings. In addition, as indicated in Box 26 above, there is not a requirement for an NRSRO to refrain from issuing credit ratings if it does not have sufficient quality information to base its rating on.**

897. CESR considers that the gap between the differences in the EU and the US requirements may be bridged by requiring an NRSRO to disclose on a rating by rating basis information regarding the attributes and limitation of each credit rating.

5) Additional disclosure requirements in respect of structured finance products

898. There is no requirement for a distinct labelling of ratings for structured finance products.

899. There is no requirement to disclose on a rating by rating basis information about the level of assessment conducted by the NRSRO on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments.

900. CESR considers that a way of bridging the gap between the EU and the US in respect of these requirements is to require an NRSRO to disclose on a rating by rating basis in respect of structured finance products the extent of due diligence that it has conducted in respect of the underlying instruments of that instrument.

901. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009 and the bill of Restoring American Financial Stability Act of 2010, that direct the SEC to prescribe rues to require NRSROs to publish with each rating information that the SEC may require, could make a significant change in the right direction to meet the objectives the EU requirements.

General and periodic disclosure about the credit rating agency

902. This section is aimed at assessing whether the US legal and regulatory framework achieves the objective of the general and periodic disclosure requirements referred to in paragraphs 191, 193, 195 and 197 above.

903. As indicated in paragraph 189 above, the objective of the said requirements is to ensure transparency about credit rating agencies and their activities, to provide credit rating users with information to carry out their own assessment on the reliance in the credit ratings as well to furnish the competent authority with information relevant for the purposes of the performance of its supervisory tasks.

General additional disclosure requirements

NRSRO's registration

904. The EU Regulation requires a credit rating agency to generally disclose to the public the fact that is registered.

905. Rule 17g-1(i) requires NRSROs to make publicly available on their website a copy of their updated Form NRSRO, including Exhibits from 1 to 9.

Box 40

NRSRO's Registration

906. CESR considers the US legal and regulatory framework achieves the objective of the EU requirement to enable credit rating users to know whether an NRSRO is registered or not. The Form NRSRO is to be published and to be kept updated.

List of ancillary services

907. Credit rating agencies are required under the EU Regulation to generally disclose to the public a list of ancillary services they provide.

908. As shown by the SEC staff in their response, in the US there is no such requirement.

909. Rule 17g-1 and the Form NRSRO (Exhibit 12) require an NRSRO to provide information regarding revenue derived from all other services and products offered besides credit rating services, including a description of any major source of revenue. The information is not required to be made publicly available.

910. The NRSRO is also required to provide information on the revenue from all other services and products for the fiscal year in the financial report to be provided annually to the SEC according to Rule 17g-3(a)(3).

911. CESR highlights that this disclosure contains more information than just a list of ancillary services as required by the EU Regulation, but the NRSRO is currently required to provide such information only to the SEC.

912. Rules 17g--5(a) and 17g--5(b)(3) require an NRSRO to publicly disclose and implement procedures to manage and address the conflict that arises from being paid to provide services other than credit rating services. Therefore, there is a disclosure to the public if an ancillary service gives raise to conflicts of interest.

913. In addition, it is noted that, on September 17, 2009 the SEC voted to propose an amendment to Exhibit 6 to Form NRSRO, pursuant to which an NRSRO is required to publicly disclose the percentage of its total net revenue attributable to providing services other than credit rating services.

914. The SEC also voted to propose a new rule (Rule 17g-7) that would require an NRSRO to publish on its website and annually update a consolidated report showing the following information for each person that paid the NRSRO to determine or monitor a credit rating: (1) the percentage of the total net revenue attributable to the person that is derived from providing services and products other than credit rating services to the person; (2) the relative standing of the person (e.g., top 10%, top 25% etc) in terms of providing net revenues to the NRSRO as compared with other persons who provided the NRSRO with revenue; and (3) all credit ratings outstanding that were paid for by the person.

915. The proposed amendments and rule are designed to further advance the goals of the SEC's current oversight program for NRSROs, including increasing transparency and disclosure, by allowing users of credit ratings to more effectively evaluate the integrity of an NRSRO's credit ratings and analyse whether the NRSRO is effectively managing its conflicts of interest.

916. The consultation regarding the proposed new amendments and rule ended on February 2, 2010. The SEC has not adopted the proposed amendments and rule yet.

917. CESR highlights that the bill of "Wall Street Reform and Consumer Protection Act of 2009" contains proposals similar to those discussed above.

Box 41

List of ancillary services

918. CESR considers that the EU requirement to disclose ancillary services is designed to inform credit rating users about potential conflicts of interest. CESR considers the objective of this requirement is met, taking into account that the NRSROs are required to publicly disclose, if relevant, conflicts of interest that may arise from the provision of services other than the credit rating services and to inform the SEC about revenue deriving from all services other than the credit rating services.

919. CESR highlights that the amendments and rule that the SEC voted to propose on September 2009 as well as the proposed amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" would further advance the said objective, by ensuring that information on the total net revenue from services and products other than credit rating services be available to credit rating users, and not only to the SEC.

Policy concerning the publication of credit ratings and other relevant communications

920. An NRSRO is required to briefly describe in its Form NRSRO (item 6B) how it makes the credit rating readily accessible for free or for a reasonable fee. The Form NRSRO shall be kept updated and made publicly available on the NRSRO's website.

Box 42

Policy concerning the publication of credit ratings and other relevant communications

921. CESR considers that the objective of the EU requirement to enable credit rating users to be informed about the policy for publication of credit ratings is met. The Form NRSRO must contain information about how credit ratings are published, and this information is made publicly available.

General nature of the compensation arrangements

922. As indicated in paragraph 191, the EU Regulation requires a credit rating agency to publicly disclose the general nature of its compensation arrangements. However, as outlined in paragraph 192 above, CESR can accept that in a third country credit rating agencies are required to provide this information to the competent authority only.

923. Rule 17g-1 and the Form NRSRO (Exhibit 13) require an NRSRO to provide information on the amount of total aggregate annual compensation paid to its credit rating analysts and the median compensation for the most recently completed fiscal or calendar year.

924. An NRSRO may decide not to disclose this information to the public but only to the SEC. Instead, an NRSRO is required under Rule 17g-3(a)(4) to provide similar information in an annual report submitted to the SEC.

925. CESR highlights that the bill of "Wall Street Reform and Consumer Protection Act of 2009" contains proposals designed to enhance disclosure of NRSRO's compensation arrangements to the public. Under the proposed amendments, the SEC shall require an NRSRO to disclose in an annual report the fees it has billed for the credit rating and the aggregate amount of net revenue earned by the NRSRO in the preceding 2 fiscal years attributable to the person being rated and its affiliates. An NRSRO would also be required to disclose the percent of net revenue earned for providing services and products other than credit rating services to each person who paid for a credit rating.

Box 43

General nature of the compensation arrangements

926. An NRSRO is required to disclose to the SEC the total aggregate annual and median compensation paid to its credit rating analysts.

927. CESR points out that the disclosure in the US regarding compensation arrangements is not as broad as expected by the EU requirement, since an NRSRO may decide not to make this information available to the public. However, the disclosure under the US requirement is in some respects more specific than what is required to be published under the EU Regulation.

928. Taking account of paragraph 192 above, CESR considers the objective of the relevant EU requirement to be met.

Methodologies, models and key rating assumptions and their material changes

929. Rule 17g-1 and Form NRSRO (Exhibit 2) require an NRSRO to publicly disclose a description of the procedures and methodologies used to determine credit ratings, including quantitative and qualitative models and metrics. The information in Exhibit 2 must be sufficiently detailed to allow for verification. As outlined above, CESR understands that, where different procedures and methodologies to determine credit ratings apply depending on the type of product or class of rating, those differences need to be reflected in Exhibit 2 of the Form NRSRO.

930. An NRSRO may provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is located.

931. The disclosure must be promptly amended if the information or documents provided become materially inaccurate. The NRSRO is therefore required to disclose material changes to its credit rating methodologies, models and metrics.

932. In addition, a registered NRSRO is required to provide an annual certification on Form NRSRO certifying that the information provided, including the description of its procedures and methodologies used in determining credit ratings, is accurate in all significant respects.

933. NRSROs must ensure that they comply with what they have disclosed.

934. As discussed above the proposed amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" would promote further disclosure about the procedure or methodology used with respect to a particular credit rating as well as about changes made to that procedure or methodology.

Box 44

Methodologies, models and key rating assumptions and their material changes

935. CESR considers that the objective of the EU requirement to allow credit rating users to be informed about the credit rating agencies methodologies, models and key rating assumptions, and their material changes, is met in the US.

936. An NRSRO is required to make publicly available a description of the procedures and methodologies used to determine credit ratings. The description must be sufficiently detailed, highlighting possible differences for different types of products and classes of ratings, and must be updated in case of material inaccuracies. In case of failure by the NRSRO to comply with its disclosure, the SEC has the power to take enforcement action.

937. CESR notes that according to the instructions to Exhibit 2 of the Form NRSRO, that an applicant may provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is included, CESR considers that it should always be the case that such reference is made in order to ensure that users of the NRSRO's credit ratings can always match the rating to the specific methodology used to determine it.

Material modifications to the credit rating agency's systems, resources or procedures

938. As indicated in paragraph 192 above, CESR can accept that in a third country information on the material modifications to the credit rating agency's systems, resources or procedures is disclosed to the competent authority only, instead of being made publicly available.

939. In case of material modifications to the information included in the Form NRSRO, an NRSRO is required to promptly update the information published on its website (Rule 17g-1(e)).

940. In particular, an NRSRO is required to publicly disclose material modification to the policies and procedures used to determine credit ratings, the procedures to prevent the misuse of material, non-public information, as well as the procedures to address and manage conflicts of interest.

941. Material amendments to the information disclosed regarding the NRSRO's organisational structure, its credit rating analysts, credit rating analysts' supervisors, the designated compliance officer as well as to the information on how credit ratings are made readily accessible, are also to be disclosed as an update of the Form NRSRO.

Box 45

Material modifications to the credit rating agency's systems, resources or procedures

942. CESR points out that, although there is no specific requirement in the US to disclose material amendments to all systems, resources or procedures of an NRSRO, the obligation to update the Form NRSRO ensures that both the SEC and the credit rating users are informed about material amendments of the core systems, resources and procedures of the NRSRO, including the

procedures to determine credit ratings, to manage conflicts of interest and to prevent the misuse of material non-public information.

943. Therefore, CESR considers the objective of the EU requirement to be met.

Code of conduct

944. Rule 17g-1 and the Form NRSRO (Exhibit 5) requires an NRSRO to publicly disclose information about the NRSRO's code of ethics or to explain the reasons why it does not have a code of ethics. The Instructions for Exhibit 5 require an NRSRO to attach a copy of its code of conducts, if any, to the Form NRSRO.

Box 46

Code of conduct

945. An NRSRO is required to publicly disclose information about its code of conduct. Therefore, CESR considers the objective of this requirement to be met.

Periodic additional disclosure requirements

List of the 20 largest clients and information on clients who mostly contributed to the grow rate in the generation of their revenue in the previous financial year

946. As indicated in paragraphs 193 to 194 above, for the purposes of assessing equivalence, CESR expects a third country regulatory framework to impose some form of disclosure to the public regarding the main clients of the credit rating agency, but it can accept these requirements not to be identical to the ones set out under the EU Regulation (eg not covering the 20 largest clients, not imposing to provide information on the clients who mostly contributed to the growth rate in the generation of their revenue in the previous financial year).

947. Rule 17g-3(a)(5) requires an NRSRO to furnish the SEC with annual reports that include, among other things, an unaudited report of the 20 largest issuers and subscribers that used the credit rating services provided by the NRSRO by amount of net revenue attributable to the issuer or subscriber during the fiscal year. An NRSRO is not required to make this report public, and may request that the SEC keeps the report confidential, to the extent permitted by an NRSRO.

948. On September 17, 2009 the SEC voted to propose an amendment to Exhibit 6 to Form NRSRO, pursuant to which an NRSRO is required to publicly disclose the percentage of its total net revenues attributable to providing services to its 20 largest clients. The proposed disclosure would be an aggregate in that it would be the sum of the amount of net revenue attributed to the 20 largest users of credit rating services (i.e. not 20 separate net revenue amounts). On November 23, 2009 the SEC solicited comments on the proposed amendment. The public consultation ended on February 2, 2010. The proposed amendment has not been adopted yet.

949. Furthermore, CESR points out that the bill of "Wall Street Reform and Consumer Protection Act of 2009" directs the SEC to introduce disclosure requirements vis-à-vis the public on the NRSRO's main clients and net revenues, as discussed above.

950. In addition, Rule 17g-5(c)(1) prohibits an NRSRO from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue (as reported under Rule 17g-3) equalling or exceeding 10% of the total net revenue of the NRSRO for the most recently ended fiscal year.

Box 47

List of the 20 largest clients and information on clients who mostly contributed to the grow rate in the generation of their revenue in the previous financial year

951. Taking into account paragraph 194 above, CESR considers that, although the disclosure requirements currently in place in the US regarding the largest clients are not identical to the EU requirement, the objective of the EU requirement is met, also given the prohibition for an NRSRO to issue or maintain a credit rating solicited from an issuer from which it has received more than 10% of its net annual revenues.

952. CESR highlights that the suggested amendment to the Rules would further advance the said objective, by ensuring that information regarding the percentage of the total net revenues attributable to providing services to the NRSRO's 20 largest clients be available to credit rating users, and not only to the SEC. In addition, CESR notes that the bill of "Wall Street Reform and Consumer Protection Act of 2009" also contains proposals designed at further promoting the objective of disclosure concerning the main clients of an NRSRO.

Historical default rates of rating categories

953. As stated in paragraph 196 above, CESR considers that, for the purposes of an equivalent assessment, a third country legal and regulatory framework shall require credit rating agencies to disclose to the public data about historical default rates of rating categories and their changes over time. However, CESR can accept that frequency for publication may be different from the one prescribed by the EU Regulation (every six months), as well as that no distinction be required to be made between the geographical areas of the issuers.

954. Rule 17g-1 and the Form NRSRO (Exhibit 1) require an NRSRO to make publicly available on its website performance measurement statistics that at a minimum show the performance of credit ratings in each class of rating for which the NRSRO is registered over 1 year, 3 year, and 10 year periods through the most recent calendar year-end. The disclosure must include, as applicable: historical ratings transition and default rates within each of the credit rating categories, notches, grades, or rankings used by the NRSRO as an indicator of the assessment of the creditworthiness of an obligor, security, or money market instrument in each class of credit rating. The default statistics must include defaults relative to the initial rating. However, an NRSRO is not provide to make a differentiation between the geographical areas of the issuers.

955. In addition, as indicated in paragraph 297 above NRSROs with 500 or more issuer-paid credit ratings in a class of credit rating are required to publicly disclose the ratings histories for 10% of the current credit ratings in that class. Pursuant to an amendment to that rule adopted on September 17, 2009 that entered into effect on February 2, 2010 with a compliance date on June 2, 2010, an NRSRO must publicly disclose the ratings history information for all current credit ratings - issuer-paid, subscriber-paid, or unsolicited credit ratings - initially determined by the NRSRO on or after June 26, 2007.

956. As discussed above, CESR points out that proposed changes under the bill of "Wall Street Reform and Consumer Protection Act of 2009" direct the SEC to require each NRSRO to establish and maintain, on a publicly accessible Internet site, a facility to disclose, in a central database, the historical default rates of all classed of financial products rated by the NRSRO.

Box 48

Historical default rates of rating categories

957. An NRSRO is required to publicly disclose statistics about credit rating performances over 1 year, 3 year, and 10 year periods. In addition, from June 2, 2010, any NRSRO will be required to disclose credit rating histories with respect to credit ratings initially determined on or after June 26, 2007.

958. CESR considers the objective of this EU requirement to be met.

Legal structure, ownership and revenue streams

959. The EU Regulation requires a credit rating agency to make a detailed description of its legal structure, ownership and revenue streams available to the public on an annual basis in an annual report on its Internet website. As indicated in paragraph 192 above, CESR considers that, for the purposes of an equivalence assessment, at a minimum, this information is to be provided to the competent authority.

960. Rule 17g-1 and Form NRSRO require an NRSRO to make publicly available information about its legal structure and ownership in the Form NRSRO and its Exhibits.

961. In particular, item 2 of the Form NRSRO requires details of the legal status (corporation, limited liability company, partnership, other) and of the place and date of formation.

962. Item 3 of the Form NRSRO requires to identify any separate legal entity or a separately identifiable department or division thereof ("credit rating affiliate") that issue credit ratings on behalf of the person furnishing the Form NRSRO to the SEC. The Form NRSRO must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, personnel, and organisational structure of each of those credit rating affiliates.

963. Exhibit 4 of the Form NRSRO requires an NRSRO to provide the following information concerning the NRSRO's organisational structure: (i) an organisational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the NRSRO; (ii) an organisational chart showing the divisions, departments, and business units of the NRSRO; and (iii) an organisational chart showing the managerial structure of the NRSRO, including the designated compliance officer.

964. Exhibit 2 of Form NRSRO requires NRSROs to provide, among other things, a description of the structure and voting process of committees that review or approve credit ratings.

965. Financial information regarding the NRSRO's aggregated revenue streams is to be furnished to the SEC according to Rule 17g-3(a)(3). An NRSRO may request that the SEC keeps such information confidential to the extent permitted by law.

966. In addition, Rule 17g-1 and Form NRSRO (Exhibit 12) require an NRSRO to disclose to the public or, where this information is qualified as confidential, to the SEC only information on the following

revenues: (i) revenue from determining and maintaining credit ratings, (ii) revenue from subscribers; (iii) revenue from granting licenses or rights to publish credit ratings; and (iv) revenue from all other services and products offered by the credit rating organisation. The disclosure must include a description of any major sources of revenue.

967. In case of material changes, the information provided in the Form NRSRO is to be updated. In addition, the NRSRO must provide an annual certification, certifying that the information provided is accurate in all significant respects.

968. As discussed above, on September 17, 2009 the SEC voted to propose rule amendments that would require an NRSRO: (1) to disclose additional information about sources of revenues on the Form NRSRO (Exhibit 6); and (2) to make publicly available a consolidated report containing information about revenues of the NRSRO attributable to persons paying the NRSRO for the issuance or maintenance of a credit rating. The consultation about the proposed amendments ended on February 2, 2010. The proposed amendments have not been adopted yet.

969. Further amendments to introduce disclosure requirements vis-à-vis requirements on the revenue of an NRSRO are contained in the bill of "Wall Street Reform and Consumer Protection Act of 2009", as discussed above.

Box 49

Legal structure, ownership and revenue streams

970. Taking account of paragraph 192 above, CESR considers that the objective of the EU requirement to provide information about the credit rating agency's legal structure, ownership and revenue stream is met.

971. CESR points out that, while the information about the NRSRO's legal structure and ownership is to be made publicly available, the information regarding the revenue stream needs only to be provided to the SEC.

Internal control mechanisms ensuring quality of credit rating activities

972. CESR understands that that the compliance officer is responsible for all internal controls ensuring quality of credit rating activities.

973. As mentioned above, pursuant to Rule 17g-1 and Form NRSRO, an NRSRO must publicly disclose on Form NRSRO, among other things, (1) a description of its procedures and methodologies used in determining credit ratings; (2) its methodologies for monitoring credit ratings; (3) its policies for preventing the misuse of material non-public information; (4) its code of ethics; (5) the conflicts of interest inherent in its activities and its policies for managing conflicts of interest; (6) the general qualifications of the firm's credit analysts; and (7) the identification and qualifications of the firm's designated compliance officer.

Box 50

Internal control mechanisms ensuring quality of credit rating activities

974. CESR considers that the US legal and regulatory framework achieves the objective of allowing credit rating users to be informed about internal control mechanisms adopted by the credit rating agency to ensure the quality of its credit rating activities.

975. An NRSRO is required to make publicly available on its Form NRSRO, among other things: (1) a description of its procedures and methodologies used in determining credit ratings; (2) its methodologies for monitoring credit ratings; (3) its policies for preventing the misuse of material non-public information; (4) its code of ethics; (5) the conflicts of interest inherent in its activities and its policies for managing conflicts of interest; (6) the general qualifications of the firm's credit analysts; and (7) the identification and qualifications of the firm's designated compliance officer.

Record keeping policy

976. In the US, there is no requirement per se to have a record keeping policy. However, an NRSRO must comply with the record-keeping obligations set out by Rule 17g-2.

977. The designated compliance officer is responsible for ensuring compliance with the securities laws and regulations, including record-keeping requirements.

978. In case of non-compliance with the record-keeping requirements, an NRSRO may be subject to liability under the federal securities laws and rules thereunder.

979. As shown by the SEC staff in their answer to, since there is no requirement to have a record-keeping policy per se, an NRSRO is not required to publicly disclose information on its record keeping policy, nor to furnish this information to the SEC.

Box 51

Record keeping policy

980. CESR points out that, although NRSROs are subject to extensive record-keeping requirements and such records are available to the SEC, there is no requirement per se to have a record-keeping policy. Consequently, there are no requirements to disclose such a policy.

Management and rotation policy

981. According to the EU Regulation, credit rating agencies shall disclose annually information on their management and rating analyst rotation policy.

982. As shown by the SEC staff in their answer, there is no such requirement in the US because there is no requirement per se to have a rotation policy.

983. An NRSRO is required to make publicly available the conflicts of interest inherent in its activities as well as its policies for managing conflicts of interest. These policies could include, if applicable, analyst rotation policies.

Box 52

Management and rotation policy

984. CESR points out that there is no requirement per se to have a rotation policy. Consequently, there is no requirement to disclose such policy.

985. However, CESR highlights that NRSROs are subject to extensive disclosure obligations towards the public in relation to the conflicts of interest inherent to their activities and their procedures to manage conflicts of interest.

Statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management

986. As shown by the SEC staff in their answer, the US legal regulatory framework does not require NRSROs to publish statistics on staff allocation to new credit ratings, credit rating reviews, methodology or model appraisal, and senior management.

987. However, pursuant to Rule 17g-1 and Form NRSRO (Exhibit 8), an NRSRO is required to disclose both its total number of credit ratings and its total number of analysts and analyst supervisors, which allow calculations of analyst-to-ratings ratios and provides information on a NRSRO's managerial ranks. Rule 17g-1 and Form NRSRO (Exhibit1) also require the disclosure of the NRSRO's ratings performance statistics (e.g., default and transition statistics over 1, 3, and 10 year time periods) for each class of credit ratings for which the NRSRO is registered. The updated Form NRSRO has to be available for as long as the NRSRO is registered with the SEC. The content of the document changes over time, as it is a living document that has to be updated regularly in case of material inaccuracies.

988. In addition, Rule 17g-3(a)(6) requires an NRSRO to furnish to the SEC (but does not require the NRSRO to disclose publicly) an unaudited report indicating, for each class of credit rating for which the NRSRO is registered, the number of upgrades, downgrades, placements on watch, or withdrawals taken during the year.

989. As indicated in paragraph 198 above, CESR can accept for the purposes of an equivalence assessment that there is no requirement to disclose the said statistics in a third country legal and regulatory framework.

Box 53

Statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management

990. CESR points out that, in the US, the focus with regard to statistics is different and less detailed than in the EU Regulation. However, taking account of paragraph 198 above, CESR considers this minor aspect as less important towards the equivalence of the whole regulatory framework and makes no recommendation in this respect.

Outcome of the annual internal review of their independent compliance function

991. As indicated by the SEC staff in their answer, an NRSRO is not required to make available annually information on the outcome of the annual internal review of its designated compliance officer.

992. An NRSRO is required to publicly disclose information on the identification and qualification of the designated compliance officer.

993. On September 17, 2009 the SEC voted to propose an amendment to the Rules that would require an NRSRO to submit to the SEC an annual report pursuant to Rule 17g-3 from its designated compliance officer, describing the steps taken by the compliance officer during the most recently ended fiscal year with respect to compliance reviews, identifications of material compliance matters, remediation measures taken to address those matters, and identification of the persons within the NRSRO advised of the results of the reviews.

994. The proposed amendment is aimed at further improving the integrity of the rating process and enhancing accountability. If adopted, it will foster discipline and rigor in the compliance officer's performance of his or her duties. It also is designed to strengthen the SEC's existing oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and by providing an additional tool for the SEC to determine whether the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act. In addition, this information is designed to assist the SEC staff in its examination of NRSROs.

995. The SEC solicited comments on whether the aforesaid report should be furnished to the NRSRO's board or a body performing similar functions of a board or to the NRSRO's senior management, in addition to requiring that it be furnished to the SEC.

996. The public consultation regarding the proposed amendment ended on February 2, 2010. The proposed amendment has not been adopted yet.

997. The bill of Restoring American Financial Stability Act of 2010 – proposes to introduce a new rule (Section 932) that provides that an NRSRO compliance officer may not perform credit ratings, take part in sales or marketing, develop ratings methodologies, or set compensation levels for NRSRO employees. An annual compliance report must be submitted to the SEC. A similar rule is proposed under the bill of "Wall Street Reform and Consumer Protection Act of 2009."

Box 54

Outcome of the annual internal review of their independent compliance function

998. CESR considers that, based on the provisions currently in force in the US, the objective of the EU requirement is not met.

999. CESR highlights that, if adopted, the suggested amendments to the Rules and the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010, that require an NRSRO to submit an annual compliance report to the SEC, will allow to achieve the objectives of the EU requirement.

Box 55

GENERAL AND PERIODIC DISCLOSURE ABOUT CREDIT RATING ACTIVITIES

1000. **CESR points out that in the US there are extensive disclosure requirements concerning an NRSRO and its procedures. The disclosure is mainly based on the obligation for an NRSRO to make publicly available on its website its Form NRSRO and the relevant Exhibits from 1 to 9, to promptly update the information disclosed in case of material inaccuracy and to certify annually that the information disclosed is accurate in all significant respects.**

1001. **An NRSRO is required (among other things), through the Form NRSRO, to make publicly available information on its registration; its legal structure and ownership; its policy concerning the publication of ratings; its procedures to determine ratings, including methodologies, models and key rating assumptions and their material changes; the procedures to manage conflicts of interest and to prevent misuse of material, non-public information and relevant material modifications; its code of conduct; and historical default rates of its rating categories.**

1002. **CESR therefore considers that the objectives of the relevant EU requirements in these respects are met.**

1003. **CESR highlights the following differences in the approach between the US and the EU:**

1004. **An NRSRO is not required to publish a list of its ancillary services. However, it must publicly disclose conflicts of interest that may arise from the provision of ancillary services and to inform the SEC about revenue deriving from all services other than the credit rating services. In September 2009, the SEC voted to propose amendments to the Rules requiring information about revenue streams to be made publicly available. The proposed amendment has not yet been adopted.**

1005. **The list of the 20 largest clients is to be provided to the SEC and is not required to be made public, but conflicts of interest inherent to the activities of the NRSRO are to be disclosed to the public and an NRSRO is prevented to issue or maintain a credit rating solicited from an issuer from which it has received more than 10% of its net annual revenues;**

1006. **The NRSRO may decide to provide to only the SEC information about the compensation of its credit rating analysts (amount of total aggregate annual compensation and median compensation of credit rating analysts for the most recently completed fiscal or calendar year);**

1007. **The focus on the disclosure regarding statistics is different and limited compared to that of the EU requirements, even though NRSROs are required to publish information on the number of their credit rating analysts as well as rating performance data.**

1008. **Taking into account paragraph 990 above, CESR considers that these differences do not hamper the achievement of the objectives of the relevant EU requirements.**

1009. **In addition, CESR points out that there is no requirement to provide the SEC with, nor to make publicly available:**

- **the record keeping policy (there is no requirement per se to have such a policy, although an NRSRO is subject to extensive record-keeping requirements)**

- **the management and rotation policy (there is no requirement per se to have such a policy, although an NRSRO has to disclose its procedures to manage conflicts of interest that may include, where applicable, rotation mechanisms);**

- **the outcome of the annual internal review of the designated compliance officer (if adopted, the suggested amendments to the Rules and the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 requiring an NRSRO to submit an annual compliance report to the SEC, will allow to achieve the objectives of the said requirement).**

G. Effective supervision and enforcement

1010. In establishing the equivalence of the US regulatory and supervisory framework to that of the EU Regulation, as explained in paragraph 214 above, CESR considers that all the powers that an EU competent authority needs to have and all the measures that it needs to be able to take, as set out in the EU Regulation, need to be firmly embedded in the relevant third country law in order for CESR to be able to classify the third country regime as having effective supervision and enforcement that can be considered as equivalent in place.

1011. These powers and measures are as set out in paragraphs 212 and 213 above.

1012. The necessary powers that the authority needs to have is the power to:

- access to any document in any form and to receive or take a copy thereof;
- demand information from any person and if necessary to summon and question a person with a view to obtaining information;
- carry out on-site inspections with or without announcement;
- require records of telephone and data traffic;

1013. In addition, the authority needs to be able to take the following measures against a credit rating agency following the establishment of a breach by it in respect of the its obligations under the EU Regulation:

- withdraw the CRA's registration or authorisation;
- prohibit the CRA from temporarily, issuing credit ratings;
- suspend the use of credit ratings issued by the CRA for regulatory purposes;
- take appropriate measures to ensure that the CRA continues to comply with its legal requirements;
- issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and
- refer matters for criminal prosecution to the relevant national authorities.

1014. As explained in some detail above, one of the fundamental differences between the US and the EU regime is the heavy reliance of the US regime on ex post supervision, and the ability of the SEC to exercise its discretion and take action against NRSROs that may be subject to liability under the federal and securities laws and rules.

1015. In order to assess the equivalence of the US in this respect, CESR has not only looked at what the SEC is empowered by law to do, but also, in light of the fact that it has been supervising NRSROs since 2007, looked at what the SEC has been doing (as part of its learning by doing approach).

1016. This section explains what the nature of the SEC powers and the measures that it can take are, the penalties that it can impose are, as well as describing the divisions and offices of the SEC responsible for the oversight of the NRSRO regulations, and how the SEC ensures adequate staffing, and gives some insight into what the SEC has been doing, and is divided as follows:

- Divisions and offices of the SEC responsible for the oversight and supervision of NRSROs
- SEC personnel
- Powers of the SEC
- Penalties

Divisions and offices of the SEC responsible for the oversight and supervision of NRSROs

1017. The divisions and offices of the SEC responsible for the oversight and supervision of NRSROs include:

a. the Division of Trading and Markets,
b. the Office of Compliance, Inspections, and Examinations,
c. the Division of Enforcement.

1018. In addition, a branch of the Division of Trading and Markets (the "Monitoring Unit") is dedicated to the monitoring of NRSROs in order to provide input on regulatory initiatives such as NRSRO rule making and maintaining a dialogue with NRSROs on the topics discussed below.

1019. The Division of Trading and Markets is entrusted, among other things, with:

- assessing initial applications for registration as an NRSRO,
- dealing with foreign competent authorities,
- providing technical advice for amendments of the NRSRO laws and regulations.

1020. The Division of Trading and Markets reviews a credit rating agency's application for NRSRO status and submits a proposal regarding the application for registration to the SEC, whether it should grant the credit rating agencies application for registration as an NRSRO or institute proceedings to determine whether registration should be denied within 90 days after the date when the application was made to the SEC.

1021. The Monitoring Unit reviews: (i) updates of Forms NRSRO that are to be submitted according to Section 15E(b)(1) of the Exchange Act if any information or document in the application become materially inaccurate; (ii) annual certifications under Section 15(E)(b)(2); and (iii) annual financial reports to be furnished according to Rule 17g-3.

1022. In addition, the Monitoring Unit is entrusted with the following tasks:

a. to establish an ongoing dialogue with NRSROs;
b. to prepare internal periodic profile reports of each NRSRO and industry theme reports;
c. to analyse and prepare reports on topics of interest or potential concern;
d. to provide input, as needed, on regulatory initiatives.

1023. The Monitoring Unit discusses a variety of topics with the NRSROs in order to gain an understanding of the models, procedures and controls they have in place and to keep the SEC informed about developments in the NRSRO's community. These topics include, among other things, the following ones:

a. NRSRO organisational developments,
b. updates to rating methodologies and practices,
c. model development, validation and governance,
d. compliance and internal audit activity,
e. financial results,
f. new issuance, surveillance and performance trends,
g. market share and competitiveness issues,
h. in-depth reviews of sectors.

1024. The Office of Compliance Inspections and Examination ("OCIE"), administers the SEC's nationwide examination and inspection program for supervised entities.

1025. The branch of the OCIE dedicated to NRSROs conducts both "routine examinations" and "cause examinations", to foster compliance with statutory and regulatory requirements applicable to NRSROs, including adherence to its disclosed and internally documented procedures, to detect violations of the law, and to keep the SEC informed of developments in the regulated community.

1026. Among the more important goals of the examination program, is the quick and informal correction of compliance problems. When deficiencies are found, a "deficiency letter" is issued identifying the problems that need to be rectified; the situation is monitored until compliance is achieved. Violations that appear too serious for informal correction are referred to the Division of Enforcement.

1027. The Division of Enforcement assists the SEC in executing its law enforcement function by recommending the commencement of investigations of violations of the securities regulations, by recommending that the SEC bring civil actions in federal Court or before an administrative law judge, and by prosecuting these cases on behalf of the SEC.

1028. There is not a separate branch within the Division of Enforcement dealing specifically with NRSROs. All SEC investigations are conducted privately. Facts are developed to the fullest extent possible through informal inquiry, interviewing witnesses, examining records, and other methods.

1029. With a formal order of investigation, the Division's staff may compel witnesses by subpoena to testify and produce books, records, and other relevant documents. Following an investigation, SEC staff present their findings to the SEC for its review. The SEC can authorise the staff to file a case in federal Court or bring an administrative action. The SEC and the party charged may decide to settle a matter without trial.

1030. In August 2007, the SEC's staff initiated examinations of Fitch Ratings, Inc., Moody's Investors Service, Inc. and Standard & Poor's Ratings Services. The focus of the examinations was the rating agencies' activities in rating subprime RMBS and CDO's linked to subprime residential mortgage-backed securities. On July 8, 2008, the SEC authorized the issuance of a staff report summarizing the issues identified in those examinations.

1031. The examinations uncovered serious shortcomings at these firms, including a lack of adequate disclosure to investors and the public, a lack of policies and procedures to manage the rating process, and insufficient attention to conflicts of interest, as detailed below:

"*The staff found:*

- *There was a substantial increase in the number and in the complexity of RMBS and CDO deals since 2002, and some of the rating agencies appear to have struggled with the growth.*
- *Significant aspects of the ratings process were not always disclosed.*
- *Policies and procedures for rating RMBS and CDOs can be better documented.*
- *The rating agencies are implementing new practices with respect to the information provided to them.*
- *The rating agencies did not always document significant steps in the ratings process, including the rationale for deviations from their models and for rating committee actions and decisions, and they did not always document significant participants in the ratings process.*
- *The surveillance processes used by the rating agencies appear to have been less robust than the processes used for initial ratings.*
- *Issues were identified in the management of conflicts of interest and improvements can be made.*
- *The rating agencies internal audit processes varied significantly"*[96].

1032. As stated in the Annual Report on NRSRO of September 2009, the remedial actions recommended by the staff include that each NRSRO:

- *"Evaluate whether it has sufficient staff and resources to manage its volume of business and meet its obligations under the Exchange Act and the rules applicable to NRSROs.*
- *Review disclosure of the ratings process and the methodologies used to rate RMBS and CDOs to ensure full compliance with SEC rules. NRSROs should review whether policies governing the timing of disclosure of a significant change to a process or methodology are reasonably designed to comply with applicable SEC disclosure requirements.*
- *Determine whether written policies and procedures used to determine credit ratings for RMBS and CDO's are fully documented.*
- *Review current policies and practices for documenting the credit ratings process and the identities of RMBS and CDO ratings analysts and committee members.*
- *Determine if adequate resources are devoted to surveillance of outstanding RMBS and CDO ratings.*
- *Review practices, policies and procedures for mitigating and managing the "issuer pays" conflict of interest.*
- *Review policies and procedures for managing the securities ownership conflict of interest to determine whether these policies are reasonably designed to ensure that employees' personal trading is appropriate and in compliance with applicable requirements.*
- *(as to two of the NRSROs examined) Review whether internal audit functions, particularly in the RMBS and CDO ratings areas, are adequate and whether they provide for proper management follow-up"*[97].

1033. In response to the findings, the SEC proposed sweeping new rules to regulate the internal policies and business practices of NRSROs as discussed above. This is an example of the "learning-by-doing" approach adopted by the SEC in the NRSRO regulations.

1034. The bill of Restoring American Financial Stability Act 2010 (Section 932) proposes the establishment of an Office of Credit Ratings within the SEC to administer SEC rules; conduct annual exams; and monitor internal supervisory controls, the management of conflicts of interest, post-employment revolving door policies, and other matters. A proposal for the establishment of an SEC office to administer the rules of the SEC with respect to the practices of NRSROs is contained also in the bill of "Wall Street Reform and Consumer Protection Act of 2009".

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96 Annual Report on NRSRO, September 2009.
97 Annual Report on NRSRO, September 2009.

1035. In addition, the bill of "Wall Street Reform and Consumer Protection Act of 2009" would require the SEC to establish a Credit Rating Agency Advisory Board to: (i) advise the SEC concerning the rules and regulations on NRSROs; (ii) ensure the SEC properly and fully executes its oversight functions and responsibilities with respect to NRSROs, and (iii) issue an annual report to the Congress detailing its work and recommending, as appropriate, possible additional Congressional actions.

1036. According to the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act 2010 the SEC would be required to conduct periodic reviews over NRSROs not less frequently than annually.

1037. No public proceedings have been opened against an NRSRO to date.

SEC's Personnel

1038. The SEC determines appropriate staffing level for the divisions and offices responsible for oversight of the SEC's NRSRO regulations.

1039. In general, the SEC, like all government organisations, has defined hard criteria for the relevant job descriptions in terms of qualifications to ensure adequate staffing. The minimum requirements are not set in the rules, but in the relevant job posting. The SEC staff indicated that a candidate that is interested to become an examiner with the SEC has to have an accountant or law degree whereas an applicant for the policy department has to have a law degree. Moreover, new staff has to demonstrate his or her experience in for example his or her role in being an examiner when they are interested in becoming staff of the SEC's Monitoring Unit.

1040. There are currently: (i) 8 lawyers in the Division of Trading and Markets, dedicated, among other things, to NRSROs; (ii) 3 members in the Monitoring Unit; (iii) 8 people in the branch of the Office of Compliance Inspections and Examinations dedicated to NRSROs; (iv) more than 1,000 people in the Enforcement Division.

Powers of the SEC

1041. According to Section 15E(c) of the Exchange Act, the SEC has exclusive authority to enforce the provisions of the Exchange Act on NRSROs if an NRSRO issues credit ratings in material contravention of those procedures - including procedures relating to the prevention of misuse of non-public information and conflicts of interest - that such NRSRO (i) includes in its application for registration; or (ii) makes and disseminates in reports pursuant to Section 17(a) of the Exchange Act or the rules and regulations thereunder.

1042. Like the EU regulation, the US regulatory framework contains a rule that prohibits the SEC to regulate the substance of credit ratings or the procedures and methodologies by which any NRSRO determine credit ratings (Section 15E(c)(2) of the Exchange Act).

1043. As can be seen from the SEC staff in their answer, for the purposes of carrying out of its supervisory tasks over NRSROs, the SEC is entrusted with a wide range of powers. These powers cover all the powers that EU competent authorities must have according to Article 23(3) of the EU Regulation.

1044. The powers of the SEC include the following:

a) Power to access to any document of a NRSRO in any form and to receive or take a copy thereof (Section 17(a)(1) and 17(b) of the Exchange Act – Rule 17g-2(f));

b) Power to make such investigations as the SEC deems necessary to determine any concrete or potential violation of the Exchange Act or the SEC Rules, including on request from a foreign securities authority (Section 21(a)(1) and (2) of the Exchange Act; Rule 17g-2(f));
c) Power to publish information concerning any such violation (Section 21(a)(1) of the Exchange Act);
d) Power to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the SEC deems relevant or material for the purposes of any such investigation (Section 21(b) of the Exchange Act)[98]; the SEC has indicated in this respect that is able to demand information from any person and if necessary to summon and question a person with a view to obtaining information;
e) Power to carry out on-site inspections with or without announcement (periodic, special, or other examinations, at any time, or from time to time) (Section 17(a) and 17(b) of the Exchange Act – Rule 17g-2(f));
f) Power to require records of telephone conversations and email communications (Section 17(a) and (b) of the Exchange Act).

1045. The SEC is able to exercise the above supervisory and investigatory powers without the need to go to Court.

1046. Where the SEC has established that a registered NRSRO is in breach of the obligation arising from the relevant regulatory framework, the SEC may adopt the following measures under Section 15E(d) of the Exchange Act:

a. Withdraw the NRSRO's registration or authorisation;
b. Prohibit the NRSRO from temporarily, issuing credit ratings;
c. Suspend the use of credit ratings issued by the NRSRO for regulatory purposes[99];
d. Take appropriate measures to ensure that the NRSRO continues to comply with is legal requirements;
e. Issue public notices where the NRSRO is in breach of its obligations arising from the relevant regulatory framework, being any relevant action taken against the NRSRO a public proceeding.

1047. Namely, Section 15E(d) of the Exchange Act provides that:

"the Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding 12 months, or revoke the registration of any nationally recognized statistical rating organization if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is necessary for the protection of investors and in the public interest and that such nationally recognized statistical rating organization, or any person associated with such an organization, whether prior to or subsequent to becoming so associated:

(1) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), (E), (H), or (G) of section 15(b)(4) [15 USCS § 78o(b)(4)], has been

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98 The SEC may invoke the aid of the Court in case of contumacy by, or refusal to obey a subpoena issued to, any person, of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records (Section 21(c) of the Exchange Act).

99 See also Section 21(d)(1) of the Exchange Act as described below.

convicted of any offense specified in section 15(b)(4)(B), or is enjoined from any action, conduct, or practice specified in subparagraph (C) of section 15(b)(4) [15 USCS § 78o(b)(4)], during the 10-year period preceding the date of commencement of the proceedings under this subsection, or at any time thereafter;

(2) has been convicted during the 10-year period preceding the date on which an application for registration is furnished to the Commission under this section, or at any time thereafter, of--
(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4)(B) [15 USCS § 78o(b)(4)(B)]; or
(B) a substantially equivalent crime by a foreign court of competent jurisdiction;

(3) is subject to any order of the Commission barring or suspending the right of the person to be associated with a nationally recognized statistical rating organization;

(4) fails to furnish the certifications required under subsection (b)(2); or

(5) fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity".

1048. The SEC has the power to refer mattes for criminal prosecution to the relevant authorities.

1049. Section 21(d)(1) of the Exchange Act provides that, whenever it appears to the SEC that any person is engaged or is about to engage in acts or practices constituting a violation of the applicable laws and regulations, the SEC has the power to bring an action to the Court to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.

1050. Section 21(d)(3) of the Exchange Act provides that, whenever it shall appear to the SEC that any person has violated any provision of Exchange Act or the SEC Rules, or a cease-and-desist order entered by the SEC pursuant to Section 21C, the SEC may bring an action to the Court to seek, and the Court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.

1051. Pursuant to Section 21(h)(9)(B) of the Exchange Act, the SEC is authorised to transfer customer information to the Attorney General without giving notice to the customer.

1052. The bill of Restoring American Financial Stability Act 2010 (Section 932(2)) authorises the SEC to fine NRSROs and to revoke a credit rating agency's NRSRO status for a particular class of securities when an NSRSO lacks financial and managerial resources to consistently produce accurate ratings.

1053. In addition to the above list of powers that the SEC has and the measures that it can take, as explained in paragraph 215 above when assessing equivalence CESR also has to assess whether or not requirement of Article 23.3 of the EU Regulation that sets out the list of those[100] in addition to the credit rating agency that the authority needs to be able to exercise its powers in respect of is met.

1054. As can be seen from paragraphs 1049 and 1050 above there is a reference in both Sections 21(d)(1) and 21(d)(3) to "any person" in respect of the SEC's ability to exercise their powers and adjoin others to an action.

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100 These are: persons involved in credit rating activities, rated entities and related third parties, third parties to whom the credit agencies have outsourced certain functions or activities; and persons otherwise related or connected to the credit rating agency or credit rating activities.

1055. CESR therefore considers that those against whom the SEC powers can be exercised are broad enough to enable the requirements of Article 23.3 of the EU Regulation to be met, and is therefore able to consider the supervision that can be exercised by the SEC as "effective".

Penalties

1056. As explained in paragraph 219 above, in assessing equivalence CESR expects the third country framework to have legal provisions setting out the penalties that can be imposed for breaches of the relevant requirements.

1057. In the US, Section 21B of the Exchange Act sets out penalties applicable to infringements of the regulatory framework.

1058. Namely, Section 21B(a) of the Exchange Act provides that:

"In any proceeding instituted pursuant to sections 15(b)(4), 15(b)(6), 15D, 15B, 15C, 15E, or 17A of this title against any person, the Commission or the appropriate regulatory agency may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person:

(1) has wilfully violated any provision of the Securities Act of 1933, the Investment Company Act of 1940, the Investment Advisers Act of 1940, or this title, or the rules or regulations thereunder, or the rules of the Municipal Securities Rule-making Board;
(2) has wilfully aided, abetted, counselled, commanded, induced, or procured such a violation by any other person;
(3) has wilfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency under this title, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein; or
(4) has failed reasonably to supervise, within the meaning of section 15(b)(4)(E) of this title, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision;
and that such penalty is in the public interest".

1059. Section 21B(c) of the Exchange Act sets out the criteria that the SEC may consider in considering whether a penalty is in the public interest:

"(1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;
(2) the harm to other persons resulting either directly or indirectly from such act or omission;
(3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behaviour;
(4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanour described in section 15(b)(4)(B) of this title ;
(5) the need to deter such person and other persons from committing such acts or omissions; and
(6) such other matters as justice may require."

1060. Section 21B(b) of the Exchange Act sets out the maximum amount of penalties. For each act or omission, there are 3 tiers for the maximum amount of penalty, as detailed below:

a. $5,000 for a natural person or $50,000 for any other person (first tier);
b. $50,000 for a natural person or $250,000 for any other person, if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement (second tier);
c. $100,000 for a natural person or $500,000 for any other person if:
(i) the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and
(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission (third tier).

1061. The proposed changes under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" would further reinforce the powers of the SEC to issue penalties.

Box 56

EFFECTIVE SUPERVISION AND ENFORCEMENT

1062. **For the purposes of carrying out its oversight tasks, the SEC is endowed with a wide and comprehensive range of powers and is able to take a number of measures against NRSROs for breach of federal securities law and the rules thereunder .**

1063. **CESR considers these powers and measures are equivalent to those that must be available to EU competent authorities under the EU Regulation.**

1064. **CESR considers that the supervision that the SEC is legally empowered to carry out can be effective, and notes that it already has a number of years of experience in supervising NRSROs.**

1065. **The US regime as a whole is, as discussed above, built on a philosophy of ex post supervision so that whatever is set out in the law or disclosed by the NRSRO has to be complied with. If upon an examination it appears that credit ratings are issued in material contravention of these requirements, the NRSRO may be subject to liability under the federal securities laws and rules thereunder.**

1066. **The SEC has already conducted both routine and theme examinations over NRSROs.**

1067. **The findings of examinations are taken into account by the SEC in assessing whether additional amendments to the NRSRO regulations may be appropriate.**

1068. **Penalties that are applicable in case of infringement to the NRSRO regulations are set out by law.**

Section V. Summary of areas of notable differences and weakness and suggestions regarding how the gap in differences between the US and the EU provisions can be bridged

1069. This section of the report summarises those areas of the US legal and supervisory framework for credit rating agencies where CESR has in Section IV identified a number of weaknesses compared to the EU regime, in relation to which a number of suggestions regarding how the differences between the US and the EU can be bridged are also set out below.

Box 57

GLOBAL ASSESSMENT

1070. **CESR concludes that overall the US legal and supervisory framework is broadly equivalent to the EU regulatory regime for credit rating agencies in terms of what CESR considers to be the overall objective of:**

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

1071. **However, there are a number of differences between the US legal and supervisory framework and the EU regulatory regime, that mainly relate to the issue of disclosure of credit ratings and the quality of credit ratings and credit rating methodologies.**

1072. **CESR recommends the identified differences be addressed to allow for further convergence between both regimes and considers that reducing the difference may be achieved by future regulatory amendments to the SEC's Rules.**

Areas of notable differences and weakness and how the gaps between the EU and the US requirements can be bridged

1073. As explained in detail in this advice, for the purposes of assessing equivalence, CESR has divided the EU Regulation into the following seven areas:

- The scope of the regulatory and supervisory framework
- Corporate governance
- Conflicts of interest management
- Organisational requirements
- Quality of methodologies and quality of ratings
- Disclosure
- Effective supervision and enforcement

1074. Of these seven areas, CESR has identified some differences of note in respect of the following two areas:

- Corporate governance.
- Conflicts of interest management.

1075. CESR has also identified some weaknesses and made suggestions regarding how the gaps between the EU and the US requirements can be bridged in respect of the following two areas:

- Quality of methodologies and quality of ratings; and
- Disclosure.

Differences of particular note

Corporate governance

1076. The US and supervisory requirements in the area of corporate governance are heavily dependant on the role that a designated compliance officer plays in ensuring that the NRSRO meets its legal requirements, and whose independence is not legally required, but where the potential consequences of this are mitigated through the other supervisory and enforcement powers of the SEC.

1077. The US requirements for NRSROs do not include provisions relating to corporate governance as this is an area that is governed by State law.

1078. CESR does consider that the requirements that are in place meet the objectives of this section in light of the following:

1079. The senior management shares the responsibility with the designated compliance officer for ensuring compliance with relevant laws and regulations as well as the NRSRO's internal policies.

1080. The designated compliance officer is responsible for administering the procedures in respect of the management of conflicts of interest and the prevention of the misuse of material confidential information, and overall for ensuring that the NRSRO adheres to the policies and procedures it has disclosed and complies with the requirements of the Exchange Act and the SEC Rules.

1081. Although there are no requirements to have independent members of the board of directors or supervisory board, CESR understands that the designated compliance officer is responsible for the specific monitoring of tasks that the EU Regulation requires to be carried out by such independent members.

1082. Although there is not an explicit requirement for the designated compliance officer to be independent, CESR understands that the independence of this individual is something that the examination office would examine in due course.

1083. In the event that this individual reporting line was questionable, this would be flagged for the purposes of examination. In addition, CESR understands that this may constitute evidence that an NRSRO did not have reasonably designed procedures for managing conflicts of interest and preventing the misuse of non public material information.

1084. Irrespective of the significant difference in the manner in which the independence of the designated compliance officer is dealt with in the US compared to the EU, CESR is satisfied that the potential negative consequences of this difference are sufficiently mitigated in the US through SEC supervision, given that in practice whether or not this individual is actually independent is something that will be determined on an ex-post basis.

1085. For a detailed explanation regarding how the EU corporate governance requirements are addressed in the US, please see sub-section 2.B. "corporate governance" paragraphs 350 to 408 above of Section IV "The US Assessment".

Conflicts of interest management

1086. CESR considers this to be an area of strength of the US legal and regulatory framework but points out that there are some differences in respect of how the objectives of the EU requirements in this area are met.

1087. The most notable difference is that an NRSRO is not prohibited from providing advisory or consultancy services, but is required to manage and disclose conflicts of interest arising from being paid for services in addition to determining credit ratings by those who have paid the NRSRO to provide a credit rating, and any other type of conflict of interest that the NRSRO considers to be material.

1088. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of "Restoring American Financial Stability Act of 2010" concerning the quality of information used by the NRSRO to determine credit ratings could make a significant change in meeting the objective of this EU requirement.

1089. For a detailed explanation regarding how the EU conflicts of interest management requirements are addressed in the US please see sub-section 2C "conflicts of interest management" paragraphs 409 to 530 above of Section IV "The US Assessment".

Areas of weakness and suggestions about how the differences between the EU and the US requirements can be bridged

Quality of methodologies and quality of ratings

1090. As explained in this advice, CESR does not consider that overall the legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to the quality of methodologies and quality of ratings.

1091. CESR points out that of the following five broad areas that these requirements relate to namely:

a. Reviewing credit ratings, models and key rating assumptions;
b. Quality of credit ratings and analysis of information used in assigning credit ratings
c. Quality of methodologies and changes to them;
d. Knowledge and experience of employees directly involved in credit rating activities; and
e. Competition

1092. CESR has identified weaknesses in respect of three of them namely a, b and c above.

a) Reviewing credit ratings, models and key rating assumptions.

1093. In respect of this set of EU requirements, there are no specific legal requirements in the US to:

- monitor the methodologies and to have a review function; or
- monitor ratings on an ongoing basis and at least annually.

1094. But there is a requirement to describe the procedures in Exhibit 2 of Form NRSRO for monitoring and reviewing credit ratings.

1095. CESR points out that if there is a requirement to disclose how ratings are monitored then there has to be a process in place to monitor them.

1096. CESR considers that the objective of these requirements, namely to ensure that methodologies and credit ratings are up to date and subject to comprehensive review on a periodical basis, are not fully met through the disclosure that has to be made in Exhibit 2 Form NRSRO.

1097. CESR considers that a way of bridging the gap between the differences in the EU and the US requirements, is for example to introduce requirements dealing with ongoing monitoring of methodologies and credit ratings, and the frequency within which their review should take place.

1098. For a detailed explanation of how the US deals with this set out EU requirements see section 2E Quality of methodologies and quality of ratings paragraphs 612 to 634 above of Section IV " US Assessment".

b) Quality of credit ratings and analysis of information used in assigning credit ratings

1099. The US has no specific requirements that deal with this set of EU requirements, although an NRSRO is required to disclose its credit rating histories.

1100. There is no requirement in the US that the NRSRO has to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information on which to base its ratings, but there is a requirement that the NRSRO discloses upfront its procedures and methodologies to determine credit ratings which may or may not cover this issue.

1101. For a detailed explanation of how the US deals with this set of EU requirements see subsection 2E Quality of methodologies and quality of ratings paragraphs 643 to 664 above of Section IV " US Assessment".

c) Quality of methodologies and changes to them

1102. There is no specific requirement to use credit rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience and back testing.

1103. There is no specific requirement to apply changes to methodologies and models consistently to existing ratings.

1104. CESR notes that the bill of "Restoring American Financial Stability Act 2010" and the bill of "Wall Street Reform and Consumer Protection Act of 2009" could direct the SEC to prescribe rules to ensure that ratings are produced in accordance with procedures and methodologies that have been approved by the NRSRO board or the senior credit officer. The potential rules shall also require that material changes to a rating procedure or methodology be applied in a consistent manner to all ratings where the changes apply, and be applied to existing ratings within a reasonable period of time.

1105. There is no specific requirement to immediately disclose the likely scope of credit ratings to be affected by changes in the methodologies used to determine them.

1106. CESR notes that potential amendments to the US regulatory framework through the bill of "Restoring American Financial Stability Act 2010" and the bill of "Wall Street Reform and

Consumer Protection Act of 2009" could make a significant change in the right direction to meet the objectives of this requirement.

1107. For a detailed explanation of how the US deals with this set of EU requirements see subsection 2E Quality of methodologies and quality of ratings paragraphs 643-664 above of Section IV " US Assessment".

Disclosure

1108. As explained in this advice, CESR has for the purposes of assessing equivalence divided the EU disclosure requirements into those disclosure requirements that a credit rating agency needs to make on a rating by rating basis, and those relating the credit rating agency itself.

1109. In respect of the EU disclosure requirements that a credit rating needs to make on a rating by rating basis, overall, CESR considers that this is an area where significant differences exist between the EU and the US.

1110. CESR recognises that the different approach adopted in the US, is related to the manner in which the US approaches the issue of non interference with the substance of credit ratings and the methodologies used to determine them.

1111. In respect of this set of EU requirements CESR considers that overall the US requirements do not meet the objectives of the EU requirements in relation to the areas covered by the EU requirements

1112. Of the 13 areas that are covered by these requirements, which are required to be disclosed on a rating by rating basis, CESR has identified weaknesses in five of these and sets out some suggestions regarding how the gap in the differences between the EU and the US can be bridged.

1113. The five areas of weakness in respect of the EU requirements that a credit rating agency is required to make on a rating by rating basis are:

1) Unsolicited ratings
2) Key elements
3) Indication of material sources of information.
4) Attributes and limitations of credit ratings; and
5) Additional disclosure requirements in respect of structured finance products.

1) Unsolicited credit ratings

1114. There is no requirement for unsolicited credit ratings to be clearly identified as such, the information is only available to the SEC.

1115. As it is impossible for credit rating users to identify whether a credit rating is solicited or unsolicited without a specific disclosure requirement on a rating-by-rating basis, CESR considers that one way of bridging the gap between the differences in the EU and the US is to require that an NRSRO makes a differentiation between solicited and unsolicited ratings, on a rating by rating basis.

1116. There is no requirement for an NRSRO to disclose on a rating by rating basis whether or not a rated entity participated in the process for determining an unsolicited credit rating or if a credit rating agency had access to the rated entity's books and records.

1117. There is an upfront disclosure requirement to provide a description of the methodologies for determining unsolicited credit ratings, which must be sufficiently detailed and cover a description of the public and non-public sources of information used in determining credit ratings and the procedures for interacting with the management of the rated entity.

1118. CESR does not consider this requirement to be adequate in meeting the objective of the EU requirement in those cases where the disclosure about the methodologies provides that participation of the rated entity and access to the rated entity's books and records may vary on a case-by-case basis, depending on the discretion of the NRSRO itself.

1119. CESR considers that a way of bridging the gap between the differences in US and the EU in respect of this requirement in these cases, is to require the NRSRO to include a statement on a rating by rating basis about whether or not the rated entity participated in the process for determining the credit rating, and whether or not the credit rating agency had access to the rated entity's books and records.

1120. CESR notes that according to the instructions to Exhibit 2 of the Form NRSRO, that an applicant may provide in Exhibit 2 the location on its website where additional information about the procedures and methodologies is included, CESR considers that it should always be the case that such reference is made in order to ensure that users of the NRSRO's credit ratings can always match the rating to the specific methodology used to determine it.

1121. For a detailed explanation of how the US deals with this set of EU requirements see sub-section 2E Disclosure paragraphs 754 to 780 above of Section IV " US Assessment".

2) Key elements

1122. There is no requirement in the US to explain the key elements underlying the credit rating when announcing a credit rating.

1123. CESR considers that a way of bridging the gap between the differences in the US and EU in relation to this set of requirements is to require an NRSRO to disclose the assumptions underlying the credit rating on a rating by rating basis.

1124. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 could make a significant change in the right direction to meeting the objectives of this requirement.

1125. For a detailed explanation of how the US deals with this set of EU requirements see sub-section 2E Disclosure paragraphs 781 to 790 above of Section IV "US Assessment".

3) Indication of material sources of information

1126. There is no requirement to disclose information about the specific sources that were substantially material in the determination of a particular credit rating.

1127. CESR considers that a way of bridging the gap between the differences in the EU and the US in respect of this requirement is to require an NRSRO on a rating by rating basis, to indicate all substantial material sources of information used to prepare the rating.

1128. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 could make a significant change in the right direction to meeting the objectives of this requirement.

1129. For a detailed explanation of how the US deals with this set of EU requirements see subsection 2E Disclosure paragraphs 811 to 819 above of Section IV "The US Assessment".

4) Attributes and limitation of credit ratings

1130. In the US, there is no requirement to disclose limitations and attributes of individual credit ratings. In addition, as indicated in Box 26 above, there is no requirement for an NRSRO to refrain from issuing credit ratings if it does not have sufficient quality information to base its rating on.

1131. CESR considers that the gap between the differences in the EU and the US requirements may be bridged by requiring an NRSRO to disclose on a rating by rating basis, information regarding the attributes and limitation of each credit rating.

1132. CESR notes that the potential amendments under the bill of "Wall Street Reform and Consumer Protection Act of 2009" and the bill of Restoring American Financial Stability Act of 2010 could make a significant change in the right direction to meeting the objectives of this requirement.

1133. For a detailed explanation of how the US deals with this set of EU requirements see subsection 2E Disclosure paragraphs 846 to 850 above of Section IV "The US Assessment".

5) Additional disclosure requirements in respect of structured finance products

1134. There is no requirement for a distinct labelling of ratings for structured finance products.

1135. There is no requirement to disclose on a rating by rating basis information about the level of assessment conducted by the NRSRO on the due diligence process carried out at the level of underlying financial instruments or other assets of structured finance instruments.

1136. CESR considers that a way of bridging the gap between the EU and the US in respect of these requirements is to require an NRSRO to disclose on a rating by rating basis in respect of structured finance products the extent of due diligence that it has conducted in respect of the underlying instruments of that instrument.

1137. CESR notes that the potential amendments under the bill of Restoring American Financial Stability Act of 2010 and the bill of "Wall Street Reform and Consumer Protection Act of 2009", direct the SEC to prescribe rules requiring NRSROs to publish information on a rating by rating basis, which could make a significant change in the right direction to meet the objectives the EU requirements.

1138. For a detailed explanation of how the US deals with this set of EU requirements see subsection 2F Disclosure paragraphs 851 to 881 above of Section IV " US Assessment.

1139. For a detailed discussion regarding how the US deal with all the EU disclosure requirements- see sub-section 2F Disclosure paragraphs 709 to 1009 above.

Section VI. Early warning system

1140. In accordance with the mandate, CESR has been asked to advise of an early warning mechanism in relation to identifying significant changes to the US regime that may in the future necessitate a change in the decision regarding equivalence that is made.

1141. CESR points out that it has included non negotiable provisions in the coordination arrangements that it is currently in the process of negotiating whereby the SEC would be sharing information on a regular basis regarding any such changes to the legal and supervisory framework.

Box 58

CHANGES TO THE US LEGAL AND REGULATORY FRAMEWORK

1142. CESR proposes upon the receipt of any information of such a change, evaluate whether or not it considers such a change to be of material significance in terms of impacting on important provisions, and in the event that this was the case, advising the European Commission accordingly.

1143. CESR points out however that it does not consider it feasible that the US would in some way undermine the regime that they currently have in place and if anything are looking to make it even stronger as is clear from the proposals set out in the bill of "Restoring Financial Stability Act of 2010" and the bill of "Wall Street Reform and Consumer Protection Act of 2009."

Annex 1

EUROPEAN COMMISSION

Internal Market and Services DG

The Director General

Brussels, 12 JUIN 2009 -129406
MARKT G3/MTF/mg Ares (2009)

Mr Eddy Wymeersch
Chairman
Committee of European Securities Regulators (CESR)
11-13 avenue de Friedland
F – 75008 Paris

Subject: **Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory regime for credit rating agencies**

Dear Eddy,

In the context of the Regulation (EC) on Credit Rating Agencies ("CRA Regulation") approved by the European Parliament on 23 April 2009 and by the Council, I enclose a mandate to CESR for advice on the equivalence between regulatory (legal and supervisory) frameworks of third countries applicable to the activity of credit rating agencies and the regulatory framework for credit rating agencies introduced in the Community by the CRA Regulation. The mandate consists of two parts:

(i) technical assistance for the assessment of the regulatory frameworks of the USA, Canada and Japan" and;

(ii) a fact finding exercise to establish whether other additional jurisdictions should be assessed.

The issue of the third country regime was the most debated point during the negotiation of the CRA Regulation. The regime agreed upon should work effectively. As you know, in order to favour competition from smaller players that are not systemically important for EU markets – and in a way avoid that third country firms provide ratings that are used in the EU without respecting the EU framework – a 'certification system' has been conceived based on an equivalence assessment of both the legal framework as well as the supervisory and enforcement system of a third country. As a key precondition for the certification mechanism, the Commission will have to recognise that the third country's regulatory and supervisory regime for credit rating agencies is equivalent to the one in the EU. Third country jurisdictions currently in the process of developing their regulatory frameworks for credit rating agencies shall ensure that rules applicable and supervisory capacity match EU standards.

On the contrary, systemically important credit rating agencies will always need to go through an 'endorsement mechanism' of the credit rating by the affiliated entity which is established in the EU. This is necessary in order to attach responsibility to a player within the EU and also allow for efficient supervision by EU regulators.

Concerning the equivalence assessment, following G-20 recommendations agreed last April all G-20 members should put in place a legal framework and oversight regime for credit rating agencies. Nevertheless, we are conscious that at this stage it would be impossible – and not necessarily useful – to assess the regulatory framework of all these countries. In this context, technical assistance by CESR is requested for the priority equivalence assessment of United States, Canada and Japan, since, according to preliminary information we have received, a number of small credit rating agencies from these countries might be interested in providing credit ratings in the EU. In addition, in order to preserve the continuity of the use of credit ratings within the EU and to avoid any unintended disruption in the financial markets, it is necessary to identify whether credit rating agencies from other jurisdictions are already providing credit ratings to EU financial institutions or have the intention to do so in the future. Thus, a fact-finding exercise is necessary to identify other jurisdictions which might need to be assessed.

As the formal adoption of the CRA Regulation is foreseen by the end of September, we anticipate receiving the CESR technical advice by 15 February 2010 in order to allow the formal comitology procedures to be in place at due time before October 2010 (expected date for the mandatory use of credit ratings issued by registered or certified credit rating agencies). The timetable is very tight as the Commission will have to obtain the formal opinion of the European Parliament during the comitology procedure, before adoption of the implementing measures. It is important that both the Commission and CESR cooperate under this very tight timetable in order to avoid any unintended disruption of the financial markets.

DG MARKT services and CESR have a long standing and successful cooperation record in working together in the preparation of implementing legislation for EU legal acts. I am confident that we will all deploy our best efforts for a successful outcome.

Yours sincerely,

Jörgen HOLMQUIST

Enclosure: - Formal mandate to CESR for technical advice

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EUROPEAN COMMISSION

Internal Market and Services DG

FORMAL MANDATE TO CESR FOR TECHNICAL ADVICE ON THE EQUIVALENCE BETWEEN CERTAIN THIRD COUNTRY LEGAL AND SUPERVISORY FRAMEWORKS AND THE EU REGULATORY REGIME FOR CREDIT RATING AGENCIES (CRAs)

The present mandate takes into consideration the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including increasing transparency. For this reason, this request for technical advice will be made available on DG Internal Market and Services' web site once it has been sent to CESR. The European Parliament has also been duly informed.

This mandate focuses on a technical issue which follows from the adoption of Regulation (EC) XX/2009 on Credit Rating Agencies (approved by the European Parliament on 23 April 2009 and by the Council on the same day; formal adoption pending): it relates to the recognition of regulatory (legal and supervisory) frameworks of third countries applicable to the activity of credit rating agencies as being equivalent to the regulatory framework for CRAs introduced in the Community by the afore-mentioned Regulation.

The legal base for future implementing measures is Article 4a(3) of Regulation (EC) XX/2009 (pending formal adoption the reference text is the one approved by the European Parliament on 23rd April 2009: P6_TA-PROV(2009)0279).

1. CONTEXT

1.1. Legal context

Role of the equivalence assessment

The CRA Regulation envisages in Article 4a(3) that the Commission may adopt an equivalence decision in accordance with the adequate comitology procedure (regulatory procedure[1]), stating that the legal and supervisory framework of a third country ensures that credit rating agencies authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from this Regulation and which are subject to effective supervision and enforcement in that third country. The CRA Regulation also stipulates that the Commission would, in accordance with the adequate comitology procedure (regulatory procedure with scrutiny[2]), specify

[1] Article 5 and Article 7 of Council Decision 1999/468/EC, OJ L184, 17.07.1999, p.23.

[2] Article 5a(1) to (4) and Article 7 of Council Decision 1999/468/EC as amended by Council Decision 2006/512/EC, OJ L200, 17.07.2006, p.11.

further or amend the criteria for assessing the equivalence in order to take account of developments on financial markets.

A positive equivalence determination will allow qualifying credit rating agencies from that third country to apply for certification in accordance with the conditions and the procedure laid down in Article 4a. Those CRAs, which have been certified by the EU competent authorities, would be able to seek exemptions from specific organisational requirements set out in Section A of Annex I and Article 6(4) and as well as from the requirement of physical presence in the Community. Any reliefs in those respects would be offered by the EU competent authorities on a case-by-case basis.

It should be stressed that a positive outcome of equivalence assessment (and resulting equivalence decision by the Commission) alone does not automatically entitle credit rating agencies from a third country concerned to operate in the European Union without any registration. Pursuant to Article 4a(1) credit rating agencies issuing ratings related to entities established or financial instruments issued in third countries would be able to apply for certification, provided that the following criteria are met in addition to a positive equivalence decision of the Commission:

(a) the credit rating agency is authorised or registered and is subject to supervision in a third country;

(b) the cooperation arrangements between the third country supervisor and the EU competent authorities are operational;

(c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

Only after all of the above conditions are satisfied and the credit rating agency from a third country has been certified, may its ratings be used in the European Union by financial institutions and other persons and may the credit rating agency from a third country be recognised as External Credit Assessment Institution ("ECAI") under Directive 2006/48/EC[3].

This specific registration procedure consisting of the recognition of equivalence of the legal and supervisory framework of a third country and the individual certification assessment of credit rating agencies from that third country is intended to enhance competition in the credit rating business. Therefore, once equivalence of the legal and supervisory framework of a third country is recognized, the credit rating agencies from that third country will have new business opportunities in the European Union.

Elements of the equivalence assessment

According to the CRA Regulation[4], a third-country legal and supervisory framework may be considered equivalent to this Regulation if the third country framework fulfils at least the following conditions:

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[3] OJ L 177, 30.6.2006, p.1 as amended

[4] See Article 4a(3) points (a) to (c) of the second subparagraph.

(a) credit rating agencies in the third country are subject to authorisation or registration and are subject to effective supervision and enforcement on an ongoing basis;

(b) credit rating agencies are subject to legally binding rules which are equivalent to those set out in Articles 5 to 10 and Annex I of this Regulation; and

(c) the third-country regulatory regime prevents interference of supervisory authorities and other public authorities of that country with the content of credit ratings and methodologies.

As stated above, the same Article 4a(3) of the CRA Regulation stipulates that the Commission would specify further or amend the criteria for assessing the equivalence in order to take account of developments on financial markets. Those measures, designed to amend non-essential elements of this Regulation, should be adopted in accordance with the adequate comitology procedure (regulatory procedure with scrutiny[5]).

1.2. Mechanism for assessing the equivalence

The Commission intends to apply, in full agreement with the European Securities Committee, the following mechanism:

– the European Securities Committee will assist the Commission as the regulatory committee under the existing comitology framework (Article 33(2) and (3) of the CRA Regulation);

– CESR should provide a technical advice for the assessment of the equivalence of regulatory (legal and supervisory) frameworks of third countries for CRAs with the regulatory framework introduced by the CRA Regulation.

1.3. Deadline for CESR's technical advice: 15 February 2010

This mandate takes into consideration that CESR needs enough time to prepare its technical advice and that the European Commission needs to formalise the relevant comitology measure while respecting the legal deadlines set within the comitology process. More importantly, it takes into account the fact that 12 months after the entry into force of the Regulation, financial institutions will be allowed to use for regulatory purposes exclusively credit ratings from registered/certified CRAs or ratings endorsed by EU-registered CRAs. For these reasons, the deadline set to CESR to deliver the technical advice is 15 February 2010.

The establishment of the deadline is based on the following timetable. In case the entry into force of the Regulation was delayed due to late publication in the Official Journal of the European Union, deadlines could be further extended if appropriately justified.

[5] Article 5a(1) to (4) and Article 7 of Council Decision 1999/468/EC as amended by Council Decision 2006/512/EC, OJ L200, 17.07.2006, p.11.

Deadline	Action
October 2009 (assumption)	Expected entry into force of the CRA regulation (20 days after publication in the Official Journal of the European Union)
15 February 2010	CESR technical advice
March 2010	Formal Commission draft comitology measure sent to the European Securities Committee and published on the Internet
March – June 2010	Examination of the draft comitology measure in the European Securities Committee
June 2010	Vote in the ESC on the comitology measure
April 2010	CRA regulation becomes applicable in the EU (six months after entry into force of the Regulation)
July 2010	Formal adoption of the comitology measure by the Commission (period for right of oversight by European Parliament taken into account)
October 2010	Financial institutions required to use for regulatory purposes exclusively ratings from registered/certified CRAs or ratings endorsed by EU-registered CRAs (12 months after the entry into force of the Regulation)

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

2.1. Nature of the assessment

The CRA Regulation has set up a strict EU legal and supervisory framework which should be preserved by all actors and market participants in order to underpin confidence in the financial markets. Therefore, the assessment to be done by CESR is of a technical nature and should not contain political considerations.

2.2. The working approach

On the working approach, CESR is invited to take account of following principles:

– CESR should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers included in the relevant comitology provision of the CRA Regulation, in the corresponding recitals as well as in the relevant Commission request included in the mandate;

– CESR should address to the Commission any questions they might have concerning the clarification on the text of the CRA Regulation, which they should consider of relevance to the preparation of its technical advice;

– The technical analysis carried out should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level.

2.3. Objectives to be observed in the examination

In giving its advice, CESR should take full account of the following key objectives:

– In the assessment whether credit rating agencies authorised or registered in a third country comply with legally binding requirements which are equivalent to the requirements resulting from the CRA Regulation and whether they are subject to effective supervision and enforcement in that third country, the priority should lie in assuring that users of ratings in the EU would benefit from equivalent protections in terms of CRAs' integrity, transparency, good governance and reliability of the credit rating activities (cf. Article 1 of the CRA Regulation). An indicative description of the areas which should be considered in the assessment, as well as the regulatory principles to be respected by the examined third country regime, has been included in the Table below.

Measures to ensure integrity and independence
– A CRA identifies and eliminates (or manages and discloses) conflicts of interest.
– A CRA ensures that business interest does not impair the independence and accuracy of ratings.
– A CRA does not provide consultancy or advisory services; an exhaustive and limited list of ancillary services, which may be provided by a CRA, is defined in the third country legal framework;
– A CRA refrains from issuing a rating when it has direct or indirect interest in the entity asking for a rating;
– Rating analysts cannot make proposals or recommendations on the design of structured finance products;
– Rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control;
– Rating analysts' compensation and performance evaluation is de-linked from the revenue they generate for the CRA;

- A stringent rotation policy is put in place (lead rating analysts to rotate client at least every 4 years);

- A CRA keeps records and audit trails of all its activities;

- A CRA has a compliance function, which operates independently;

- Two independent directors on the CRA's administrative or supervisory board are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest.

- Competent authorities do not interfere with the content of ratings or the CRAs methodologies.

Measures relating to ratings' quality and enhancing the transparency of the rating activity

- A CRA discloses to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on. It will not be allowed to rate financial instruments if it does not have sufficient quality information to base its ratings on.

- A CRA discloses the models, methodologies and key assumptions on which it bases its ratings.

- A CRA differentiates the ratings of structured products by adding a specific symbol.

- A CRA has a function devoted to the periodical review of methodologies and models (review function).

- A CRA applies consistently the changes in methodologies and models to existing ratings.

- A CRA monitors its ratings and methodologies on an on-going basis and at least annually.

- A CRA has a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such.

- A CRA collects and provides on a regular basis historical performance data (default and transition studies), in accordance with commonly agreed standards.

- A CRA ensures on an on-going basis general disclosure of key information relating to its activity (i.e. on managing conflicts of interest, ancillary services provided, compensation arrangements for its staff, policy on the publication of credit ratings, etc)

- A CRA makes periodical disclosures (i.e. data on the historical default rates, the 20 largest clients by revenue)

- A CRA makes public an annual transparency report with information on the ownership of the agency, staff allocation, description of the quality control system,

outcome of the internal review of independence compliance, financial information regarding the revenue streams, etc.

– A global and holistic assessment of the regulatory framework in question should be carried out from a technical point of view. It should not be limited to just assessing the third country's commitment to any international convergence initiatives aiming at a single set of regulatory standards, such as the Code of Conduct Fundamentals developed by the International Organisation of Securities Commissions (IOSCO). Moreover, the regulatory framework of the third country must include mandatory requirements for the registered CRAs; voluntary regimes are not to be considered equivalent to the regulatory and supervisory framework introduced by the CRA Regulation. CESR should also examine what type of remedies could be applied in case of discrepancy in some limited areas (e.g. introduction in the third country of a special regime for CRAs established in that third country that intend to apply for certification under the CRA Regulation) as specified in point 3.3. of this mandate.

– The global and holistic technical assessment should be based on the entirety of the third country regulatory framework in force in that country. The assessment should focus on the differences between the regulatory regime established at EU level and the third country framework in question. CESR should evaluate and give its judgement on the material importance of such differences. In doing so it should focus on technical criteria and not take into account any considerations of a political nature.

- The third country regulatory and supervisory framework should enter into force at the latest twelve months after entry into force of the CRA Regulation; otherwise the CRAs registered in that third country should apply for registration in the EU and comply with the requirement of being a legal person established in the Community.

– The assessment of whether CRAs are subject to effective supervision and enforcement in that third country should be made in due consideration of the legal and institutional setting in which the third country supervisory authority operates (including its ability to impose sanctions) as well as of its supervisory programme and operational ability to ensure effective compliance.

- Following CESR's technical advice the Commission will decide on the equivalence or otherwise of the third country jurisdictions and adopt a decision following the procedure under Article 4a(3) of the CRA Regulation.

3. CESR IS INVITED TO PROVIDE TECHNICAL ADVICE BY 15 FEBRUARY 2010

3.1. Scope of the assessment

3.1.1. Priority assessment

It is essential that the smooth functioning of the internal market in financial services is preserved; therefore it is necessary to start the equivalence assessment with those third countries where a significant number of ratings used in the EU are produced. CESR is invited to assess by 15 February 2010 the equivalence of the regulatory regimes of the following jurisdictions:

a) United States of America,

b) Japan and

c) Canada.

Prioritisation of these 3rd country jurisdictions takes into account that:

- some small to medium sized CRAs, established in third countries and specialised in financial instruments issued in third countries and entities established in third countries, have already been recognised as an External Credit Assessment Institution (ECAIs) under the Directive on Capital Requirements (Directive 2006/48/EC on the taking up and pursuit of the business of credit institutions),

- following the G-20 recommendations the third countries in which the CRAs are established have started the appropriate legislative procedures in order to amend their regulatory and supervisory framework for CRAs,

- some small credit rating agencies in certain jurisdictions have shown interest to access the EU market,

- one of the objectives of the CRA Regulation is to create incentives for the emergence of new CRAs in the market.

3.1.2. Additional jurisdictions

CESR should also assess whether, beyond the three countries mentioned in point 3.1.1., other third countries regulatory and supervisory frameworks should be included in the present evaluation. CESR is therefore invited to carry out a fact-finding exercise of the use in the European Union of credit ratings issued by credit rating agencies established in third countries other than the three mentioned in point 3.1.1. which refer to the creditworthiness of entities established in those third countries and/or to financial instruments issued in those third countries.

Should there be a confirmed need to examine the equivalence of the regulatory regimes of other third countries, the European Commission will send a new request to CESR to undertake such examination as well.

3.2. Objective of the assessment

CESR is invited to:

a) undertake a global assessment of a third country regulatory regime in accordance with Point 2.2. first indent of this Mandate;

b) advise on an early warning mechanism in case of significant changes to the third country regulatory framework foreseen after 15 February 2010; and

c) describe the supervisory arrangements provided for in the each of the above mentioned jurisdictions which ensure that the regulatory framework applicable to CRAs registered/authorised there is respected.

3.3. Negative outcome of the equivalence assessment

In case where CESR's advice to the Commission would be that there is no equivalence of a third country regulatory regime, CESR is invited to identify clearly those areas where significant discrepancies exist. It is also invited to suggest any solutions which could be considered by the Commission to overcome such discrepancies. Such solutions could be sought from that third country in the context of expected bilateral discussions between the Commission and the third country authorities concerned in order to reach a positive outcome of the equivalence assessment.

Annex 2

16 July 2009
Ref.: CESR/09-719

Assessing the equivalence of CRA regulatory frameworks

1. Introduction

This questionnaire is part of the European Union's legal preparations for establishing a regulatory framework to register and supervise credit rating agencies whose ratings are used for regulatory purposes within the European Union (EU). The new CRA Regulation, due to enter into force approximately on or around the beginning of October 2009, introduces a common regulatory approach in order to enhance the integrity, transparency, responsibility, good governance, and reliability of credit rating activities, contributing to the quality of credit ratings issued in the EU. The regulation lays down the conditions for the issuance of credit ratings and rules on the organisation and conduct of credit rating agencies to promote their independence and avoidance of conflicts of interest.

Article 4a (3) of the CRA Regulation sets out that the EU-Commission may adopt an equivalence decision, stating that the legal and supervisory framework of a third country ensures that credit rating agencies authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from this Regulation and which are subject to effective supervision and enforcement in that third country.

A positive equivalence determination by the EU-Commission will allow qualifying credit rating agencies from that third country to apply to CESR for certification in accordance with the conditions and the procedure laid down in Article 4a. Those CRAs, which then become certified by the EU competent authorities, would be able to seek exemptions from specific organisational requirements set out in Section A of Annex I and Article 6 (4) as well as from the requirement of physical presence in the European Union. Any reliefs in those respects would be offered by the EU competent authorities on a case-by-case basis.

CESR was mandated by the EU-Commission to provide it with technical advice in order for it to be able to assess the equivalence of third countries regulatory (legal and supervisory) frameworks for CRAs with the EU regulatory framework which will be introduced by the CRA Regulation.

CESR recognises that your time is at a premium, but points out that your answers to this questionnaire will be the first step in establishing whether or not credit rating agencies from your jurisdiction will be able to operate in the European Union following the implementation of the Regulation. As such, your answers are very important and are essential in building an accurate picture of the regulatory framework a credit rating agency faces when operating in your jurisdiction.

CESR is aware of the fact that some of the third country regimes that is going to assess will not have been fully adopted by the time it issues its advice. Therefore, that advice will have to be updated as the implementation schedule develops in those countries.

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

With respect to assessing the equivalence of third country regulatory frameworks and providing advise to the Commission, CESR is running to an extremely tight time schedule, and as such invites you to complete the survey before **1st September 2009**.

All the information you provide will be treated in the strictest confidence

When you have completed the questionnaire please return it via e-mail to rgarcia@cesr.eu and jruiz@cnmv.es. If you have any queries or if you would like further information about this survey please do not hesitate to contact either Javier Ruiz (jruiz@cnmv.es), Raquel García (rgarcia@cesr.eu) or Jörg Schmidt-Ebeling (Joerg.Schmidt-Ebeling@bafin.de).

Instructions to fill in the questionnaire

In order to use this document as a form –and therefore be able to tick on the boxes and fill in the grey areas you need to follow these steps:

- In the bar on top of the screen, click on ***tools***
- Then click on ***protect document***
- Then a new menu pops up on the right side of the screen. Go there and on the second item ***editing restrictions*** tick the box ***allow only this type of editing in the document***
- Scrolls down the menu displayed below and choose ***filling in forms***
- Now go to the third item ***start enforcement*** and click on the box ***Yes, start enforcing protection***
- Then a new window pops up: ***start enforcing protection***. Just click on ***accept*** (no need for password)
- Now you should be able to fill in the document

2. Definitions

The following definitions are taken from Article 3 of the new EU Regulation to facilitate a common understanding of what CESR means when using certain terms throughout this questionnaire:

"credit rating" means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a financial instrument, issued using an established and defined ranking system of rating categories;

"credit rating agency" means a legal person whose occupation includes the issuance of credit ratings on a professional basis;

"rating analyst" means a person who performs analytical functions that are necessary for the issuance of a credit rating;

"lead rating analyst" means a person with primary responsibility for elaborating a credit rating or for communication with the issuer with respect to a particular credit rating or, generally, with respect to the credit rating of a financial instrument issued by that issuer and, where relevant, for preparing recommendations to the rating committee in relation thereto;

"rating category" means a rating symbol, such as a letter symbol or a numerical symbol which might be accompanied by appending identifying characters, used in a credit rating to provide a relative measure of risk to distinguish the different risk characteristics of the types of rated entities, issuers and financial instruments or other assets.

3. Legislative Framework

3.1 General

1. Is there some form of legally binding regulatory and/or supervisory framework for credit rating agencies in your jurisdiction?

☒ Yes ☐ No

(please provide details of this framework)

Further Response to Question 1

Please refer to Appendix I for a comprehensive discussion of the laws and regulations governing the activities of credit rating agencies in the US that are registered as "nationally recognized statistical rating organizations" ("NRSROs"). In addition, please refer to Appendix II setting forth: (1) the text of relevant sections of the Securities Exchange Act of 1934 (the "Exchange Act"); and (2) the regulations adopted by the United States Securities

and Exchange Commission ("Commission") to establish a registration and oversight program for NRSROs.

The US Congress passed the Credit Rating Agency Reform Act of 2006 ("Rating Agency Act") with the goals of improving ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry. The Rating Agency Act defined the term "NRSRO" and provided exclusive authority to the Securities and Exchange Commission ("Commission") to implement registration, recordkeeping, financial reporting and oversight rules with respect to NRSROs. It also provided the Commission with authority to examine and take enforcement actions against NRSROs. The term "NRSRO" is used in US statutes and regulations. A credit rating agency that wants to be treated as an NRSRO for the purposes of these statutes and regulations must be registered with the Commission as an NRSRO.

In June 2007, the Commission approved the rules implementing a registration and oversight program for NRSROs under the Rating Agency Act. The rules became effective that same month. In June 2008, the Commission proposed a set of amendments to the NRSRO rules; the majority of these amendments were adopted in February 2009. At that time, the Commission proposed an additional set of amendments, which were adopted on September 17, 2009.

Rule 17g-1 prescribes, among other things, how a credit rating agency may apply to be with the Commission as an NRSRO and how a registered NRSRO is required to keep its registration up-to-date. Specifically, these actions must be accomplished by furnishing the Commission with a Form NRSRO. Pursuant to Rule 17g-1, an NRSRO must disclose information about: (1) the firm's ratings performance statistics (e.g., default and transition statistics over 1, 3, and 10 year time periods) for each class of credit ratings for which the NRSRO is registered.; (2) the firm's methodologies for determining credit ratings, including whether and, if so, how information about verification performed on assets underlying or referenced by a structured finance product is relied on in determining the rating and whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a structured finance product factor into the determination of credit ratings; (3) the firm's methodologies for monitoring credit ratings, including how frequently credit ratings are reviewed, whether different models are used for surveillance, and whether changes to initial rating or surveillance models are applied retroactively to existing ratings; (4) the firm's policies for preventing the misuse of material non-public information; (5) the firm's organizational structure; (6) the firm's code of ethics; (7) the conflicts of interest inherent in the firm's activities; (8) the firm's policies for managing conflicts of interest; (9) the general qualifications of the firm's credit analysts; and (10) the identification and qualifications of the firm's designated compliance officer.

Rule 17g-2, among other things, requires an NRSRO to make and retain certain financial records; document the identities of the credit analysts who determined a rating action and persons who approved the rating action; document the identities issuers that have paid for ratings and the ratings determined for them; and document all ratings methodologies. NRSROs also are required to retain records such as compliance and internal audit reports; marketing materials; and communications (e.g., emails) relating to determining ratings actions. If a quantitative model was a substantial component in the process of determining

a credit rating for a structured finance product, an NRSRO is required to make a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued. In addition, for each outstanding credit rating, an NRSRO is required to make a record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor. In addition, NRSROs with 500 or more issuer-paid credit ratings in a class of credit rating must publicly disclose the ratings histories for 10% of the current credit ratings in that class. Finally, Rule 17g-2 requires NRSROs to retain any written communications received from persons not associated with the NRSRO (e.g., individuals that are not employees) that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

Rule 17g-3, among other things, requires an NRSRO to furnish the SEC with annual reports that include: (1) audited financial statements; (2) an unaudited report of revenues received from the different types of rating services offered by the NRSRO; (3) an unaudited report of the aggregate and median compensation of the NRSRO's credit analysts; (4) an unaudited report of the 20 largest clients of the NRSRO as determined by revenues received and (5) an unaudited report indicating, for each class of credit rating for which the NRSRO is registered, the number of upgrades, downgrades, placements on watch, or withdrawals taken during the year.

Rule 17g-4, among other things, requires an NRSRO to have procedures to address the handling of material non-public information received during the rating process; the trading of securities while in possession of material non-public information; and to avoid the selective disclosure of a pending ratings decision.

Rule 17g-5, among other things, requires an NRSRO to disclose and manage each conflict of interest inherent in their business activities, including from the issuer-pay and the subscriber-pay models. It also prohibits an NRSRO from having the following conflicts: (1) receiving more than 10% of their annual revenues from a single client; (2) having an analyst rate or approve the rating for a security the analyst owns; (3) rating an affiliate; (4) having an analyst rate or approve the rating for a security of a company where the analyst is a director or officer of the company; (5) issuing or maintaining a credit rating where the NRSRO or an affiliate of the NRSRO made recommendations to issuer, obligor or arranger about how to structure the rated entity or security; (6) issuing or maintaining a credit rating where the fee paid to the NRSRO to determine or maintain the credit rating was negotiated by a credit rating analyst; and (7) issuing or maintaining a credit rating where a credit analyst who determined the rating or approved the rating received a gift from the person paying for the rating.

Rule 17g-6, among other things, prohibits an NRSRO from engaging in certain practices that are unfair, coercive or abusive. These include: (1) conditioning a rating on the rated person buying another service of the NRSRO; (2) deviating or threatening to deviate from established methodologies for determining credit ratings because an issuer did not agree to pay for the rating; (3) modifying or threatening to modify a rating because the issuer does not agree to continue to pay for the rating; and (4) employing a methodology for rating

structured finance products that discounts (notches), for anticompetitive purposes, the ratings of other NRSROs for assets underlying the structured finance product.

2. What is the definition of a CRA in your jurisdiction?

Response to Question 2

The Exchange Act defines "credit rating agency" to mean "any person—

> **(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;**
>
> **(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and**
>
> **(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof."**

The Exchange Act defines a "credit rating" to mean "an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments."

The Exchange Act defines "nationally recognized statistical rating organization" as a "credit rating agency that—

> **(A) has been in the business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under [Section 15E of the Exchange Act];**
>
> **(B) issues credit rating ratings certified by qualified institutional buyers, in accordance with Section 15E(a)(1)(B)(ix) [of the Exchange Act], with respect to –**
>
> > **(i) financial institutions, brokers, or dealers;**
> >
> > **(ii) insurance companies;**
> >
> > **(iii) corporate issuers;**
> >
> > **(iv) issuers of asset-backed securities (as that term is defined in Section 1101(c) of part 229 of Title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph);**
> >
> > **(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or**
> >
> > **(vi) a combination of one or more categories of obligors described in any of**

the clauses (i) through (v); and

(C) is registered under Section 15E [of the Exchange Act].”

3. Are CRAs in your jurisdiction currently subject to:

- A registration process? ☒ Yes ☐ No
- An authorisation process? ☒ Yes ☐ No
- Effective ongoing supervision and enforcement? ☒ Yes ☐ No

(Please specify and if necessary provide English translations of the relevant laws and regulations)

Further Response to Question 3

The application process for credit rating agencies to register with the Commission as NRSROs is prescribed in: (1) Section 15E(a) of the Exchange Act (15 U.S.C. 78o-7(a)); (2) Rule 17g-1 (17 CFR 240.17g-1) (3) and Commission form “Form NRSRO” (17 CFR 249b.300).

After registration, NRSROs are subject to provisions in Section 15E of the Exchange Act (15 U.S.C. 78o-7. For example, Section 15E(g)(1) of the Exchange Act (15 U.S.C. 78o-7(g)(1)) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information in violation of the Exchange Act (15 U.S.C. 78a et seq). Additionally, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest (15 U.S.C. 78o-7(h)(1)). And, Section 15E(j) of the Exchange Act requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws (“designated compliance officer”) (15 U.S.C. 78o-7(j)). NRSROs also are subject to the Commission’s rules under the Exchange Act governing NRSROs (discussed above and in Appendix I); namely: Rule 17g-1 (17 CFR 240.17g-1), Rule 17g-2 (17 CFR 240.17g-2), Rule 17g-3 (17 CFR 240.17g-3), Rule 17g-4 (17 CFR 240.17g-4), Rule 17g-5 (17 CFR 240.17g-5) and Rule 17g-6 (17 CFR 240.17g-6).

After registration, the books and records of an NRSRO are subject to examination by the Commission under Section 17 of the Exchange Act (15 U.S.C. 78q).

In addition, after registration, Section 15E of the Exchange Act (15 U.S.C. 78o-7) provides the Commission with authority to take actions against an NRSRO for violations of, among other things, the provisions of the statute and the Commission’s rules thereunder. For example, Section 15E(d) of the Exchange Act (15 U.S.C. 78o-7(d)) provides that the Commission shall, by order, censure, place limitations on the activities, functions or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO if, among other things, the NRSRO fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity (15 U.S.C. 78o-7(d)). The Commission also can take such action if the NRSRO or an associated person: (1)

has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Exchange Act, has been convicted of any offense specified in section 15(b)(4)(B) of the Exchange Act , or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Exchange Act of; (2) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Exchange Act, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (3) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.

Section 21B(a) of the Exchange Act to provide the Commission with authority to assess money penalties against NRSROs in proceedings instituted under Section 15E of the Exchange Act.

Refer to Appendix I for a more comprehensive discussion of the US registration and oversight program for NRSROs.

4. Have all relevant laws and regulations already entered into force?

☒ Yes ☐ No (if no, please set out the timetable for the adoption of relevant laws and regulations -and base your answers to this questionnaire on the last draft available):

5. Do you expect any significant changes to be made to the existing laws and regulations before the 15th February 2010?

☐ No ☒ Yes
(If yes please explain briefly what you anticipate these changes might be!):

Further Response to Question 5

On September 17, 2009 the Commission voted to propose additional amendments to its existing NRSRO rules and a new NRSRO rule. The proposals are described briefly below:

- **An amendment that would require an NRSRO to submit an annual report pursuant to Rule 17g-3 (17 CFR 240.17g-3) from its designated compliance officer describing the steps taken by the compliance officer during the most recently ended fiscal year to carry out the compliance officer's responsibilities.**

- **An amendment to Exhibit 6 to Form NRSRO that would require an NRSRO to publicly disclose the percentage of its total net revenues attributable to providing services to its 20 largest clients and the percentage of its total net revenue attributable to providing services other than credit rating services (e.g., ancillary services).**

- **A new rule (Rule 17g-7) that would require an NRSRO to publish and annually update a consolidated report showing the following information for each person that paid the NRSRO to determine or monitor a credit rating: (1) the percentage of the total net**

revenue attributable to the person that is derived from providing ancillary services to the person; (2) the relative standing of the person (e.g., top 10%, top 25% etc..) in terms of providing net revenues to the NRSRO; and (3) the credit ratings outstanding that were determined for the person.

6. Do you supervise CRAs also on a group level?

☒ Yes ☐ No

Further Response to Question 6

The requirements applicable to NRSROs extend to all affiliates included within the NRSROs' registration. Form NRSRO requires an NRSRO to identify any affiliates that issue credit ratings on behalf of the NRSRO. The information that an NRSRO submits and discloses in Form NRSRO must incorporate information from all credit rating affiliates identified on the Form. The credit ratings issued by these affiliates will be deemed credit ratings of the NRSRO and subject to the requirements applicable to NRSROs. The credit ratings of any affiliates not identified on the Form will not be deemed credit ratings of the NRSRO and, therefore, could not be used in the US for regulatory purposes.

7. Do you offer exemptions from specific requirements for smaller CRAs?

☒ No ☐ Yes (please explain briefly!):

8. How do you define smaller CRAs that are eligible for such exemptions?

3.2 Measures to ensure integrity and independence

Independence and avoidance of conflicts of interest

9. Are CRAs in your jurisdiction required to identify and eliminate or alternatively manage and disclose conflicts of interest?

☐ No ☒ Yes

Organisational requirements

10. Do you require a CRA to:

a. have an administrative or supervisory board? ☐ Yes ☒ No
b. be organised in a manner that ensures that it's business interest does not impair the independence and accuracy of it's credit rating activities? ☒ Yes ☐ No

c. have at least two independent directors on the CRA's administrative or supervisory board that are tasked with monitoring the credit rating policy, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest? ☐ Yes ☒ No

d. ensure that the compensation of the independent members of administrative or supervisory board is not linked to the business performance of the credit rating agency and is arranged so as to ensure the independence of their judgement? ☐ Yes ☒ No

e. ensure that the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable? ☐ Yes ☒ No

f. define a term limit for the independent members of the administrative or supervisory board?

☐ Yes ☒ No

g. If you answer yes to the previous question, please advise what the relevant period is:

(period in years)

h. ensure that the majority of members of the administrative or supervisory board, including its independent members have sufficient expertise in financial services? ☐ Yes ☒ No

i. ensure that, if the credit rating agency issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments?

☐ Yes ☒ No

j. ensure that, in addition to the overall responsibility of the board, the independent members of administrative or supervisory board have the specific task of monitoring:

- the development of the credit rating policy,? ☐ Yes ☒ No
- the development of the methodologies the CRA uses in credit rating activities?

☐ Yes ☒ No

- the effectiveness of the internal quality control system of the CRA in relation to credit rating activities? ☐ Yes ☒ No
- the effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed? ☐ Yes ☒ No
- the compliance and governance processes including the efficiency of the review function[1]? ☐ Yes ☒ No

Clarifying Note Regarding Questions 10a, 10c, 10d, 10e, 10f, 10g, 10h, 10i and 10j

While NRSROs are not subject to the requirements identified in Questions 10a, 10c, 10d, 10e, 10f, 10g, 10h, 10i and 10j above, they are subject to requirements that are designed to achieve the same objectives and effects in practice, in particular those requiring NRSROs to: (1) document their established procedures and methodologies for determining credit

[1] The function devoted to the periodical review of methodologies, models and key rating assumptions

ratings (17 CFR 240.17g-2(a)(6)); (2) to establish, maintain and enforce written policies and procedures to prevent the misuse of material non-public information (Section 15E(g) of the Exchange Act [15 U.S.C. 78o-7(g)]); (3) to establish, maintain and enforce written policies and procedures to address and manage conflicts of interest (Section 15E(h) of the Exchange Act [15 U.S.C. 78o-7(h)]); and (4) to disclose and manage certain conflict of interest inherent in their business activities while prohibiting others outright (17 CFR 240.17g-5). These provisions collectively require an NRSRO to have procedures and controls around its operations. Moreover, under Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7) an NRSRO must designate a compliance officer responsible for ensuring the NRSRO adheres to these policies and procedures.

Corporations in the United States are chartered at the state level. As such, corporate governance, including board composition, is generally regulated by state, not Federal, law.

k. establish adequate policies and procedures that ensure compliance of its obligations under your regulation? ☒ Yes ☐ No

l. have sound

- administrative and accounting procedures? ☒ Yes ☐ No
- internal control mechanisms designed to secure compliance with decisions and procedures at all levels? ☒ Yes ☐ No
- effective procedures for risk assessment ☒ Yes ☐ No
- effective control and safeguard arrangements for information processing systems? ☒ Yes ☐ No

Further Response to Questions 10k and 10l

Pursuant to Section 15E of the Exchange Act (15 U.S.C. 78o-7) and Exchange Act Rule 17g-1 (17 CFR 240.17g-1), an NRSRO is required to establish, maintain and enforce certain written policies and procedures. These include policies and procedures reasonably designed to manage conflicts of interest and to prevent the misuse of material, nonpublic information in violation of the Exchange Act. An NRSRO must disclose these policies, as well as other information including its procedures and methodologies for determining credit ratings and its code of ethics (or explanation as to why it does not have a code of ethics), on Form NRSRO. An NRSRO that did not adhere to its disclosed procedures and methodologies may be subject to liability under the federal securities laws and rules thereunder . Consequently, an NRSRO must have a control environment that is designed to ensure that it adheres to its disclosed methodologies, procedures, and policies.

Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7(j)) requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO, including policies and procedures to prevent the misuse of material nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws ("designated compliance officer"). Failing to adhere to disclosed methodologies, procedures, and policies may subject an NRSRO to liability under the federal securities laws and rules thereunder. Consequently, the designated

compliance officer is responsible for ensuring that an NRSRO adheres to its disclosed methodologies, procedures, and policies.

m. implement and maintain decision-making procedures and organisational structures, which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities?

☒ Yes ☐ No

Further Response to Question 10m

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 4 to Form NRSRO, an NRSRO is required to disclose information about its organizational structure, including, as applicable, an organizational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the NRSRO; an organizational chart showing the divisions, departments, and business units of the NRSRO; and an organizational chart showing the managerial structure of the NRSRO.

In addition, Section 15E(j) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the NRSRO established pursuant to Sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations. An NRSRO must identify the designated compliance officer in Item 4 of its Form NRSRO and include the designated compliance officer in the Exhibit 4 organizational chart described above. Exhibit 9 of Form NRSRO also requires an NRSRO to provide the following information about its designated compliance officer:

- **Name**
- **Employment history**
- **Post secondary education**
- **Whether employed by the NRSRO full-time or part-time**

n. have a permanent and effective compliance function, which operates independently?

☒ Yes ☐ No

o. establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest? ☒ Yes ☐ No

p. employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities? ☒ Yes ☐ No

q. have a function (review function) devoted to the periodical review of

- methodologies ☒ Yes ☐ No
- models ☒ Yes ☐ No
- key rating assumptions ☒ Yes ☐ No

Further Response to Questions 10p and 10q

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Form NRSRO, an NRSRO must include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure. This disclosure must be promptly amended if the information or documents provided in a previously furnished Form NRSRO become materially inaccurate. In addition, a registered NRSRO is required to provide an annual certification on Form NRSRO certifying that the information provided, including the description of its procedures and methodologies used in determining credit ratings, is accurate in all significant respects. NRSROs are also required to designate a compliance officer to ensure compliance with applicable securities laws, rules, and regulations. An NRSRO that did not adhere to its disclosed procedures and methodologies may be subject to liability under the federal securities laws and rules thereunder.

r. monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with your requirements and take appropriate measures to address any deficiencies? ☒ Yes ☐ No

Further Response to Question 10r

Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7(j)) requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws ("designated compliance officer"). Notwithstanding this designation, senior management shares the responsibility for ensuring compliance with relevant laws and regulations as well as the NRSRO's internal policies.

Operational requirements

11. Do you require a CRA to:

a. identify, eliminate or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees as well as any other natural persons whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuance of credit ratings and persons approving credit ratings? ☒ Yes ☐ No
b. publicly disclose the names of the rated entities or related third parties from which it receives more than 5 % of its annual revenue? ☐ Yes ☒ No

Clarifying Note Regarding Question 11b

Rule 17g-3(a)(5) (17 CFR 240.17g-3(a)(5)) requires an NRSRO to provide the Commission with an unaudited report of the 20 largest clients of the NRSRO as determined by revenues received on an annual basis. An NRSRO is not required to make this report public, and may request that the Commission keep the report confidential, to the extent permitted by law.

c. not issue a credit rating or, in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected where:
   - the credit rating agency or related persons[2], directly or indirectly owns financial instruments of the rated entity or any related third party or has any other direct or indirect ownership interest in that entity or party other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance; ☒ Yes ☐ No
   - the credit rating is issued with respect to a rated entity or any related third party directly or indirectly linked to the credit rating agency by control; ☒ Yes ☐ No
   - a related person is a member of the administrative or supervisory boards of the rated entity or any related third party; ☒ Yes ☐ No
   - an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interests? ☒ Yes ☐ No

d. not provide consultancy or advisory services? ☐ Yes ☒ No
e. define what they consider as such services? ☐ Yes ☒ No

Clarifying Note Regarding Questions 11d and 11e

Rule 17g-5(c)(5) (17 CFR 240.17g-5(c)(5) prohibits an NRSRO from issuing or maintaining a credit rating where the NRSRO or an affiliate of the NRSRO made recommendations to the issuer, obligor or arranger about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. In addition, Rules 17g-5(a) and (b) (17 CFR 240.17g-5(a) and (b)) require an NRSRO to publicly disclose and implement procedures to manage and address the conflict that arises from being paid to provide services other credit rating services.

Rule 17g-2(a)(5) (17 CFR 240.17g-2(a)(5)) requires an NRSRO to make a record listing the general types of services and products offered by the NRSRO, which must be promptly furnished to the Commission or its representatives pursuant to Rule 17g-2(f) (17 CFR

[2] The persons referred to in the first question of this section (*operational requirements)*

240.17g-2(f)). Rule 17g-3(a)(3) (17 CFR 240.17g-3(a)(3)) requires an NRSRO to annually furnish the Commission with a financial report providing information concerning the revenue of the NRSRO in each of the following categories (as applicable) for the fiscal year: (i) revenue from determining and maintaining credit ratings; (ii) revenue from subscribers; (iii) revenue from granting licenses or rights to publish credit ratings; and (iv) revenue from all other services and products (which must include descriptions of any major sources of revenue).

f. ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity ☒ Yes (part 1)

and shall disclose in the final ratings reports any ancillary services provided for the rated entity or any related third party?

☒ No (part 2)

Clarifying Note Regarding Question 11f

Question 11f appears to ask two separate questions. The answer to the first question is "yes," as Rule 17g-5(c)(5) (17 CFR 240.17g-5(c)(5) prohibits an NRSRO from issuing or maintaining a credit rating where the NRSRO or an affiliate of the NRSRO from making recommendations to the issuer, obligor or arranger about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. In addition, Rules 17g-5(a) and (b) (17 CFR 240.17g-5(a) and (b)) require an NRSRO to publicly disclose and implement procedures to manage and address the conflict that arises from being paid to provide services other credit rating services. An NRSRO is not, however, required to disclose any ancillary services provided when issuing its final ratings.

g. ensure that rating analysts or persons that approve ratings cannot make proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating?

☒ Yes ☐ No

h. design its reporting and communication channels so as to ensure independence of related persons from the other activities of the credit rating agency carried out on a commercial basis? ☒ Yes ☐ No

i. keep adequate records and audit trails of all its rating activities at its premises for at least five years?

☐ Yes ☒ No

Clarifying Note Regarding Question 11i

Rule 17g-2 (17 CFR 240.17g-2), among other things, requires an NRSRO to make and retain certain records for a period of three years. The three year retention period is designed to require the NRSRO to retain the records for a sufficiently long period of time so that they will be available to Commissioner examiners for at least one examination cycle and available to the NRSRO's internal auditors and compliance personnel for at least one internal audit or compliance review cycle. The records that must be retained under Rule

17g-2, include documenting the identities of the credit analysts who determined a rating action and persons who approved the rating action; records documenting the identities of the issuers that have paid for ratings and the ratings determined for them; and records documenting all ratings methodologies. The rule also requires NRSROs to retain records such as compliance reports and compliance exception reports, internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the internal auditors of the NRSRO as necessary to perform the audit of an activity that relates to its business as a credit rating agency. In addition, an NRSRO must retain marketing materials and communications (e.g., emails) relating to determining ratings actions, including communications received from persons not associated with the NRSRO (e.g., individuals that are not employees) that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating. If a quantitative model was a substantial component in the process of determining a credit rating for a structured finance product, an NRSRO is required to make a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued. In addition, for each outstanding credit rating, an NRSRO is required to make a record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor.

12. What other operational requirements ensure that a CRA takes all necessary steps to ensure that the issuance of a credit rating is not affected by any existing or potential conflict of interest or business relationship?

Response to Question 12

Please refer to the discussion in Appendix I and the citations in Appendix II for the following provisions, among others, addressing conflicts of interest: (1) Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7); (2) Section 15E(h) of the Exchange Act; Exhibits 6 and 7 of Form NRSRO; and Rule 17g-5 (17 CFR 240.17g-5).

Rating analysts, employees and other persons involved in the issuance of credit ratings

13. Are CRAs required to ensure that rating analysts, employees of the credit rating agency as well as any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned?

☐ Yes ☒ No (if yes, please explain how this is verified?)

Clarifying Note Regarding Question 13

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 8 to Form NRSRO, an NRSRO is required to disclose the following information regarding credit analysts and the persons who supervise credit analysts:

- **The total number of credit analysts.**
- **The total number of credit analyst supervisors.**
- **A general description of the minimum qualifications required of the credit analysts, including education level and work experience (if applicable, distinguishing between junior, mid, and senior level credit analysts).**
- **A general description of the minimum qualifications required of the credit analyst supervisors, including education level and work experience.**

An NRSRO whose analysts and supervisors did not conform to this disclosed information may be subject to liability under the federal securities laws and rules thereunder. In addition, NRSROs are required to document their established procedures and methodologies for determining credit ratings (17 CFR 240.17g-2(a)(6)). An NRSRO must follow its documented procedures when determining credit ratings or it may be subject to liability under the federal securities laws and rules thereunder. Therefore, an NRSRO must have analysts with the expertise to determine credit ratings in the manner documented by the NRSRO.

14. Does your regulatory framework require that rating analysts are not involved in the negotiation of the fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control?

☒ Yes ☐ No (please explain briefly!):

Further Response to Question 14

Rule 17g-5(c)(6) (17 CFR 240.17g-5(c)(6)) prohibits an NRSRO from issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models.

15. Does your regulatory framework contain the following or similar prohibitions regarding rating analysts and other persons (described below) directly involved in credit rating activities?

a. Rating analysts and employees of the CRA as well as any other natural persons whose services are placed at the disposal or under the control of the CRA and who are directly involved in credit rating activities, as well as persons closely associated with shall not buy or sell or engage in any transaction in any financial instrument issued, guaranteed, or otherwise supported by any rated entity within the area of primary analytical responsibility of those persons, other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance.

☒ Yes ☐ No

b. No person referred to in question 15.a shall participate in or otherwise influence the determination of a credit rating of any particular rated entity if this person:

a) owns financial instruments of the rated entity, other than holdings in diversified collective investment schemes; ☒ Yes ☐ No

b) owns financial instruments of any entity related to a rated entity, the ownership of which may cause or may be generally perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes; ☐ Yes ☒No

Clarifying Note Regarding Question 15b.b

It is unclear what is meant by "entity related to a rated entity." As discussed below, credit analysts cannot participate in the determination of a credit rating if they own securities being rated. Moreover, NRSROs must have policies and procedures designed to address the situation where an employee that did not participate in the rating owns securities subject to a rating of the NRSRO. Specifically, Rules 17g-5(a) and (b) (17 CFR 240.17g-5(a) and (b)) require an NRSRO to disclose and implement procedures to address having persons within the NRSRO who directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO. However, this only is permitted if the person within the NRSRO does not participate in determining a credit rating for the issuer or obligor. Specifically, Rule 17g-5(c)(4) (17 CFR 240.17g-5(c)(4)) prohibits an NRSRO from issuing or maintaining a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, where the NRSRO, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating.

c) has had a recent employment or other business relationship or any other relationship with the rated entity that may cause or may be generally perceived as causing a conflict of interest.

☐ Yes ☒No

Clarifying Note Regarding Question 15b.c

Rules 17g-5(a) and (b) (17 CFR 240.17g-5(a) and (b)) require an NRSRO to disclose and implement procedures to address allowing persons within the NRSRO to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the NRSRO. In addition, Rule 17g-5(c) (17 CFR 240.17g-5(c)) prohibits an NRSRO from issuing or maintaining a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating.

Moreover, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest. Allowing its analysts to have employment, business, or other relationships with rated entities that could cause the analyst to be unduly influenced in the performance of determining credit ratings may constitute evidence that an NRSRO did not have reasonably designed procedures for managing this conflict.

c. Are CRAs required to ensure that persons referred to in question 15a of this section:

a) take all reasonable measures to protect property and records in possession of the credit rating agency from fraud, theft or misuse taking into account the nature, scale and complexity of their business and the nature and range of their credit rating activities; ☒ Yes ☐ No
b) do not disclose any information about credit ratings or possible future credit ratings of the credit rating agency, except to the rated entity or its related third party; ☒ Yes ☐ No
c) do not share confidential information entrusted to the credit rating agency with rating analysts and employees of any person directly or indirectly linked to it by control as well as with any other natural persons whose services are placed at the disposal or under the control of any person directly or indirectly linked to it by control and who is directly involved in the credit rating activities; ☒ Yes ☐ No
d) do not use or share confidential information for the purpose of trading financial instruments, or for any other purpose except the conduct of the credit rating activities. ☒ Yes ☐ No

d. Are those persons referred to in question 15a of this section prohibited from soliciting or accepting money, gifts or favours from anyone with whom the CRA does business?
☒ Yes ☐ No

e. If a person referred to in question 15a of this section considers that any other such person has engaged in a conduct that he or she considers to be illegal, is it required to report such information immediately to the compliance officer without negative consequences for the reporting person?
☐ Yes ☒ No

f. Where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, a is the CRA required to review the relevant work of the analyst preceding his departure? ☐ Yes ☒ No

g. For what period prior to that rating analyst departure (in years or months) is the rating analysts pervious work required to be reviewed?

☐ years ☐ months

h. Are those persons referred to in question 15a of this section prohibited from taking up a key management position with the rated entity or its related third party for a period of at least 6 months since the date of said person assigning that entity or its related third party a credit rating?
☐ Yes ☒ No

Clarifying Note Regarding Questions 15e, 15f, and 15h

The legislation and rules requiring NRSROs to disclose and manage certain conflicts of interest inherent in their business activities while prohibiting others outright are meant to detect and prevent the undue influence issues raised in these questions. Please refer to the discussion in Appendix I and the citations in Appendix II for the following provisions, among others, addressing conflicts of interest: (1) Section 15E(j) of the Exchange Act (15

U.S.C. 78o-7); (2) Section 15E(h) of the Exchange Act; Exhibits 6 and 7 of Form NRSRO; and Rule 17g-5 (17 CFR 240.17g-5).

In addition, the SEC's examination authority over NRSROs is designed to uncover any instances of undue influence. The SEC could initiate enforcement action were examiners to determine that a rating was influenced by the conflicts referred to in these questions in violation of federal securities laws and SEC rules.

i. If the period is less than 6 months, please advise what the relevant period is.

Period ☐ (in months)

16. Are CRAs required to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings?

☒ No ☐ Yes (if yes, please describe the rotation policy):

- What is the maximum amount of time (in years or months) that each of the following persons are allowed to be involved in the credit rating activities relating to the same rated entity or its related third parties?
  - lead rating analysts
  - rating analysts
  - persons approving credit ratings

17. Are lead analysts, rating analysts, and persons approving credit ratings required to be involved in credit ratings activities with a rated entity or its related third party for a minimum amount of time?

☒ No ☐ Yes (if yes, please specify the amount of time in months or years)

18. Does your regulatory framework prohibit a link between a rating analysts' compensation and performance evaluation and the revenue he or she generates for the CRA?

☐ Yes ☒ No

Clarifying Note Regarding Questions 16, 17 and 18

Rule 17g-5 (17 CFR 240.17g-5) includes prohibitions on an NRSRO issuing or maintaining a credit rating where:

- **the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models; or**
- **A credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $25.**

Please refer to the discussion of conflict of interest requirements set forth in Appendix I and the citations in Appendix II for the following provisions, among others: (1) Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7); (2) Section 15E(h) of the Exchange Act; Exhibits 6 and 7 of Form NRSRO; and Rule 17g-5 (17 CFR 240.17g-5).

Moreover, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest. Linking analysts' compensation and performance evaluations to revenue generated by the analyst in a manner that caused the analyst to be unduly influenced in the performance of determining credit ratings may constitute evidence that an NRSRO did not have reasonably designed procedures for managing this conflict.

Methodologies, models and key rating assumptions

19. Are CRAs required to disclose the following information?
(please tick the relevant box!)

a. the fact that it is registered in accordance with the relevant laws and regulations ☒ Yes ☐ No

b. any actual and potential conflicts of interest ☒ Yes ☐ No

c. list of its ancillary services ☐ Yes ☒ No

Clarifying Note Regarding Question 19c

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 12 to Form NRSRO, an NRSRO is required to provide the Commission with information regarding revenue derived from all other services and products offered besides credit rating services, including descriptions of any major sources of revenue. An NRSRO is not required to publicly disclose the information required under Exhibit 12, and may request that the Commission keep such information confidential to the extent permitted by law.

d. the policy of the CRA concerning the publications of credit ratings and other related communications ☒ Yes ☐ No

e. the general nature of its compensation arrangements ☒ Yes ☐ No

f. the methodologies, and descriptions of models and key ratings assumptions such as mathematical or correlation assumptions used in its credit rating activities as well as their material changes ☒ Yes ☐ No

g. any material modification to its systems, resources or procedures ☒ Yes ☐ No

h. its code of conduct ☒ Yes ☐ No

20. Are CRAs required to periodically disclose the following information?
(please tick the relevant box and specify the frequency within which the disclosure is required!)

a. data about the historical default rates of its rating categories (please specify the frequency!)
☒ Yes ☐ No
1, 3 and 10 year periods

- distinguishing between the main geographical areas of the issuers and, ☐ Yes ☒ No
- whether the default rates of these categories have changed over time ☒ Yes ☐ No

b. a list of the largest 20 clients of the CRA by revenue generated of them (please specify the frequency!): ☐ Yes ☒ No

Clarifying Note Regarding Question 20b

Rule 17g-3(a)(5) (17 CFR 240.17g-3(a)(5)) requires an NRSRO to furnish the Commission on an annual basis a financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the NRSRO by amount of net revenue attributable to the issuer or subscriber during the fiscal year. An NRSRO is not required to make this information public and may request that the Commission keep such information confidential to the extent permitted by law. Pursuant to Section 15E(k) of the Exchange Act (15 U.S.C. 78o-7(k)), this information is disclosed on a confidential basis.

c. a list of the CRA's clients whose contribution to the growth rate in the generation of revenue of the CRA in the previous financial year exceeded the growth rate in the total revenues of the CRA in that year by a factor of more than 1,5 times. (please specify the frequency!):

☐ Yes ☒ No

(client means an entity, its subsidiaries, and associated entities in which the entity has holdings of more than 20%, as well as any other entities in respect of which it has negotiated the structuring of a debt issue on behalf of a client and where a fee was paid, directly or indirectly, to the CRA for the ratings of that debt issue.)

Clarifying Note Regarding Question 20c

Although there is no public disclosure requirement for the clients referenced in Question 20c, Rule 17g-5(c) (17 CFR 240.17g-5(c)) prohibits an NRSRO from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the

NRSRO with net revenue (as reported under Rule 17g-3) equaling or exceeding 10% of the total net revenue of the NRSRO for the most recently ended fiscal year.

21. Are CRAs in your jurisdiction required

a. to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies? ☐ Yes ☒ No

b. to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources? ☐ Yes ☒ No

c. to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing? ☐ Yes ☒ No

d. not to refuse to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another CRA, where a CRA is using an existing credit rating prepared by another credit rating agency with respect to underlying assets or structured finance instruments? ☐ Yes ☒ No

Clarifying Note Regarding Question 21d

Rule 17g-6(a)(9) (17 CFR 240.17g-6(a)(4)) prohibits an NRSRO from issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw a credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the NRSRO, where such practice is engaged in by the NRSRO for an anticompetitive purpose. In addition, Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 of Form NRSRO, an NRSRO must include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure and pursuant to Rule 17g-2(a)(6) an NRSRO must internally document its procedures. An NRSRO whose practices did not conform to this disclosed and internally documented information may be subject to liability under the federal securities laws and rules thereunder.

e) to record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to underlying assets or structured finance instruments providing a justification for the differing assessment? ☒ Yes ☐ No

Clarifying Note Regarding Question 21e

Rule 17g-2(a)(7) (17 CFR 240.17g-2(a)(7)), which sets forth the recordkeeping requirements applicable to credit ratings for structured finance products, requires an NRSRO to make a record any time it takes into consideration credit ratings for the pool assets determined by another NRSRO (whether or not it uses such ratings). Rule 17g-2(b)(10) (17 CFR 240.17g-2(b)(10)) requires the NRSRO to retain this record.

f. to monitor its ratings and methodologies on an on-going basis and at least annually? ☐ Yes ☒ No

Clarifying Note Regarding Question 21f

Pursuant to Exchange Act Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 to Form NRSRO, an NRSRO is required to disclose its methodologies for monitoring credit ratings, including how frequently credit ratings are reviewed. An NRSRO that did not adhere to its disclosed methodologies may be subject to liability under the federal securities laws and rules thereunder.

g. to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings?

☐ Yes ☒ No

h. When methodologies, models or key rating assumptions used in credit rating activities are changed are CRAs required:

- to apply the changes in methodologies and models consistently to existing ratings?

☐ Yes ☒ No

- to immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings

☐ Yes ☒ No

- to review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation

☐ Yes ☒ No

Clarifying Note Regarding Question 21g and 21h

Pursuant to Exchange Act Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 to Form NRSRO, an NRSRO is required to disclose its methodologies for monitoring credit ratings, including whether different models are used for surveillance and whether changes to initial rating or surveillance models are applied retroactively to existing ratings. An NRSRO that did not provide the required disclosures may be subject to liability under the federal securities laws and rules thereunder.

Disclosure and presentation of credit ratings

22. Are CRAs in your jurisdiction required to:

a. disclose any credit rating, as well as any decisions to discontinue a credit rating on a non-selective basis and in a timely manner? ☒ Yes ☐ No

Further Response to Question 22a

Section 15E(g)(1) of the Exchange Act (15 U.S.C. 78o-7(g)(1)) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information in violation of the Exchange Act. In addition, Rule 17g-4(a)(3) (17 CFR 240.17g-4(a)(3)) requires an NRSRO to implement procedures designed to address the inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.

b. disclose the decision to discontinue a credit rating including the reasons for such a decision?

☐ Yes ☒ No

c. differentiate the ratings of structured products by adding a specific symbol? ☐ Yes ☒ No

Clarifying Note Regarding Question 22c

In September 2009, the Commission announced that it was soliciting additional comments regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings and the risks relating to structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information.

d. have a clear and fair policy in relation to unsolicited ratings, which shall be differentiated as such?

☒ Yes ☐ No

Clarifying Note Regarding Question 22d

Rule 17g-6 (17 CFR 240.17g-4(a)(3)) prohibits an NRSRO from conditioning or threatening to condition issuing a credit rating, issuing or threatening to issue a credit rating not in accordance with its established procedures or methodologies, or modifying or threatening to modify a rating based on whether the rated person, or affiliate of the person, purchases the credit rating or any other service or product of the NRSRO. An NRSRO that uses the threat of an unsolicited rating to influence an issuer in any manner may be subject to liability under the federal securities laws and rules thereunder.

e. prominently state in the credit rating whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts and other relevant internal documents of the rated entity or its related third party, when a CRA issues an unsolicited credit rating? ☐ Yes ☒ No

Clarifying Note Regarding Questions 22d and 22e

Pursuant to Exchange Act Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 to Form NRSRO, an NRSRO is required to provide on its Form NRSRO a general description of the procedures and methodologies used by the NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the NRSRO is registered. This disclosure must include, as applicable, descriptions of the NRSRO's policies for determining whether to initiate a credit rating and a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors.

f. ensure that they do not use the name of any relevant authority in such a way that would indicate or suggest endorsement or approval by that authority of the credit ratings or any credit rating activities of the CRA? ☒ Yes ☐ No

Clarifying Note Regarding Question 22f

Section 15E(f) (15 U.S.C. 78o-7(f)) of the Exchange Act states that it shall be unlawful for any NRSRO to represent or imply in any manner whatsoever that such NRSRO has been designated, sponsored, recommended, or approved, or that the abilities or qualifications thereof have in any respect been passed upon, by the United States or any agency, officer, or employee thereof.

g. ensure that they state clearly and prominently the name and job title of the lead rating analyst in a given credit rating activity and the name and position of the person primarily responsible for approving the credit rating? ☐ Yes ☒ No

Clarifying Note Regarding Question 22g

Pursuant to Rule 17g-2(a)(2) (17 CFR 240.17g-2(a)(2)) an NRSRO must make and retain internal records documenting the identities of the credit analysts who determined a rating action and the persons who approved the rating action.

23. Are CRAs in your jurisdiction required to ensure that at least:

- all substantially material sources used to prepare the credit rating are indicated?

  ☐ Yes ☒ No

- the principal methodology or methodology version that was used in determining the rating is clearly indicated, with a reference to its comprehensive description? ☐ Yes ☒ No
- the meaning of each rating category and the definition of default or recovery is explained? ☒ Yes ☐ No

- the date at which the credit rating was first released for distribution and when it was last updated is indicated clearly and prominently? ☐ Yes ☒ No
- information on whether the credit rating concerns a newly issued financial instrument and whether the credit rating agency is rating the financial instrument for the first time?

☐ Yes ☒ No

24. Are CRAs in your jurisdiction required to inform the entity subject to the rating at least 12 hours before publication of the credit rating and of the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors?
☐ Yes ☒ No

25. Are CRAs in your jurisdiction required to disclose to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on? ☒ Yes ☐ No

26. Are CRAs in your jurisdiction required to state clearly and prominently when disclosing credit ratings any attributes and limitations of the credit rating? ☐ Yes ☒ No

Clarifying Note Regarding Question 26

In September 2009, the Commission announced that it was soliciting additional comments regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings and the risks relating to structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information.

27. Are CRAs in your jurisdiction required to refrain from issuing a credit rating or withdraw an existing rating if it does not have sufficient quality information to base its ratings on?
☐ Yes ☒ No

Clarifying Note Regarding Question 27

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 of Form NRSRO, an NRSRO must include a description of its procedures and methodologies used in determining credit ratings in its Form NRSRO disclosure and pursuant to Rule 17g-2(a)(6) an NRSRO must internally document its procedures. An NRSRO whose practices did not conform to this disclosed and internally documented information may be subject to liability under the federal securities laws and rules thereunder.

28. Are CRAs in your jurisdiction required to explain in its press releases or reports the key elements underlying the credit rating when announcing a credit rating? ☐ Yes ☒No

Clarifying Note Regarding Question 28

In September 2009, the Commission announced that it was soliciting additional comments regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings and the risks relating to structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information.

29. Are CRAs in your jurisdiction required to publish information on their historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes? ☒ Yes ☐ No

30. Are CRAs required to provide in the credit ratings of structured finance instruments all information about:
    - loss and cash-flow analysis it has performed or is relying upon and ☐ Yes ☒ No
    - an indication of any expected change of the credit rating ☐ Yes ☒ No

    where a CRA rates a structured finance instrument?

31. Does your regulatory framework require that CRAs have to state what level of assessment they have performed concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments? ☒ Yes ☐ No

32. Does your regulatory framework require a CRA to disclose whether it has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment, indicating how the outcome of such assessment impacts the credit rating? ☐ Yes ☒ No

Clarifying Note Regarding Question 32

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Exhibit 2 to Form NRSRO, an NRSRO is required to disclose a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; and the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings. An NRSRO that did not adhere to its disclosures may be subject to liability under the federal securities laws and rules thereunder.

33. Does your regulatory framework require a CRA to disclose the models, methodologies and key assumptions on which it bases its ratings including clear and easily comprehensible guidance?

☒ Yes ☐ No

34. Does your regulatory framework require a CRA to disclose, on an ongoing basis, information about all structured finance products submitted to it for their initial review or for preliminary rating even when an issuer does not contract with the credit rating agency for a final rating? ☐ Yes ☒ No

Clarifying Note Regarding Question 34

On September 17. 2009, the SEC proposed rule amendments that would require disclosure of credit ratings and related information in registration statements when ratings are used in connection with selling registered securities. The proposed information to be disclosed would include whether any "preliminary ratings" were obtained from other rating agencies, regardless of whether the issuer contracted with the credit rating agency for a final rating.

3.3 Measures relating to ratings' quality and enhancing the transparency of the rating activity

Outsourcing

35. Are CRAs in your jurisdiction allowed to outsource important operational functions?
☐ No ☒ Yes (please explain briefly what activities can be outsourced!):

36. Do CRAs face any restrictions with respect to outsourcing?
☐ No ☒ Yes (please explain briefly what these restrictions are!):

Further Response to Questions 35 and 36

An NRSRO cannot outsource responsibility for compliance with the requirements of Section 15E of the Exchange Act and rules adopted by the Commission thereunder.

37. How does the regulatory framework in your jurisdiction ensure that:
- none of the outsourced functions impair the quality of the CRAs internal controls?
- outsourcing does not impair the ability of the relevant authority to supervise the CRAs compliance with its obligations under your jurisdiction's regulatory requirements?

Response to Question 37

Pursuant to Section 15E(j) of the Exchange Act, an NRSRO must designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws ("designated compliance officer") (15 U.S.C. 78o-7(j)). Neither this position nor the compliance function as a whole may be outsourced. An NRSRO is directly responsible for maintaining all internal controls mandated by law or regulation.

Pursuant to Rule 17g-2(e) (17 CFR 240.17g-2(e)), the records an NRSRO is required to retain under paragraphs (a) and (b) of Rule 17g-2 may be made or retained by a third-party record custodian, provided the NRSRO furnishes the SEC with a written undertaking of the custodian executed by a duly authorized person. This undertaking is required to specify that the third-party signatory acknowledges that any books and records it has made or is retaining for the NRSRO are the exclusive property of the NRSRO. The custodian is further required to undertake that upon the request of the NRSRO, it will promptly provide the books and records to the NRSRO or the SEC, and that upon the request of the SEC it will

promptly permit examination of the records at any time and promptly furnish to the SEC a true and complete copy of any or all or any part of such books and records.

Rule 17g-2(e) explicitly states that an NRSRO that engages a third-party record custodian remains responsible for complying with every provision of the rule.

Disclosure

38. Are CRAs in your jurisdiction required to publicly disclose the following information on at least an annual basis? (Please tick) In the event that this information is not disclosed on an annual basis, please specify the frequency of disclosure.

a. detailed information about the:

- legal structure of the CRA ☒ Yes ☐ No
- ownership of the CRA ☒ Yes ☐ No
- financial information regarding its revenue streams ☐ Yes ☒ No

Clarifying Note Regarding Question 38a

Pursuant to Rule 17g-3 (17 CFR 240.17g-3), an NRSRO is required to provide the Commission with information regarding its aggregate revenues, including:

- **Revenue from determining and maintaining credit ratings;**
- **Revenue from subscribers;**
- **Revenue from granting licenses or rights to publish credit ratings; and**
- **Revenue from all other services and products offered by your credit rating organization (include descriptions of any major sources of revenue).**

Section 15E(k) of the Exchange Act provides that an NRSRO can provide this information to the Commission on a confidential basis.

b. a description of:

- the internal control mechanism ensuring quality of the credit rating activities ☒ Yes ☐ No
- the CRA's record-keeping policy ☐ Yes ☒ No
- the CRA's quality control system ☐ Yes ☒ No
- the CRA's management and analyst rotation policy ☐ Yes ☒ No

Clarifying Note Regarding Question 38b

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Form NRSRO, an NRSRO must disclose on Form NRSRO, among other things, (1) a description of its procedures and methodologies used in determining credit ratings, including whether and, if so, how information about

verification performed on assets underlying or referenced by a structured finance product is relied on in determining the rating and whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a structured finance product factor into the determination of credit ratings; (2) its methodologies for monitoring credit ratings, including how frequently credit ratings are reviewed, whether different models are used for surveillance, and whether changes to initial rating or surveillance models are applied retroactively to existing ratings; (3) its policies for preventing the misuse of material non-public information; (4) its code of ethics; (5) the conflicts of interest inherent in its activities and its policies for managing conflicts of interest (which could include, if applicable, analyst rotation policies); (6) the general qualifications of the firm's credit analysts; and (7) the identification and qualifications of the firm's designated compliance officer.

c. statistics on:

- staff allocation to new credit ratings ☐ Yes ☒ No
- credit rating reviews ☐ Yes ☒ No
- methodology or model appraisal ☐ Yes ☒ No
- senior management ☐ Yes ☒ No

Clarifying Note Regarding Question 38c

Pursuant to Rule 17g-1 (17 CFR 240.17g-1) and Form NRSRO, an NRSRO is required to disclose both its total number of credit ratings and its total number of analysts and analyst supervisors, which allows calculations of analyst-to-ratings ratios and provides information on a NRSRO's managerial ranks. Rule 17g-1 and Form NRSRO also require the disclosure of the NRSRO's ratings performance statistics (e.g., default and transition statistics over 1, 3, and 10 year time periods) for each class of credit ratings for which the NRSRO is registered.

Pursuant to Rule 17g-2 (17 CFR 240.17g-2) requires NRSROs with 500 or more issuer-paid credit ratings in a class of credit rating to publicly disclosure the ratings histories for 10% of the current credit ratings in that class. In addition, pursuant to an amendment to that rule adopted on September 17, 2009 but not yet in effect, must publicly disclose the ratings history information for all current credit ratings initially determined by the NRSRO on or after June 26, 2007. In each case, there is a grace period between the time the rating action occurs and the requirement to disclose the information.

Rule 17g-3 (17 CFR 240.17g-3) requires an NRSRO to furnish to the SEC (but does not require the NRSRO to disclose publicly) an unaudited report indicating, for each class of credit rating for which the NRSRO is registered, the number of upgrades, downgrades, placements on watch, or withdrawals taken during the year.

d. the outcome of the internal review of the CRA's independence compliance function ☐ Yes ☒ No

e. other information not specified above (please explain briefly!):

For how many years has the information mentioned in question 38 to be available to the public?

Response to Question 38

The Commission's regulations implementing the NRSRO registration and oversight program under the Rating Agency Act became effective in June 2007. A registered NRSRO must make its Form NRSRO, containing the information discussed above, public. The Commission approved the applications of seven NRSROs in September 2007 and one apiece in December 2007, February 2008 and June 2008. The NRSROs began disclosing the types of information identified above within weeks of being registered.

4. Supervisory issues

4.1 Personnel

39. How do you ensure that your authority is adequately staffed, with regard to capacity and expertise, in order to be able to apply the CRA regulation in your jurisdiction? (please explain briefly!):

Response to Question 39

The Commission determines appropriate staffing level for the divisions and offices responsible for oversight of the Commission's NRSRO regulations. Those include the Division of Trading and Markets, the Division of Enforcement, and the Office of Compliance, Inspections, and Examinations.

4.2 Powers of the relevant authorities in jour jurisdiction

40. Are you or any other public authorities in your country allowed to influence the content of ratings or CRAs methodologies?

☒ No ☐ Yes (if yes please explain briefly!):

41. How do you ensure that your authority does not interfere with the content of ratings or CRAs methodologies? (please explain briefly!):

Response to Question 41

Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o-7(c)(2)) prohibits the Commission, nor any State (or political subdivision thereof) from regulating the substance of credit ratings or the procedures and methodologies by an NRSRO determines credit ratings.

42. Are you able to exercise your supervisory and investigative powers

- directly ☒ Yes ☐ No
- in collaboration with other entities ☒ Yes ☐ No
- by application to the competent judicial authorities ☐ Yes ☒ No

in order to carry out your duties under the regulation in your jurisdiction?

43. Does your authority have the following powers for use in your supervisory capacity on CRAs?

- power to access to any document in any form and to receive or take a copy thereof ☒ Yes ☐ No

- power to demand information from any person and if necessary to summon and question a person with a view to obtaining information ☒ Yes ☐ No
- power to carry out on-site inspections with or without announcement ☒ Yes ☐ No
- power to require records of telephone and data traffic ☒ Yes ☐ No

44. Where you have established that a registered CRA is in breach of the obligations arising from the relevant regulatory framework in your jurisdiction, does your authority have the power to use the following measures?

- withdraw the CRA's registration or authorisation? ☒ Yes ☐ No
- prohibit the CRA from temporarily, issuing credit ratings? ☒ Yes ☐ No
- suspend the use of credit ratings issued by the CRA for regulatory purposes? ☒ Yes ☐ No
- take appropriate measures to ensure that the CRA continues to comply with its legal requirements? ☒ Yes ☐ No
- issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction ? ☒ Yes ☐ No
- refer matters for criminal prosecution to the relevant national authorities? ☒ Yes ☐ No

Further Response to Questions 43-44

Exchange Act Section 21(b) provides the SEC with the authority to issue subpoenas, while Section 21(d)(1) provides the SEC with the authority to transfer evidence to the Attorney General for possible criminal prosecution. In addition, under Exchange Act Section 21(h)(9)(B), the SEC is authorized to transfer customer information to the Attorney General without giving notice to the customer.

4.3 Penalties

45. Does your legislation sets out penalties applicable to infringements of your regulatory framework?

☒ Yes ☐ No

APPENDIX I

THE RATING AGENCY ACT AND COMMISSION RULES APPLICABLE TO NRSROS

The purpose of the Rating Agency Act is to "improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry."[3] As discussed in more detail below, the Rating Agency Act, among other things, amended Section 3 of the Exchange Act to add certain definitions, added Section 15E to the Exchange Act to implement a registration and oversight program for NRSROs, amended Section 17 of the Exchange Act to provide the Commission with recordkeeping, reporting, and examination authority over NRSROs, and amended Section 21B(a) of the Exchange Act to provide the Commission with authority to assess money penalties against NRSROs in proceedings instituted under Section 15E of the Exchange Act. The operative provisions of the Rating Agency Act became applicable upon the Commission's adoption in June 2007 of a series of rules implementing a registration and oversight program for credit rating agencies that register as NRSROs.[4]

A. Provisions of the Rating Agency Act

The Rating Agency Act added definitions of "credit rating,"[5] "credit rating agency,"[6] "nationally recognized statistical rating organization,"[7] and "qualified institutional buyer"[8]

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3 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. 1.

4 See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Securities Exchange Act of 1934 ("Exchange Act") Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007) ("Adopting Release").

5 15 U.S.C. 78c(a)(60). The Exchange Act defines a "credit rating" to mean "an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments." Id.

6 15 U.S.C. 78c(a)(61). The Exchange Act defines "credit rating agency" to mean "any person—
(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and

("QIB") to Section 3 of the Exchange Act.[9] Taken together, these definitions prescribe the type of entity that can apply to the Commission to be registered as an NRSRO. First, the entity must meet the definition of "credit rating agency" in Section 3 of the Exchange Act, which means, among other things, it must issue "credit ratings" as defined in the Exchange Act (i.e., assessments of the creditworthiness of obligors as entities or with respect to specific securities or money market instruments). Furthermore, to be a "credit rating agency," the entity must be engaged in the business of issuing credit ratings on the internet or through another readily accessible means, for free or for a reasonable fee. In addition, the entity must employ either a quantitative or qualitative model or both to determine credit ratings and receive fees from issuers, investors, or other market participants.

To register with the Commission, a "credit rating agency" must meet the definition of "nationally recognized statistical rating organization." For example, under the Rating Agency Act, the credit rating agency must have been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration with the Commission.[10] In addition, the credit rating agency must issue credit ratings with respect to one or more classes of specific types of obligors: (1) financial institutions, brokers, or dealers; (2) insurance

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(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof." Id.

7 15 U.S.C. 78c(a)(62). A "nationally recognizced statistical rating organization" is defined as a "credit rating agency that—

(A) has been in the business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under [Section 15E of the Exchange Act];

(B) issues credit rating ratings certified by qualified institutional buyers, in accordance with Section 15E(a)(1)(B)(ix) [of the Exchange Act], with respect to –

(i) financial institutions, brokers, or dealers;

(ii) insurance companies;

(iii) corporate issuers;

(iv) issuers of asset-backed securities (as that term is defined in Section 1101(c) of part 229 of Title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph);

(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or

(vi) a combination of one or more categories of obligors described in any of the clauses (i) through (v); and

(C) is registered under Section 15E [of the Exchange Act]." Id.

8 15 U.S.C. 78c(64).

9 15 U.S.C. 78c.

10 See 15 U.S.C. 78c(a)(62)(A).

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

companies; (3) corporate issuers; (4) issuers of asset-backed securities; and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.[11]

A credit rating agency that meets these statutory definitions can seek to be registered with the Commission as an NRSRO under Section 15E of the Exchange Act. Section 15E(a)(1)(B) of the Exchange Act, prescribes certain minimum information a credit rating agency must provide in its application for registration as an NRSRO.[12] This information is:

- Credit ratings performance measurement statistics over short-, mid-, and long-term periods, as applicable;[13]
- The procedures and methodologies that the applicant uses in determining ratings;[14]
- Policies or procedures adopted and implemented by the applicant to prevent the misuse, in violation of the of the Exchange Act (or the rules and regulations hereunder) of material, non-public information;[15]
- The organizational structure of the applicant;[16]
- Whether or not the applicant has in effect a code of ethics, and if not, the reasons therefore;[17]
- Any conflict of interest relating to the issuance of credit ratings by the applicant;[18]

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11 See 15 U.S.C. 78c(a)(62)(B)(i) – (v).

12 15 U.S.C. 78o-7(a)(1)(B).

13 15 U.S.C. 78o-7(a)(1)(B)(i).

14 15 U.S.C. 78o-7(a)(1)(B)(ii).

15 15 U.S.C. 78o-7(a)(1)(B)(iii).

16 15 U.S.C. 78o-7(a)(1)(B)(iv).

17 15 U.S.C. 78o-7(a)(1)(B)(v).

18 15 U.S.C. 78o-7(a)(1)(B)(vi).

- The categories described in any of clauses (i) through (v) of Section 3(a)(62)(B) of the Exchange Act with respect to which the applicant intends to apply for registration under Section 15E of the Exchange Act (i.e., the classes of obligors identified in the definition of "nationally recognized statistical rating organization");[19]

- On a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services of the applicant, by amount of net revenues received therefrom in the fiscal year immediately preceding the date of submission of the application;[20] and

- On a confidential basis, as to each category of obligor described in clauses (i) through (v) of Section 3(a)(62)(B) of the Exchange Act, written certifications described in Section 15E(a)(1)(C) of the Exchange Act, except as provided in Section 15E(a)(1)(D) of the Exchange Act.[21]

Section15E(a)(2)(A) of the Exchange Act requires the Commission to grant an application for registration as an NRSRO or commence proceedings on whether to deny the application within 90 days from the date the application is furnished to the Commission or a longer period if the applicant consents.[22] Further, if proceedings are commenced, Section 15E(a)(2)(B) of the Exchange Act[23] requires the Commission to conclude them within 120 days

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19 15 U.S.C. 78o-7(a)(1)(B)(vii).

20 15 U.S.C. 78o-7(a)(1)(B)(viii).

21 15 U.S.C. 78o-7(a)(1)(B)(ix). Specifically, this provision requires the applicant to provide the certifications from QIBs as specified in Section 15E(a)(1)(C) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(C)). Sections 15E(a)(1)(C)(i) – (iii) of the Exchange Act require an applicant to furnish certifications from a minimum of 10 QIBs, including certifications from no less than two QIBs for each category of obligor for which the applicant intends to be registered. 15 U.S.C. 78o-7(a)(1)(C)(i) – (iii). Section 15E(a)(1)(C)(iv) requires that the certification state that the entity meets the definition of a QIB and has used the credit ratings of the applicant for at least the 3 years immediately preceding the date of the certification in the subject category or categories. 15 U.S.C. 78o-7(a)(1)(C)(iv). Section 15E(a)(1)(D) of the Exchange Act provides an exemption from the furnishing the QIB certifications for any applicant that had received, or been the subject of, a no-action letter provided by Commission staff prior to August 2, 2006. 15 U.S.C. 78o-7(a)(1)(D).

22 15 U.S.C. 78o-7(a)(2)(A). Under Exchange Act Rule 17g-1, an application will be considered 'furnished" when the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions.

23 15 U.S.C. 78o-7(a)(2)(B).

of the date the application is furnished to the Commission.[24] Section 15E(a)(2)(C)(i) of the Exchange Act provides that the Commission shall grant a credit rating agency registration if the requirements of Section 15E of the Exchange Act are satisfied.[25] Section 15E(a)(2)(C)(ii) of the Exchange Act provides that the Commission shall deny the application if it finds that the applicant does not have adequate financial and managerial resources to consistently produce credit ratings with integrity and materially comply with the procedures and methodologies disclosed pursuant to Section 15E(a)(1)(B) of the Exchange Act and established pursuant Sections 15E(g), (h), (i) and (j) or if the applicant were so registered, its registration would be subject to suspension or revocation under Section 15E(d) of the Exchange Act.[26]

After registration, a credit rating agency – now an NRSRO – becomes subject to certain provisions in Section 15E of the Exchange Act. Some of these provisions require the NRSRO to keep the information provided in its registration application up-to-date. For example, Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly update its application for registration if, after registration, any information or document provided as part of the application becomes materially inaccurate.[27] The statute further provides that the information on credit ratings performance statistics required pursuant to Section 15E(a)(1)(B) of the Exchange Act must be updated only on an annual basis and that the certifications from the QIBs are not required to be updated.[28] In addition, 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 (the "annual certification").[29] 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 during the previous calendar year.[30]

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24 Under Section 15E(a)(2)(B)(iii) of the Exchange Act, the Commission can extend this period for an additional 90 days for good cause or for such other period as the applicant consents (15 U.S.C. 78o-7(a)(2)(B)(iii)).

25 15 U.S.C. 78o-7(a)(2)(C)(i).

26 15 U.S.C. 78o-7(a)(2)(C)(ii).

27 15 U.S.C. 78o-7(b)(1).

28 Id.

29 15 U.S.C. 78o-7(b)(2).

30 Id.

Other provisions of Section 15E of the Exchange Act require an NRSRO to implement certain types of controls to manage its activities. For example, Section 15E(g)(1) of the Exchange Act[31] requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[32] Additionally, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest.[33] And, Section 15E(j) of the Exchange Act requires an NRSRO to designate an individual responsible for administering the policies and procedures of the NRSRO to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws ("designated compliance officer").[34]

Section 15E of the Exchange Act also provides the Commission with authority to take actions against an NRSRO. For example, Section 15E(d) of the Exchange Act provides that the Commission shall, by order, censure, place limitations on the activities, functions or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO if, among other things, the NRSRO fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.[35] The Commission also can take such action if the NRSRO or an associated person: (1) has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Exchange Act, has been convicted of any offense specified in section 15(b)(4)(B) of the Exchange Act , or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Exchange Act of; (2) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Exchange Act, or has been convicted of a substantially equivalent crime by a foreign court of competent

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31 15 U.S.C. 78o-7(g)(1).

32 15 U.S.C. 78a et seq.

33 15 U.S.C. 78o-7(h)(1).

34 15 U.S.C. 78o-7(j).

35 15 U.S.C. 78o-7(d).

jurisdiction; or (3) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.[36]

B. Commission's NRSRO Rules

By adding Section 15E and amending Section 17 of the Exchange Act, the Rating Agency Act provided the Commission with rulemaking authority in a variety of areas. The Commission adopted six rules in June 2007.

1. Rule 17g-1 and Form NRSRO

Rule 17g-1 prescribes, among other things, how an NRSRO must apply to be registered with the Commission, keep its registration up-to-date, and comply with the statutory requirement to furnish the Commission with an annual certification.[37] Specifically, all of these actions must be accomplished by furnishing the Commission with a Form NRSRO. As described below, the Form NRSRO elicits information about the credit rating agency applying for registration and, after registration about the NRSRO, including the information required under 15E(a)(1)(B) of the Exchange Act.[38] Rule 17g-1(i) requires an NRSRO to make its current Form NRSRO and information and documents submitted in Exhibits 1 though 9 (described below) publicly available within 10 business days of being granted an initial registration or registration in an additional class of credit ratings and within 10 business days of furnishing an update to amend information on the form, to provide the annual certification, and to withdraw a registration.[39]

Form NRSRO contains 8 line items and 13 Exhibits. The line items elicit information about the applicant credit rating agency or NRSRO such as: its address; corporate form; credit rating affiliates that would be, or are, a part of its registration; the classes of credit ratings for which it is seeking, or is, registered as an NRSRO; the number of credit ratings it has issued in each class and the date it began issuing credit ratings in each class; and whether it or a person associated with it has committed or omitted any act, been convicted of any crime, or is subject to any order identified in Section 15(d) of the Exchange Act. Form NRSRO also directs an applicant credit rating agency, if not exempt from the requirement, to submit a minimum of 10

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36 Id.

37 See 17 CFR 240.17g-1.

38 15 U.S.C. 78o-7(a)(1)(B).

39 See 17 CFR 240.17g-1(i).

QIB certifications, of which at least two must address each class of credit rating the applicant is seeking to be registered in, and prescribes the form of the QIB certification.

The 13 Exhibits to Form NRSRO elicit the information required under Sections 15E(a)(1)(B)(i) through (ix) of the Exchange Act and additional information the Commission prescribed under authority in Section 15E(a)(1)(B)(x) of the Exchange Act.[40] As noted above, an NRSRO must make Exhibits 1 through 9 publicly available after it is registered. Exhibits 10 through 13 do not need to be publicly disclosed pursuant to Rule 17g-1(i) and need to be furnished only when applying for registration. These Exhibits elicit financial information about the applicant credit rating agency that the Commission uses in making the finding required under Section 15E(a)(2)(C)(ii) of the Exchange Act[41] that the applicant has adequate financial and managerial resources to consistently produce credit ratings with integrity and materially comply with the procedures and methodologies disclosed pursuant to Section 15E(a)(1)(B) of the Exchange Act[42] and established pursuant Sections 15E(g), (h), (i) and (j) of the Exchange Act.[43] After registration, an NRSRO is required to furnish financial information to the Commission in an annual report required by Rule 17g-3 (discussed below) that is similar to the information elicited in Exhibits 10 through 13.[44] The NRSRO rules do not require that the annual reports furnished to the Commission pursuant to Rule 17g-3 be made publicly available by the NRSRO.[45]

Exhibit 1 elicits the information required by Section 15E(a)(1)(B)(i) of the Exchange Act: credit ratings performance measurement statistics over one, three and ten year time periods within each class of credit rating for which the NRSRO is registered.[46] The instructions for the Exhibit provide that an applicant and NRSRO must include in the Exhibit definitions of the credit ratings (i.e., an explanation of each category and notch) and explanations of the performance measurement statistics, including the metrics used to derive the statistics.

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40 15 U.S.C. 78o-7(a)(1)(B)(i) – (x).

41 15 U.S.C. 78o-7(a)(2)(C)(ii).

42 15 U.S.C. 78o-7(a)(1)(B).

43 15 U.S.C. 78o-7(g), (h), (i) and (j).

44 See 17 CFR 240.17g-3.

45 See Adopting Release, 72 FR at 33590.

46 15 U.S.C. 78o-7(a)(1)(B)(i).

Exhibit 2 elicits the information required by Section 15E(a)(1)(B)(ii) of the Exchange Act: information regarding the procedures and methodologies used by the credit rating agency to determine credit ratings.[47] The instructions for the Exhibit require a description of the procedures and methodologies (not the submission and disclosure of each actual procedure and methodology). The instructions further provide that the description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes the applicant or NRSRO employs to determine credit ratings. The instructions also identify a number of areas that must be addressed in the description to the extent they are applicable.[48]

Exhibit 3 elicits the information required by Section 15E(a)(1)(B)(iii) of the Exchange Act: the policies or procedures adopted and implemented by the credit rating agency to prevent the misuse of material, nonpublic information in violation of Exchange Act provisions and rules.[49] The instructions for the Exhibit provide that the applicant or NRSRO is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information is disclosed.

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47 15 U.S.C. 78o-7(a)(1)(B)(ii).

48 Specifically, the instructions require an NRSRO to provide descriptions of the following areas (as applicable): policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings; the methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating.

49 15 U.S.C. 78o-7(a)(1)(B)(iii).

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

Exhibit 4 elicits the information required by Section 15E(a)(1)(B)(iv) of the Exchange Act: information regarding the organizational structure of the credit rating agency.[50] The instructions for the Exhibit provide that the applicant or NRSRO must provide three different charts as applicable. The first required organizational chart is of the credit rating agency's ultimate and sub-holding companies, subsidiaries, and material affiliates, if applicable. The second organizational chart is of the credit rating agency's divisions, departments, and business units, if applicable. The third organizational chart is of the credit rating agency's management structure and senior management reporting lines and must include its designated compliance officer under Section 15E(j) of the Exchange Act.[51]

Exhibit 5 elicits the information required by Section 15E(a)(1)(B)(v) of the Exchange Act: whether the credit rating agency has a code of ethics in effect or an explanation of why the credit rating agency has not established a code of ethics.[52] The instructions for the Exhibit require the credit rating agency to attach a copy of any established code of ethics or an explanation of why it does not have a code of ethics.

Exhibit 6 elicits the information required by Section 15E(a)(1)(B)(vi) of the Exchange Act: information regarding any conflict of interest relating to the issuance of credit ratings by the applicant and NRSRO.[53] The instructions to the Exhibit require the credit rating agency to provide a list describing in general terms the types of conflicts of interest that arise from its business activities. The instructions list 10 different generic conflicts of interest that may apply to a credit rating agency based on its business model and activities.[54] These conflicts are

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50 15 U.S.C. 78o-7(a)(1)(B)(iv).

51 15 U.S.C. 78o-7(j).

52 15 U.S.C. 78o-7(a)(1)(B)(v).

53 15 U.S.C. 78o-7(a)(1)(B)(vi).

54 The conflicts of interest identified in Exhibit 6 are:

- The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.
- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.
- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or

included in the instructions as examples of conflicts.[55] The instructions further provide that the credit rating agency can use the descriptions provided in the instructions to identify an applicable conflict of interest and is not required to provide any further information. Thus, the credit rating agency can review each item on the list and determine whether it describes an applicable conflict. A credit rating agency can choose to provide its own description of the conflict or further explanation to one of the descriptions in the instructions.

Exhibit 7 requires the credit rating agency to furnish a copy of the written policies and procedures it establishes, maintains, and enforces to address and manage conflicts of interest pursuant to Section 15E(h) of the Exchange Act.[56] The instructions for the Exhibit provide that the credit rating agency is not required to submit in the Exhibit any specific information in the policies and procedures that is proprietary or would diminish the effectiveness of the policies and procedures if such information were disclosed.

Exhibit 8 requires the credit rating agency to furnish summary information about its credit analysts. Specifically, the Exhibit requires the following information:

- The total number of credit analysts.

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relief under, statutes and regulations using the term "nationally recognized statistical rating organization."

- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:
  - Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
  - Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
- A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).
- The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

55 As discussed below, these conflicts of interest also are identified in paragraph (b) of Rule 17g-5. 17 CFR 240.17g-5(b). Rule 17g-5 provides that these types of conflicts are prohibited unless the NRSRO discloses them in Form NRSRO and establishes procedures to manage them as required by 15 U.S.C. 78o-7(h).

56 15 U.S.C. 78o-7(h).

- The total number of credit analyst supervisors.

- A general description of the minimum required qualifications of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).

- A general description of the minimum required qualifications of the credit analyst supervisors, including education level and work experience.

Exhibit 9 (the last of the Exhibits that must be publicly disclosed under Rule 17g-1(i)) requires an applicant and NRSRO to provide certain background information on the entity's designated compliance officer.

Exhibit 10 elicits the information required by Section 15E(a)(1)(B)(viii) of the Exchange Act: on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services provided by the credit rating agency by amount of net revenue received by the credit rating agency in the fiscal year immediately preceding the date of submission of the application.[57] The instructions for the Exhibit provide that the credit rating agency must disclose in the list large obligors (i.e., persons who are rated as an entity as opposed to having their securities rated) and underwriters if they are determined to have provided at least as much net revenue as the 20th largest issuer or subscriber. Consequently, a credit rating agency is required to identify the 20 largest issuers and subscribers as required by Section 15E(a)(1)(B)(viii) of the Exchange Act[58] and include in the list any obligor and underwriter that meets the above criteria. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i).[59] Instead, Rule 17g-3 requires an NRSRO to include similar information in an annual report furnished to the Commission.[60]

Exhibit 11 requires the credit rating agency to furnish audited financial statements for the past three fiscal or calendar years immediately preceding the date of the application. To accommodate credit rating agencies that did obtain audits in the normal course prior to

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57 15 U.S.C. 78o-7(a)(1)(B)(viii).

58 Id.

59 17 CFR 240.17g-1(i).

60 See 17 CFR 240.17g-3(a)(5).

registration as NRSROs, the instructions for the Exhibit provide that the credit rating agency may furnish an audited financial statement for the fiscal year immediately preceding the date of the application and unaudited financial statements for the prior years. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i). Instead, Rule 17g-3 requires an NRSRO to include audited financial statements in an annual report furnished to the Commission.[61]

Exhibit 12 requires the credit rating agency to provide information as to the amount of revenue generated from various credit rating services and a separate computation of total revenue from all other services. Specifically, the instructions for the Exhibit require the following information:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings; and
- Revenue from all other services and products offered by the credit rating agency (include descriptions of any major sources of revenue).

The instructions provide that this information be for the most recently completed fiscal or calendar year and is not required to be audited. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i).[62] Instead, Rule 17g-3 requires an NRSRO to include similar information in an annual report furnished to the Commission.[63]

Exhibit 13 requires the credit rating agency to furnish the Commission with the amount of total aggregate annual compensation paid to its credit analysts and the median compensation. The instructions provide that the information must be for the most recently completed fiscal or calendar year and will not have to be audited. An NRSRO does not need to publicly disclose this information pursuant to Rule 17g-1(i).[64] Instead, Rule 17g-3 requires an NRSRO to provide similar information in an annual report furnished to the Commission.[65]

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61 17 CFR 240.17g-3(a)(1).

62 17 CFR 240.17g-1(i).

63 See 17 CFR 240.17g-3(a)(3).

64 17 CFR 240.17g-1(i).

2. Rule 17g-2

Rule 17g-2 requires an NRSRO to make and retain certain records relating to its business and to retain certain other records made in the normal course of business operations.[66] The rule also prescribes the time periods and manner in which all these records must be retained.[67] Paragraph (a) of Rule 17g-2 requires an NRSRO to make and retain the following records:[68]

- Records of original entry into the accounting system of the NRSRO and records reflecting entries to and balances in all general ledger accounts of the NRSRO for each fiscal year;[69]

- Records with respect to each current credit rating of the NRSRO indicating (as applicable): (1) the identity of any credit analyst(s) that participated in determining the credit rating; (2) the identity of the person(s) that approved the credit rating before it was issued; (3) if a quantitative model was a substantial component in the process of determining the 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, a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued; and (4) whether the credit rating was solicited or unsolicited;[70]

- An account record for each person (for example, an obligor, issuer, underwriter, or other user) that has paid the NRSRO for the issuance or maintenance of a credit rating indicating: (1) the identity and address of the person; and (2) the credit rating(s) determined or maintained for the person;[71]

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65 See 17 CFR 240.17g-3(a)(4).

66 See 17 CFR 240.17g-2.

67 Id.

68 17 CFR 240.17g-2(a).

69 17 CFR 240.17g-2(a)(1).

70 17 CFR 240.17g-2(a)(2).

71 17 CFR 240.17g-2(a)(3).

- An account record for each subscriber to the credit ratings and/or credit analysis reports of the NRSRO indicating the identity and address of the subscriber;[72]

- A record listing the general types of services and products offered by the NRSRO;[73]

- A record documenting the established procedures and methodologies used by the NRSRO to determine credit ratings;[74] and

- A record that lists each security and money market instrument and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the NRSRO, in determining the credit rating for the security or money market instrument, treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the NRSRO by any or a combination of the following methods: (1) determining credit ratings for the unrated assets; (2) performing credit assessments or determining private credit ratings for the unrated assets; (3) determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration the internal credit analysis of another person; or (4) determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration (but not necessarily adopting) the credit ratings of another NRSRO;[75]

- For each outstanding credit rating, a record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor.[76]

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72 17 CFR 240.17g-2(a)(4).

73 17 CFR 240.17g-2(a)(5).

74 17 CFR 240.17g-2(a)(6).

75 17 CFR 240.17g-2(a)(7).

76 17 CFR 240.17-2(a)(8).

Paragraph (b) of Rule 17g-2 identifies certain types of records that an NRSRO must retain if the NRSRO makes or receives the record.[77] These records are:

- Significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports furnished by the NRSRO to the Commission pursuant to Rule 17g-3;[78]

- Internal records, including nonpublic information and work papers, used to form the basis of a credit rating issued by the NRSRO;[79]

- Credit analysis reports, credit assessment reports, and private credit rating reports of the NRSRO and internal records, including nonpublic information and work papers, used to form the basis for the opinions expressed in these reports;[80]

- Compliance reports and compliance exception reports;[81]

- Internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the internal auditors of the NRSRO as necessary to perform the audit of an activity that relates to its business as a credit rating agency;[82]

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77 17 CFR 240.17g-2(b).

78 17 CFR 240.17g-2(b)(1). In the Adopting Release, the Commission stated that this would include: bank statements, bills payable and receivable, trial balances, and records relating to the determination of the largest customers. See Adopting Release, 72 FR at 33586.

79 17 CFR 240.17g-2(b)(2). In the Adopting Release, the Commission stated that this would include, for example: notes of conversations with the management of an issuer or obligor that was the subject of the credit rating and the inputs and raw results of a quantitative model used to determine the credit rating. See Adopting Release, 72 FR at 33586.

80 17 CFR 240.17g-2(b)(3).

81 17 CFR 240.17g-2(b)(4).

82 17 CFR 240.17g-2(b)(5).

- Marketing materials of the NRSRO that are published or otherwise made available to persons that are not associated with the NRSRO;[83]

- External and internal communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating;[84]

- Internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another NRSRO for the purpose of determining a credit rating for a security or money market instrument issued by an asset pool or part of any asset-backed or mortgage-backed securities transaction;[85]

- For each security or money market instrument identified in the record required to be made and retained under paragraph (a)(7) of Rule 17g-2, any document that contains a description of how assets within such pool or as a part of such transaction not rated by the NRSRO but rated by another NRSRO were treated for the purpose of determining the credit rating of the security or money market instrument;[86] and

- Form NRSROs (including Exhibits and accompanying information and documents) submitted to the Commission by the NRSRO;[87]

- Any written communications received from persons not associated with the nationally recognized statistical rating organization that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.[88]

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83 17 CFR 240.17g-2(b)(6).

84 17 CFR 240.17g-2(b)(7).

85 17 CFR 240.17g-2(b)(8).

86 17 CFR 240.17g-2(b)(9).

87 17 CFR 240.17g-2(b)(10).

88 17 CFR 240.17g-2(b)(8).

Paragraph (c) of Rule 17g-2 requires an NRSRO to retain the records identified in paragraphs (a) and (b) for three years after the date the record is made or received.[89] Paragraph (d) of Rule 17g-2 requires an NRSRO to maintain an original, or a true and complete copy of the original, of each record required to be retained pursuant to paragraphs (a) and (b) of Rule 17g-2 in a manner that, for the applicable retention period specified in paragraph (c) of Rule 17g-2, makes the original record or copy easily accessible to the principal office of the NRSRO and to any other office that conducted activities causing the record to be made or received.[90]

In addition, paragraph (d) provides that an a NRSRO must make and keep publicly available on its corporate Internet Web site in an XBRL (eXtensible Business Reporting Language) format the ratings action information for ten percent of the outstanding credit ratings required to be retained pursuant to paragraph (a)(8) of this section and which were paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated, selected on a random basis, for each class of credit rating for which it is registered and for which it has issued 500 or more outstanding credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated.[91] It further provides that any ratings action required to be disclosed pursuant to this paragraph (d) need not be made public less than six months from the date such ratings action is taken.[92] If a credit rating made public pursuant to this paragraph (d) is withdrawn or the instrument rated matures, the nationally recognized statistical rating organization must randomly select a new outstanding credit rating from that class of credit ratings in order to maintain the 10 percent disclosure threshold.[93] In making the information available on its corporate Internet Web site, the nationally recognized statistical rating organization shall use the List of XBRL Tags for NRSROs as specified on the Commission's Internet Web site.[94]

[**Note, the requirement described in this bracketed text was adopted by the Commission on September 17, 2009 but NRSROs are not required to comply with this requirement until June 2, 2010.** Paragraph (d) of Rule 17g-2 also requires an NRSRO to make

89 17 CFR 240.17g-2(c).

90 17 CFR 240.17g-2(d).

91 Id.

92 Id.

93 Id.

94 Id.

publicly available on its corporate Internet Web site in an interactive data file that uses a machine-readable format the ratings action information required to be retained pursuant to paragraph (a)(8) of Rule 17g-5 (the ratings history information for all current credit ratings) for any credit rating initially determined by the nationally recognized statistical rating organization on or after June 26, 2007. There is a grace period between the time the rating action occurs and the requirement to disclose the information on the NRSRO's Internet Web site; however this requirement applies to all NRSROs regardless of the rating action information related to the credit ratings were paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated or not.]

Paragraph (f) of Rule 17g-2 requires an NRSRO to promptly furnish the Commission or its representatives with legible, complete, and current copies, and, if specifically requested English translations, of those records of the NRSRO required to be retained under Rule 17g-2, or any other records of the NRSRO subject to examination under Section 17(b) of the Exchange Act [95] that are requested by the Commission or its representatives.[96] The requirement for an English translation arises from the fact that foreign credit rating agencies can register as NRSROs.[97]

3. Rule 17g-3

Rule 17g-3 requires an NRSRO to furnish the Commission four, or in some cases five, financial reports annually.[98] The reports must be furnished not more than 90 days after the end of the NRSRO's fiscal year and the information in the reports must be as of the most recently ended fiscal year.[99] Certain of the information required to be included in the reports is identical or similar to the information that credit rating agency applicants seeking registration as NRSROs furnish in Exhibits 10 through 13 of Form NRSRO.[100] The financial reports required by Rule 17g-3 are:

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95 See 15 U.S.C 78q(b).

96 17 CFR 240.17g-2(f).

97 See Adopting Release, 72 FR at 33589-33590.

98 17 CFR 240.17g-3.

99 17 CFR 240.17g-3(a).

100 See Adopting Release, 72 FR at 33591-33593.

- Audited financial statements of the NRSRO or audited consolidated financial statements of its parent if the NRSRO is a separately identifiable division or department of the parent;[101]

- If applicable, unaudited consolidated financial statements of the parent of the NRSRO that include the NRSRO;[102]

- An unaudited financial report providing information concerning the revenue of the NRSRO in each of the following categories (as applicable) for the fiscal year: (i) Revenue from determining and maintaining credit ratings; (ii) Revenue from subscribers; (iii) Revenue from granting licenses or rights to publish credit ratings; and (iv) Revenue from all other services and products (include descriptions of any major sources of revenue);[103]

- An unaudited financial report providing the total aggregate and median annual compensation of the credit analysts of the NRSRO for the fiscal year;[104]

- An unaudited financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the NRSRO by amount of net revenue attributable to the issuer or subscriber during the fiscal year;[105]

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101 17 CFR 240.17g-3(a)(1). Rule 17g-3 provides that the audited financial statements must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity and be prepared in accordance with generally accepted accounting principles in the jurisdiction where the NRSRO or its parent is incorporated, organized, or has its principal office. In addition, the audited financial statements must be certified by an accountant who is qualified and independent in accordance with 17 CFR 240.210.2-01(a), (b), and (c)(1), (2), (3), (4), (5) and (8). Further, the accountant must give an opinion on the financial statements in accordance with 17 CFR 210.2-02(a), (b), (c) and (d). See 17 CFR 240.17g-3(a)(1)(i) – (iii).

102 17 CFR 240.17g-3(a)(2). This financial report must be furnished only if the audited financial statements provided pursuant to paragraph (a)(1) of Rule 17g-3 are consolidated financial statements of the parent of the NRSRO. See Note to paragraph (a)(2) in Rule 17g-3.

103 17 CFR 240.17g-3(a)(3).

104 17 CFR 240.17g-3(a)(4).

105 17 CFR 240.17g-3(a)(5). Rule 17g-3 further provides that the NRSRO include on the list any obligor or underwriter that used the credit rating services provided by the NRSRO if the net revenue attributable to the obligor or underwriter during the fiscal year equaled or exceeded the net revenue

- An unaudited report of the number of credit ratings actions (upgrades, downgrades, placements on credit watch, and withdrawals) taken during the fiscal year in each class of credit ratings identified in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) for which the nationally recognized statistical rating organization is registered with the Commission.[106]

Paragraph (b) of Rule 17g-3 provides that the NRSRO must attach to each financial report a signed statement by a duly authorized person associated with the NRSRO that the person has responsibility for the report and, to the best knowledge of the person, the financial report fairly presents, in all material respects, the financial condition, results of operations, cash flows, revenues, and analyst compensation, as applicable, of the NRSRO for the period presented.[107]

4. Rule 17g-4

As noted above, Section 15E(g)(1) of the Exchange Act[108] requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[109] Rule 17g-4 requires an NRSRO to establish procedures to address three areas where material, nonpublic information could be inappropriately disclosed or used.[110] Specifically, it requires that the written policies and procedures an NRSRO establishes, maintains, and enforces pursuant to section 15E(g)(1) of the Exchange Act must include policies and procedures reasonably designed to prevent:

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attributable to the 20th largest issuer or subscriber. Additionally, the NRSRO must include the net revenue amount for each person on the list. Id.

106 17 CFR 240.17g-3(a)(6).

107 17 CFR 240.17g-3(b).

108 15 U.S.C. 78o-7(g)(1).

109 15 U.S.C. 78a et seq.

110 17 CFR 240.17g-4.

- The inappropriate dissemination within and outside the NRSRO of material nonpublic information obtained in connection with the performance of credit rating services;[111]

- A person within the NRSRO from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments;[112]

- The inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.[113]

Paragraph (b) of Rule 17g-4, defines the term "person within" an NRSRO to mean, for the purposes of the Rule, the NRSRO, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the NRSRO or its credit rating affiliates (or any person occupying a similar status or performing similar functions).[114]

5. Rule 17g-5

Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest.[115] Section 15E(h)(2) of the Exchange Act

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111 17 CFR 240.17g-4(a)(1). The Commission stated in the Adopting Release that some credit rating agencies, as part of their analysis, contact senior management of the obligors and issuers subject to their credit ratings. In the course of these contacts, an issuer or obligor may provide the credit rating agency with nonpublic information including contemplated business transactions or estimated financial projections. See Adopting Release, 72 FR at 33593.

112 17 CFR 240.17g-4(a)(2).

113 17 CFR 240.17g-4(a)(3). The Commission stated in the Adopting Release that this provision recognizes that a credit rating action of an NRSRO may be material, nonpublic information. Consequently, an NRSRO must have policies designed to ensure that its pending credit rating actions are not selectively disclosed before the credit rating is issued on the Internet or through another readily accessible means. See Adopting Release, 72 FR at 33594-33595.

114 17 CFR 240.17g-4(b).

115 15 U.S.C. 78o-7(h)(1).

requires the Commission to adopt rules to prohibit or require the management and disclosure of conflicts of interest relating to the issuance of credit ratings.[116] The statute also identifies certain types of conflicts relating to the issuance of credit ratings that the Commission may include in its rules.[117] Furthermore, it contains a catchall provision for any other potential conflict of interest that the Commission deems is necessary or appropriate in the public interest or for the protection of investors to include in its rules.[118] The Commission implemented these statutory provisions through the adoption of Rule 17g-5, which prohibits the conflicts identified in the statute and certain additional conflicts either outright or if the NRSRO has not disclosed them and established policies and procedures to manage them.[119]

Paragraph (a) of Rule 17g-5[120] prohibits a person within an NRSRO from having a conflict of interest relating to the issuance of a credit rating that is identified in paragraph (b) of the rule unless the NRSRO has disclosed the type of conflict of interest in compliance with Rule 17g-1 (i.e., in Exhibit 6 to Form NRSRO) and has implemented policies and procedures to address and manage the type of conflict of interest in accordance with Section 15E(h)(1) of the Exchange Act.[121] The following conflicts are identified in paragraph (b) of Rule 17g-5 and, therefore, subject to the provisions of paragraph (a):

- Being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite;[122]

- Being paid by obligors to determine credit ratings with respect to the obligors;[123]

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116 15 U.S.C. 78o-7(h)(2).

117 See 15 U.S.C. 78o-7(h)(2)(A) – (D).

118 See 15 U.S.C. 78o-7(h)(2)(E).

119 See 17 CFR 240.17g-5.

120 17 CFR 240.17g-5(a).

121 15 U.S.C. 78o-7(h)(1).

122 17 CFR 240.17g-5(b)(1).

123 17 CFR 240.17g-5(b)(2).

- Being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a credit rating;[124]

- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons may use the credit ratings of the NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term "NRSRO;"[125]

- Being paid by persons for subscriptions to receive or access the credit ratings of the NRSRO and/or for other services offered by the NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the NRSRO;[126]

- Allowing persons within the NRSRO to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the NRSRO;[127]

- Allowing persons within the NRSRO to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the NRSRO;[128]

- Having a person associated with the NRSRO that is a broker or dealer engaged in the business of underwriting securities or money market instruments;[129]

- Issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed

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124 17 CFR 240.17g-5(b)(3).

125 17 CFR 240.17g-5(b)(4).

126 17 CFR 240.17g-5(b)(5).

127 17 CFR 240.17g-5(b)(6).

128 17 CFR 240.17g-5(b)(7).

129 17 CFR 240.17g-5(b)(8).

securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument; and

- Any other type of conflict of interest relating to the issuance of credit ratings by the NRSRO that is material to the NRSRO and that is identified by the NRSRO in Exhibit 6 to Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)) and Rule 17g-1.[130]

[**Note, the requirement described in this bracketed text was adopted by the Commission on September 17, 2009 but NRSROs are not required to comply with this requirement until June 2, 2010.** Paragraph (a) further requires that an NRSRO subject to the conflict set forth in paragraph (b)(9) (issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument) must maintain a password-protected Internet Web site containing a list of each structured finance security or money market instrument for which it currently is in the process of determining an initial credit rating. The list must be made in chronological order and identify the type of security or money market instrument, the name of the issuer, and the date the rating process was initiated. An NRSRO must provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification stating it is accessing the Web site solely for the purpose of determining or monitoring credit ratings. The NRSRO must grant access to other NRSROs that either (1) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to Rule 17g-5(a)(3) in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (2) has not accessed information pursuant to Rule 17g-5(a)(3) as amended 10 or more times in the calendar year prior to the year covered by the certification. Lastly, an NRSRO required to maintain such a Web site also must obtain a written representation from the issuer, sponsor, or underwriter of the security or money market instrument (or "arranger"). Through the representation, the arranger agrees to also maintain a password-protected Internet Web site to make available to other NRSROs (and only other NRSROs) the same information it provides to the hired NRSROs, whether provided for the purpose of determining an initial rating or for monitoring a rating. Making this information available creates a mechanism requiring NRSROs hired to rate structured finance products to alert other NRSROs that an arranger has initiated the rating process and to promptly inform the other NRSROs where information being provided by the arranger to the hired NRSRO to determine the credit rating may be obtained.]

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130 17 CFR 240.17g-5(b)(9).

Paragraph (c) of Rule 17g-5 specifically prohibits outright seven types of conflicts of interest.[131] Consequently, an NRSRO would violate the rule regardless of whether it had disclosed them and established procedures reasonably designed to address them. The seven prohibited conflicts are:

- The NRSRO issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue (as reported under Rule 17g-3) equaling or exceeding 10% of the total net revenue of the NRSRO for the fiscal year;[132]

- The NRSRO issues or maintains a credit rating with respect to a person (excluding a sovereign nation or an agency of a sovereign nation) where the NRSRO, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating;[133]

- The NRSRO issues or maintains a credit rating with respect to a person associated with the NRSRO;[134]

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131 17 CFR 240.17g-5(c)(1) – (4).

132 17 CFR 240.17g-5(c)(1). In the Adopting Release, the Commission responded to comments from smaller credit rating agencies that this prohibition could impact them, particularly with respect to ratings business they get from large sponsors of structured finance products, by stating that it would monitor whether this prohibition interferes with how NRSROs as a matter of course deal with structured finance product sponsors. See Adopting Release, 72 FR at 33598. The Commission stated that it would evaluate whether the rule should be modified to accommodate this business practice or whether an exemption would be appropriate. Id. Two of the NRSROs granted registration during the year were given one year exemptions from this prohibition. See Order Granting Temporary Exemption of LACE Financial Corp. from the Conflict of Interest Prohibition in Rule 17a-5(c)(1) of the Securities Exchange Act of 1934, Exchange Act Release No. 57301 (February 11, 2008) and Order Granting Temporary Exemption of Realpoint LLC from the Conflict of Interest Prohibition in Rule 17a-5(c)(1) of the Securities Exchange Act of 1934, Exchange Act Release No. 58001 (June 23, 2008).

133 17 CFR 240.17g-5(c)(2). In the Adopting Release, the Commission stated the prohibition applied to "direct" ownership of securities and, therefore, would not apply to indirect ownership interests, for example, through mutual funds or blind trusts. See Adopting Release, 72 FR at 33598.

134 17 CFR 240.17g-5(c)(3).

- The NRSRO issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating;[135]

- The NRSRO issues or maintains a credit rating with respect to an obligor or security where the NRSRO or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security;[136]

- The NRSRO issues or maintains a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models;[137] and

- The NRSRO issues or maintains a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $25.[138]

6. Rule 17g-6

Section 15E(i)(1) of the Exchange Act[139] provides that the Commission shall adopt rules prohibiting any act or practice by an NRSRO that the Commission determines is unfair, abusive, or coercive, including certain acts and practices set forth in paragraphs (i)(1)(A)-(C) of Section 15E of the Exchange Act.[140] In explaining this statutory provision, the Senate Report stated that

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135 17 CFR 240.17g-5(c)(4).

136 17 CFR 240.17g-5(c)(5).

137 17 CFR 240.17g-5(c)(6).

138 17 CFR 240.17g-5(c)(7).

139 15 U.S.C. 78o-7(i)(1).

140 15 U.S.C. 78o-7(i)(1)(A), (B) and (C).

"the Commission, as a threshold consideration, must determine that the practices subject to prohibition under this section are unfair, coercive or abusive before adopting rules prohibiting such practices."[141] The Commission implemented this statutory authority by adopting Rule 17g-6,[142] which prohibits the following practices:

- Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the NRSRO or any person associated with the NRSRO;[143]

- Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO;[144]

- Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the NRSRO's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO or any person associated with the NRSRO;[145] and

- Issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw a credit rating, with respect to securities or money market

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141 Senate Report, p. 11.

142 See 17 CFR 240.17g-6.

143 17 CFR 240.17g-6(a)(1). This prohibition addresses the situation where an NRSRO conditions the issuance of a credit rating on the purchase of another service or product. See Adopting Release, 72 FR at 33600.

144 17 CFR 240.17g-6(a)(2). This prohibition addresses the situation where an NRSRO conditions the opinion reached in the credit rating on the purchase of the credit rating or another service or product. See Adopting Release, 72 FR at 33600.

145 17 CFR 240.17g-6(a)(3).

instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the NRSRO, where such practice is engaged in by the NRSRO for an anticompetitive purpose.[146]

146 17 CFR 240.17g-6(a)(4).

Appendix II

U.S. Laws and Regulations

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

15 USCS § 78c

§ 78c. Definitions and application

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(60) Credit rating. The term "credit rating" means an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.

(61) Credit rating agency. The term "credit rating agency" means any person--

(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;

(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and

(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.

(62) Nationally recognized statistical rating organization. The term "nationally recognized statistical rating organization" means a credit rating agency that--

(A) has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under section 15E [*15 USCS § 78o-7*];

(B) issues credit ratings certified by qualified institutional buyers, in accordance with section 15E(a)(1)(B)(ix) [*15 USCS § 78o-7(a)(1)(B)(ix)*], with respect to--

(i) financial institutions, brokers, or dealers;

(ii) insurance companies;

(iii) corporate issuers;

(iv) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph);

(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or

(vi) a combination of one or more categories of obligors described in any of clauses (i) through (v); and

(C) is registered under section 15E [*15 USCS § 78o-7*].

(63) Person associated with a nationally recognized statistical rating organization. The term "person associated with" a nationally recognized statistical rating organization means any partner, officer, director, or branch manager of a nationally recognized statistical rating organization (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a nationally recognized statistical rating organization, or any employee of a nationally recognized statistical rating organization.

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

(64) Qualified institutional buyer. The term "qualified institutional buyer" has the meaning given such term in *section 230.144A(a) of title 17, Code of Federal R*egulations, or any successor thereto.

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15 USCS § 78o-7

§ 78o-7. Registration of nationally recognized statistical rating organizations

(a) Registration procedures.

(1) Application for registration.

(A) In general. A credit rating agency that elects to be treated as a nationally recognized statistical rating organization for purposes of this *title [15 USCS §§ 78a* et seq.] (in this section referred to as the "applicant"), shall furnish to the Commission an application for registration, in such form as the Commission shall require, by rule or regulation issued in accordance with subsection (n), and containing the information described in subparagraph (B).

(B) Required information. An application for registration under this section shall contain information regarding--

(i) credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the applicant;

(ii) the procedures and methodologies that the applicant uses in determining credit ratings;

(iii) policies or procedures adopted and implemented by the applicant to prevent the misuse, in violation of this *title [15 USCS §§ 78a* et seq.] (or the rules and regulations hereunder), of material, nonpublic information;

(iv) the organizational structure of the applicant;

(v) whether or not the applicant has in effect a code of ethics, and if not, the reasons therefore;

(vi) any conflict of interest relating to the issuance of credit ratings by the applicant;

(vii) the categories described in any of clauses (i) through (v) of section 3(a)(62)(B) [*15 USCS § 78c(a)(62)(B)*] with respect to which the applicant intends to apply for registration under this section;

(viii) on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services of the applicant, by amount of net revenues received therefrom in the fiscal year immediately preceding the date of submission of the application;

(ix) on a confidential basis, as to each applicable category of obligor described in any of clauses (i) through (v) of section 3(a)(62)(B) [*15 USCS § 78c(a)(62)(B)*], written certifications described in subparagraph (C), except as provided in subparagraph (D); and

(x) any other information and documents concerning the applicant and any person associated with such applicant as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(C) Written certifications. Written certifications required by subparagraph (B)(ix)--

(i) shall be provided from not fewer than 10 qualified institutional buyers, none of which is affiliated with the applicant;

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

(ii) may address more than one category of obligors described in any of clauses (i) through (v) of section 3(a)(62)(B) [*15 USCS § 78c(a)(62)(B)*];

(iii) shall include not fewer than 2 certifications for each such category of obligor; and

(iv) shall state that the qualified institutional buyer--

(I) meets the definition of a qualified institutional buyer under section 3(a)(64) [*15 USCS § 78c(a)(64)*]; and

(II) has used the credit ratings of the applicant for at least the 3 years immediately preceding the date of the certification in the subject category or categories of obligors.

(D) Exemption from certification requirement. A written certification under subparagraph (B)(ix) is not required with respect to any credit rating agency which has received, or been the subject of, a no-action letter from the staff of the Commission prior to August 2, 2006, stating that such staff would not recommend enforcement action against any broker or dealer that considers credit ratings issued by such credit rating agency to be ratings from a nationally recognized statistical rating organization.

(E) Limitation on liability of qualified institutional buyers. No qualified institutional buyer shall be liable in any private right of action for any opinion or statement expressed in a certification made pursuant to subparagraph (B)(ix).

(2) Review of application.

(A) Initial determination. Not later than 90 days after the date on which the application for registration is furnished to the Commission under paragraph (1) (or within such longer period as to which the applicant consents) the Commission shall--

(i) by order, grant such registration for ratings in the subject category or categories of obligors, as described in clauses (i) through (v) of section 3(a)(62)(B) [*15 USCS § 78c(a)(62)(B)*]; or

(ii) institute proceedings to determine whether registration should be denied.

(B) Conduct of proceedings.

(i) Content. Proceedings referred to in subparagraph (A)(ii) shall--

(I) include notice of the grounds for denial under consideration and an opportunity for hearing; and

(II) be concluded not later than 120 days after the date on which the application for registration is furnished to the Commission under paragraph (1).

(ii) Determination. At the conclusion of such proceedings, the Commission, by order, shall grant or deny such application for registration.

(iii) Extension authorized. The Commission may extend the time for conclusion of such proceedings for not longer than 90 days, if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which the applicant consents.

(C) Grounds for decision. The Commission shall grant registration under this subsection--

(i) if the Commission finds that the requirements of this section are satisfied; and

(ii) unless the Commission finds (in which case the Commission shall deny such registration) that--

(I) the applicant does not have adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with the procedures and methodologies disclosed under paragraph (1)(B) and with subsections (g), (h), (i), and (j); or

(II) if the applicant were so registered, its registration would be subject to suspension or revocation under subsection (d).

(3) Public availability of information. Subject to section 24 [*15 USCS § 78x*], the Commission shall, by rule, require a nationally recognized statistical rating organization, upon the granting of registration under

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

this section, to make the information and documents submitted to the Commission in its completed application for registration, or in any amendment submitted under paragraph (1) or (2) of subsection (b), publicly available on its website, or through another comparable, readily accessible means, except as provided in clauses (viii) and (ix) of paragraph (1)(B).

(b) Update of registration.

(1) Update. Each nationally recognized statistical rating organization shall promptly amend its application for registration under this section if any information or document provided therein becomes materially inaccurate, except that a nationally recognized statistical rating organization is not required to amend--

(A) the information required to be furnished under subsection (a)(1)(B)(i) by furnishing information under this paragraph, but shall amend such information in the annual submission of the organization under paragraph (2) of this subsection; or

(B) the certifications required to be provided under subsection (a)(1)(B)(ix) by furnishing information under this paragraph.

(2) Certification. Not later than 90 days after the end of each calendar year, each nationally recognized statistical rating organization shall furnish to the Commission an amendment to its registration, in such form as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors--

(A) certifying that the information and documents in the application for registration of such nationally recognized statistical rating organization (other than the certifications required under subsection (a)(1)(B)(ix)) continue to be accurate; and

(B) listing any material change that occurred to such information or documents during the previous calendar year.

(c) Accountability for ratings procedures.

(1) Authority. The Commission shall have exclusive authority to enforce the provisions of this section in accordance with this *title [15 USCS §§ 78a* et seq.] with respect to any nationally recognized statistical rating organization, if such nationally recognized statistical rating organization issues credit ratings in material contravention of those procedures relating to such nationally recognized statistical rating organization, including procedures relating to the prevention of misuse of nonpublic information and conflicts of interest, that such nationally recognized statistical rating organization--

(A) includes in its application for registration under subsection (a)(1)(B)(ii); or

(B) makes and disseminates in reports pursuant to section 17(a) [*15 USCS § 78q(a)*] or the rules and regulations thereunder.

(2) Limitation. The rules and regulations that the Commission may prescribe pursuant to this *title [15 USCS §§ 78a* et seq.], as they apply to nationally recognized statistical rating organizations, shall be narrowly tailored to meet the requirements of this *title [15 USCS §§ 78a* et seq.] applicable to nationally recognized statistical rating organizations. Notwithstanding any other provision of law, neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any nationally recognized statistical rating organization determines credit ratings.

(d) Censure, denial, or suspension of registration; notice and hearing. The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding 12 months, or revoke the registration of any nationally recognized statistical rating organization if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is necessary for the protection of investors and in the public interest and that such nationally recognized statistical rating organization, or any person associated with such an organization, whether prior to or subsequent to becoming so associated--

(1) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), (E), (H), or (G) of section 15(b)(4) [*15 USCS § 78o(b)(4)*], has been convicted of any offense specified in section 15(b)(4)(B), or is enjoined from any action, conduct, or practice specified in subparagraph (C) of section 15(b)(4) [*15 USCS § 78o(b)(4)*], during the 10-year period preceding the date of commencement of the proceedings under this subsection, or at any time thereafter;

(2) has been convicted during the 10-year period preceding the date on which an application for registration is furnished to the Commission under this section, or at any time thereafter, of--

(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4)(B) [*15 USCS § 78o(b)(4)(B)*]; or

(B) a substantially equivalent crime by a foreign court of competent jurisdiction;

(3) is subject to any order of the Commission barring or suspending the right of the person to be associated with a nationally recognized statistical rating organization;

(4) fails to furnish the certifications required under subsection (b)(2); or

(5) fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.

(e) Termination of registration.

(1) Voluntary withdrawal. A nationally recognized statistical rating organization may, upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors, withdraw from registration by furnishing a written notice of withdrawal to the Commission.

(2) Commission authority. In addition to any other authority of the Commission under this *title [15 USCS §§ 78a* et seq.], if the Commission finds that a nationally recognized statistical rating organization is no longer in existence or has ceased to do business as a credit rating agency, the Commission, by order, shall cancel the registration under this section of such nationally recognized statistical rating organization.

(f) Representations.

(1) Ban on representations of sponsorship by united states or agency thereof. It shall be unlawful for any nationally recognized statistical rating organization to represent or imply in any manner whatsoever that such nationally recognized statistical rating organization has been designated, sponsored, recommended, or approved, or that the abilities or qualifications thereof have in any respect been passed upon, by the United States or any agency, officer, or employee thereof.

(2) Ban on representation as NRSRO of unregistered credit rating agencies. It shall be unlawful for any credit rating agency that is not registered under this section as a nationally recognized statistical rating organization to state that such credit rating agency is a nationally recognized statistical rating organization registered under this *title [15 USCS §§ 78a* et seq.].

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(3) Statement of registration under Securities Exchange Act of 1934 provisions. No provision of paragraph (1) shall be construed to prohibit a statement that a nationally recognized statistical rating organization is a nationally recognized statistical rating organization under this *title [15 USCS §§ 78a* et seq.], if such statement is true in fact and if the effect of such registration is not misrepresented.

(g) Prevention of misuse of nonpublic information.

(1) Organization policies and procedures. Each nationally recognized statistical rating organization shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such nationally recognized statistical rating organization, to prevent the misuse in violation of this *title [15 USCS §§ 78a* et seq.], or the rules or regulations hereunder, of material, nonpublic information by such nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization.

(2) Commission authority. The Commission shall issue final rules in accordance with subsection (n) to require specific policies or procedures that are reasonably designed to prevent misuse in violation of this *title [15 USCS §§ 78a* et seq.] (or the rules or regulations hereunder) of material, nonpublic information.

(h) Management of conflicts of interest.

(1) Organization policies and procedures. Each nationally recognized statistical rating organization shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such nationally recognized statistical rating organization and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business.

(2) Commission authority. The Commission shall issue final rules in accordance with subsection (n) to prohibit, or require the management and disclosure of, any conflicts of interest relating to the issuance of credit ratings by a nationally recognized statistical rating organization, including, without limitation, conflicts of interest relating to--

(A) the manner in which a nationally recognized statistical rating organization is compensated by the obligor, or any affiliate of the obligor, for issuing credit ratings or providing related services;

(B) the provision of consulting, advisory, or other services by a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, to the obligor, or any affiliate of the obligor;

(C) business relationships, ownership interests, or any other financial or personal interests between a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, and the obligor, or any affiliate of the obligor;

(D) any affiliation of a nationally recognized statistical rating organization, or any person associated with such nationally recognized statistical rating organization, with any person that underwrites the securities or money market instruments that are the subject of a credit rating; and

(E) any other potential conflict of interest, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(i) Prohibited conduct.

(1) Prohibited acts and practices. The Commission shall issue final rules in accordance with subsection (n) to prohibit any act or practice relating to the issuance of credit ratings by a nationally recognized statistical

rating organization that the Commission determines to be unfair, coercive, or abusive, including any act or practice relating to--

(A) conditioning or threatening to condition the issuance of a credit rating on the purchase by the obligor or an affiliate thereof of other services or products, including pre-credit rating assessment products, of the nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization;

(B) lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the nationally recognized statistical rating organization; or

(C) modifying or threatening to modify a credit rating or otherwise departing from its adopted systematic procedures and methodologies in determining credit ratings, based on whether the obligor, or an affiliate of the obligor, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with such organization.

(2) Rule of construction. Nothing in paragraph (1), or in any rules or regulations adopted thereunder, may be construed to modify, impair, or supersede the operation of any of the antitrust laws (as defined in the first section of the Clayton Act [*15 USCS § 12*], except that such term includes section 5 of the Federal Trade Commission Act [*15 USCS § 45*], to the extent that such section 5 applies to unfair methods of competition).

(j) Designation of compliance officer. Each nationally recognized statistical rating organization shall designate an individual responsible for administering the policies and procedures that are required to be established pursuant to subsections (g) and (h), and for ensuring compliance with the securities laws and the rules and regulations thereunder, including those promulgated by the Commission pursuant to this section.

(k) Statements of financial condition. Each nationally recognized statistical rating organization shall, on a confidential basis, furnish to the Commission, at intervals determined by the Commission, such financial statements, certified (if required by the rules or regulations of the Commission) by an independent public accountant, and information concerning its financial condition, as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(l) Sole method of registration.

(1) In general. On and after the effective date of this section [effective Sept. 29, 2006], a credit rating agency may only be registered as a nationally recognized statistical rating organization for any purpose in accordance with this section.

(2) Prohibition on reliance on no-action relief. On and after the effective date of this section [effective Sept. 29, 2006]--

(A) an entity that, before that date, received advice, approval, or a no-action letter from the Commission or staff thereof to be treated as a nationally recognized statistical rating organization pursuant to the Commission rule at *section 240.15c3-1 of title 17, Code of Federal R*egulations, may represent itself or act as a nationally recognized statistical rating organization only--

(i) during Commission consideration of the application, if such entity has furnished an application for registration under this section; and

(ii) on and after the date of approval of its application for registration under this section; and

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(B) the advice, approval, or no-action letter described in subparagraph (A) shall be void.

(3) Notice to other agencies. Not later than 30 days after the date of enactment of this section [enacted Sept. 29, 2006], the Commission shall give notice of the actions undertaken pursuant to this section to each Federal agency which employs in its rules and regulations the term "nationally recognized statistical rating organization" (as that term is used under Commission rule 15c3-1 (*17 C.F.R. 240.15c3-1*), as in effect on the date of enactment of this section [enacted Sept. 29, 2006]).

(m) Rules of construction.

(1) No waiver of rights, privileges, or defenses. Registration under and compliance with this section does not constitute a waiver of, or otherwise diminish, any right, privilege, or defense that a nationally recognized statistical rating organization may otherwise have under any provision of State or Federal law, including any rule, regulation, or order thereunder.

(2) No private right of action. Nothing in this section may be construed as creating any private right of action, and no report furnished by a nationally recognized statistical rating organization in accordance with this section or section 17 [*15 USCS § 78q*] shall create a private right of action under section 18 [*15 USCS § 78r*] or any other provision of law.

(n) Regulations.

(1) New provisions. Such rules and regulations as are required by this section or are otherwise necessary to carry out this section, including the application form required under subsection (a)--

(A) shall be issued by the Commission in final form, not later than 270 days after the date of enactment of this section [enacted Sept. 29, 2006]; and

(B) shall become effective not later than 270 days after the date of enactment of this section [enacted Sept. 29, 2006].

(2) Review of existing regulations. Not later than 270 days after the date of enactment of this section [enacted Sept. 29, 2006], the Commission shall--

(A) review its existing rules and regulations which employ the term "nationally recognized statistical rating organization" or "NRSRO"; and

(B) amend or revise such rules and regulations in accordance with the purposes of this section, as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(o) NRSROs subject to Commission authority.

(1) In general. No provision of the laws of any State or political subdivision thereof requiring the registration, licensing, or qualification as a credit rating agency or a nationally recognized statistical rating organization shall apply to any nationally recognized statistical rating organization or person employed by or working under the control of a nationally recognized statistical rating organization.

(2) Limitation. Nothing in this subsection prohibits the securities commission (or any agency or office performing like functions) of any State from investigating and bringing an enforcement action with respect to fraud or deceit against any nationally recognized statistical rating organization or person associated with a nationally recognized statistical rating organization.

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(p) Applicability. This section, other than subsection (n), which shall apply on the date of enactment of this section [enacted Sept. 29, 2006], shall apply on the earlier of--

(1) the date on which regulations are issued in final form under subsection (n)(1); or

(2) 270 days after the date of enactment of this section [enacted Sept. 29, 2006].

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15 USCS § 78q

§ 78q. Records and reports

(a) Rules and regulations.

(1) Every national securities exchange, member thereof, broker or dealer who transacts a business in securities through the medium of any such member, registered securities association, registered broker or dealer, registered municipal securities dealer, registered securities information processor, registered transfer agent, **nationally recognized statistical rating organization**, and registered clearing agency and the Municipal Securities Rulemaking Board shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this *title [15 USCS §§ 78a* et seq.]. Any report that a nationally recognized statistical rating organization is required by Commission rules under this paragraph to make and disseminate to the Commission shall be deemed furnished to the Commission.

(2) Every registered clearing agency shall also make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports, as the appropriate regulatory agency for such clearing agency, by rule, prescribes as necessary or appropriate for the safeguarding of securities and funds in the custody or control of such clearing agency or for which it is responsible.

(3) Every registered transfer agent shall also make and keep for prescribed periods such records, furnish such copies thereof, and make such reports as the appropriate regulatory agency for such transfer agent, by rule, prescribes as necessary or appropriate in furtherance of the purposes of section 17A of this *title [15 USCS § 78q-1*].

(b) Records subject to examination.

(1) Procedures for cooperation with other agencies. All records of persons described in subsection (a) of this section are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission and the appropriate regulatory agency for such persons as the Commission or the appropriate regulatory agency for such persons deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this *title [15 USCS §§ 78a* et seq.]: *Provided, however,* That the Commission shall, prior to conducting any such examination of a--

(A) registered clearing agency, registered transfer agent, or registered municipal securities dealer for which it is not the appropriate regulatory agency, give notice to the appropriate regulatory agency for such clearing agency, transfer agent, or municipal securities dealer of such proposed examination and consult with such appropriate regulatory agency concerning the feasibility and desirability of coordinating such examination with examinations conducted by such appropriate regulatory agency with a view to avoiding

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unnecessary regulatory duplication or undue regulatory burdens for such clearing agency, transfer agent, or municipal securities dealer; or

(B) broker or dealer registered pursuant to section 15(b)(11) [*15 USCS § 78o(b)(11)*], exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*], or national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*] gives notice to the Commodity Futures Trading Commission of such proposed examination and consults with the Commodity Futures Trading Commission concerning the feasibility and desirability of coordinating such examination with examinations conducted by the Commodity Futures Trading Commission in order to avoid unnecessary regulatory duplication or undue regulatory burdens for such broker or dealer or exchange.

(2) Furnishing data and reports to CFTC. The Commission shall notify the Commodity Futures Trading Commission of any examination conducted of any broker or dealer registered pursuant to section 15(b)(11) [*15 USCS § 78o(b)(11)*], exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*], or national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*] and, upon request, furnish to the Commodity Futures Trading Commission any examination report and data supplied to, or prepared by, the Commission in connection with such examination.

(3) Use of CFTC reports. Prior to conducting an examination under paragraph (1), the Commission shall use the reports of examinations, if the information available therein is sufficient for the purposes of the examination, of--

(A) any broker or dealer registered pursuant to section 15(b)(11) [*15 USCS § 78o(b)(11)*];

(B) [an] exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*]; or

(C) [a] national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*];

that is made by the Commodity Futures Trading Commission, a national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*], or an exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*].

(4) Rules of construction.

(A) Notwithstanding any other provision of this subsection, the records of a broker or dealer registered pursuant to section 15(b)(11) [*15 USCS § 78o(b)(11)*], an exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*], or a national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*] described in this subparagraph shall not be subject to routine periodic examinations by the Commission.

(B) Any recordkeeping rules adopted under this subsection for a broker or dealer registered pursuant to section 15(b)(11) [*15 USCS § 78o(b)(11)*], an exchange registered pursuant to section 6(g) [*15 USCS § 78f(g)*], or a national securities association registered pursuant to section 15A(k) [*15 USCS § 78o-3(k)*] shall be limited to records with respect to persons, accounts, agreements, contracts, and transactions involving security futures products.

(C) Nothing in the proviso in paragraph (1) shall be construed to impair or limit (other than by the requirement of prior consultation) the power of the Commission under this subsection to examine any clearing agency, transfer agent, or municipal securities dealer or to affect in any way the power of the Commission under any other provision of this *title [15 USCS §§ 78a* et seq.] or otherwise to inspect, examine, or investigate any such clearing agency, transfer agent, or municipal securities dealer.

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15 USCS § 78u-2

§ 78u-2. Civil remedies in administrative proceedings

(a) Commission authority to assess money penalties. In any proceeding instituted pursuant to sections 15(b)(4), 15(b)(6), 15D, 15B, 15C, **15E**, or 17A of this *title [15 USCS § 78o(b)(4)*, (6), 78o-6, 78o-4, 78o-5, 78o-7, or 78q-1] against any person, the Commission or the appropriate regulatory agency may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such person--

(1) has willfully violated any provision of the Securities Act of 1933 [*15 USCS §§ 77a* et seq.], the Investment Company Act of 1940 [*15 USCS §§ 80a-1* et seq.], the Investment Advisers Act of 1940 [*15 USCS §§ 80b-1* et seq.], or this *title [15 USCS §§ 78a* et seq.], or the rules or regulations thereunder, or the rules of the Municipal Securities Rulemaking Board;

(2) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;

(3) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency under this *title [15 USCS §§ 78a* et seq.], or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein; or

(4) has failed reasonably to supervise, within the meaning of section 15(b)(4)(E) of this *title [15 USCS § 78o(b)(4)(E)*], with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision;

and that such penalty is in the public interest.

(b) Maximum amount of penalty.

(1) First tier. The maximum amount of penalty for each act or omission described in subsection (a) shall be $ 5,000 for a natural person or $ 50,000 for any other person.

(2) Second tier. Notwithstanding paragraph (1), the maximum amount of penalty for each such act or omission shall be $ 50,000 for a natural person or $ 250,000 for any other person if the act or omission described in subsection (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(3) Third tier. Notwithstanding paragraphs (1) and (2), the maximum amount of penalty for each such act or omission shall be $ 100,000 for a natural person or $ 500,000 for any other person if--

(A) the act or omission described in subsection (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(B) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

(c) Determination of public interest. In considering under this section whether a penalty is in the public interest, the Commission or the appropriate regulatory agency may consider--

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(1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

(2) the harm to other persons resulting either directly or indirectly from such act or omission;

(3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

(4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 15(b)(4)(B) of this *title [15 USCS § 78o(b)(4)(B)*];

(5) the need to deter such person and other persons from committing such acts or omissions; and

(6) such other matters as justice may require.

(d) Evidence concerning ability to pay. In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, a respondent may present evidence of the respondent's ability to pay such penalty. The Commission or the appropriate regulatory agency may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person's ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon such person's assets and the amount of such person's assets.

(e) Authority to enter an order requiring an accounting and disgorgement. In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

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*** THIS SECTION IS CURRENT THROUGH THE SEPTEMBER 3, 2009 ISSUE OF ***
*** THE FEDERAL REGISTER ***

TITLE 17 -- COMMODITY AND SECURITIES EXCHANGES
CHAPTER II -- SECURITIES AND EXCHANGE COMMISSION
PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934
SUBPART A -- RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934
NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

17 CFR 240.17g-1

§ 240.17g-1 Application for registration as a nationally recognized statistical rating organization.

(a) Initial application. A credit rating agency applying to the Commission to be registered under section 15E of the Act *(15 U.S.C. 78o-7)* as a nationally recognized statistical rating organization must furnish the Commission with an initial application on Form NRSRO (§ 249b.300 of this chapter) that follows all applicable instructions for the Form.

(b) Application to register for an additional class of credit ratings. A nationally recognized statistical rating organization applying to register for an additional class of the credit ratings described in section 3(a)(62)(B) of the Act *(15 U.S.C. 78c*(a)(62)(B)) must furnish the Commission with an application to add a class of credit ratings on Form NRSRO that follows all applicable instructions for the Form. The application will be subject to the requirements of section 15E(a)(2) of the Act *(15 U.S.C. 78o-7*(a)(2)).

(c) Supplementing an application prior to final action by the Commission. An applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an initial application to be registered as a nationally recognized statistical rating organization or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information that was found to be materially inaccurate. The applicant also must promptly furnish the Commission with an application supplement on Form NRSRO that follows all applicable instructions for the Form.

(d) Withdrawing an application. An applicant may withdraw an initial application to be registered as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings prior to the date of a Commission order granting or denying the application. To withdraw the application, the applicant must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

(e) Update of registration. A nationally recognized statistical rating organization amending materially inaccurate information in its application for registration pursuant to section 15E(b)(1) of the Act *(15 U.S.C. 78o-7*(b)(1)) must promptly furnish the Commission with the update of its registration on Form NRSRO that follows all applicable instructions for the Form.

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(f) Annual certification. A nationally recognized statistical rating organization amending its application for registration pursuant to section 15E(b)(2) of the Act *(15 U.S.C. 78o-7*(b)(2)) must furnish the Commission with the annual certification on Form NRSRO that follows all applicable instructions for the Form not later than 90 days after the end of each calendar year.

(g) Withdrawal from registration. A nationally recognized statistical rating organization withdrawing from registration pursuant to section 15E(e)(1) of the Act *(15 U.S.C. 78o-7*(e)(1)) must furnish the Commission with a notice of withdrawal from registration on Form NRSRO that follows all applicable instructions for the Form. The withdrawal from registration will become effective 45 calendar days after the notice is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors.

(h) Furnishing Form NRSRO. A Form NRSRO submitted under any paragraph of this section will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form. Information submitted on a confidential basis and for which confidential treatment has been requested pursuant to applicable Commission rules will be accorded confidential treatment to the extent permitted by law.

(i) Public availability of Form NRSRO. A nationally recognized statistical rating organization must make its current Form NRSRO and information and documents submitted in Exhibits 1 through 9 to Form NRSRO publicly available on its Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission order granting an initial application for registration as a nationally recognized statistical rating organization or an application to register for an additional class of credit ratings and within 10 business days after furnishing a Form NRSRO to the Commission under paragraphs (e), (f), or (g) of this section.

17 CFR 240.17g-2

§ 240.17g-2 Records to be made and retained by nationally recognized statistical rating organizations.

(a) Records required to be made and retained. A nationally recognized statistical rating organization must make and retain the following books and records, which must be complete and current:

(1) Records of original entry into the accounting system of the nationally recognized statistical rating organization and records reflecting entries to and balances in all general ledger accounts of the nationally recognized statistical rating organization for each fiscal year.

(2) Records with respect to each current credit rating of the nationally recognized statistical rating organization indicating (as applicable):

(i) The identity of any credit analyst(s) that participated in determining the credit rating;

(ii) The identity of the person(s) that approved the credit rating before it was issued;

(iii) If a quantitative model was a substantial component in the process of determining the credit rating of a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-

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backed securities transaction, a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued; and

(iv) Whether the credit rating was solicited or unsolicited.

(3) An account record for each person (for example, an obligor, issuer, underwriter, or other user) that has paid the nationally recognized statistical rating organization for the issuance or maintenance of a credit rating indicating:

(i) The identity and address of the person; and

(ii) The credit rating(s) determined or maintained for the person.

(4) An account record for each subscriber to the credit ratings and/or credit analysis reports of the nationally recognized statistical rating organization indicating the identity and address of the subscriber.

(5) A record listing the general types of services and products offered by the nationally recognized statistical rating organization.

(6) A record documenting the established procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings.

(7) A record that lists each security and money market instrument and its corresponding credit rating issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction where the nationally recognized statistical rating organization, in determining the credit rating for the security or money market instrument, treats assets within such pool or as a part of such transaction that are not subject to a credit rating of the nationally recognized statistical rating organization by any or a combination of the following methods:

(i) Determining credit ratings for the unrated assets;

(ii) Performing credit assessments or determining private credit ratings for the unrated assets;

(iii) Determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration the internal credit analysis of another person; or

(iv) Determining credit ratings or private credit ratings, or performing credit assessments for the unrated assets by taking into consideration (but not necessarily adopting) the credit ratings of another nationally recognized statistical rating organization.

(8) For each outstanding credit rating, a record showing all rating actions and the date of such actions from the initial credit rating to the current credit rating identified by the name of the rated security or obligor and, if applicable, the CUSIP of the rated security or the Central Index Key (CIK) number of the rated obligor.

(b) Records required to be retained. A nationally recognized statistical rating organization must retain the following books and records (excluding drafts of documents) that relate to its business as a credit rating agency:

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(1) Significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports furnished by the nationally recognized statistical rating organization to the Commission pursuant to § 240.17g-3.

(2) Internal records, including nonpublic information and work papers, used to form the basis of a credit rating issued by the nationally recognized statistical rating organization.

(3) Credit analysis reports, credit assessment reports, and private credit rating reports of the nationally recognized statistical rating organization and internal records, including nonpublic information and work papers, used to form the basis for the opinions expressed in these reports.

(4) Compliance reports and compliance exception reports.

(5) Internal audit plans, internal audit reports, documents relating to internal audit follow-up measures, and all records identified by the internal auditors of the nationally recognized statistical rating organization as necessary to perform the audit of an activity that relates to its business as a credit rating agency.

(6) Marketing materials of the nationally recognized statistical rating organization that are published or otherwise made available to persons that are not associated with the nationally recognized statistical rating organization.

(7) External and internal communications, including electronic communications, received and sent by the nationally recognized statistical rating organization and its employees that relate to initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

(8) Any written communications received from persons not associated with the nationally recognized statistical rating organization that contain complaints about the performance of a credit analyst in initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

(9) Internal documents that contain information, analysis, or statistics that were used to develop a procedure or methodology to treat the credit ratings of another nationally recognized statistical rating organization for the purpose of determining a credit rating for a security or money market instrument issued by an asset pool or part of any asset-backed or mortgage-backed securities transaction.

(10) For each security or money market instrument identified in the record required to be made and retained under paragraph (a)(7) of this section, any document that contains a description of how assets within such pool or as a part of such transaction not rated by the nationally recognized statistical rating organization but rated by another nationally recognized statistical rating organization were treated for the purpose of determining the credit rating of the security or money market instrument.

(11) Form NRSROs (including Exhibits and accompanying information and documents) submitted to the Commission by the nationally recognized statistical rating organization.

(c) Record retention periods. The records required to be retained pursuant to paragraphs (a) and (b) of this section must be retained for three years after the date the record is made or received.

(d) Manner of retention. An original, or a true and complete copy of the original, of each record required to be retained pursuant to paragraphs (a) and (b) of this section must be maintained in a manner that, for the applicable retention period specified in paragraph (c) of this section, makes the original record or copy easily accessible to the principal office of the nationally recognized statistical rating organization and to any other

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office that conducted activities causing the record to be made or received. In addition, a nationally recognized statistical rating organization must make and keep publicly available on its corporate Internet Web site in an XBRL (eXtensible Business Reporting Language) format the ratings action information for ten percent of the outstanding credit ratings required to be retained pursuant to paragraph (a)(8) of this section and which were paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated, selected on a random basis, for each class of credit rating for which it is registered and for which it has issued 500 or more outstanding credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated. Any ratings action required to be disclosed pursuant to this paragraph (d) need not be made public less than six months from the date such ratings action is taken. If a credit rating made public pursuant to this paragraph (d) is withdrawn or the instrument rated matures, the nationally recognized statistical rating organization must randomly select a new outstanding credit rating from that class of credit ratings in order to maintain the 10 percent disclosure threshold. In making the information available on its corporate Internet Web site, the nationally recognized statistical rating organization shall use the List of XBRL Tags for NRSROs as specified on the Commission's Internet Web site.

(e) Third-party record custodian. The records required to be retained pursuant to paragraphs (a) and (b) of this section may be made or retained by a third-party record custodian, provided the nationally recognized statistical rating organization furnishes the Commission at its principal office in Washington, DC with a written undertaking of the custodian executed by a duly authorized person. The undertaking must be in substantially the following form:

The undersigned acknowledges that books and records it has made or is retaining for [the nationally recognized statistical rating organization] are the exclusive property of [the nationally recognized statistical rating organization]. The undersigned undertakes that upon the request of [the nationally recognized statistical rating organization] it will promptly provide the books and records to [the nationally recognized statistical rating organization] or the U.S. Securities and Exchange Commission ("Commission") or its representatives and that upon the request of the Commission it will promptly permit examination by the Commission or its representatives of the records at any time or from time to time during business hours and promptly furnish to the Commission or its representatives a true and complete copy of any or all or any part of such books and records.

A nationally recognized statistical rating organization that engages a third-party record custodian remains responsible for complying with every provision of this section.

(f) A nationally recognized statistical rating organization must promptly furnish the Commission or its representatives with legible, complete, and current copies, and, if specifically requested, English translations of those records of the nationally recognized statistical rating organization required to be retained pursuant to paragraphs (a) and (b) this section, or any other records of the nationally recognized statistical rating organization subject to examination under section 17(b) of the Act (*15 U.S.C. 78q(b)*) that are requested by the Commission or its representatives.

17 CFR 240.17g-3

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§ 240.17g-3 Annual financial reports to be furnished by nationally recognized statistical rating organizations.

(a) A nationally recognized statistical rating organization must annually, not more than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO), furnish the Commission, at the Commission's principal office in Washington, DC, with the following financial reports as of the end of its most recent fiscal year:

(1) Audited financial statements of the nationally recognized statistical rating organization or audited consolidated financial statements of its parent if the nationally recognized statistical rating organization is a separately identifiable division or department of the parent. The audited financial statements must:

(i) Include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity;

(ii) Be prepared in accordance with generally accepted accounting principles in the jurisdiction in which the nationally recognized statistical rating organization or its parent is incorporated, organized, or has its principal office; and

(iii) Be certified by an accountant who is qualified and independent in accordance with paragraphs (a), (b), and (c)(1), (2), (3), (4), (5) and (8) of § 210.2-01 of this chapter. The accountant must give an opinion on the financial statements in accordance with paragraphs (a) through (d) of § 210.2-02 of this chapter.

(2) If applicable, unaudited consolidating financial statements of the parent of the nationally recognized statistical rating organization that include the nationally recognized statistical rating organization.

Note to paragraph (a)(2): This financial report must be furnished only if the audited financial statements provided pursuant to paragraph (a)(1) of this section are consolidated financial statements of the parent of the nationally recognized statistical rating organization.

(3) An unaudited financial report providing information concerning the revenue of the nationally recognized statistical rating organization in each of the following categories (as applicable) for the fiscal year:

(i) Revenue from determining and maintaining credit ratings;

(ii) Revenue from subscribers;

(iii) Revenue from granting licenses or rights to publish credit ratings; and

(iv) Revenue from all other services and products (include descriptions of any major sources of revenue).

(4) An unaudited financial report providing the total aggregate and median annual compensation of the credit analysts of the nationally recognized statistical rating organization for the fiscal year.

Note to paragraph (a)(4): In calculating total and median annual compensation, the nationally recognized statistical rating organization may exclude deferred compensation, provided such exclusion is noted in the report.

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(5) An unaudited financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the nationally recognized statistical rating organization by amount of net revenue attributable to the issuer or subscriber during the fiscal year. Additionally, include on the list any obligor or underwriter that used the credit rating services provided by the nationally recognized statistical rating organization if the net revenue attributable to the obligor or underwriter during the fiscal year equaled or exceeded the net revenue attributable to the 20th largest issuer or subscriber. Include the net revenue amount for each person on the list.

Note to paragraph (a)(5): A person is deemed to have "used the credit rating services" of the nationally recognized statistical rating organization if the person is any of the following: an obligor that is rated by the nationally recognized statistical rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market instruments subject to a credit rating of the nationally recognized statistical rating organization (regardless of whether the issuer paid for the credit rating); any other person that has paid the nationally recognized statistical rating organization to determine a credit rating with respect to a specific obligor, security, or money market instrument; or a subscriber to the credit ratings, credit ratings data, or credit analysis of the nationally recognized statistical rating organization. In calculating net revenue attributable to a person, the nationally recognized statistical rating organization should include all revenue earned by the nationally recognized statistical rating organization for any type of service or product, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person by the nationally recognized statistical rating organization.

(6) An unaudited report of the number of credit ratings actions (upgrades, downgrades, placements on credit watch, and withdrawals) taken during the fiscal year in each class of credit ratings identified in section 3(a)(62)(B) of the Act (*15 U.S.C. 78c(a)(62)(B)*) for which the nationally recognized statistical rating organization is registered with the Commission.

Note to paragraph (a)(6): A nationally recognized statistical rating organization registered in the class of credit ratings described in section 3(a)(62)(B)(iv) of the Act (*15 U.S.C. 78c(a)(62)(B)(iv)*) must include credit ratings actions taken on credit ratings of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction for purposes of reporting the number of credit ratings actions in this class.

(b) The nationally recognized statistical rating organization must attach to the financial reports furnished pursuant to paragraphs (a)(1) through (a)(6) of this section a signed statement by a duly authorized person associated with the nationally recognized statistical rating organization stating that the person has responsibility for the financial reports and, to the best knowledge of the person, the financial reports fairly present, in all material respects, the financial condition, results of operations, cash flows, revenues, analyst compensation, and credit rating actions of the nationally recognized statistical rating organization for the period presented.

(c) The Commission may grant an extension of time or an exemption with respect to any requirements in this section either unconditionally or on specified terms and conditions on the written request of a nationally recognized statistical rating organization if the Commission finds that such extension or exemption is necessary or appropriate in the public interest and consistent with the protection of investors.

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17 CFR 240.17g-4

§ 240.17g-4 Prevention of misuse of material nonpublic information.

(a) The written policies and procedures a nationally recognized statistical rating organization establishes, maintains, and enforces to prevent the misuse of material, nonpublic information pursuant to section 15E(g)(1) of the Act *(15 U.S.C. 78o-7*(g)(1)) must include policies and procedures reasonably designed to prevent:

(1) The inappropriate dissemination within and outside the nationally recognized statistical rating organization of material nonpublic information obtained in connection with the performance of credit rating services;

(2) A person within the nationally recognized statistical rating organization from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is aware of material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments; and

(3) The inappropriate dissemination within and outside the nationally recognized statistical rating organization of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means.

(b) For the purposes of this section, the term person within a nationally recognized statistical rating organization means a nationally recognized statistical rating organization, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the nationally recognized statistical rating organization or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

17 CFR 240.17g-5

§ 240.17g-5 Conflicts of interest.

(a) A person within a nationally recognized statistical rating organization is prohibited from having a conflict of interest relating to the issuance or maintenance of a credit rating identified in paragraph (b) of this section, unless:

(1) The nationally recognized statistical rating organization has disclosed the type of conflict of interest in Exhibit 6 to Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (*15 U.S.C. 78o-7(a)(1)(B)(vi)*) and § 240.17g-1; and

(2) The nationally recognized statistical rating organization has established and is maintaining and enforcing written policies and procedures to address and manage conflicts of interest in accordance with section 15E(h) of the Act (*15 U.S.C. 78o-7(h)*).

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(b) Conflicts of interest. For purposes of this section, each of the following is a conflict of interest:

(1) Being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

(2) Being paid by obligors to determine credit ratings with respect to the obligors.

(3) Being paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the nationally recognized statistical rating organization to determine a credit rating.

(4) Being paid by persons for subscriptions to receive or access the credit ratings of the nationally recognized statistical rating organization and/or for other services offered by the nationally recognized statistical rating organization where such persons may use the credit ratings of the nationally recognized statistical rating organization to comply with, and obtain benefits or relief under, statutes and regulations using the term nationally recognized statistical rating organization.

(5) Being paid by persons for subscriptions to receive or access the credit ratings of the nationally recognized statistical rating organization and/or for other services offered by the nationally recognized statistical rating organization where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the nationally recognized statistical rating organization.

(6) Allowing persons within the nationally recognized statistical rating organization to directly own securities or money market instruments of, or having other direct ownership interests in, issuers or obligors subject to a credit rating determined by the nationally recognized statistical rating organization.

(7) Allowing persons within the nationally recognized statistical rating organization to have a business relationship that is more than an arms length ordinary course of business relationship with issuers or obligors subject to a credit rating determined by the nationally recognized statistical rating organization.

(8) Having a person associated with the nationally recognized statistical rating organization that is a broker or dealer engaged in the business of underwriting securities or money market instruments.

(9) Any other type of conflict of interest relating to the issuance of credit ratings by the nationally recognized statistical rating organization that is material to the nationally recognized statistical rating organization and that is identified by the nationally recognized statistical rating organization in Exhibit 6 to Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (*15 U.S.C. 78o-7(a)(1)(B)(vi)*) and § 240.17g-1.

(c) Prohibited conflicts. A nationally recognized statistical rating organization is prohibited from having the following conflicts of interest relating to the issuance or maintenance of a credit rating as a credit rating agency:

(1) The nationally recognized statistical rating organization issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the nationally recognized statistical rating organization with net revenue (as reported under § 240.17g-3) equaling or exceeding 10% of the total net revenue of the nationally recognized statistical rating organization for the fiscal year;

(2) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to a person (excluding a sovereign nation or an agency of a sovereign nation) where the nationally

recognized statistical rating organization, a credit analyst that participated in determining the credit rating, or a person responsible for approving the credit rating, directly owns securities of, or has any other direct ownership interest in, the person that is subject to the credit rating;

(3) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to a person associated with the nationally recognized statistical rating organization;

(4) The nationally recognized statistical rating organization issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person responsible for approving the credit rating, is an officer or director of the person that is subject to the credit rating;

(5) The nationally recognized statistical rating organization issues or maintains a credit rating with respect to an obligor or security where the nationally recognized statistical rating organization or a person associated with the nationally recognized statistical rating organization made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security;

(6) The nationally recognized statistical rating organization issues or maintains a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the nationally recognized statistical rating organization who has responsibility for participating in determining credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models; or

(7) The nationally recognized statistical rating organization issues or maintains a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $ 25.

(d) For the purposes of this section, the term person within a nationally recognized statistical rating organization means a nationally recognized statistical rating organization, its credit rating affiliates identified on Form NRSRO, and any partner, officer, director, branch manager, and employee of the nationally recognized statistical rating organization or its credit rating affiliates (or any person occupying a similar status or performing similar functions).

17 CFR 240.17g-6

§ 240.17g-6 Prohibited acts and practices.

(a) Prohibitions. A nationally recognized statistical rating organization is prohibited from engaging in any of the following unfair, coercive, or abusive practices:

(1) Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating

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assessment products, of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(2) Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the nationally recognized statistical rating organization's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(3) Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the nationally recognized statistical rating organization's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

(4) Issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating, or withdrawing or threatening to withdraw a credit rating, with respect to securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the nationally recognized statistical rating organization, where such practice is engaged in by the nationally recognized statistical rating organization for an anticompetitive purpose.

Form NRSRO

OMB APPROVAL
OMB Number: 3235-0625
Expires: August 31, 2012
Estimated average burden hours per response: 400

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

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Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1541 (2-07)

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APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

☐ INITIAL APPLICATION ☐ ANNUAL CERTIFICATION

☐ APPLICATION TO ADD CLASS OF CREDIT RATINGS ☐ UPDATE OF REGISTRATION Items and/or Exhibits Amended: _____

☐ APPLICATION SUPPLEMENT Items and/or Exhibits Supplemented: _____ ☐ WITHDRAWAL FROM REGISTRATION

Important: Refer to Form NRSRO Instructions for General Instructions, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO). "You" and "your" mean the person furnishing this Form NRSRO to the Commission. "Applicant" and "NRSRO" mean the person furnishing this Form NRSRO to the Commission and any credit rating affiliate identified in Item 3.

1. A. Your full name:

_____

B. (i) Name under which your credit rating business is primarily conducted, if different from Item 1A:

_____

(ii) Any other name under which your credit rating business is conducted and where it is used (other than the name of a credit rating affiliate identified in Item 3**)**:

_____

C. Address of your principal office (do not use a P.O. Box):

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:

_____

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(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (See Instructions):

_____
(Number and Street)

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form NRSRO on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including Exhibits and attachments, all of which are part of this Form, are accurate in all significant respects. If this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate in all significant respects.

_____
_____
(Date) (Name of the Applicant/NRSRO)

By:

_____
(Signature) (Print Name and Title)

2. **A**. Your legal status:

☐ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) _____

B. Month and day of your fiscal year end: _____

C. Place and date of your formation (i.e., state or country where you were incorporated, where your partnership agreement was filed, or where you otherwise were formed):

State/Country of formation: _____ Date of formation: _____

3. Your credit rating affiliates (See Instructions):

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

_____
(Name) (Address)

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4. The designated compliance officer of the Applicant/NRSRO (See Instructions)*:*

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail how this Form NRSRO and Exhibits 1 through 9 to this Form NRSRO will be made publicly available on Web site of the Applicant/NRSRO, or through another comparable, readily accessible means (See Instructions):

_____

_____

_____

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION, APPLICATION SUPPLEMENT, OR APPLICATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. For each class, indicate the approximate number of credit ratings the Applicant/NRSRO presently has outstanding in that class as of the date of this application and the approximate date the Applicant/NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit ratings	Applying for registration	Approximate number currently outstanding	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Exchange Act			

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

(15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

_____

C. Check the applicable box and attach certifications from qualified institutional buyers, if required (See Instructions):

☐ The Applicant/NRSRO is attaching _____ certifications from qualified institutional buyers to this application. Each is marked "Certification from Qualified Institutional Buyer."

☐ The Applicant/NRSRO is exempt from the requirement to submit certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: You are not required to make a Certification from a Qualified Institutional Buyer submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the certifications confidential upon request to the extent permitted by law.

7. DO NOT COMPLETE ITEM 7 IF THIS IS AN INITIAL APPLICATION.

A. Indicate below the classes of credit ratings for which the NRSRO is currently registered. For each class, indicate the approximate number of credit ratings the NRSRO had outstanding in that class as of the most recent calendar year end and the approximate date the NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit rating	Currently registered	Approximate number outstanding as of the most recent calendar year end	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		

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insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		
issuers of government securities as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee (See Instructions):

_____

_____

_____

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and submit the Disclosure Reporting Page with this Form NRSRO (See Instructions). You are not required to make any disclosure reporting pages submitted with this Form publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.		
	YES	**NO**
A. Has the Applicant/NRSRO or any person within the Applicant/NRSRO committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934 in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the Applicant/NRSRO or any person within the Applicant/NRSRO been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☐

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C. Is any person within the Applicant/NRSRO subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐ ☐

9. Exhibits (See Instructions).

Exhibit 1. Credit ratings performance measurement statistics. ☐ Exhibit 1 is attached and made a part of this Form NRSRO.
Exhibit 2. A description of the procedures and methodologies used in determining credit ratings. ☐ Exhibit 2 is attached and made a part of Form NRSRO.
Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information. ☐ Exhibit 3 is attached and made a part of this Form NRSRO.
Exhibit 4. Organizational structure. ☐ Exhibit 4 is attached to and made a part of this Form NRSRO.
Exhibit 5. The code of ethics or a statement of the reasons why a code of ethics is not in effect. ☐ Exhibit 5 is attached to and made a part of this Form NRSRO.
Exhibit 6. Identification of conflicts of interests relating to the issuance of credit ratings. ☐ Exhibit 6 is attached to and made a part of this Form NRSRO.
Exhibit 7. Policies and procedures to address and manage conflicts of interest. ☐ Exhibit 7 is attached to and made a part of this Form NRSRO.
Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors. ☐ Exhibit 8 is attached to and made a part of this Form NRSRO.
Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer.

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

☐ Exhibit 9 is attached to and made a part of this Form NRSRO.

Exhibit 10. A list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application.

☐ Exhibit 10 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application.

☐ Exhibit 11 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application.

☐ Exhibit 12 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

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FORM NRSRO INSTRUCTIONS

A. GENERAL INSTRUCTIONS.

1. Form NRSRO is the Application for Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO") under Section 15E of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 17g-1. Exchange Act Rule 17g-1 requires an Applicant/NRSRO to use Form NRSRO to furnish the U.S. Securities and Exchange Commission ("Commission") with:

    - An initial application to be registered as an NRSRO;
    - An application to register for an additional class of credit ratings;
    - An application supplement;
    - An update of registration pursuant to Section 15E(b)(1) of the Exchange Act;
    - An annual certification pursuant to Section 15E(b)(2) of the Exchange Act; and
    - A withdrawal of registration pursuant to Section 15E(e) of the Exchange Act.

2. Exchange Act Rule 17g-1(c) requires that an Applicant/NRSRO promptly provide the Commission with a written notice if information submitted to the Commission in an initial application for registration or in an application to register for an additional class of credit ratings is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must identify the information found to be materially inaccurate. The Applicant/NRSRO must also promptly furnish the Commission with accurate and complete information as an application supplement on Form NRSRO.

3. Pursuant to Exchange Act Rule 17g-1(i), an NRSRO must make its current Form NRSRO and information and documents furnished in Exhibits 1 through 9 to Form NRSRO publicly available on its Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission Order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after submitting an update of registration, annual certification, or withdrawal from registration to the Commission on Form NRSRO.

   The certifications from qualified institutional buyers, disclosure reporting pages, and Exhibits 10 through 13 are not required to be made publicly available by the NRSRO pursuant to Rule 17g-1(i). An Applicant/NRSRO may request that the Commission keep confidential the certifications from qualified institutional buyers, the disclosure reporting pages, and the information and documents in Exhibits 10 – 13 submitted to the Commission. An Applicant/NRSRO seeking confidential treatment for these submissions should mark each page "Confidential Treatment" and comply with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep this information confidential to the extent permitted by law.

4. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny an initial application for registration as an NRSRO. These time periods also apply to an application to register for an additional class of credit ratings.

5. Type or clearly print all information. Use only the current version of Form NRSRO or a reproduction of it.

6. Section 15E of the Exchange Act (15 U.S.C. 78o-7) authorizes the Commission to collect the Information on Form NRSRO from an Applicant/NRSRO. The principal purposes of Form NRSRO are to determine whether an Applicant should be granted registration as an NRSRO, whether an NRSRO should be granted registration in an additional class of credit ratings, whether an NRSRO continues to meet the criteria for registration as an NRSRO, to withdraw a registration, and to provide information about an NRSRO to users of credit ratings. Intentional misstatements or omissions may constitute federal criminal violations under 18 U.S.C. 1001.

   The information collection is in accordance with the clearance requirements of Section 3507 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). The Commission may not conduct or sponsor, and you are not required to respond to, a collection of information unless it displays a valid Office of Management and Budget (OMB) control number. The time required to complete and furnish this form will vary depending on individual circumstances. The estimated average time to complete an initial application is displayed on the facing page of this Form. Send comments regarding this burden estimate or suggestions for reducing the burden to Director, Office of Information Technology, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

7. Under Exchange Act Rule 17g-2(b)(10), an NRSRO must retain copies of all Form NRSROs (including Exhibits, accompanying information, and documents) submitted to the Commission. Exchange Act Rule 17g-2(c) requires that these records be retained for three years after the date the record is made**.**

8. ADDRESS - The mailing address for Form NRSRO is:

U. S. Securities and Exchange Commission

100 F Street, NE

Washington, DC 20549

9. A Form NRSRO will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the Form.

B. INSTRUCTIONS FOR AN INITIAL APPLICATION

An Applicant applying to be registered with the Commission as an NRSRO must furnish the Commission with an initial application on Form NRSRO. To complete an initial application:

- Check the "INITIAL APPLICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, and 8. (See Instructions below for each Item). Enter "None" or "N/A" where appropriate.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers, marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- Attach Exhibits 1 through 13 (See Instructions below for each Exhibit).
- Execute the Form.

The Applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an initial application is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also

must promptly furnish the Commission with an application supplement on Form NRSRO (See instructions below for an application supplement).

C. INSTRUCTIONS FOR AN APPLICATION TO ADD A CLASS OF CREDIT RATINGS

An NRSRO applying to register for an additional class of credit ratings must furnish the Commission with an application on Form NRSRO. To complete an application to register for an additional class of credit ratings:

- Check the "APPLICATION TO ADD CLASS OF CREDIT RATINGS" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 6, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- Unless exempt from the requirement, attach certifications from qualified institutional buyers for the additional class of credit ratings marked "Certification from Qualified Institutional Buyer" (See Instructions below for Item 6C).
- If any information in an Exhibit previously furnished is materially inaccurate, update that information.
- Execute the Form.

The Applicant must promptly furnish the Commission with a written notice if information submitted to the Commission in an application to add a class of credit ratings is found to be or becomes materially inaccurate prior to the date of a Commission order granting or

denying the application. The notice must identify the information found to be materially inaccurate. The Applicant also must promptly furnish the Commission with an application supplement on Form NRSRO (See instructions below for an application supplement).

D. INSTRUCTIONS FOR AN APPLICATION SUPPLEMENT

An Applicant must furnish an application supplement to the Commission on Form NRSRO if information submitted to the Commission in a pending initial application for registration as an NRSRO or a pending application to register for an additional class of credit ratings is found to be or becomes materially inaccurate. To complete an application supplement:

- Check the "APPLICATION SUPPLEMENT" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being supplemented.
- Complete Items 1, 2, 3, 4, 5 and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If supplementing an initial application, also complete Item 6. If supplementing an application for registration in an additional class of credit ratings, also complete Items 6 and 7. If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If a certification from a qualified institutional buyer is being updated or a new certification is being added, attach the updated or new certification.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

E. INSTRUCTIONS FOR AN UPDATE OF REGISTRATION

After registration is granted, Section 15E(b)(1) of the Exchange Act requires that an NRSRO must promptly amend its application for registration if information or documents provided in the previously furnished Form NRSRO become materially inaccurate. This requirement does not apply to Item 7 and Exhibit 1, which only are required to be updated annually with the annual certification. It also does not apply to Exhibits 10 – 13 and the certifications from qualified institutional buyers, which are not required to be updated on Form NRSRO after registration. An NRSRO amending its application for registration must furnish the Commission with an update of its registration on Form NRSRO. To complete an update of registration:

- Check the "UPDATE OF REGISTRATION" box at the top of Form NRSRO.
- Indicate on the line provided under the box the Item(s) or Exhibit(s) being updated.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If an Exhibit is being updated, attach the updated Exhibit.
- Execute the Form.

F. INSTRUCTIONS FOR ANNUAL CERTIFICATIONS

After registration is granted, Section 15E(b)(2) of the Exchange Act requires that an NRSRO furnish the Commission with an annual certification not later than 90 days after the

end of each calendar year. The annual certification must be furnished to the Commission on Form NRSRO and must include an update of the information in Item 7 and the credit ratings performance measurement statistics furnished in Exhibit 1, a certification that the information and documents furnished on or with Form NRSRO continue to be accurate (use the certification on the Form), and a list of material changes to the application for registration that occurred during the previous calendar year. To complete an annual certification:

- Check the "ANNUAL CERTIFICATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information in an Item on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- If any information in an Exhibit previously furnished is materially inaccurate, update that information.
- Attach a list of all material changes made to the information or documents in the application for registration of the NRSRO that occurred during the previous calendar year.
- Execute the Form.

G. INSTRUCTIONS FOR A WITHDRAWAL FROM REGISTRATION

Section 15E(e)(1) of the Exchange Act provides that an NRSRO may voluntarily withdraw its registration with the Commission. To withdraw from registration, an NRSRO must

furnish the Commission with a notice of withdrawal from registration on Form NRSRO. The withdrawal from registration will become effective 45 calendar days after the withdrawal from registration is furnished to the Commission upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors. To complete a withdrawal from registration:

- Check the "WITHDRAWAL FROM REGISTRATION" box at the top of Form NRSRO.
- Complete Items 1, 2, 3, 4, 5, 7, and 8 on the Form following all applicable instructions for each Item (See Instructions below for each Item). If any information on the previously furnished Form NRSRO is materially inaccurate, update that information. Enter "None" or "N/A" where appropriate. Complete each Item even if the Item is not being updated.
- Execute the Form.

H. INSTRUCTIONS FOR SPECIFIC LINE ITEMS

Item 1A. Provide the name of the person (e.g., XYZ Corporation) that is furnishing the Form NRSRO to the Commission. This means the name of the person that is applying for registration as an NRSRO or is registered as an NRSRO and not the name of the individual that is executing the Form.

Item 1E. The individual listed as the contact person must be authorized to receive all communications and papers from the Commission and must be responsible for their dissemination within the Applicant/NRSRO.

Certification. The certification must be executed by the Chief Executive Officer or the President of the person that is furnishing the Form NRSRO to the Commission or an individual with similar responsibilities.

Item 3. Identify credit rating affiliates that issue credit ratings on behalf of the person furnishing the Form NRSRO to the Commission in one or more of the classes of credit ratings identified in Item 6 or Item 7. A "credit rating affiliate" is a separate legal entity or a separately identifiable department or division thereof that determines credit ratings that are credit ratings of the person furnishing the Form NRSRO to the Commission. The information in Items 4 – 8 and all the Exhibits must incorporate information about the credit ratings, methodologies, procedures, policies, financial condition, results of operations, personnel, and organizational structure of each credit rating affiliate identified in Item 3, as applicable. Any credit rating determined by a credit rating affiliate identified in Item 3 will be treated as a credit rating issued by the person furnishing the Form NRSRO to the Commission for purposes of Section 15E of the Exchange Act and the Commission's rules thereunder. The terms "Applicant" and "NRSRO" as used on Form NRSRO and the Instructions for the Form mean the person furnishing the Form NRSRO to the Commission and any credit rating affiliate identified in Item 3.

Item 4. Section 15E(j) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the NRSRO established pursuant to Sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations.

Item 5. Section 15E(a)(3) of the Exchange Act and Exchange Act Rule 17g-1(i) require an NRSRO to make Form NRSRO and Exhibits 1 – 9 to Form NRSRO furnished to the Commission publicly available on the NRSRO's Web site, or through another comparable, readily accessible means within 10 business days after the date of the Commission order granting an initial application for registration as an NRSRO or an application to register for an additional class of credit ratings and within 10 business days after furnishing the Commission with an amendment, annual certification, or withdrawal of registration on Form NRSRO. The certifications from qualified institutional investors, Disclosure Reporting Pages, and Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's Web site, or through another comparable, readily accessible means. Describe how the current Form NRSRO and Exhibits 1 – 9 will be made publicly available. If they will be posted on a Web site, for example, give the Internet address and link to the Form and Exhibits.

Item 6. Complete Item 6 only if furnishing an initial application for registration, an application to be registered in an additional class of credit ratings, or an application supplement.

Item 6A. Pursuant to Section 15E(a)(1)(B)(vii) of the Exchange Act, an Applicant applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. Indicate these classes by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of credit ratings the Applicant/NRSRO presently has outstanding as of the date of the application. Pursuant to the definition of "nationally recognized statistical rating organization" in Section 3(a)(62) of the Exchange Act, an Applicant/NRSRO must have been in business as a "credit rating agency" for at least the 3 consecutive years immediately preceding the

date of its application for registration as an NRSRO. For each class of credit ratings, also provide in the appropriate box the approximate date the Applicant/NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in Section 3(a)(61) of the Exchange Act. If there was a period when the Applicant/NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the Applicant/NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency" in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the Applicant/NRSRO began operating as a "credit rating agency."

Item 6B. To meet the definition of "credit rating agency" pursuant to Section 3(a)(61)(A) of the Exchange Act, the Applicant must, among other things, issue "credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee." Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the Applicant/NRSRO, provide a fee schedule or describe the price(s) charged.

Item 6C. If the Applicant/NRSRO is required to furnish qualified institutional buyer certifications, under Section 15E(a)(1)(C) of the Exchange Act, submit a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the Applicant/NRSRO. Each certification may address more than one class of credit ratings. To be registered as an NRSRO for a class of credit ratings identified in Item 6A under "Applying for Registration," the Applicant/NRSRO must submit at least two certifications that address the class of credit ratings. If

this is an application of an NRSRO to be registered in one or more additional classes of credit ratings, furnish at least two certifications that address each additional class of credit ratings.

The required certifications must be signed by a person duly authorized by the certifying entity, must be notarized, must be marked "Certification from Qualified Institutional Buyer," and must be in substantially the following form:

"I, [Executing official], am authorized by [Certifying entity] to execute this certification on behalf of [Certifying entity]. I certify that all actions by stockholders, directors, general partners, and other bodies necessary to authorize me to execute this certification have been taken and that [Certifying entity]:

(i) Meets the definition of a 'qualified institutional buyer' as set forth in section 3(a)(64) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(64)) pursuant to the following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];

(ii) Has seriously considered the credit ratings of [the Applicant/NRSRO] in the course of making some of its investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings: [Insert applicable classes of credit ratings]; and

(iii) Has not received compensation either directly or indirectly from [the Applicant/NRSRO] for executing this certification.

[Signature]_____

Print Name and Title

You are not required to make a Certification from a Qualified Institutional Buyer submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the certifications confidential upon request to the extent permitted by law.

Item 7. An Applicant furnishing Form NRSRO to apply for registration as an NRSRO should not complete Item 7. An NRSRO furnishing Form NRSRO for any other reason must complete Item 7. The information in Item 7 must be updated on an annual basis with the furnishing of the annual certification.

Item 7A. Indicate the classes of credit ratings for which the NRSRO is currently registered by checking the appropriate box or boxes. For each class of credit ratings, provide in the appropriate box the approximate number of credit ratings the NRSRO had outstanding as of the end of the most recently ended calendar year. For each class of credit ratings, also provide in the appropriate box the approximate date the NRSRO began issuing and making readily accessible credit ratings in the class on a continuous basis through the present as a "credit rating agency," as that term is defined in Section 3(a)(61) of the Exchange Act. If there was a period when the NRSRO stopped issuing credit ratings in a particular class or stopped operating as a credit rating agency, provide the approximate date the NRSRO resumed issuing and making readily accessible credit ratings in that class as a credit rating agency. Refer to the definition of "credit rating agency"

in the instructions below (also at 15 U.S.C. 78c(a)(61)) to determine when the NRSRO began operating as a "credit rating agency."

Item 7B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee. If a person must pay a fee to obtain a credit rating made readily accessible by the NRSRO, provide a fee schedule or describe the price(s) charged.

Item 8. Answer each question by checking the appropriate box. Refer to the definition of "person within an Applicant/NRSRO" set forth below to determine the persons to which the questions apply. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and furnished with Form NRSRO. Submit a separate Disclosure Reporting Page (NRSRO) for each person that: (a) has committed or omitted any act, or has been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions. Note: the definition of "person within an Applicant/NRSRO" is narrower than the

definition of “person associated with a nationally recognized statistical rating organization” in Section 3(a)(63) of the Exchange Act.

You are not required to make any disclosure reporting pages submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page “Confidential Treatment” and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires a credit rating agency’s application for registration as an NRSRO to contain certain specific information and documents and, pursuant to Section 15E(a)(1)(B)(x), any other information and documents concerning the applicant and any person associated with the applicant that the Commission requires as necessary or appropriate in the public interest or for the protection of investors. If any information or document required to be included with any Exhibit is maintained in a language other than English, provide a copy of the original document and a version of the document translated into English. Attach a certification by an authorized person that the translated version is a true, accurate, and complete English translation of the information or document. Attach the Exhibits to Form NRSRO in numerical order. Bind each Exhibit separately, and mark each Exhibit or bound volume of the Exhibit with the appropriate Exhibit number. The information provided in the Exhibits must be sufficiently detailed to allow for verification. The information and documents provided in Exhibits 1 through 9 must be made publicly available on the NRSRO’s Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). The information

and documents required to be provided in Exhibits 10 through 13 are not required to be made publicly available on the NRSRO's Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep these Exhibits confidential by marking each page of them "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in these Exhibits confidential upon request to the extent permitted by law.

Exhibit 1. Provide in this Exhibit performance measurement statistics of the credit ratings of the Applicant/NRSRO, including performance measurement statistics of the credit ratings separately for each class of credit rating for which the Applicant/NRSRO is seeking registration or is registered (as indicated in Item 6 and/or 7 of Form NRSRO). For the purposes of this Exhibit, an Applicant/NRSRO registered in the class of credit ratings described in Section 3(a)(62)(B)(iv) of the Act (15 U.S.C. 78c(a)(62)(B)(iv)) must include credit ratings of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction for purposes of reporting the performance measurement statistics for this class. In addition, the class of government securities should be separated into three additional classes: sovereigns, United States public finance, and international public finance. The performance measurement statistics must at a minimum show the performance of credit ratings in each class over 1 year, 3 year, and 10 year periods (as applicable) through the most recent calendar year-end, including, as applicable: historical ratings transition and default rates within each of the credit rating categories, notches, grades, or rankings used by the Applicant/NRSRO as an indicator of the

assessment of the creditworthiness of an obligor, security, or money market instrument in each class of credit rating. The default statistics must include defaults relative to the initial rating. As part of this Exhibit, define the credit rating categories, notches, grades, and rankings used by the Applicant/NRSRO and explain the performance measurement statistics, including the inputs, time horizons, and metrics used to determine the statistics. If the Applicant/NRSRO is required to make and keep publicly available on its corporate Internet Web site in an XBRL (eXtensible Business Reporting Language) format a sample of ratings action information pursuant to the requirements of 17 CFR 240.17g-2(d), provide in this Exhibit the Web site address where this information is, or will be, made publicly available.

Exhibit 2. Provide in this Exhibit a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings, including unsolicited credit ratings within the classes of credit ratings for which the Applicant/NRSRO is seeking registration or is registered. The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings, including, as applicable, descriptions of: policies for determining whether to initiate a credit rating; a description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; the quantitative and qualitative models and metrics used to determine credit ratings, including whether and, if so, how assessments of the quality of originators of assets

underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction factor into the determination of credit ratings; the methodologies by which credit ratings of other credit rating agencies are treated to determine credit ratings for securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgaged-backed securities transaction; the procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings, including how frequently credit ratings are reviewed, whether different models or criteria are used for ratings surveillance than for determining initial ratings, whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings, and whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating. An Applicant/NRSRO may provide in Exhibit 2 the location on its Web site where additional information about the procedures and methodologies is located.

Exhibit 3. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to prevent the misuse of material, nonpublic information pursuant to Section 15E(g) of the Exchange Act and 17 CFR 240.17g-

4. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 4. Provide in this Exhibit information about the organizational structure of the Applicant/NRSRO, including, as applicable, an organizational chart that identifies, as applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the Applicant/NRSRO; an organizational chart showing the divisions, departments, and business units of the Applicant/NRSRO; and an organizational chart showing the managerial structure of the Applicant/NRSRO, including the designated compliance officer identified in Item 4.

Exhibit 5. Provide in this Exhibit a copy of the written code of ethics the Applicant/NRSRO has in effect or a statement of the reasons why the Applicant/NRSRO does not have a written code of ethics in effect.

Exhibit 6. Identify in this Exhibit the types of conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO that are material to the Applicant/NRSRO. First, identify the conflicts described in the list below that apply to the Applicant/NRSRO. The Applicant/NRSRO may use the descriptions below to identify an applicable conflict of interest and is not required to provide any further details. Second, briefly describe any other type of conflict of interest relating to the issuance of credit ratings by the Applicant/NRSRO that is not covered in the descriptions below that is material to the Applicant/NRSRO (for example, one the Applicant/NRSRO has established specific policies and procedures to address):

- The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.
- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.

- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term "nationally recognized statistical rating organization."
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:
    - Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
    - Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.

- A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).
- The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

Exhibit 7. Provide in this Exhibit a copy of the written policies and procedures established, maintained, and enforced by the Applicant/NRSRO to address and manage conflicts of interest pursuant to Section 15E(h) of the Exchange Act. Do not include any information that is proprietary or that would diminish the effectiveness of a specific policy or procedure if made publicly available.

Exhibit 8. Provide in this Exhibit the following information about the Applicant/NRSRO's credit analysts (See definition below) and the persons who supervise the credit analysts:

- The total number of credit analysts.
- The total number of credit analyst supervisors.
- A general description of the minimum qualifications required of the credit analysts, including education level and work experience (if applicable, distinguish between junior, mid, and senior level credit analysts).
- A general description of the minimum qualifications required of the credit analyst supervisors, including education level and work experience.

Exhibit 9. Provide in this Exhibit the following information about the designated compliance officer (identified in Item 4) of the Applicant/NRSRO:

- Name.

- Employment history.
- Post secondary education.
- Whether employed by the Applicant/NRSRO full-time or part-time.

Exhibit 10. Provide in this Exhibit a list of the largest users of credit rating services of the Applicant by the amount of net revenue earned by the Applicant attributable to the person during the fiscal year ending immediately before the date of the initial application. First, determine and list the 20 largest issuers and subscribers in terms of net revenue. Next, add to the list any obligor or underwriter that, in terms of net revenue during the fiscal year, equaled or exceeded the 20th largest issuer or subscriber. In making the list, rank the persons in terms of net revenue from largest to smallest and include the net revenue amount for each person. For purposes of this Exhibit:

Net revenue means revenue earned by the Applicant for any type of service or product provided to the person, regardless of whether related to credit rating services, and net of any rebates and allowances the Applicant paid or owes to the person; and

Credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each

page “Confidential Treatment” and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Provide in this Exhibit the financial statements of the Applicant, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in ownership equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date of the Applicant’s initial application to the Commission, subject to the following:

If the Applicant is a division, unit, or subsidiary of a parent company, the Applicant may provide audited consolidated financial statements of its parent company.

If the Applicant does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date of the initial application, the Applicant can provide unaudited financial statements for the applicable year or years, but must provide audited financial statements for the fiscal or calendar year ending immediately before the date of the initial application. Attach to the unaudited financial statements a certification by a person duly authorized by the Applicant to make the certification that the person has responsibility for the financial statements and that to the best knowledge of the person making the certification the financial statements fairly present, in all material respects, the Applicant’s financial condition, results of operations, and cash flows for the period presented.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An

NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Provide in this Exhibit the following information, as applicable, and which is not required to be audited, regarding the Applicant's aggregate revenues for the fiscal or calendar year ending immediately before the date of the initial application:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings; and
- Revenue from all other services and products offered by your credit rating organization (include descriptions of any major sources of revenue).

An NRSRO is not required to make this Exhibit publicly available on its Web site or, through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. Provide in this Exhibit the approximate total and median annual compensation of the Applicant's credit analysts for the fiscal or calendar year ending immediately before the date of this initial application. In calculating total and median annual compensation, the Applicant may exclude deferred compensation, provided such exclusion is noted in the Exhibit.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

F. EXPLANATION OF TERMS.

1. COMMISSION - The U. S. Securities and Exchange Commission.

2. CREDIT RATING [Section 3(a)(60) of the Exchange Act] - An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.

3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act] - Any person:

- engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
- employing either a quantitative or qualitative model, or both to determine credit ratings; and
- receiving fees from either issuers, investors, other market participants, or a combination thereof.

4. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act] - A credit rating agency that:

- has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO;
- issues credit ratings certified by qualified institutional buyers in accordance with section 15(a)(1)(B)(ix) of the Exchange Act with respect to:
    - financial institutions, brokers, or dealers;
    - insurance companies;
    - corporate issuers;
    - issuers of asset-backed securities;
    - issuers of government securities, municipal securities, or securities issued by a foreign government; or
    - a combination of one or more of the above; and
- is registered as an NRSRO.

6. PERSON - An individual, partnership, corporation, trust, company, limited liability company, or other organization (including a separately identifiable department or division).

7. PERSON WITHIN AN APPLICANT/NRSRO – The person furnishing Form NRSRO identified in Item 1, any credit rating affiliates identified in Item 3, and any partner, officer, director, branch manager, or employee of the person or the credit rating affiliates (or any person occupying a similar status or performing similar functions).

8. SEPARATELY IDENTIFIABLE DEPARTMENT OR DIVISION - A unit of a corporation or company:

- that is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities; and
- for which all of the records relating to its credit rating activities are separately created or maintained in or extractable from such unit's own facilities or the facilities of the corporation, and such records are so maintained or otherwise accessible as to permit independent examination and enforcement by the Commission of the Exchange Act and rules and regulations promulgated thereunder.

8. QUALIFIED INSTITUTIONAL BUYER [Section 3(a)(64) of the Exchange Act] - An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency.

DISCLOSURE REPORTING PAGE (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to provide information concerning affirmative responses to **Item 8** of Form NRSRO.

Submit a separate DRP for each person that: (a) has committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, has been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or has been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934; (b) has been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or has been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction; or (c) is subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO.

Name of Applicant/NRSRO Date

_____ _____

Check Item being responded to:

☐ Item 8A

☐ Item 8B

☐ Item 8C

Full name of the person for whom this DRP is being submitted:

_____

If this DRP provides information relating to a "Yes" answer to Item 8A, describe the act(s) that was (were) committed or omitted; or the order(s) or finding(s); or the injunction(s) (provide the relevant statute(s) or regulation(s)) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8B, describe the crime(s) and provide jurisdiction(s) and date(s):

_____

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.

If this DRP provides information relating to a “Yes” answer to Item 8C, attach the relevant Commission order(s) and provide the date(s):

_____

The answers in this questionnaire represent the responses of the staff of the U.S. Securities and Exchange Commission (SEC-Commission) to specific questions posed by CESR. The purpose in responding to this questionnaire is solely to assist CESR in providing technical assistance to the EU-Commission for an equivalence assessment. The responses are not intended to serve as guidance to nationally recognized statistical rating organizations or credit rating agencies and they should not be relied on as guidance. As staff responses, the answers have not been approved by the SEC-Commission.