

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

SUPPORTING STATEMENT

A. Justification

1. Need For Information Collection

The Credit Rating Agency Reform Act of 2006¹ (“Rating Agency Act”), enacted on September 29, 2006, defines the term “nationally recognized statistical rating organization,” or “NRSRO,” provides authority for the Securities and Exchange Commission (“Commission”) to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue implementing rules no later than 270 days after its enactment.

The rules proposed under the Rating Agency Act contain recordkeeping and disclosure requirements. The collection of information obligations imposed by the proposed rules would be mandatory. The proposed rules, however, would apply only to credit rating agencies that are applying to register or are registered with the Commission as NRSROs, and registration is voluntary.

The Rating Agency Act added a new Section 15E, “Registration of Nationally Recognized Statistical Rating Organizations,”² to the Securities Exchange Act of 1934 (“Exchange Act”). Section 15E(a)(1) of the Exchange Act requires a credit rating agency applying for registration with the Commission as an NRSRO under Section 15E to furnish an application in a form prescribed by Commission rule containing certain specified information and such other information as the Commission prescribes as necessary or appropriate in the public interest or for the protection of investors.

Proposed Rule 17g-1 would implement this statutory provision by requiring a credit rating agency to furnish an initial application on proposed Form NRSRO.³ The proposed rule would also provide that if information on the application becomes materially inaccurate before the Commission has granted or denied the application, the credit rating agency must promptly notify the Commission and amend the application with accurate and complete information by submitting an amended initial application on proposed Form NRSRO. Proposed Rule 17g-1 would also provide a mechanism for a credit rating agency to withdraw its application before the Commission takes final action on it. Specifically, it would require the credit rating agency to furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

¹ Pub. L. No. 109-291.

² 15 U.S.C. 78o-7.

³ This provision would be implemented under the Commission’s authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o-7(a)(1)(A)).

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if, after registration, any information or document provided as part of the application becomes materially inaccurate.⁴ Proposed Rule 17g-1 provides that an NRSRO would need to meet the statutory requirement to amend an application if information becomes materially inaccurate by promptly furnishing the amendment to the Commission on Form NRSRO.

Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, shall require an NRSRO, after registration, to make the information submitted in its completed application and any amendments publicly available on its Web site or through another comparable, readily accessible means.⁵ It also permits the Commission to determine by rule the information that shall be made publicly available.⁶ Proposed Rule 17g-1 would require that the information be made publicly available within five business days of the NRSRO being registered or furnishing an amendment to the application.

A credit rating agency may apply to be registered for fewer than all five categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act.⁷ Proposed Rule 17g-1 would create a mechanism for an NRSRO registered for fewer than the five categories to apply to be registered with respect to an additional category. The proposed rule provides that the NRSRO would need to furnish an amended Form NRSRO and indicate where appropriate on the form the additional category for which it is applying to be registered.

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish the Commission with an amendment to its registration not later than 90 days after the end of each calendar year in a form prescribed by Commission rule (the “annual certification”).⁸ 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. Proposed Rule 17g-1 would implement these statutory provisions by requiring an NRSRO to furnish the annual certification on Form NRSRO.

Finally, Section 15E(e)(1) of the Exchange Act provides that an NRSRO may withdraw from registration, subject to terms and conditions the Commission may establish as necessary in the public interest or for the protection of investors, by furnishing the Commission with a written notice of withdrawal.⁹ Proposed Rule 17g-1

⁴ 15 U.S.C. 78o-7(b)(1).

⁵ 15 U.S.C. 78o-7(a)(3).

⁶ Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o-7(a)(3)).

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

⁸ 15 U.S.C. 78o-7(b)(2).

⁹ 15 U.S.C. 78o-7(e)(1).

would provide that the notice must be executed by a person duly authorized by the NRSRO.

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

Proposed Rule 17g-1, Form NRSRO, and the Instructions for Form NRSRO would create a registration program for NRSROs. The collections of information in the proposed rules are designed to allow the Commission to determine whether an entity should be registered as an NRSRO. Further, they would assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E of the Exchange Act and Exchange Act rules.

These proposed rules also are designed to assist users of credit ratings by requiring the disclosure of information with respect to an NRSRO that could be used to compare the credit ratings quality of different NRSROs. The information would include: methods for determining credit ratings; organizational structure; policies for managing material, non-public information; information regarding conflicts of interest; policies for managing conflicts of interest; credit analyst experience; and management experience. As noted in the Senate Report accompanying the Act, the information that NRSROs would have to make public “will facilitate informed decisions by giving investors the opportunity to compare ratings quality of different firms.”¹⁰

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

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

4. Efforts To Identify Duplication

No duplication is apparent.

5. Effects on Small Entities

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

¹⁰ See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

6. Consequences of Less Frequent Collection

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

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

The collection of information would not be inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. The comment period for the release that discusses proposed Rule 17g-1¹¹ is 30 days. This comment period will afford the public an opportunity to respond to the proposal.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Some of the information collection under proposed Rule 17g-1 will be afforded confidential treatment to the extent permitted by law.

11. Sensitive Questions

Not applicable. Questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

The number of respondents that would be subject to the proposed rule would depend, in part, on the number of entities that would meet the statutory requirement to be eligible for registration. Further, registration is voluntary, and, consequently, the number of respondents would also depend on the number of entities that would choose to register with the Commission. The Commission estimates that approximately 30 credit rating agencies would register with the Commission as NRSROs under section 15E of the Exchange Act.

The Commission estimates that the average time necessary to complete the initial Form NRSRO, and compile the various attachments, would be approximately 300 hours per applicant. This estimate is based on staff experience with the current NRSRO no-action letter process.¹² The Commission, therefore, estimates that the total one-time

¹¹ Release No. 34-55231 (Feb. 2, 2007), 72 FR 6378 (Feb. 9, 2007).

burden to the industry as a result of this requirement would be approximately 9,000 hours.¹³

The Commission also anticipates that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average, an outside counsel would spend approximately 40 hours assisting an NRSRO in preparing its application for registration for a one-time aggregate burden to the industry of 1,200 hours. The Commission further estimates that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimates that the average hourly cost for an outside counsel would be approximately \$400 per hour. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be \$16,000¹⁴ and the one-time cost to the industry would be \$480,000.¹⁵

As noted, proposed Rule 17g-1 would require a credit rating agency to provide the Commission with a written notice if it intends to withdraw its application prior to final Commission action. Based on staff experience, the Commission estimates that one credit rating agency per year would withdraw a Form NRSRO prior to final Commission action on the application and, consequently, would furnish a notice of its intent to withdraw the application. Based on the Commission's current estimates for a broker-dealer to file a notice with the Commission under Rule 17a-11, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal would be one hour.¹⁶ Thus, the Commission estimates that the aggregate annual burden to the industry of providing a notice of withdrawal prior to final Commission action would be one hour per year.¹⁷

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

¹² As a comparison, the Commission notes that Form ADV, the registration form for investment advisers, is estimated to take approximately 22.25 hours to complete. See Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004). The Commission estimates that the hour burden under Rule 17g-1 would be greater, given the substantially larger amount of information that would be required in proposed Form NRSRO.

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

¹⁴ \$400 per hour x 40 hours = \$16,000.

¹⁵ \$16,000 x 30 NRSROs = \$480,000.

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

¹⁷ 1 hour x 1 entity = 1 hour.

¹⁸ See proposed Rule 17g-1(e).

amended Form NRSRO for this purpose would take an average of approximately 25 hours per NRSRO.¹⁹

The Commission further estimates based on staff experience that approximately five of the 30 credit rating agencies expected to register with the Commission would apply to register for additional categories of credit ratings within the first year. The Commission believes that almost all NRSROs would initially apply to register for the first three categories of credit ratings identified in the definition of NRSRO: (1) financial institutions, brokers, or dealers; (2) insurance companies; and (3) corporate issuers.²⁰ The Commission believes these are the most common types of credit ratings issued, particularly since some credit rating agencies limit their credit ratings to domestic companies. The Commission believes that, after these three categories, the next largest category of credit ratings for which most NRSROs would be registered would be for credit ratings with respect to issuers of government securities, municipal securities, and foreign government securities.²¹ These types of credit ratings take additional expertise. Finally, the Commission believes the category of credit ratings for which the least number of NRSROs would be registered would be credit ratings of issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)).²² This assumption is based on the fact that determining a credit rating for an asset-backed security takes specialized expertise beyond that for determining credit ratings of corporate issuers and obligors. For example, it requires analysis of complex legal structures.

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

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate. Proposed Rule 17g-1 would require an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO. Based on staff experience, the Commission estimates that an NRSRO would file two amendments of its Form NRSRO per year on average. Furthermore, for the reasons discussed above, the Commission estimates that it would take an average of

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

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

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

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

²³ 25 hours x 5 NRSROs = 125 hours.

approximately 25 hours to prepare and furnish an amendment on Form NRSRO.²⁴ Therefore, the Commission estimates that the total aggregate annual burden to the industry to update Form NRSRO would be approximately 1,500 hours each year.²⁵

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.²⁶ Proposed Rule 17g-1 would require an NRSRO to furnish the annual certification on Form NRSRO.²⁷ The Commission estimates that the annual certification, generally, would take less time than an amendment to Form NRSRO because it would be done on a regular basis (albeit yearly) and, therefore, become more a matter of routine over time. Consequently, the Commission estimates that the burden would be similar to that of broker-dealers filing the quarterly reports required under Rules 17h-1T and 17h-2T, which is approximately 10 hours per year for each respondent.²⁸ Therefore, the Commission estimates it would take an NRSRO approximately 10 hours to complete the annual certification for a total aggregate annual hour burden to the industry of 300 hours.²⁹

Finally, section 15E(a)(3) of the Exchange Act requires an NRSRO to make the information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.³⁰ Proposed Rule 17g-1 would require that this be done within five business days of the granting of an NRSRO's registration or the furnishing of an amendment to the form or annual certification.³¹ The Commission assumes that each NRSRO already would have a Web site and would choose to use their Web site to comply with Section 15E(a)(3). Therefore, based on staff experience, the Commission estimates that, on average, an NRSRO would spend 30 hours to disclose the information in its initial application on its Web site and, thereafter, 10 hours per year to disclose updated information. Accordingly, the total aggregate one-time burden to the industry to make Form NRSRO publicly available would be 900 hours³² and the total aggregate annual burden would be 300 hours.³³

The Commission therefore estimates that the total one-time burden as a result of proposed Rule 17g-1 would be 10,000 hours ($9,000 + 125 + 900 = 10,025$, rounded to 10,000) and that the total one-time cost would be \$480,000. The Commission also estimates that the total annual burden would be 2,100 hours ($1 + 1,500 + 300 + 300 = 2,101$, rounded to 2,100).

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

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

²⁶ 15 U.S.C. 78o-7(b)(2).

²⁷ See proposed Rule 17g-1(g).

²⁸ See 17 CFR 240.17h-1T and 2T.

²⁹ 10 hours x 30 NRSROs = 300 hours.

³⁰ 15 U.S.C. 78o-7(a)(3).

³¹ See proposed Rule 17g-1(d).

³² 30 hours x 30 NRSROs.

³³ 10 hours x 30 NRSROs.

13. Estimate of Total Annualized Cost Burden

The Commission believes that there would be no additional reporting costs associated with the proposed rule, other than the costs described in Item 12 above.

14. Estimate of Cost to Federal Government

Commission staff estimates that the review and processing of an initial Form NRSRO would take approximately 120 hours of staff time. We estimate that the hourly cost, including related overhead, is \$75 per hour. Therefore, the cost to the government to review and process the 30 applications we estimate we would receive on Form NRSRO would be approximately \$270,000 (120 hours x 30 applications x \$75 = \$270,000). We also estimate that it would take 5 hours to review and process amendments to Form NRSRO and 5 hours to review and process annual certifications on Form NRSRO. As discussed above, we estimate that the Commission would receive approximately 60 amendments and 30 annual certifications per year. Therefore, the cost to the government to review and process amendments and annual certifications would be approximately \$33,750 (5 hours x 90 submissions x \$75 = \$33,750). In sum, the total cost to the government for reviewing and processing initial applications, amendments, and annual certifications on Form NRSRO would be approximately \$303,750 (\$270,000 + \$33,750 = \$303,750).

For purposes of this submission, our estimates regarding cost burdens have been computed according to the guidelines set forth in GSA, Guide to Estimating Reporting Costs (1973). Accordingly, the Commission has assumed that related overhead would be 35 percent of the salaries of Commission staff.

15. Explanation of Changes in Burden

Not applicable. Proposed Rule 17g-1 would be a new rule.

16. Information Collection Planned for Statistical Purposes

Not applicable. There is no intention to publish the information for any purpose.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor would the implementation of such methods reduce the burden or improve the accuracy of results.