

Rule 17g-2: Records to be made and retained by nationally recognized statistical rating organizations

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SUPPORTING STATEMENT

A. Justification

1. Need For Information Collection

The Credit Rating Agency Reform Act of 2006<sup>1</sup> (“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 amended Section 17(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) to add NRSROs to the list of entities required to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.<sup>2</sup> The inclusion of NRSROs on the list also provides the Commission with authority under Section 17(b)(1) of the Exchange Act to examine all the records of an NRSRO.<sup>3</sup>

Proposed Rule 17g-2, “Records to be made and retained by nationally recognized statistical rating organizations,” would implement the Commission’s recordkeeping rulemaking authority under Section 17(a) of the Exchange Act.<sup>4</sup> The proposed rule would require an NRSRO to make and retain certain records relating to its business and to retain certain other business records, if such records are made. The rule also would prescribe the time periods and manner in which all these records must be retained.

With respect to other regulated entities, the Commission has made clear that books and records rules are “integral to the Commission’s investor protection function because the preserved records are the primary means of monitoring compliance with

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

<sup>2</sup> See Section 5 of the Act and 15 U.S.C 78q(a)(1).

<sup>3</sup> See 15 U.S.C 78q(b)(1).

<sup>4</sup> 15 U.S.C 78q.

applicable securities laws.”<sup>5</sup> Proposed Rule 17g-2 is designed to ensure that an NRSRO makes and retains records that would assist the Commission in monitoring, through its examination authority, whether an NRSRO continued to meet the requirements for registration as an NRSRO and whether the NRSRO was complying with applicable laws and regulations.

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

The collections of information in proposed Rule 17g-2 are designed to allow the Commission to determine whether an NRSRO continues to meet the requirements for registration and is complying with applicable laws and regulations. In particular, the collections of information in proposed Rule 17g-2 would assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E Exchange Act,<sup>6</sup> as added by the Rating Agency Act, and applicable Exchange Act rules under the Rating Agency Act.

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

The records that proposed Rule 17g-2 would require NRSROs to make and retain could be made and retained electronically. The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens associated with proposed Rule 17g-2. NRSROs are not prevented by proposed Rule 17g-2 from using computers or other mechanical devices to generate the records required under the proposed Rule.

4. Efforts To Identify Duplication

No duplication is apparent.

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<sup>5</sup> See Electronic Storage of Broker-Dealer Records, Exchange Act Release No. 47806 (May 7, 2003), 68 FR 25281 (May 12, 2003); see also Commission order in Matter of Deutsche Bank Securities, Inc. et al, Exchange Act Release No. 46937 (December 3, 2002) (“The record keeping rules are ‘a keystone of the surveillance of broker-dealers’”) (citations omitted); Commission order in Matter of J.P. Morgan Securities Inc., Exchange Act Release No. 51200 (February 14, 2005); Electronic Recordkeeping by Investment Companies and Investment Advisers, Investment Company Act Release No. 24991 (May 24, 2001) (“The recordkeeping requirements are a key part of the Commission’s regulatory program for funds and advisers, as they allow [the Commission] to monitor fund and adviser operations, and to evaluate their compliance with federal securities laws.”).

<sup>6</sup> 15 U.S.C. 78o-7.

5. Effects on Small Entities

Small entities may be affected by the proposed rule because all credit rating agencies, regardless of size, that are registered as NRSROs would be required to make and retain records in accordance with the proposed rule.

6. Consequences of Less Frequent Collection

Up to date records are essential for the Commission to monitor whether an NRSRO continues to meet the requirements for registration as an NRSRO. If an NRSRO did not make these records, or if it made these records less frequently, the goals of the Rating Agency Act--including enhancing the information used by investors to make investment decisions--would be diminished.

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-2<sup>7</sup> 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

The records that an NRSRO would be required to make or retain under proposed Rule 17g-2, other than the documents and information that an NRSRO would have to make public under Section 15E of the Exchange Act and proposed Rule 17g-1, would be available only to the examination staff of the Commission. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. 552 ("FOIA") and the Commission's rules under FOIA (17 CFR 200.80(b)(4)(iii)), the Commission generally does not publish or make available information contained in reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

11. Sensitive Questions

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

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

## 12. Estimate of Respondent Reporting Burden

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

The Commission estimates that the average one-time burden of implementing a recordkeeping system to comply with proposed rule 17g-2 would be approximately 300 hours. This estimate is based on the Commission's experience with, and burden estimates for, certain recordkeeping requirements applicable to consolidated supervised entities ("CSEs") subject to Commission supervision.<sup>8</sup>

The Commission also estimates that an NRSRO may need to purchase recordkeeping system software to establish a recordkeeping system in conformance with the proposed rule. The Commission estimates that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSRO's would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs would be approximately \$1000 per firm. Therefore, the one-time cost to the industry would be approximately \$30,000.

Additionally, the Commission estimates that the average amount of time that an NRSRO would spend annually to make and maintain these records would be approximately 254 hours per year. This estimate is based on the Commission's present estimate of the amount of time it would take a broker-dealer to comply with the broker-dealer recordkeeping rule, Rule 17a-4.<sup>9</sup> Therefore, the Commission estimates that the one-time hour burden for making and preserving records under proposed Rule 17g-2 would be approximately 9,000 hours<sup>10</sup> and the total annual hour burden would be approximately 7,620 hours per year.<sup>11</sup>

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<sup>8</sup> See 17 CFR 15c3-1g.

<sup>9</sup> See 17 CFR 240.17a-4 (recordkeeping requirements for broker-dealers). This rule has previously been subject to notice and comment and has been approved by OMB. The Commission notes that proposed Rule 17g-2 is based, in part, on Exchange Act Rules 17a-3 (17 CFR 240.17a-3) and 17a-4. The annual hour burden estimate for the proposed rule, however, is based only on the PRA estimate for Rule 17a-4. The proposed rule would require substantially fewer records to be made and maintained than Rules 17a-3 and 17a-4. Therefore, the Commission is basing its estimate only on the burden estimate for Rule 17a-4 (as opposed to Rules 17a-3 and 17a-4 combined).

<sup>10</sup> 300 hours x 30 NRSROs = 9,000 hours.

<sup>11</sup> 254 hours x 30 NRSROs = 7,620 hours.

Proposed Rule 17g-2 also would require that an NRSRO that uses a third-party record custodian furnish the Commission with an undertaking from the custodian. Based on staff experience, the Commission estimates that approximately five NRSROs would file this undertaking on a one-time basis. Proposed Rule 17g-2 also would require that a non-resident NRSRO provide an undertaking to the Commission. The Commission estimates, based on staff experience, that approximately five non-resident NRSROs would provide this undertaking to the Commission. The Commission estimates, based on staff experience, that it would take an NRSRO approximately 10 hours to complete an undertaking prior to furnishing it to the Commission.<sup>12</sup> Therefore, the Commission estimates that the total one-time hour burden for these undertakings would be 100 hours.<sup>13</sup>

The Commission therefore estimates that the burden associated with proposed Rule 17g-2 is 9,100 hours (9,000 + 100 = 9,100) on a one-time basis, 7,620 hours annually, and a cost of \$30,000 on a one-time basis.

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

There would be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

Not applicable. Proposed Rule 17g-2 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.

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<sup>12</sup> The estimated 10 hours includes drafting, legal review, and receiving corporate authorization to file the undertaking with the Commission.

<sup>13</sup> (10 hours x 5 NRSROs) + (10 hours x 5 NRSROs) = 100 hours.

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.