

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-62120; File No. S7-04-09)**

**May 19, 2010**

**ORDER GRANTING TEMPORARY CONDITIONAL EXEMPTION FOR NATIONALLY  
RECOGNIZED STATISTICAL RATING ORGANIZATIONS FROM REQUIREMENTS OF  
RULE 17g-5 UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND REQUEST FOR  
COMMENT**

**I. Introduction**

The Securities and Exchange Commission (“Commission”) is conditionally exempting, with respect to certain credit ratings and until December 2, 2010, nationally recognized statistical rating organizations (“NRSROs”) from requirements in Rule 17g-5(a)(3)<sup>1</sup> under the Securities Exchange Act of 1934 (“Exchange Act”) discussed below that have a compliance date of June 2, 2010.<sup>2</sup> Starting on that date, Rule 17g-5(a)(3) will apply when an issuer, sponsor, or underwriter (each an “arranger”) hires an NRSRO to determine an initial 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 (a “structured finance product”).<sup>3</sup> However, under this order, an NRSRO is not required to comply with Rule 17g-5(a)(3) until December 2, 2010 with respect to credit ratings where: (1) the issuer of the structured finance product is a non-U.S. person; and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance

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<sup>1</sup> 17 CFR 240.17g-5(a)(3).

<sup>2</sup> See Securities Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009) (“Adopting Release”).

<sup>3</sup> In the Adopting Release, the Commission stated that it intended the term “security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction,” which mirrors, in part, the text of Section 15E(i)(1)(B) of the Exchange Act (15 U.S.C. 78o-7(i)(1)(B)), to cover the full range of structured finance products, including, but not limited to, securities collateralized by static and actively managed pools of loans or receivables (e.g., commercial and residential mortgages, corporate loans, auto loans, education loans, credit card receivables, and leases), collateralized debt obligations, collateralized loan obligations, collateralized mortgage obligations, structured investment vehicles, synthetic collateralized debt obligations that reference debt securities or indexes, and hybrid collateralized debt obligations.

product after issuance, only in transactions that occur outside the U.S. The Commission also is soliciting comment regarding the application of Rule 17g-5(a)(3) to transactions outside of the U.S.

## **II. Background**

Rule 17g-5 identifies, in paragraphs (b) and (c) of the rule, a series of conflicts of interest arising from the business of determining credit ratings.<sup>4</sup> Paragraph (a) of Rule 17g-5<sup>5</sup> prohibits an NRSRO from issuing or maintaining a credit rating if it is subject to the conflicts of interest identified in paragraph (b) of Rule 17g-5 unless the NRSRO has taken the steps prescribed in paragraph (a)(1) (i.e., disclosed the type of conflict of interest in Exhibit 6 to Form NRSRO in accordance with Section 15E(a)(1)(B)(vi) of the Exchange Act<sup>6</sup> and Rule 17g-1)<sup>7</sup> and paragraph (a)(2) (i.e., 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 Exchange Act).<sup>8</sup> Paragraph (c) of Rule 17g-5 specifically prohibits outright seven types of conflicts of interest. Consequently, an NRSRO is prohibited from issuing or maintaining a credit rating when subject to these conflict regardless of whether it had disclosed them and established procedures reasonably designed to address them.

In December 2009, the Commission adopted subparagraph (a)(3) of Rule 17g-5, which added new provisions to Rule 17g-5. These provisions require an NRSRO that is hired by an arranger to determine an initial credit rating for a structured finance product to take certain steps designed to allow an NRSRO that is not hired by the arranger to nonetheless determine an initial credit rating –

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<sup>4</sup> 17 CFR 240.17g-5(b) and (c).

<sup>5</sup> 17 CFR 240.17g-5(a).

<sup>6</sup> 15 U.S.C. 78o-7(a)(1)(B)(vi).

<sup>7</sup> 17 CFR 240.17g-1.

<sup>8</sup> 15 U.S.C. 78o-7(h).

and subsequently monitor that credit rating – for the structured finance product.<sup>9</sup> In particular, under Rule 17g-5(a)(3), an NRSRO is prohibited from issuing or maintaining a credit rating when it is subject to the conflict of interest identified in paragraph (b)(9) of Rule 17g-5 (i.e., being hired by an arranger to determine a credit rating for a structured finance product)<sup>10</sup> unless it has taken the steps prescribed in paragraphs (a)(1) and (2) of Rule 17g-5 (discussed above) and the steps prescribed in new paragraph (a)(3) of Rule 17g-5.<sup>11</sup> Rule 17g-5(a)(3), among other things, requires that the NRSRO must:

- Maintain on a password-protected Internet Web site a list of each structured finance product for which it currently is in the process of determining an initial credit rating in chronological order and identifying the type of structured finance product, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the arranger represents the information provided to the hired NRSRO can be accessed by other NRSROs;
- 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 described in paragraph (e) of Rule 17g-5 that covers that calendar year;<sup>12</sup> and

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<sup>9</sup> See 17 CFR 240.17g-5(a)(3); see also Adopting Release at 63844-45.

<sup>10</sup> Paragraph (b)(9) Rule 17g-5 identifies the following conflict of interest: 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. 17 CFR 240.17g-5(b)(9).

<sup>11</sup> 17 CFR 240.17g-5(a)(3).

<sup>12</sup> Paragraph (e) of Rule 17g-5 requires that an NRSRO seeking to access the hired NRSRO's Internet web site during the applicable calendar year must furnish the Commission with the following certification:

The undersigned hereby certifies that it will access the Internet Web sites described in 17 CFR §240.17g-5(a)(3) solely for the purpose of determining or monitoring credit ratings. Further, the undersigned certifies that it will keep the information it accesses pursuant to 17 CFR §240.17g-5(a)(3) confidential and treat it as material nonpublic information subject to its written policies and procedures established, maintained, and enforced pursuant to section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) and 17 CFR §240.17g-4. Further, the undersigned certifies that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to 17 CFR §240.17g-5(a)(3)(iii), if it accesses such information for 10 or more issued securities or money market instruments in the calendar year covered by the certification. Further, the

- Obtain from the arranger a written representation that can reasonably be relied upon that the arranger will, among other things, disclose on a password-protected Internet web site the information it provides to the hired NRSRO to determine the initial credit rating (and monitor that credit rating) and provide access to the web site to an NRSRO that provides it with a copy of the certification described in paragraph (e) Rule 17g-5.<sup>13</sup>

The Commission stated in the Adopting Release that subparagraph Rule 17g-5(a)(3) is designed to address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products.<sup>14</sup> For example, the Commission noted that when an NRSRO is hired to rate a structured finance product,

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undersigned certifies one of the following as applicable: (1) In the most recent calendar year during which it accessed information pursuant to §17 CFR 240.17g-5(a)(3), the undersigned accessed information for [Insert Number] issued securities and money market instruments through Internet Web sites described in 17 CFR §240.17g-5(a)(3) and determined and maintained credit ratings for [Insert Number] of such securities and money market instruments; or (2) The undersigned previously has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year.

<sup>13</sup> In particular, under paragraph (a)(3)(iii) of Rule 17g-5, the arranger must represent to the hired NRSRO that it will:

(1) Maintain the information described in paragraphs (a)(3)(iii)(C) and (a)(3)(iii)(D) of Rule 17g-5 available at an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied on to determine or monitor the credit rating;

(2) Provide 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 described in paragraph (e) of Rule 17g-5 that covers that calendar year, provided that such certification indicates that the nationally recognized statistical rating organization providing the certification either: (i) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to paragraph (a)(3)(iii) of Rule 17g-5 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 (ii) has not accessed information pursuant to paragraph (a)(3) of Rule 17g-5 10 or more times during the most recently ended calendar year.

(3) Post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the NRSRO; and

(4) Post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the NRSRO.

<sup>14</sup> Adopting Release at 63844.

some of the information it relies on to determine the rating is generally not made public.<sup>15</sup> As a result, structured finance products frequently are issued with ratings from only the one or two NRSROs that have been hired by the arranger, with the attendant conflict of interest that creates.<sup>16</sup> Consequently, the Commission stated that subparagraph Rule 17g-5(a)(3) was designed to increase the number of credit ratings extant for a given structured finance product and, in particular, to promote the issuance of credit ratings by NRSROs that are not hired by the arranger.<sup>17</sup> The Commission's goal in adopting the rule was to provide users of credit ratings with more views on the creditworthiness of the structured finance product.<sup>18</sup> In addition, the Commission stated that Rule 17g-5(a)(3) was designed to reduce the ability of arrangers to obtain better than warranted ratings by exerting influence over NRSROs hired to determine credit ratings for structured finance products.<sup>19</sup> Specifically, by opening up the rating process to more NRSROs, the Commission intended to make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately favor the arranger could be exposed to the market through the credit ratings issued by other NRSROs.<sup>20</sup>

Rule 17g-5(a)(3) became effective on February 2, 2010, and the compliance date for Rule 17g-5(a)(3) is June 2, 2010.

### **III. Basis for Relief**

As discussed above, Rule 17g-5(a)(3) requires the hired NRSRO to obtain certain representations from an arranger in order to determine an initial credit rating for a structured finance

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<sup>15</sup> Id.

<sup>16</sup> Id.

<sup>17</sup> Id.

<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> Id.

product. Staff from the U.K. Financial Services Authority (“U.K. FSA”), the Japan Financial Services Authority (“Japan FSA”), Ontario Securities Commission (“OSC”) and the German Federal Financial Services Authority (“BaFin”) (collectively, the “Foreign Securities Regulators”), as well as a number of market participants,<sup>21</sup> have notified the Commission staff that arrangers of structured finance products located outside the U.S. generally were not aware that they would be required to make the representations prescribed in Rule 17g-5 in order to obtain credit ratings from NRSROs. These Foreign Securities Regulators and market participants have informed the Commission staff that many foreign arrangers are not prepared to make and adhere to the prescribed representations beginning on June 2, 2010 in terms of establishing the requisite Internet web sites, implementing other systems requirements necessary to make the disclosures and analyzing the application of local laws to their adherence to the disclosure requirements. Consequently, they have expressed concern that local securitization markets may be disrupted because the arrangers would not be able to make and adhere to the representations necessary to obtain credit ratings from NRSROs for new issuances of structured finance products. Foreign Securities Regulators and European issuers have also expressed concern about the potential conflict between the requirements of Rule 17g-5(a)(3) and European Union (“EU”) data protection and bank secrecy law and EU rating regulation, in addition to explaining that additional time is needed to identify other potential conflicts with EU and national laws.<sup>22</sup>

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<sup>21</sup> See letter dated March 30, 2010 from Richard Watson, Managing Director and Chief Operating Officer, Association for Financial Markets in Europe / European Securitisation Forum (AFME / ESF); letter dated April 30, 2010 from Christopher Killian, Vice President, Securitization Group of the Securities Industry and Financial Markets Association (SIFMA); letter dated April 30, 2010 from Neal Sullivan, Bingham McCutchen LLP on behalf of Rating and Investment Information, Inc.; letter dated May 3, 2010 from Tom Deutsch, Executive Director, American Securitization Forum; letter dated May 5, 2010 from Richard Watson, Managing Director and Chief Operating Officer, AFME / ESF; and letter dated May 12, 2010 from Guido Ravoet, European Banking Federation (“EBF Letter”). These letters, as well as other comments received by Commission staff in connection with subparagraph (a)(3) of Rule 17g-5 are available on the Commission’s Internet Web site, located at <http://www.sec.gov/comments/s7-04-09/s70409.shtml> and for web site viewing and printing in the Commission’s Public Reference Room in its Washington, DC headquarters.

<sup>22</sup> See, e.g., EBF Letter.

In the Adopting Release, the Commission noted that it was providing a delayed compliance date – 180 days after publication of certain rule amendments, including Rule 17g-5(a)(3), in the Federal Register – to allow NRSROs sufficient time to implement the new requirements.<sup>23</sup> Despite this delayed compliance date, overseas arrangers and market participants are not ready to comply with Rule 17g-5(a)(3), and Foreign Securities Regulators have expressed their respective belief that, absent relief, these arrangers and market participants will be unable to comply with Rule 17g-5(a)(3) with the result that overseas securitization markets may be disrupted. Section 36 of the Exchange Act authorizes the Commission to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision of the Exchange Act or any rule thereunder to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. Given the risk of serious disruptions to local securitization markets that have been described by Foreign Securities Regulators, the Commission believes that it is in the public interest, and consistent with the protection of investors, to delay the application of Rule 17g-5(a)(3) to certain overseas transactions and entities. Accordingly, the Commission is conditionally exempting, with respect to certain credit ratings and until December 2, 2010, NRSROs from requirements in Rule 17g-5(a)(3)<sup>24</sup> with respect to certain overseas transactions that are more fully described below.

#### **IV. Description of the Conditional Temporary Exemption**

The Commission is conditionally exempting NRSROs from Rule 17g-5(a)(3) until December 2, 2010 with respect to credit ratings where: (1) the issuer of the structured finance product is a non-U.S. person; and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance

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<sup>23</sup> See Adopting Release at 63834.

<sup>24</sup> 17 CFR 240.17g-5(a)(3).

product will effect transactions in the structured finance product after issuance, only in transactions that occur outside the U.S. These conditions are designed to confine the exemption’s application to credit ratings of structured finance products issued in, and linked to, financial markets outside the U.S.

The Commission notes that this exemption only applies to subparagraph (a)(3) of Rule 17g-5. It does not cover any other requirements in Rule 17g-5. Consequently, if an NRSRO determines a credit rating for a structured finance product that is exempt from Rule 17g-5(a)(3), the NRSRO remains subject to all the other prohibitions in Rule 17g-5.

**A. The issuer must be a non-U.S. person**

The first condition of the exemption is that the issuer of the structured finance product must be a non-U.S. person. The Commission understands that preparations for compliance with Rule 17g-5(a)(3) are lacking with respect to overseas issuers. This condition – that the issuer be a non-U.S. person -- is designed to provide the necessary relief for overseas issuers while circumscribing the relief to the scope of the problem that has been described to the Commission staff so that Rule 17g-5(a)(3) may go into effect to the extent possible. Further, the requirement is designed to suit the nature of the structured finance issuers. Many structured finance product issuers are bankruptcy remote special purpose vehicles. As such, they are primarily legal constructions as compared with operating companies that have employees, principal places of business, and physical locations. Consequently, rather than impose a condition that the issuer be located outside the U.S., the Commission is establishing a condition that the issuer be a non-U.S. person. To this end, and for the purposes of this order, the Commission intends a “U.S. person” to have the same definition as under Regulation S under the Securities Act.<sup>25</sup> Consequently, to satisfy this exemption, the NRSRO must be determining a credit rating for a structured finance product issued by a person that is not a U.S.

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<sup>25</sup> 17 CFR 230.902(k).

person.

**B. Transactions must be outside the U.S.**

The second condition of the exemption is that the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S. The Commission is confining the relief to only those transactions that occur outside the U.S. because it understands that it is with respect to overseas transactions that compliance preparations are lacking. Thus, circumscribing the relief to only those transactions that occur outside the U.S. will provide the necessary relief but still allow Rule 17g-5(a)(3) to come into effect where there are no such problems. An example of a transaction that occurs outside the U.S. would be a transaction that complies with the applicable safe harbor under Rules 903 and 904 of Regulation S.<sup>26</sup>

The question of whether an NRSRO has a “reasonable basis” to conclude that the structured finance product will be offered and sold upon issuance, and than any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, in transactions that occur outside the U.S. will depend on the facts and circumstances of a given situation. In order to have a reasonable basis to make these conclusions, the NRSRO should discuss with any arranger linked to the structured finance product (i.e., the sponsor, underwriter, and issuer) how they intend to market and sell the structured finance product and how they intend to engage in any secondary market activities (i.e., re-sales) of the structured finance product. An NRSRO may choose to obtain from the arranger a representation upon which the NRSRO can reasonably rely that sales of the structured finance product will meet this condition. Factors relevant to the analysis of whether such reliance would be reasonable would include, but not be limited to: (1) ongoing or prior

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<sup>26</sup> 17 CFR. 230.903; 17 CFR 230.904.

failures by the arranger to adhere to its representations; or (2) a pattern of conduct by the arranger where it fails to promptly correct breaches of its representations.

## **V. Request for Comment**

The Commission notes that it intends to monitor the use of this temporary exemption to evaluate whether it is being used for transactions that meet the above-described conditions. If the Commission discovers that this temporary exemption is being used otherwise, it will consider whether further action is appropriate, including whether to revise or revoke the exemption. In this connection, the Commission requests comment on the following:

- With respect to foreign regulators, regulations, and laws, what specific conflicts, if any, will arise from the application of Rule 17g-5(a)(3)?
- Do any NRSROs, or credit rating agencies considering applying for registration as an NRSRO, intend to use information required to be provided on password-protected Internet Web sites by Rule 17g-5(a)(3) to determine and monitor credit ratings with respect to credit ratings that are being exempted from the requirements of Rule 17g-5(a)(3)? NRSROs or credit rating agencies that intend to use such information to determine and monitor credit ratings with respect to credit ratings that are being exempted are asked to provide specific details on when they expect to be ready to determine and monitor such credit ratings.
- What are the different types of structured finance and similar products used outside the U.S.? What factors should determine whether an instrument sold entirely or primarily outside of the U.S. is a structured finance product?
- What actions are NRSROs taking to prepare to comply with Rule 17g-5(a)(3)'s application to credit ratings that are being exempted by this order? What specific costs – compliance, operational, and any others -- will be associated with that compliance, including costs to arrangers?

Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/exorders.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-04-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7-04-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/exorders.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F St. NE., Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions.

You should submit only information that you wish to make available publicly

## **VI. Conclusion**

For the foregoing reasons, the Commission believes it would be necessary or appropriate in the public interest and consistent with the protection of investors to grant a temporary exemption from the requirements in Rule 17g-5(a)(3) with respect to certain credit ratings.

ACCORDINGLY,

IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act, that a nationally recognized statistical rating organization is exempt until December 2, 2010 from the requirements in Rule 17g-5(a)(3) (17 CFR 240.17g-5(a)(3)) for credit ratings where:

(1) The issuer of the security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902(k)); and

(2) The nationally recognized statistical rating organization has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S.

By the Commission.

Elizabeth M. Murphy  
Secretary