
Annual Report on Nationally Recognized Statistical Rating Organizations

As Required by Section 6
of the Credit Rating Agency Reform Act of 2006



This is a report of the Staff of the U.S. Securities and Exchange Commission.

The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

December 2018

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ANNUAL REPORT ON NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

As Required by Section 6 of the Credit Rating Agency Reform Act of 2006

I. INTRODUCTION

The staff (the “Staff”) of the U.S. Securities and Exchange Commission (the “Commission” or “SEC”) is providing this report (“Report”) regarding nationally recognized statistical rating organizations (“NRSROs”) pursuant to Section 6 of the Credit Rating Agency Reform Act of 2006 (“Rating Agency Act”).¹ This Report reflects solely the Staff’s views. Section 6 of the Rating Agency Act requires the Commission to submit an annual report (“Annual Report”) to the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate and the Committee on Financial Services of the U.S. House of Representatives that, with respect to the year to which the Annual Report relates:

- identifies applicants for registration as NRSROs under Section 15E of the Securities Exchange Act of 1934 (as amended, the “Exchange Act”);²
- specifies the number of, and actions taken on, such applications; and
- specifies the views of the Commission on the state of competition, transparency, and conflicts of interest among NRSROs.

This Report generally focuses on the period from June 26, 2017 to June 25, 2018 (the “Report Period”). In addition to addressing the items specified in Section 6 of the Rating Agency Act, this Report provides an overview of certain Commission and Staff activities relating to NRSROs.

Information regarding the topics covered in this Report with respect to prior periods can be found on the Office of Credit Ratings (“OCR” or the “Office”) page of the Commission’s website.³

¹ Pub. L. No. 109-291, 120 Stat. 1327 (Sept. 29, 2006). The Rating Agency Act, among other things, added Section 15E to the Securities Exchange Act of 1934 to establish self-executing requirements on NRSROs and provide the Commission with the authority to implement a registration and oversight program for NRSROs. In June 2007, the Commission approved rules implementing such a program. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Release No. 34-55857, 72 FR 33564 (Jun. 18, 2007), available at <https://www.sec.gov/rules/final/2007/34-55857.pdf>.

² Unless otherwise noted, all references to specific statutory sections and rules in this Report are to sections in the Exchange Act and related rules.

³ Prior Annual Reports can be found under “Annual Reports to Congress” in the “Reports and Studies” section of the OCR webpage, available at <http://www.sec.gov/ocr>.

II. STATUS OF REGISTRANTS AND APPLICANTS

Section 3(a)(62) defines a “nationally recognized statistical rating organization” as a credit rating agency that is registered under Section 15E and issues credit ratings certified by qualified institutional buyers, in accordance with Section 15E(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 17 CFR 229.1101(c));
- (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) above.

As of the date of this Report, there are ten credit rating agencies registered as NRSROs. The NRSROs, categories of credit ratings described in clauses (i) through (v) of Section 3(a)(62)(A) in which they are registered, and locations of their principal offices, as of the date of this Report, are listed below:⁴

NRSRO	Categories of Credit Ratings	Principal Office
A.M. Best Rating Services, Inc. ("A.M. Best")	(ii), (iii), and (iv)	U.S.
DBRS, Inc. ("DBRS")	(i) through (v)	U.S.
Egan-Jones Ratings Company ("EJR")	(i) through (iii)	U.S.
Fitch Ratings, Inc. ("Fitch")	(i) through (v)	U.S.
HR Ratings de México, S.A. de C.V. ("HR Ratings")	(i), (iii), and (v)	Mexico
Japan Credit Rating Agency, Ltd. ("JCR")	(i), (ii), (iii), and (v)	Japan
Kroll Bond Rating Agency, Inc. ("KBRA")	(i) through (v)	U.S.
Moody's Investors Service, Inc. ("Moody's")	(i) through (v)	U.S.
Morningstar Credit Ratings, LLC ("Morningstar")	(i), (iii), and (iv)	U.S.
S&P Global Ratings ("S&P")	(i) through (v)	U.S.

For purposes of this Report only, we refer to Fitch, Moody's, and S&P as larger NRSROs and the seven other NRSROs (A.M. Best, DBRS, EJR, HR Ratings, JCR, KBRA, and Morningstar) as smaller NRSROs.

⁴ See the current Form NRSRO on each NRSRO's website for any updates to this information.

Applications for initial registration and for registration by current NRSROs in additional rating categories are filed on Form NRSRO (“Form NRSRO”).⁵ In addition, Section 15E(b) requires NRSROs to promptly amend Form NRSRO if any information or document provided therein becomes materially inaccurate. This section also requires NRSROs to annually amend Form NRSRO to update ratings count and performance information, certify the continuing accuracy of the information and documents provided therein, and list any material change thereto during the previous calendar year. OCR Staff review such amendments to Forms NRSRO in light of the requirements of Section 15E(b), Rule 17g-1, and the instructions to Form NRSRO.

During the Report Period, EJR filed with the Commission an application to re-register in the asset-backed securities and government securities credit ratings classes.⁶ On July 9, 2018, the Commission issued an order instituting proceedings pursuant to Section 15E(a)(2)(A)(ii) to determine whether EJR’s application should be granted or denied.⁷ On November 2, 2018, the Commission issued an order dismissing the proceedings in response to EJR’s motion to dismiss the proceedings following EJR’s voluntary withdrawal of its application.⁸

No other complete applications for initial registration as an NRSRO or for registration by current NRSROs in additional rating categories were received during the Report Period.

III. ACTIVITIES RELATING TO NRSROs

A. Activities

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)⁹ mandated the creation of OCR. OCR is responsible for the oversight of credit rating agencies registered with the Commission as NRSROs. OCR’s Staff includes professionals with expertise

⁵ See Section 15E(a) and Rule 17g-1. Rule 17g-1 requires an applicant/NRSRO to use Form NRSRO for the following, as applicable:

- 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);
- an annual certification pursuant to Section 15E(b)(2); and
- a withdrawal of registration pursuant to Section 15E(e).

See also Form NRSRO, available at <http://www.sec.gov/about/forms/formnrsro.pdf>.

⁶ EJR had previously been registered in such ratings classes. See Order Granting Registration of Egan-Jones Rating Company to Add Two Additional Classes of Credit Ratings, Release No. 34-59056 (Dec. 4, 2008), available at <https://www.sec.gov/rules/other/2008/34-59056.pdf>. On January 22, 2013, EJR and its founder Sean Egan consented to a Commission order under which, among other things, EJR agreed to be barred from rating as set-backed and government securities issuers as an NRSRO, with the right to re-apply for registration in these classes after 18 months from the date of the order. See In the Matter of Egan-Jones Ratings Company and Sean Egan, Release No. 34-68703 (Jan. 22, 2013), available at <http://www.sec.gov/litigation/admin/2013/34-68703.pdf>.

⁷ See Order Instituting Administrative Proceedings Pursuant to Section 15E(a)(2)(A)(ii) of the Securities Exchange Act of 1934 and Notice of Hearing, Release No. 34-83610 (July 9, 2018), available at <https://www.sec.gov/litigation/admin/2018/34-83610.pdf>.

⁸ See Order Dismissing Proceedings, Release No. 34-84530 (Nov. 2, 2018), available at <https://www.sec.gov/litigation/opinions/2018/34-84530.pdf>.

⁹ See Pub. L. No. 111-203, 124 Stat. 1376 (2010).

in a variety of areas that relate to its regulatory mission, such as corporate, municipal, and structured debt finance.¹⁰

OCR's responsibilities – as mandated by the Dodd-Frank Act – include, among other things, conducting an examination of each NRSRO at least annually in eight specified review areas.¹¹ Information regarding the examinations is included in OCR's annual examination reports.¹²

OCR also monitors trends and developments affecting the credit rating industry. For example, OCR Staff may meet with NRSROs to discuss rating and industry developments and with the boards of directors of NRSROs to discuss, among other things, compliance and oversight matters. OCR Staff also may meet with a variety of other market participants, including investors, issuers, regulators, and industry organizations, to discuss matters relevant to the credit rating industry.

During the Report Period, OCR Staff continued to participate in meetings that involved rating agency regulators globally, including those of the supervisory colleges that were formed for the largest internationally-active credit rating agencies. The supervisory colleges were formed to enhance communication among credit rating agency regulators globally with respect to examinations of the relevant credit rating agencies.¹³ During the Report Period, each college held an in-person meeting and conducted quarterly calls. OCR Staff also conducted additional discussions with international regulators as appropriate.

B. Commission Orders and Releases and Staff Publications

The Commission and the Staff, as applicable, issued the following orders, releases, and publications relating to NRSROs or credit ratings in general from the start of the Report Period to November 30, 2018:

- Order Dismissing Proceedings, Release No. 34-84530 (Nov. 2, 2018).¹⁴ The Commission issued an order dismissing the proceedings to determine whether EJR's application for registration in the asset-backed securities and government securities credit ratings classes should be granted or denied. The Commission issued the order in response to EJR's motion to dismiss the proceedings following EJR's voluntary withdrawal of its application.

¹⁰ See Section 15E(p)(2) for a description of OCR staffing requirements.

¹¹ See Section 15E(p)(3) for a description of the scope of the required examinations.

¹² The examination reports can be found under "Summary Examination Reports" in the "Reports and Studies" section of the OCR webpage, available at <http://www.sec.gov/ocr>.

¹³ See Supervisory Colleges for Credit Rating Agencies, Final Report (July 2013), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD416.pdf>. The SEC serves as chair of the colleges for S&P and Moody's, and OCR Staff represents the SEC in this regard. The European Securities and Markets Authority serves as chair of the college for Fitch.

¹⁴ Available at <https://www.sec.gov/litigation/opinions/2018/34-84530.pdf>.

- Proposed Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-84289 (Sept. 26, 2018), 83 FR 50297 (Oct. 5, 2018).¹⁵ The Commission proposed an amendment to Rule 17g-5(a)(3) that would provide for an exemption from the rule with respect to credit ratings for certain structured finance products where the issuer is a non-U.S. person and the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold exclusively outside the United States. The Commission also proposed conforming amendments to similar exemptions in Rule 17g-7(a) and Rule 15Ga-2.
- Orders Instituting Cease-and-Desist Proceedings. On August 28, 2018, the Commission issued the following orders pertaining to proceedings regarding certain rating practices at Moody's:
 - Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Release No. 34-83965 (Aug. 28, 2018).¹⁶ The Commission instituted settled administrative proceedings against Moody's concerning its internal control structure with regard to the use of certain models in its methodology for rating residential mortgage-backed securities.
 - Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Release No. 34-83966 (Aug. 28, 2018).¹⁷ The Commission instituted settled administrative proceedings against Moody's concerning its policies and procedures designed to define and consistently apply credit rating symbols.
- Order Granting Temporary Conditional Exemption for Japan Credit Rating Agency, Ltd. from Certain Requirements of Section 15E(t) of the Securities Exchange Act of 1934, Release No. 34-83884 (Aug. 17, 2018).¹⁸ The Commission granted JCR a temporary, conditional exemption from certain corporate governance requirements under Section 15E(t). The exemption expires on August 20, 2021 and thereafter renews until August 20, 2023, unless the Commission determines otherwise.
- Final Rule: Disclosure Update and Simplification, Release Nos. 33-10532, 34-83875, and IC-33203 (Aug. 17, 2018), 83 FR 50148 (Oct. 4, 2018).¹⁹ The Commission adopted amendments, effective November 5, 2018, to certain disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded, in light of other Commission disclosure requirements, U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), or changes in the information environment. The amendments include a change to Rule 17g-3 to conform the financial statement reporting requirements applicable to NRSROs to U.S. GAAP.

¹⁵ Available at <https://www.sec.gov/rules/proposed/2018/34-84289.pdf>.

¹⁶ Available at <https://www.sec.gov/litigation/admin/2018/34-83965.pdf>.

¹⁷ Available at <https://www.sec.gov/litigation/admin/2018/34-83966.pdf>.

¹⁸ Available at <https://www.sec.gov/rules/exorders/2018/34-83884.pdf>.

¹⁹ Available at <https://www.sec.gov/rules/final/2018/33-10532.pdf>.

- Order Instituting Administrative Proceedings Pursuant to Section 15E(a)(2)(A)(ii) of the Securities Exchange Act of 1934 and Notice of Hearing, Release No. 34-83610 (July 9, 2018).²⁰ The Commission issued an order instituting proceedings pursuant to Section 15E(a)(2)(A)(ii) to determine whether EJR’s application for registration in the asset-backed securities and government securities credit ratings classes should be granted or denied.
- Order Granting an Extension of Time to File Audited Financial Statements of DBRS Ratings Limited in Accordance With Exchange Act Rule 17g-3(a)(1), Release No. 34-82787 (Feb. 27, 2018).²¹ The Commission granted DBRS an extension of time to file with the Commission in accordance with Rule 17g-3(a)(1) the audited financial statements of its credit rating affiliate DBRS Ratings Limited for the fiscal year ended November 30, 2017.
- Order Extending Conditional Temporary Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5(a)(3) under the Securities Exchange Act of 1934, Release No. 34-82144 (Nov. 22, 2017), 82 FR 56309 (Nov. 28, 2017).²² The Commission extended the order exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to credit ratings for certain structured finance products where the issuer is a non-U.S. person and the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold only in transactions outside the United States, until the earlier of (i) December 2, 2019, or (ii) the compliance date set forth in any final rule that may be adopted by the Commission that provides for a similar exemption.
- 2017 Summary Report of Commission Staff’s Examinations of Each Nationally Recognized Statistical Rating Organization, dated December 2017, as required under Section 15E(p)(3)(C).²³ The report summarizes essential findings of the examinations conducted by Staff under Section 15E(p)(3)(C), generally focusing on the period from January 1, 2016 through December 31, 2016.
- Annual Report on Nationally Recognized Statistical Rating Organizations, dated December 2017, as required by Section 6 of the Rating Agency Act.²⁴ The Annual Report addresses the matters described in the first paragraph under Section I. of this Report, generally covering the period from June 26, 2016 to June 25, 2017.

²⁰ Available at <https://www.sec.gov/litigation/admin/2018/34-83610.pdf>.

²¹ Available at <https://www.sec.gov/rules/other/2018/34-82787.pdf>.

²² Available at <https://www.sec.gov/rules/exorders/2017/34-82144.pdf>.

²³ Available at <https://www.sec.gov/oct/reports-and-publications/special-studies/nrsro-summary-report-2017.pdf>.

²⁴ Available at <https://www.sec.gov/oct/reportspubs/annual-reports/2017-annual-report-on-nrsros.pdf>.

IV. COMPETITION

A. Select NRSRO Statistics

Sections 1. through 3. below summarize and discuss certain information reported by NRSROs on Form NRSRO or pursuant to Rule 17g-3 that provides insight into the state of competition among NRSROs. While this information indicates that Moody's, S&P, and Fitch continue to account for the highest percentages of outstanding ratings, other information suggests that smaller NRSROs have gained market share in certain asset classes.²⁵

1. NRSRO Credit Ratings Outstanding

(a) Number of Outstanding Ratings in Statutory Rating Categories

Each NRSRO annually reports the number of credit ratings outstanding, as of the end of the preceding calendar year, in each rating category for which it is registered.²⁶ This information, for the calendar year ending December 31, 2017, is summarized in Charts 1 through 4 below and can be useful in determining the breadth of an NRSRO's coverage with respect to issuers, obligors, and securities or money market instruments within a particular rating category.

Chart 1 depicts the number of credit ratings each NRSRO had outstanding in each rating category for which it was registered as of December 31, 2017. Chart 2 shows the percentage of credit ratings each NRSRO had outstanding across all rating categories and also breaks out the percentages for each NRSRO in each of the rating categories. Chart 3 illustrates the relative size of each rating category based on the aggregate number of ratings reported outstanding by all NRSROs. Chart 4 depicts the percentage of ratings each NRSRO had outstanding across all rating categories other than the government securities category.

Comparing the number of ratings *outstanding* for established NRSROs and newer NRSROs may not provide as comprehensive a picture of the state of competition as comparing the number of ratings *issued* by such NRSROs in a given period. Certain NRSROs (particularly the larger NRSROs) have a longer history of issuing ratings and their ratings include those for debt obligations and obligors that were rated well before the establishment of the newer entrants.²⁷ Consequently, the information described in Section IV.B.1. of this Report (relating to

²⁵ As discussed in Section IV.B.1. of this Report, information available on the websites of Commercial Mortgage Alert (<https://www.emalert.com/>) and Asset-Backed Alert (<https://www.abalert.com/>) regarding NRSRO market shares in the asset-backed securities category indicates that some of the smaller NRSROs have developed significant market shares in such category over the past few years. In addition, Section IV.B.2. of this Report provides examples of certain asset classes in which it has been reported that smaller NRSROs have gained market share.

²⁶ Annual certifications on Form NRSRO must be filed with the Commission on EDGAR pursuant to Rule 17g-1(f) and made publicly and freely available on each NRSRO's website pursuant to Rule 17g-1(i). The number of outstanding credit ratings for each rating category for which an NRSRO is registered is reported on Item 7A of Form NRSRO.

²⁷ The ratings counts disclosed on Item 7A of Form NRSRO include outstanding credit ratings, regardless of when they were issued. As a result, the ratings counts of the more established NRSROs may include credit ratings that were issued before the newer entrants began issuing credit ratings. These earlier ratings will continue to be included in the disclosed ratings counts until the rated securities are repaid or the credit ratings are otherwise withdrawn. Because outstanding ratings are included in the ratings counts, historical results factor significantly into the disclosed number of ratings, making it more difficult to discern current-year trends and identify gains achieved by the newer entrants.

recent market share developments in the asset-backed securities rating category) may provide additional insight regarding how newer entrants are competing with more established rating agencies, specifically in the asset-backed securities rating category.

There are additional limitations to assessing the state of competition in each rating category and in the aggregate based on the number of outstanding ratings. For instance, some NRSROs have pursued business strategies to specialize in particular rating categories or sub-categories²⁸ and may not desire to issue ratings in certain of the other NRSRO rating categories. Also, the reported information does not reflect any credit ratings being issued by NRSROs in rating categories in which they are not registered with the Commission, nor does it reflect ratings issued by an affiliate of an NRSRO unless the affiliate is identified as a credit rating affiliate on Item 3 of Form NRSRO.

Further, the outstanding ratings reported by the NRSROs are based on their own determinations of the applicable categories and number of ratings, which are not necessarily consistent among NRSROs. In addition, to the extent NRSROs have adjusted their ratings count disclosures in accordance with the amended instructions to Form NRSRO, it may be more difficult to draw comparisons to ratings counts disclosed in prior years.²⁹

Chart 1 provides the number of outstanding credit ratings reported by each NRSRO in its annual certification for the calendar year ending December 31, 2017, in each of the five categories identified in Section 3(a)(62) for which the NRSRO is registered, as applicable.

²⁸ For example, A.M. Best has traditionally focused on credit ratings with respect to insurance companies and their affiliates.

²⁹ Effective January 1, 2015, Item 7A of Form NRSRO and the corresponding instructions were amended to clarify the manner in which the number of outstanding credit ratings should be calculated and presented. The clarifying amendments are designed to ensure that disclosures on Item 7A of Form NRSRO are consistent across NRSROs. The change in instructions may have caused some NRSROs to modify the way they count ratings for purposes of Item 7A of Form NRSRO, which may affect comparisons to disclosures made in prior years. See Nationally Recognized Statistical Rating Organizations, Release No. 34-72936 (Aug. 27, 2014), 79 FR 55077 (Sept. 15, 2014) at 55220-22 (discussing the clarifying amendments to Item 7A of Form NRSRO).

Chart 1: Number of Outstanding Credit Ratings as of December 31, 2017 by Rating Category*						
NRSRO	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total Ratings
A.M. Best	N/R	7,191	1,079	5	N/R	8,275
DBRS	12,730	164	2,938	14,951	18,865	49,648
EJR	9,446	864	6,420	N/R	N/R	16,730
Fitch	39,189	3,261	18,933	29,108	205,674	296,165
HR Ratings	560	N/R	184	N/R	374	1,118
JCR	839	59	2,464	N/R	440	3,802
KBRA	838	32	0	8,110	72	9,052
Moody's	36,631	2,484	28,635	59,320	598,614	725,684
Morningstar	44	N/R	297	2,530	N/R	2,871
S&P	57,091	6,496	51,213	43,760	920,306	1,078,866
Total	157,368	20,551	112,163	157,784	1,744,345	2,192,211

* N/R indicates that the NRSRO was not registered in the applicable rating category as of the reporting date.
Source: NRSRO annual certifications for the 2017 calendar year, Item 7A on Form NRSRO

Chart 2 displays the percentage of each NRSRO's outstanding credit ratings of the total outstanding credit ratings of all NRSROs, for each rating category in which the NRSRO was registered, based on information reported by the NRSROs as of December 31, 2017.³⁰

Chart 2: Percentage by Rating Category of Each NRSRO's Outstanding Credit Ratings of the Total Outstanding Credit Ratings of all NRSROs, as of December 31, 2017*						
NRSRO	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total Ratings
A.M. Best	N/R	35.0%	1.0%	<0.1%	N/R	0.4%
DBRS	8.1%	0.8%	2.6%	9.5%	1.1%	2.3%
EJR	6.0%	4.2%	5.7%	N/R	N/R	0.8%
Fitch	24.9%	15.9%	16.9%	18.4%	11.8%	13.5%
HR Ratings	0.4%	N/R	0.2%	N/R	0.0%	0.1%
JCR	0.5%	0.3%	2.2%	N/R	0.0%	0.2%
KBRA	0.5%	0.2%	0.0%	5.1%	0.0%	0.4%
Moody's	23.3%	12.1%	25.5%	37.6%	34.3%	33.1%
Morningstar	<0.1%	N/R	0.3%	1.6%	N/R	0.1%
S&P	36.5%	31.6%	45.7%	27.7%	52.8%	49.2%

* N/R indicates that the NRSRO was not registered in the applicable rating category as of the reporting date.
Percentages have been rounded to the nearest one-tenth of one percent.
Source: NRSRO annual certifications for the 2017 calendar year, Item 7A on Form NRSRO

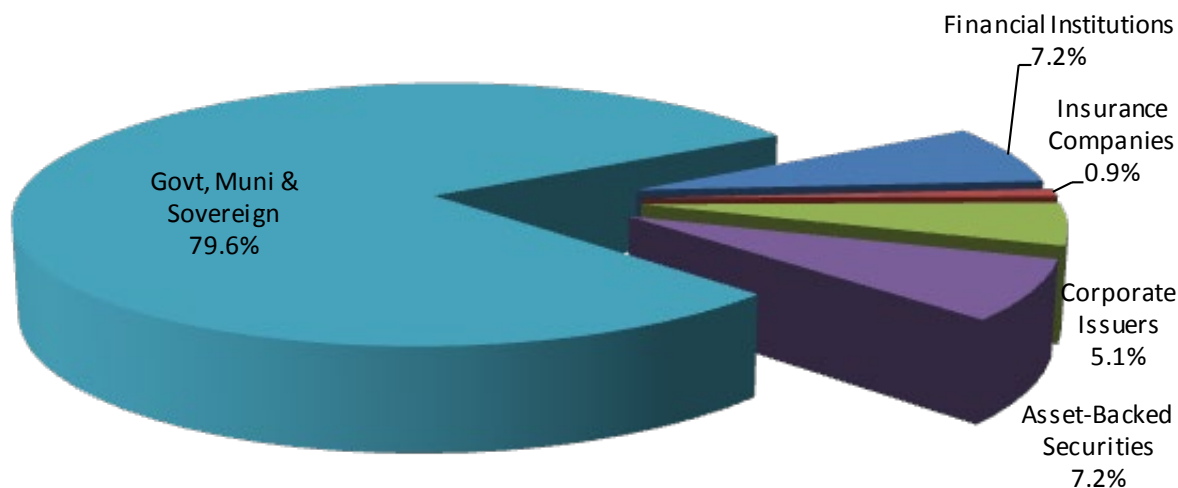
³⁰ For example, according to Chart 1, A.M. Best reported that it had 7,191 insurance company credit ratings, and the total of the credit ratings in that category reported by all NRSROs was 20,551. Dividing 7,191 by 20,551 equals (approximately) 0.350 or 35.0% (which is the percentage of NRSRO insurance company ratings attributable to A.M. Best, as shown on Chart 2).

As illustrated in Chart 2, the larger NRSROs account for 95.8% of all the ratings outstanding as of December 31, 2017—slightly lower than their 96.4% share as of December 31, 2016.³¹ The share of outstanding credit ratings that were issued by the larger NRSROs decreased in each category, most significantly in the asset-backed securities category and the financial institutions category, which decreased by 3.7% and 3.4%, respectively.

Notably, Chart 2 also shows that A.M. Best, one of the smaller NRSROs, had the most credit ratings outstanding in the insurance category. A.M. Best has consistently reported being one of the top three issuers of insurance ratings.³²

Chart 3 depicts the percentages of outstanding credit ratings attributable to each rating category, based on information reported by the NRSROs as of December 31, 2017.

Chart 3: Breakdown of Ratings Reported Outstanding on December 31, 2017*



* Percentages have been rounded to the nearest one-tenth of one percent.
Source: NRSRO annual certifications for the 2017 calendar year, Item 7A on Form NRSRO

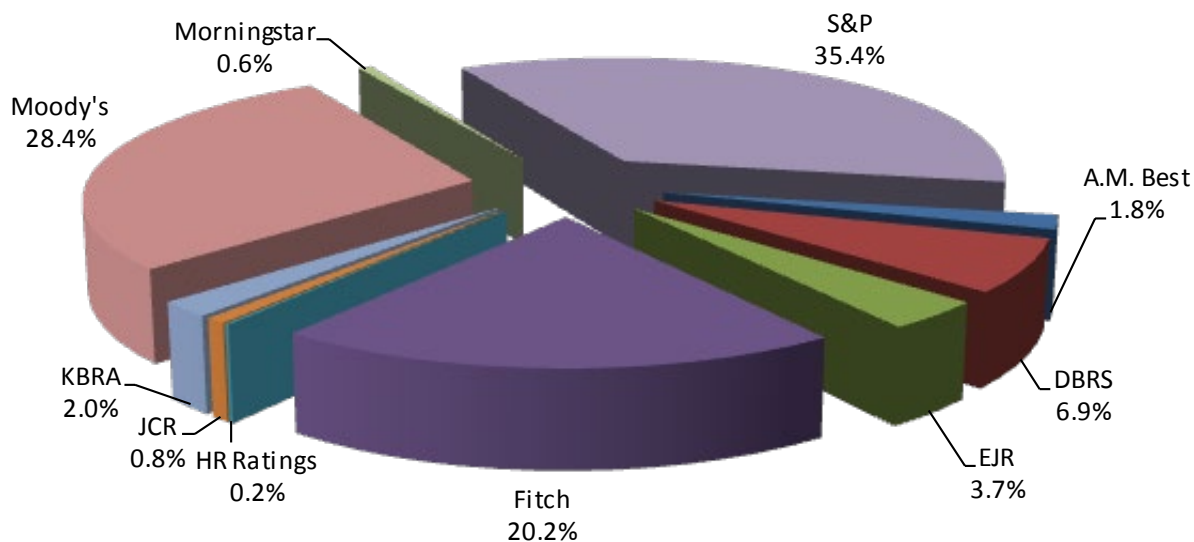
As illustrated by Chart 3, as of December 31, 2017, a large proportion of the aggregate credit ratings reported to be outstanding were in the government securities category, which may be attributable to the large number of government bond issuers and their multiple debt offerings. The government securities category accounted for 79.6% of the total number of credit ratings reported across all categories and, as shown on Chart 2, is also the most concentrated rating category, with Moody’s and S&P accounting for 87.1% of all outstanding government ratings.

³¹ In 2007, the year when NRSROs began reporting outstanding ratings on Form NRSRO, these three NRSROs accounted for 98.8% of all outstanding ratings.

³² See Annual Reports for prior years, which can be found under “Annual Reports to Congress” in the “Reports and Studies” section of the OCR webpage, available at <http://www.sec.gov/ocr>.

Chart 4 depicts the percentages of the credit ratings outstanding that are attributable to each NRSRO over all the rating categories other than the government securities category, based on information reported by the NRSROs as of December 31, 2017.

Chart 4: Breakdown of Non-Government Securities Ratings Reported Outstanding on December 31, 2017*



* Percentages have been rounded to the nearest one-tenth of one percent.

Source: NRSRO annual certifications for the 2017 calendar year, Item 7A on Form NRSRO

A comparison of Chart 4 to Chart 2 (which shows each NRSRO's share of outstanding ratings over all the rating categories, including government securities) illustrates that there is less concentration in the non-government securities rating categories. S&P's and Moody's percentage share of all outstanding ratings declines by 13.8 and 4.7 percentage points, respectively, when government securities are excluded. Fitch's percentage share of outstanding ratings, on the other hand, increases by 6.7 percentage points when government securities are excluded. The percentage share for all the remaining NRSROs also increases when government securities are excluded.

Further, when government securities are included in the total calculation, each of the smaller NRSROs except for one (i.e., DBRS) has less than 1.0% of all outstanding ratings, making it difficult to assess their relative market shares. When government securities are excluded, a clearer picture of the relative percentage shares of the smaller NRSROs can be observed, as illustrated in Chart 4. For most smaller NRSROs, their percentage share for all rating categories other than government securities as of December 31, 2017 did not change significantly compared to their percentage share as of December 31, 2016.³³ DBRS saw the most significant increase of a smaller NRSRO in its share of outstanding ratings for all rating categories other than government securities over this time period, increasing from 4.8% as of

³³ A comparison of Chart 4 in this Report with Chart 4 in Section IV.A.1.(a) of the December 2017 Annual Report (available at <https://www.sec.gov/ocr/reportspubs/annual-reports/2017-annual-report-on-nrsros.pdf>) shows that five of the seven smaller NRSROs had total market shares (excluding government securities) as of December 31, 2017 within 0.2% of such market shares as of December 31, 2016.

December 31, 2016 to 6.9% as of December 31, 2017. KBRA's share of outstanding ratings for all rating categories other than government securities also increased from 1.3% as of December 31, 2016 to 2.0% as of December 31, 2017.

As discussed above, Charts 1 through 4 reflect the number of credit ratings outstanding as of December 31, 2017, which may include credit ratings that were issued years ago. As a result, the measure may not be indicative of the current market position of each NRSRO with respect to newly issued credit ratings. For a discussion of recent market share developments in the asset-backed securities rating category and other developments that could impact NRSRO market share, see Section IV.B. of this Report.

(b) Industry Concentration

Economists generally measure industry concentration, which indicates the competitiveness of an industry, by using the Herfindahl-Hirschman Index ("HHI").³⁴ The inverse of the HHI ("HHI Inverse") can be used to represent the number of firms with equal market share necessary to replicate the degree of concentration in a particular industry.³⁵ In other words, an industry with an HHI Inverse of 3.0 has a concentration that is equal to an industry where the entire market is evenly divided among three firms with a market share of one third each. A highly concentrated market will have a low HHI Inverse, whereas an unconcentrated market will have a high HHI Inverse.³⁶

Calculations of the HHI and HHI Inverse for the NRSRO industry are consistent with the results included in Section IV.A.1.(a) of this Report and further illustrate gains in market share made by smaller NRSROs in the asset-backed securities rating category. Based on the number of outstanding ratings included in such section,³⁷ the HHI Inverse indicates that the NRSRO industry constitutes a "highly concentrated" market, and has the equivalent concentration of an industry with approximately 2.7 firms with equal market share. This is consistent with the high proportion of outstanding ratings that have been issued by the larger NRSROs, especially Moody's and S&P. Although the industry remains highly concentrated, a comparison of the HHI Inverse calculations since 2008 shows that the asset-backed securities rating category and the financial institutions rating category have become less concentrated.

³⁴ See, e.g., U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines §5.3 (2010) (discussing how the Department of Justice and the Federal Trade Commission use HHI to measure the impact of a merger on market concentration); however, since the HHI calculation does not take into account that multiple NRSROs may rate a single issue, different considerations may be applicable to the use of the HHI calculation for NRSROs.

³⁵ The HHI Inverse is calculated by dividing 10,000 (i.e., the highest possible HHI) by the HHI. For additional discussion of the HHI Inverse, see VERA PAWLOWSKY-GLAHN & ANTONELLA BUCCIANI, COMPOSITIONAL DATA ANALYSIS: THEORY AND APPLICATIONS (2011); Toby Roberts, When Bigger is Better: A Critique of the Herfindahl-Hirschman Index's Use to Evaluate Mergers in Network Industries, 34 PACE L. REV. 894, 908 (2014).

³⁶ A market with an HHI Inverse of less than 4.0 is considered to be highly concentrated; a market with an HHI Inverse between 4.0 and 6.67 is considered to be moderately concentrated; and a market with an HHI Inverse above 6.67 is considered to be unconcentrated. See generally U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines §5.3 (2010).

³⁷ See Section IV.A.1.(a) of this Report for a discussion of certain limitations involved in determining the number of outstanding ratings reported.

Chart 5 reports the HHI Inverses calculated from 2008 to 2017 for the ratings outstanding (as reported by the NRSROs) in each rating category, in total for all rating categories, and in total for all rating categories excluding government securities.

Chart 5: HHI Inverses for Each Rating Category*							
Year	Financial Institutions	Insurance Companies	Corporate Issuers	Asset-Backed Securities	Government Securities	Total (all rating categories)	Total (excluding government securities)
2008	3.72	4.05	3.79	2.82	2.83	2.99	3.56
2009	3.85	3.84	3.18	3.18	2.65	2.86	3.58
2010	3.99	3.37	3.17	3.20	2.69	2.88	3.55
2011	4.16	3.76	3.02	3.38	2.47	2.74	3.70
2012	4.04	3.72	3.00	3.44	2.50	2.75	3.68
2013	3.99	3.68	3.03	3.48	2.46	2.72	3.65
2014	4.30	3.83	3.35	3.34	2.40	2.68	3.81
2015	3.72	3.82	3.23	3.53	2.40	2.65	3.67
2016	3.75	3.82	3.26	3.68	2.40	2.67	3.78
2017	3.88	3.79	3.26	3.79	2.44	2.70	3.94

* The number of credit rating agencies registered as NRSROs varies by category and can change over time, potentially affecting comparisons across categories and with prior years. For example, Morningstar and HR Ratings each registered and had outstanding ratings in the financial institutions and corporate issuers categories in 2016, contributing to the increase in the HHI Inverse in these categories compared to the prior year.

Source: NRSRO annual certifications for the 2008-17 calendar years, Item 7A on Form NRSRO

As noted in Section IV.A.1.(a) of this Report, as of December 31, 2017, the government securities rating category (which includes sovereigns, U.S. public finance, and international public finance) was the category with the most ratings (comprising approximately 79.6% of all ratings outstanding). Given the disproportionate size of the government securities rating category relative to the other rating categories and the high concentration of NRSROs rating government securities,³⁸ the inclusion of the government securities category in the calculation of the aggregate HHI Inverse may make it difficult to assess the overall level of market concentration in the other four rating categories. Chart 5 therefore also includes the HHI Inverse for these four rating categories in the aggregate. When the government securities rating category is excluded, the total HHI inverse with respect to the four remaining rating categories increases to 3.94. Though still highly concentrated,³⁹ this reflects the lowest concentration (i.e., the highest HHI Inverse and greatest historical competition) since NRSROs began reporting information regarding the number of ratings outstanding on Form NRSRO.

Industry concentration in the asset-backed securities category is also at its lowest point since NRSROs began reporting information regarding the number of ratings outstanding on Form NRSRO. This may reflect increased competition from some of the smaller NRSROs that have focused on rating securities in this category (see Section IV.B. of this Report for a discussion of recent NRSRO market shares in the asset-backed securities category). The other

³⁸ As shown in Chart 5, the government securities category has an HHI Inverse of 2.44, which is significantly lower than the other categories, illustrating its status as the most concentrated rating category.

³⁹ See supra note 36.

rating categories were more concentrated in 2017 than they were in 2008, except for the financial institutions rating category, which is slightly less concentrated than in 2008.

2. NRSRO Analytical Staffing Levels

Chart 6 reports the number of credit analysts (including credit analyst supervisors) and the number of credit analyst supervisors employed by each of the NRSROs, as reported on Exhibit 8 of Form NRSRO.⁴⁰

NRSRO	Credit Analysts (Including Credit Analyst Supervisors)	Credit Analyst Supervisors
A.M. Best	144	47
DBRS	287	59
EJR	16	9
Fitch	1,176	310
HR Ratings	49	7
JCR	62	31
KBRA	144	28
Moody's	1,595	238
Morningstar	77	16
S&P	1,582	129
Total	5,132	874

Source: NRSRO annual certifications for the 2017 calendar year, Exhibit 8 on Form NRSRO

The larger NRSROs report employing 4,353 credit analysts (including supervisors), which is approximately 84.8% of the total number employed by all of the NRSROs. Although the smaller NRSROs in the aggregate employ only approximately 15.2% of all credit analysts employed by NRSROs, this percentage has increased steadily in recent years.⁴¹ During this time, some of the smaller NRSROs have reported significant increases in their analytical staff.⁴² The trend in the number of rating analysts employed by an NRSRO can indicate the state of the NRSRO's business or its business outlook—i.e., NRSROs that are increasing their staff may be experiencing or anticipating an increase in ratings volumes or planning to enter new markets.

⁴⁰ Effective January 1, 2015, the instructions for Exhibit 8 of Form NRSRO were amended to clarify that NRSROs must include credit analyst supervisors in the total number of credit analysts disclosed on Exhibit 8. This amendment was designed to enhance consistency of the disclosures on Exhibit 8 of Form NRSRO.

⁴¹ Based on reports by the currently-registered NRSROs on their annual certifications for the applicable calendar year, the smaller NRSROs employed approximately 11.4% of all NRSRO analysts in 2014, 12.8% of all NRSRO analysts in 2015, and 14.6% of all NRSRO analysts in 2016.

⁴² For example, in its most recent annual certification, DBRS reported employing 287 credit analysts (including credit analyst supervisors), a 15.7% increase from the number of analysts reported on its annual certification for the prior year and nearly double the 150 analysts reported as of March 31, 2015.

3. NRSRO Revenue Growth

The total revenue reported to the Commission⁴³ by all of the NRSROs for their 2017 fiscal year was approximately \$7.1 billion, which was higher by approximately \$1.2 billion than the amount reported in the 2016 fiscal year. Chart 7 shows the percentage of total NRSRO revenues since 2014 that were accounted for by the larger NRSROs in the aggregate and by the smaller NRSROs in the aggregate.

Chart 7: NRSRO Revenue Information: Fiscal Year Percentage of Total Reported NRSRO Revenue				
	2014	2015	2016	2017
S&P, Fitch, and Moody's	94.3%	93.7%	94.4%	94.1%
All Other NRSROs	5.7%	6.3%	5.6%	5.9%
Total	100.0%	100.0%	100.0%	100.0%

Source: Financial reports provided to the Commission under Rule 17g-3(a)(3) for the fiscal years ended 2014-17. For the preparation of this Report, if an NRSRO reported revenue in a foreign currency, the revenue was converted to U.S. dollars using the average exchange rate over all U.S. banking days in the fiscal year of such NRSRO.

Further revenue information is available for NRSROs that are owned, in whole or in part, by public companies. The following information is from the most recent annual reports of public companies with an ownership interest in an NRSRO:

- Moody's Corporation, the owner of Moody's, reported a 17% increase in revenues at Moody's from the previous fiscal year, noting growth across all lines of business. Moody's Corporation identified strong global leveraged finance rated issuance volumes as the primary driver of the increase in revenue and also noted growth in the banking sector and in collateralized loan obligation issuance. Additionally, Moody's Corporation noted benefits from changes in the mix of fee type, new fee initiatives, and pricing increases as contributing to Moody's revenue growth.⁴⁴
- S&P Global Inc. ("S&P Global"), which is S&P's parent company, indicated that revenue at S&P increased by 18% compared to its 2016 results, attributed primarily to an increase in bank loan ratings revenue in the U.S. and Europe and an increase in corporate bond ratings revenue. S&P Global additionally highlighted an increase in structured finance revenue driven by increased U.S. collateral loan obligation and U.S. commercial mortgage-backed securities issuance, an increase in surveillance fees, and higher entity

⁴³ Under Rule 17g-3(a)(3), each NRSRO is required to file annually with the Commission an unaudited report providing revenue information, including revenue from determining and maintaining credit ratings, revenue from subscribers, revenue from granting licenses or rights to publish credit ratings, and revenue from other services and products. These reports are not required to be made publicly available.

⁴⁴ See Moody's Corporation Annual Report on Form 10-K for the year ended December 31, 2017, available at <https://www.sec.gov/Archives/edgar/data/1059556/000119312518058986/d540752d10k.htm>.

credit ratings revenue as contributors to revenue growth. S&P Global also noted that the increase in revenue was partially offset by a decline in public finance revenue.⁴⁵

- Morningstar's parent company, Morningstar, Inc., noted an increase of revenue at Morningstar primarily due to new-issue growth in asset-backed securities, which was partially offset by a slight decrease in ratings on commercial mortgage-backed securities.⁴⁶

More recent regulatory filings of these entities have indicated a growth in revenue in the first half of 2018. Moody's Corporation reported a 9% increase in revenue at Moody's in the first half of 2018, as compared to the first half of 2017, identifying growth in the structured finance group and corporate finance group as well as the favorable impact of changes in the mix of fee type and pricing increases as contributing factors.⁴⁷ S&P Global reported a 4% increase in revenue at S&P in the first half of 2018, as compared to the first half of 2017, and attributed the growth to an increase in surveillance fees, higher entity credit ratings revenue, and an increase in Rating Evaluation Service activity.⁴⁸ Morningstar, Inc. indicated that revenue at Morningstar increased during both the first and second quarters of 2018, in each case as compared to the corresponding three-month period in 2017, due to new-issue growth in residential mortgage-backed securities and asset-backed securities.⁴⁹

B. Recent Developments in the State of Competition among NRSROs

1. Market Share Developments in the Asset-Backed Securities Rating Category

As noted in Section IV.A.1.(a) of this Report, the number of ratings recently issued by NRSROs may give a clearer picture of competition than the number of ratings each NRSRO currently has outstanding. For example, Chart 2 indicates that, as of December 31, 2017, the smaller NRSROs collectively have 16.2% of the ratings outstanding in the asset-backed securities rating category. However, the market share data discussed in Sections (a) and (b) below show that higher market share percentages have been obtained by smaller NRSROs in ratings issuance with respect to certain types of asset-backed securities. This market share data continues the growth trend the Staff has observed since the 2012 Annual Report for some smaller NRSROs in the asset-backed securities rating category.

⁴⁵ See S&P Global Inc. Annual Report on Form 10-K for the year ended December 31, 2017, available at <https://www.sec.gov/Archives/edgar/data/64040/000006404018000061/spgi-20171231x10k.htm>.

⁴⁶ See Morningstar, Inc. Annual Report on Form 10-K for the year ended December 31, 2017, available at https://www.sec.gov/Archives/edgar/data/1289419/000128941918000008/morn_10kx12312017.htm.

⁴⁷ See Moody's Corporation Quarterly Report on Form 10-Q for the period ended June 30, 2018, available at <https://www.sec.gov/Archives/edgar/data/1059556/000119312518235267/d585104d10q.htm>.

⁴⁸ See S&P Global Inc. Quarterly Report on Form 10-Q, for the period ended June 30, 2018, available at <https://www.sec.gov/Archives/edgar/data/64040/000006404018000162/spgi-2018630x10q.htm>. S&P describes its Rating Evaluation Service as an assessment of the potential credit impact of strategic or financial initiatives under consideration by an entity. See [spratings.com](https://www.spratings.com), Ratings Evaluation Service (RES), https://www.spratings.com/en_US/products/-/product-detail/rating-evaluation-service-res-.

⁴⁹ See Morningstar, Inc. Quarterly Report on Form 10-Q for the period ended March 31, 2018, available at https://www.sec.gov/Archives/edgar/data/1289419/000128941918000014/morn_10qx03312018.htm; Morningstar, Inc. Quarterly Report on Form 10-Q for the period ended June 30, 2018, available at https://www.sec.gov/Archives/edgar/data/1289419/000128941918000092/morn_10qx06302018.htm.

Sections (a) and (b) below discuss NRSRO market share information with respect to certain asset-backed securities, as reported on the Commercial Mortgage Alert and Asset-Backed Alert websites.⁵⁰ Commercial Mortgage Alert and Asset-Backed Alert currently report NRSRO market share information on four categories of asset-backed securities: (i) CMBS;⁵¹ (ii) MBS;⁵² (iii) CLOs;⁵³ and (iv) ABS.⁵⁴

(a) CMBS

Charts 8 through 11 provide information concerning U.S.⁵⁵ CMBS ratings by NRSROs, as reported in Commercial Mortgage Alert. NRSRO market share varies between the conduit CMBS and single borrower CMBS segments,⁵⁶ the two segments that account for most of the non-agency⁵⁷ U.S.

⁵⁰ See Asset-Backed Alert website, available at <https://www.abalert.com/> and Commercial Mortgage Alert website, available at <https://www.cmalert.com/>. The information in Charts 8 through 14 is based on these websites as of September 13, 2018. Although the information available on these websites may provide insight into recent developments regarding the state of competition among NRSROs in the asset-backed securities rating category, it has certain limitations. For instance, the information is self-reported by NRSROs. In addition, the information is presented using the number of transactions with respect to which an NRSRO has reported issuing a credit rating and the aggregate dollar amount thereof, rather than indicating where an NRSRO may have rated fewer than all tranches of a particular transaction.

⁵¹ The “CMBS” category is comprised of transactions collateralized by mortgages or leases on commercial or multi-family income-producing properties (excluding commercial real estate collateralized debt obligations). See Commercial Mortgage Alert website, available at <https://www.cmalert.com/>.

⁵² The “MBS” category is comprised of securities secured by U.S. first-lien mortgages on residential properties (excluding Fannie Mae and Freddie Mac issues, securities secured by non-performing or re-performing mortgages, subprime mortgages, or mortgages financing single-family rental businesses, and refinancings of previously offered securities). See Asset-Backed Alert website, available at <https://www.abalert.com/>.

⁵³ The “CLO” category is comprised of arbitrage collateralized loan obligations secured by broadly syndicated corporate loans and middle market collateralized loan obligations secured by loans to small to medium sized enterprises. Asset-Backed Alert included NRSRO market shares for the CLO category for the first time in the information reported for the first half of 2018. See id.

⁵⁴ The “ABS” category is comprised of securities that are collateralized by assets of some kind (excluding the following: CMBS; MBS; Fannie Mae and Freddie Mac issues (other than risk transfer transactions); issuances by municipalities; tax exempt issues; issues that are fully retained by an affiliate of the deal sponsor; commercial paper and other continuously offered securities such as medium-term notes; CLOs and other collateralized debt obligations; and refinancings of previously offered securities). See id.

⁵⁵ References to “U.S.” CMBS, MBS, ABS, and CLO issuance and market shares in this Section IV.B.1. reflect securities issued for sale primarily in the U.S., which include securities issued publicly and those issued under Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”). See Asset-Backed Alert website, available at <https://www.abalert.com/>; Commercial Mortgage Alert website, available at <https://www.cmalert.com/>.

⁵⁶ The term “conduit” refers to a financial intermediary that functions as a link, or conduit, between the lender(s) originating loans and the ultimate investor(s). The conduit makes loans or purchases loans from third party correspondents under standardized underwriting parameters and once sufficient volume has accumulated, pools the loans for sale to investors in the CMBS market. See https://www.crefc.org/uploadedFiles/Site_Framework/Industry_Resources/Glossary%20Revised%202014%20Update.pdf. In contrast, a single borrower transaction includes commercial mortgage loans made to a single borrower.

⁵⁷ “Non-agency” CMBS refers to CMBS that are not issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae. “Agency” CMBS generally refers to CMBS that are issued or guaranteed by such entities.

CMBS transactions rated by NRSROs. The charts include reported market share information for total non-agency U.S. CMBS transactions,⁵⁸ U.S. conduit CMBS transactions, U.S. single borrower CMBS transactions, and agency CMBS transactions⁵⁹ for calendar year 2016, calendar year 2017, and the first half of calendar year 2018.

Chart 8: Rating Agency Market Share for Total Non-Agency U.S. CMBS Issued in 2016, 2017, and First Half of 2018*

1H 2017 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Fitch	27,286.8	33	67.4	59,146.5	75	62.0	53,161.7	72	70.0
2	KBRA	19,844.7	23	49.0	47,931.8	63	50.3	36,280.7	51	47.8
3	S&P	17,580.8	31	43.4	39,240.3	64	41.2	19,255.7	41	25.3
4	Moody's	17,483.0	22	43.2	55,736.8	67	58.5	57,314.0	73	75.4
5	DBRS	12,048.5	20	29.8	26,755.3	37	28.1	17,549.1	26	23.1
6	Morningstar	4,646.7	9	11.5	12,024.5	25	12.6	14,516.6	27	19.1
	Total Rated Market	40,482.9	64		95,343.3	196		75,967.3	166	

Source: <https://www.cmalert.com/rankings.pl?O=78>

Chart 9: Rating Agency Market Share for U.S. Conduit CMBS Issued in 2016, 2017, and First Half of 2018*

1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Fitch	19,682.2	21	99.2	48,522.9	52	100.0	46,388.8	54	96.6
2	KBRA	13,111.6	14	66.1	30,425.7	33	62.7	30,390.3	35	63.3
3	Moody's	11,596.0	14	58.4	45,617.1	49	94.0	48,017.1	57	100.0
4	S&P	8,251.2	8	41.6	9,411.2	10	19.4	4,679.6	5	9.7
5	DBRS	6,735.6	8	33.9	17,918.3	19	36.9	13,755.6	17	28.6
6	Morningstar	0.0	0	0.0	2,175.6	2	4.5	6,443.1	8	13.4
	Total Rated Market	19,847.2	22		48,522.9	52		48,017.1	57	

Source: <https://www.cmalert.com/rankings.pl?O=78>

* Charts 8 and 9 reflect market share percentages based on dollar amounts of issuance. The sum of the market share percentages exceeds 100% since more than one NRSRO may rate a particular transaction or obligor.

⁵⁸ Total U.S. CMBS ratings include conduit CMBS, single-borrower CMBS, and other types of CMBS, such as distressed/non-performing CMBS transactions and re-securitizations of CMBS transactions.

⁵⁹ Only agency CMBS transactions with a rating from one or more NRSROs are included for determining NRSRO market share in the agency CMBS category. See Commercial Mortgage Alert website, available at <https://www.cmalert.com/>.

Chart 10: Rating Agency Market Share for U.S. Single Borrower CMBS Issued in 2016, 2017, and First Half of 2018*

1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	S&P	8,959.5	22	45.1	26,301.6	45	72.1	12,667.0	30	65.5
2	Fitch	7,214.6	11	36.3	8,959.7	13	24.5	4,229.8	6	21.9
3	KBRA	6,733.1	9	33.9	14,864.9	17	40.7	4,598.7	10	23.8
4	Moody's	5,887.0	8	29.6	9,038.3	12	24.8	8,528.9	13	44.1
5	DBRS	5,313.0	12	26.7	7,924.3	15	21.7	3,025.5	6	15.6
6	Morningstar	4,646.7	9	23.4	8,668.4	18	23.7	6,944.3	14	35.9
	Total Rated Market	19,875.5	40		36,499.6	64		19,339.0	39	

Source: <https://www.cmaalert.com/rankings.pl?Q=78>

Chart 11: Rating Agency Market Share for Agency CMBS Issued in 2016, 2017, and First Half of 2018*

1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Fitch	8,972.3	7	77.8	10,226.8	10	51.9	11,688.0	11	100.0
2	KBRA	6,110.0	5	53.0	11,488.7	10	58.3	5,378.2	5	46.0
3	Moody's	2,553.0	2	22.2	4,717.5	5	23.9	0.0	0	0.0
4	DBRS	2,510.6	2	21.8	2,417.5	2	12.3	0.0	0	0.0
5	S&P	1,470.5	1	12.8	5,812.1	5	29.5	2,081.0	2	17.8
6	Morningstar	1,434.2	1	12.4	4,781.1	4	24.2	4,228.8	4	36.2
	Total Rated Market	11,525.3	9		19,721.9	18		11,688.0	11	

Source: <https://www.cmaalert.com/rankings.pl?Q=78>

* Charts 10 and 11 reflect market share percentages based on dollar amounts of issuance. The sum of the market share percentages exceeds 100% since more than one NRSRO may rate a particular transaction or obligor.

As illustrated in Charts 8 through 10 above, some of the smaller NRSROs continue to report significant market shares in rating non-agency U.S. CMBS transactions. In both 2016 and 2017, KBRA had the third highest non-agency U.S. CMBS market share of all NRSROs, and, in the first half of 2018, KBRA's market share rose to the second highest. In each of these periods, KBRA rated approximately half of the overall non-agency U.S. CMBS transaction volume. DBRS also increased its overall non-agency U.S. CMBS market share in the first half of 2018 to 29.8%.

S&P has continued to gain market share in the U.S. conduit CMBS segment after having been subject to a one-year timeout from marketing or rating new issue U.S. conduit CMBS transaction in accordance with a settlement, dated January 21, 2015, between S&P and the Commission regarding charges relating to S&P's ratings on certain conduit transactions.⁶⁰ It has been reported that, due to differences in Moody's and S&P's methodologies that result in

⁶⁰ See In the Matter of Standard & Poor's Ratings Services, Release Nos. 33-9705 and 34-74104 (Jan. 21, 2015), available at <http://www.sec.gov/litigation/admin/2015/33-9705.pdf>.

varying credit enhancement requirements, conduit issuers tend to hire only one of the two firms to rate a transaction, frequently pairing the chosen firm with Fitch in order to satisfy investment guidelines of certain investors that require ratings from at least two of Moody's, S&P, and Fitch.⁶¹

The relative size of the U.S. single borrower segment has increased significantly in recent years and in the first half of 2018 accounted for just under half of all non-agency U.S. CMBS transactions.⁶² S&P retained a leading market share position in this segment in the first half of 2018, but had a lower market share compared to prior years. The remaining NRSROs active in the U.S. single borrower segment (including DBRS, KBRA, and Morningstar) each had market shares greater than 23%. Reports indicate that Morningstar hopes to expand its business in this segment further as single-borrower issuers become more familiar with its recently published criteria for rating U.S. single borrower transactions.⁶³

Chart 11 shows a relatively competitive landscape between the larger and smaller NRSROs with respect to credit ratings of agency CMBS transactions. Fitch and KBRA are the most active NRSROs in this segment, each having rated more than half of the transactions issued in 2017 and the first half of 2018. Though they have rated significantly fewer transactions than Fitch and KBRA, the two remaining smaller NRSROs have obtained market shares in this segment that are comparable to those of the remaining larger NRSROs.

(b) ABS/MBS

Charts 12 through 14 provide information concerning U.S. ABS, U.S. MBS, and U.S. CLO ratings by NRSROs, as reported in Asset-Backed Alert. The charts include reported market share information for (i) U.S. ABS transactions and U.S. MBS transactions for calendar year 2016, calendar year 2017, and the first half of calendar year 2018 and (ii) U.S. CLO transactions for the first half of calendar years 2017 and 2018.⁶⁴

⁶¹ See Fitch Leads Rankings; S&P Gains on Moody's, Commercial Mortgage Alert, July 20, 2018.

⁶² Among other factors, market participants have attributed the growth of issuance in the single borrower segment to favorable conditions in the bond market for securities that pay interest based on a floating rate. See Single-Borrower Deals Dominating Issuance, Commercial Mortgage Alert, Aug. 3, 2018.

⁶³ See id. Morningstar published distinct criteria for U.S. single borrower transactions during the Report Period. See Morningstar Credit Ratings, LLC Publishes New Methodology for U.S. Single-Asset/Single-Borrower Ratings, Morningstar Credit Ratings, LLC, June 1, 2018, available at <https://ratingagency.morningstar.com/PublicDocDisplay.aspx?i=GX1XH4Gv88A%3d&m=i0Pyc%2bx7qZZ4%2bsXnymazBA%3d%3d&s=LviRtUKXqs8kml5dHt7FTeE2SZmY0Fvqd4iX49Mk%2f9UapyiFTEO6TA%3d%3d>.

⁶⁴ As noted supra in note 53, Asset-Backed Alert only recently began reporting NRSRO market share for U.S. CLO transactions. Historical market share information for this category (i.e., prior to 2017, and for the full 2017 calendar year) was not included with rankings published following the first half of calendar year 2018.

Chart 12: Rating Agency Market Shares for U.S. ABS Issued in 2016, 2017, and First Half of 2018*										
1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	S&P	94,711.6	146	55.0	161,248.6	243	57.1	125,432.7	202	56.5
2	Fitch	89,303.2	112	51.9	154,302.3	207	54.7	123,080.6	160	55.5
3	Moody's	85,944.2	116	49.9	138,987.3	192	49.2	119,772.8	170	54.0
4	DBRS	39,881.2	72	23.2	68,316.1	133	24.2	46,139.3	117	20.8
5	KBRA	28,437.2	74	16.5	48,740.3	124	17.3	38,756.5	101	17.5
6	Morningstar	14,157.1	31	8.2	14,835.8	33	5.3	7,921.2	23	3.6
	Total Rated Market	172,187.9	284		282,313.2	472		221,849.7	395	

Source: <https://www.abalert.com/rankings.pl?Q=102>

Chart 13: Rating Agency Market Shares for U.S. MBS Issued in 2016, 2017, and First Half of 2018*										
1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	2017 Issuance (\$Mil.)	No. of deals	Market Share (%)	2016 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Moody's	10,144.1	20	66.1	12,070.9	23	73.6	5,279.6	16	63.6
2	KBRA	7,456.1	16	48.6	6,967.5	15	42.5	3,008.4	9	36.2
3	DBRS	7,309.3	15	47.7	9,878.9	15	60.2	3,245.9	10	39.1
4	Fitch	6,240.2	12	40.7	6,694.4	9	40.8	3,478.4	12	41.9
5	S&P	3,917.8	5	25.5	3,114.5	4	19.0	1,216.0	4	14.6
6	Morningstar	0.0	0	0.0	0.0	0	0.0	585.6	4	7.1
	Total Rated Market	15,339.4	30		16,402.7	29		8,300.5	29	

Source: <https://www.abalert.com/rankings.pl?Q=102>

Chart 14: Rating Agency Market Shares for U.S. CLO Issued in First Half of 2017 and First Half of 2018*							
1H 2018 Rank	NRSRO	1H-2018 Issuance (\$Mil.)	No. of deals	Market Share (%)	1H-2017 Issuance (\$Mil.)	No. of deals	Market Share (%)
1	Moody's	52,246.9	94	73.6	47,603.6	84	91.6
2	Fitch	51,982.5	93	73.2	34,401.1	62	66.2
3	S&P	31,866.3	57	44.9	20,293.9	35	39.1
4	Morningstar	4,504.5	6	6.3	5,085.7	7	9.8
5	DBRS	604.9	1	0.9	348.9	1	0.7
	Total Rated Market	71,004.4	128		51,944.3	93	

Source: <https://www.abalert.com/rankings.pl?Q=102>

* Charts 12 through 14 reflect market share percentages based on dollar amounts of issuance. The sum of the market share percentages exceeds 100% since more than one NRSRO may rate a particular transaction or obligor.

Chart 12 shows that smaller NRSROs, in particular DBRS and KBRA, have built significant market share rating U.S. ABS.⁶⁵ DBRS has consistently attained a market share of over 20% in each of 2016, 2017, and the first half of 2018, and KBRA has maintained a market share of approximately 17% during the same time period. Morningstar has also more than doubled its market share from 3.6% in 2016 to 8.2% in the first half of 2018.

Chart 13 shows that ratings by KBRA and DBRS continue to represent a large portion of the U.S. MBS market, with the second and third, respectively, highest market shares in the first half of 2018.

Chart 14 shows that the larger NRSROs have the highest market shares in the U.S. CLO segment. However, Morningstar attained some market share in the U.S. CLO segment as well. Efforts by Morningstar and other smaller NRSROs to develop business in this segment are discussed in Section IV.B.2. of this Report.

2. Other NRSRO Developments⁶⁶

As described in Section IV.B.1. of this Report, some of the smaller NRSROs have reported market share gains in the asset-backed securities rating category. In particular, these NRSROs have had success rating asset-backed securities backed by discrete asset types, in particular newer or unique asset types.

For instance, smaller NRSROs are significant raters of securities backed by unsecured consumer loans, including consumer loans originated through marketplace lending platforms. KBRA and DBRS had the two highest market shares in this category during the Report Period, rating 68.5% and 51.3%, respectively, of the transactions priced during such period.⁶⁷

Another asset class, single family rental securitizations, is predominately rated by three NRSROs, including two smaller NRSROs. During the Report Period, issuers priced fourteen rated single family rental securitizations with an aggregate principal amount of \$7.8 billion. Morningstar issued ratings on all but one of these transactions.⁶⁸ KBRA also issued ratings on 88.8% of these transactions.⁶⁹

An additional example of market share gains achieved by smaller NRSROs in discrete asset classes is KBRA's rating of securitizations backed by aircraft-lease receivables. KBRA rated each of the fifteen aircraft-lease receivables transactions (with an aggregate principal amount of \$9.2 billion)

⁶⁵ See Section IV.B.2. of this Report for a discussion of specific ABS asset classes where the smaller NRSROs have reported success in gaining market share.

⁶⁶ Unless noted otherwise, all market share percentages in this Section IV.B.2. are based on dollar amounts of issuance. The information in this Section IV.B.2. from the [Asset-Backed Alert](#) database was obtained from the database available on the [Asset-Backed Alert](#) website on September 13, 2018.

⁶⁷ See [Asset-Backed Alert](#) database. The [Asset-Backed Alert](#) database indicates that 48 unsecured consumer loan transactions totaling \$17.8 billion priced during the Report Period.

⁶⁸ See [id.](#)

⁶⁹ See [id.](#)

that priced during the Report Period.⁷⁰ KBRA has rated each aircraft-lease receivables transaction (twenty-seven in total) issued from December 2015 through the end of the Report Period.⁷¹

Smaller NRSROs have also been able to gain market share in rating more traditional types of asset-backed securities. DBRS has gained the largest market share among the smaller NRSROs with respect to the more traditional types of asset-backed securities (aside from the MBS and CMBS categories). For example, DBRS rated 58.6% of the transactions backed by student loans that priced during the Report Period.⁷² DBRS also rated a sizable minority of two of the largest asset-backed securities asset classes—i.e., credit card and prime auto loan transactions.⁷³ DBRS rated 18.7% and 13.5% of the credit card asset-backed securities and prime auto loan asset-backed securities, respectively, priced during the Report Period.⁷⁴

DBRS has also been able to gain market share in other auto-related asset-backed securities. During the Report Period, DBRS rated 69.8% of the auto-fleet lease transactions, 35.8% of the subprime auto loan transactions, 12.4% of the auto lease transactions, and 9.4% of the floorplan loan transactions that priced during the Report Period.⁷⁵ KBRA has also established a market share presence in some of these auto-related asset-backed security categories, rating 20.3% of the auto-fleet lease transactions and 22.8% of the subprime auto loan transactions during the Report Period.⁷⁶

Smaller NRSROs have also achieved notable market share in certain types of residential mortgage-backed securities not included in Chart 13. For instance, DBRS has gained large market shares in the non-performing/re-performing mortgage⁷⁷ and risk transfer asset classes.⁷⁸ During the Report Period, DBRS achieved the highest market share of all NRSROs rating securities backed by

⁷⁰ See [id.](#)

⁷¹ See [id.](#)

⁷² See [id.](#) The [Asset-Backed Alert](#) database indicates that 37 student loan transactions totaling \$23.9 billion priced during the Report Period.

⁷³ The [Asset-Backed Alert](#) database lists 65 credit card transactions totaling \$43.4 billion and 97 prime auto loan transactions totaling \$78.4 billion that priced during the Report Period. These are the third and fourth largest asset classes shown on the database, behind only collateralized debt obligations and non-U.S. residential loans.

⁷⁴ See [Asset-Backed Alert](#) database.

⁷⁵ See [id.](#) For the Report Period, the [Asset-Backed Alert](#) database lists 23 auto-fleet lease transactions totaling \$9.8 billion, 56 subprime auto loan transactions totaling \$27.4 billion, 43 auto lease transactions totaling \$32.4 billion, and 19 floorplan loan transactions totaling \$13.1 billion.

⁷⁶ See [id.](#)

⁷⁷ Generally, “non-performing” transactions are those where the collateral is comprised of loans that are delinquent or in default at the time of the securitization, and “re-performing” transactions are those where the collateral is comprised of loans that were previously delinquent or in default but are paying at the time of the securitization. See, e.g., [Moody’s Approach to Ratings Securitizations Backed by Non-Performing and Re-Performing Loans](#), Moody’s Investors Service, Aug. 2016.

⁷⁸ The [Asset-Backed Alert](#) database indicates that 28 non-performing/re-performing mortgage transactions totaling \$16.1 billion and 22 risk transfer transactions totaling \$23.4 billion priced during the Report Period. Risk transfer transactions refer to asset-backed securities issued pursuant to credit risk transfer programs implemented by Fannie Mae and Freddie Mac. See [Credit Risk Transfer](#), available at <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Credit-Risk-Transfer.aspx> (last visited Sept. 13, 2018).

non-performing or re-performing mortgages, rating 86.9% of such transactions,⁷⁹ and the second highest market share of all NRSROs rating risk transfer issuances, rating 62.1% of such transactions.⁸⁰ Additionally, Morningstar achieved the second highest market share of all NRSROs rating securities backed by subprime mortgages, rating 40.6% of the transactions priced during the Report Period.⁸¹

Smaller NRSROs have continued to pursue growth in other types of asset-backed securities as well, including collateralized loan obligations. As shown in Chart 14 in Section IV.B.1.(b) of this Report, Morningstar was the only smaller NRSRO to rate multiple U.S. CLO transactions in the first half of 2018. Over the course of the Report Period, Morningstar issued credit ratings with respect to twenty-one collateralized loan obligations.⁸² KBRA rated a number of commercial real estate collateralized loan obligations during the Report Period.⁸³ It has also been reported that KBRA is expanding its coverage to include collateralized loan obligations backed by leveraged loans,⁸⁴ and KBRA has since released a methodology for rating structured credit transactions, including collateralized loan obligations backed by corporate loan portfolios.⁸⁵

Smaller NRSROs continue to pursue opportunities in rating categories other than asset-backed securities. For example, during the Report Period, Morningstar published methodology for rating real estate investment trusts (REITs) and issued a number of unsolicited credit ratings on REITs.⁸⁶ KBRA also published several new methodologies during the Report Period in rating categories other than asset-backed securities.⁸⁷

Smaller NRSROs have also pursued growth through international expansion. For instance, during the Report Period, KBRA announced its expansion into Europe with the opening of an office in Dublin, Ireland.⁸⁸ Kroll Bond Rating Agency Europe Limited (“KBRA Europe”), a credit rating affiliate of KBRA, was registered by the European Securities and Markets Authority, which enables it to issue credit ratings that can be used for regulatory purposes by certain European institutions.⁸⁹

⁷⁹ See [Asset-Backed Alert](#) database. Morningstar was also active in this asset class, rating 27.8% of such transactions. See [id.](#)

⁸⁰ See [id.](#) KBRA and Morningstar were also active in this asset class, rating 19.4% and 15.9%, respectively, of these transactions. See [id.](#)

⁸¹ See [id.](#) The [Asset-Backed Alert](#) database indicates that 17 subprime mortgage transactions totaling \$5.5 billion priced during the Report Period. DBRS and KBRA were also active in this asset class, rating 32.6% and 22.4%, respectively, of these transactions. See [id.](#)

⁸² See <https://ratingagency.morningstar.com/mcr/ratings-surveillance/structured-finance> (listing rated structured finance transactions and providing links to more detailed information).

⁸³ See <https://www.krollbondratings.com/ratings/cmb>s (listing rated commercial real estate transactions and providing links to more detailed information)

⁸⁴ See, e.g., [Kroll Staffs Up for CLO Push](#), [Asset-Backed Alert](#), March 23, 2018.

⁸⁵ See [KBRA Releases Global Structured Credit Rating Methodology](#), Kroll Bond Rating Agency, Aug. 7, 2018.

⁸⁶ See [Morningstar Credit Ratings, LLC Launches Ratings of REITs](#), Morningstar Credit Ratings, LLC, Sept. 15, 2017. See also <https://ratingagency.morningstar.com/mcr/ratings-surveillance/corporate-financial%20institutions> (listing corporate and financial institution ratings and providing links to more detailed information).

⁸⁷ See, e.g., [KBRA Releases U.S. Not-For-Profit Healthcare Rating Methodology](#), Kroll Bond Rating Agency, Oct. 25, 2017; [KBRA Releases Global Captive Insurer Rating Methodology](#), Kroll Bond Rating Agency, Nov. 1, 2017.

⁸⁸ See [KBRA Expands into Europe with Opening of Dublin Office](#), Kroll Bond Rating Agency, Sept. 26, 2017.

⁸⁹ See [ESMA Registers Kroll Bond Rating Agency Europe Limited as a Credit Rating Agency](#), European Securities and Markets Authority, Nov. 13, 2017.

KBRA Europe published its first European credit rating during the Report Period.⁹⁰ KBRA was also designated as a designated rating organization for structured finance products in Canada during the Report Period,⁹¹ and has been recognized as an external credit assessment institution by the Office of the Superintendent of Financial Institutions, the regulator of Canadian banks and other financial institutions.⁹²

C. Barriers to Entry

Despite the notable progress made by smaller NRSROs in gaining market share in some types of asset-backed securities over the past few years (see Section IV.B. of this Report), barriers to entry continue to exist in the credit ratings industry, presenting competitive challenges for the smaller NRSROs.⁹³

One such potential barrier referred to by certain smaller NRSROs is the minimum ratings requirements that specify use of the ratings of particular rating agencies in the investment management contracts of institutional fund managers and the investment guidelines of fixed income mutual fund managers, pension plan sponsors, and endowment fund managers.⁹⁴ The effect of these requirements can be to increase the demand and liquidity for securities bearing the ratings of specified rating agencies.⁹⁵ Historically, many of these guidelines refer to the ratings from the larger NRSROs by name (i.e., S&P, Moody's, and Fitch). Despite reports in recent years that investors are increasingly changing their guidelines to allow for investments in securities rated by a wider group of NRSROs,⁹⁶ investment guidelines continue to be identified as a factor impacting the selection of NRSROs to rate certain transactions.⁹⁷

A related barrier to entry is the inclusion requirements of some fixed income indices. To be included in many of these indices, securities must be rated by specific NRSROs. Certain

⁹⁰ See KBRA Issues First European Ratings, Kroll Bond Rating Agency, Apr. 27, 2018.

⁹¹ See Canadian Securities Regulators Publish Amendments Relating to Designated Rating Organizations, Canadian Securities Administrators, March 29, 2018, available at <https://www.securities-administrators.ca/aboutcsa.aspx?id=1676>.

⁹² See KBRA Recognized as an External Credit Assessment Institution by OSFI, Kroll Bond Rating Agency, July 19, 2018.

⁹³ See Shankar Ramakrishnan and Philip Scipio, Big three in credit ratings still dominate business, May 4, 2016, available at <http://www.reuters.com/article/uscorpbonde-ratings-idUSL2N17U1L4>.

⁹⁴ See letter from KBRA to the Commission, dated August 19, 2014, available at <http://www.sec.gov/comments/s7-18-11/s71811-88.pdf>. This barrier to entry was also mentioned during the SEC's Credit Ratings Roundtable held on May 14, 2013. At the roundtable, a representative of Morningstar mentioned that, according to a study conducted by Morningstar, approximately 42% of open-end fixed income funds with investment guidelines that reference ratings specifically refer to S&P, Moody's, or a "major NRSRO." See Credit Rating Roundtable, May 14, 2013, available at <http://www.sec.gov/spotlight/credit-ratings-roundtable.shtml>.

⁹⁵ The effect of including particular NRSROs in investment guidelines was highlighted in an article concerning a loan securitization. In the article, an issuer referred to the fact that many institutional buyers are limited to purchasing securities rated by one of the larger NRSROs, and that a larger NRSRO's rating expanded the number of entities which could purchase the rated securities. See Tracy Alloway, Peer-to-Peer Lender Wins Landmark Rating, Fin. Times, July 10, 2014 at Companies and Markets, p. 18.

⁹⁶ See, e.g., Big Investors Accept More Rating Agencies, Asset-Backed Alert, May 19, 2017.

⁹⁷ See supra note 61 and accompanying text.

investment companies try to closely track the performance of the indices by purchasing the securities included in them, and can thus increase the demand for securities bearing the ratings of specific NRSROs. For instance, during the Report Period, Fitch announced that its ratings had been added to the J.P. Morgan High-Yield Bond Indices, noting that investors rely on such indices to determine which bonds suit their level of credit risk.⁹⁸

Market participants and academics have identified various other barriers to entry in the credit rating industry, including economic and regulatory barriers.⁹⁹ Among the regulatory barriers to entry for NRSROs are the costs associated with complying with the statutory provisions implemented by the Rating Agency Act and the Dodd-Frank Act and the related rules adopted by the Commission, including the rules and rule amendments that the Commission adopted pursuant to the Dodd-Frank Act (the “NRSRO Amendments”).¹⁰⁰ Commenters on the proposed NRSRO Amendments expressed concerns that certain of the requirements would be burdensome for smaller NRSROs to implement and could raise barriers to entry for credit rating agencies that seek to register as NRSROs.¹⁰¹ In connection with the NRSRO Amendments, the Commission acknowledged that, despite efforts to limit the impact on small entities, the Dodd-Frank Act contained requirements, including those implemented by the NRSRO Amendments, which impose costs on NRSROs and may consequently create barriers to entry and have negative impacts on competition.¹⁰² As discussed in more detail in a prior Annual Report, the NRSRO Amendments as adopted by the Commission include various changes intended to address concerns regarding barriers to entry, including standards allowing NRSROs to tailor particular requirements to their business models, size, and rating methodologies.¹⁰³

V. TRANSPARENCY

Congress described the Rating Agency Act as an act to improve ratings quality “by fostering accountability, transparency, and competition in the credit rating agency industry.”¹⁰⁴ Section 932 of the Dodd-Frank Act is entitled “Enhanced regulation, accountability, and transparency of NRSROs.” Both Acts contain various provisions designed to increase the transparency—through clear disclosure open to public scrutiny—of, among other things, NRSROs’ credit rating procedures and methodologies, business practices, and credit ratings performance.

The NRSRO Amendments improved and expanded the disclosure requirements applicable to NRSROs. Additional sources of information that can be beneficial to investors and

⁹⁸ See Fitch Ratings Joins J.P. Morgan High Yield Bond Indices, Fitch Ratings, June 28, 2017.

⁹⁹ See, e.g., Section IV.C. of the March 2012 Annual Report, available at <https://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0312.pdf>.

¹⁰⁰ See Nationally Recognized Statistical Rating Organizations, Release No. 34-72936 (Aug. 27, 2014), 79 FR 55077 (Sept. 15, 2014) (“Adopting Release”).

¹⁰¹ See Adopting Release, 79 FR at 55090, 55154, 55161, and 55254-55. See also comment letters received with respect to the NRSRO Amendments as proposed, available at <http://www.sec.gov/comments/s7-18-11/s71811.shtml>.

¹⁰² See Adopting Release, 79 FR at 55254.

¹⁰³ See Section IV.C. of the December 2015 Annual Report, available at <https://www.sec.gov/ocr/reportspubs/annual-reports/2015-annual-report-on-nrsros.pdf>.

¹⁰⁴ See the preamble to the Rating Agency Act.

others are required to be made publicly available under the NRSRO Amendments. These requirements are designed to enhance the transparency of NRSRO credit ratings by reducing information asymmetries that may adversely affect users of credit ratings.¹⁰⁵ Specifically, under the NRSRO Amendments, NRSROs must disclose:

- (1) standardized performance statistics;¹⁰⁶
- (2) consolidated and increased information about credit rating histories;¹⁰⁷
- (3) information about material changes and significant errors in the procedures and methodologies used to determine credit ratings;¹⁰⁸
- (4) information about specific rating actions;¹⁰⁹ and
- (5) clear definitions of each symbol, number, or score in the rating scale used by the NRSRO.¹¹⁰

An objective of these requirements is to improve the information provided to users of credit ratings in order to facilitate external scrutiny of NRSRO activities, enable ratings users to make more informed investment and credit-related decisions and allow users to compare the performance of credit ratings by different NRSROs.¹¹¹

In accordance with the NRSRO Amendments, each NRSRO must disclose certain information in connection with each rating action it takes.¹¹² Such information includes, among other things, the version of the procedure or methodology used to determine the credit rating, a description of the types of data that were relied upon for purposes of determining the credit rating, an assessment of the quality of information available and considered in determining the credit rating, and information on the sensitivity of the credit ratings to assumptions made by the NRSRO.¹¹³ These requirements are designed to promote transparency of the process for determining credit rating actions, allowing users of credit ratings to better understand how credit ratings are produced and the information content of credit ratings, including how these factors vary across NRSROs.¹¹⁴

In addition to the disclosures required by rule, NRSROs often issue press releases and reports at the time of a rating action to describe the rationale behind such rating action,¹¹⁵ and make versions of the methodologies for determining credit ratings available on their websites. The availability of the underlying methodologies, together with a report discussing the analysis supporting a rating action, provides additional transparency into the credit rating process.

¹⁰⁵ See Adopting Release, 79 FR at 55091.

¹⁰⁶ See Instructions for Exhibit 1 to Form NRSRO; Adopting Release, 79 FR at 55295-302.

¹⁰⁷ See Rule 17g-7(b); Adopting Release, 79 FR at 55266-67.

¹⁰⁸ See Rule 17g-8(a)(4); Adopting Release, 79 FR at 55267-68.

¹⁰⁹ See Rule 17g-7(a); Adopting Release, 79 FR at 55264-66.

¹¹⁰ See Rule 17g-8(b)(2); Adopting Release, 79 FR at 55268.

¹¹¹ See Adopting Release, 79 FR at 55091.

¹¹² See Rule 17g-7(a).

¹¹³ See Rule 17g-7(a)(1)(ii).

¹¹⁴ See Adopting Release, 79 FR at 55180.

¹¹⁵ The reports accompanying a rating action are frequently available on a paid subscription basis, although some NRSROs provide access to such reports for free.

Beyond the disclosures required under Section 15E and the related Commission rules, and information otherwise made available by NRSROs with respect to their credit ratings, transparency may be increased to the extent NRSROs publish commentaries or research that highlight differences of opinion they may have with other NRSROs. There are a number of examples of such publications from the Report Period. For instance, KBRA published several reports during the Report Period that discussed differences in its approach to rating financial institutions from those of other NRSROs.¹¹⁶ Another example is a commentary published by Fitch regarding a specific asset-backed securities offering. In this commentary, Fitch noted several concerns regarding the transaction and concluded that the transaction would not meet its investment grade standards.¹¹⁷

Commentaries and research pieces such as those mentioned above may provide additional insight into the credit characteristics of certain securities or asset types and/or highlight differences in opinions and ratings criteria among NRSROs. This type of information can serve to enhance investors' understanding of the differences in ratings approaches used by the NRSROs.

Technological advances may also impact transparency and other aspects of the credit rating industry. For instance, DBRS published a commentary discussing the use of virtual reality technology in the commercial real estate industry, such as by providing real estate purchasers and investors with online access to images of commercial properties. DBRS noted that the use of this technology "could provide improved analytics and transparency for investors in the commercial mortgage-backed security market."¹¹⁸ Other technological advances such as artificial intelligence have the potential to impact the credit rating industry as well,¹¹⁹ and some NRSROs have launched initiatives related to technological developments. For example, Moody's formed an Analytic and Technology Solutions group in 2017 to, among other things, "expand [its] technological innovation activities, including advanced capabilities in machine learning and artificial intelligence."¹²⁰ The parent companies of certain NRSROs have also made investments in artificial intelligence and other technology companies.¹²¹

¹¹⁶ See, e.g., Credit Card Banks: A Fresh Perspective on Risk, Kroll Bond Rating Agency, Sept. 18, 2017; Why Haven't Ratings Changed Much on Large U.S. Regionals Since the Credit Crisis?, Kroll Bond Rating Agency, Sept. 28, 2017; Bank Preferred Notching: A Sensible Approach, Kroll Bond Rating Agency, Jan. 3, 2018.

¹¹⁷ See Fitch: BJETS 2017-1 Aircraft ABS Not Investment Grade, Fitch Ratings, Oct. 10, 2017.

¹¹⁸ See The VR Revolution in the Commercial Real Estate Industry, DBRS, May 2, 2017.

¹¹⁹ Though not specifically discussing the use of artificial intelligence in the credit rating industry, in a research report published during the Report Period, Moody's identified some potential benefits of artificial intelligence as "boosting productivity, automating routine tasks and reducing error rates" but noted that "the most transformative uses are still in early development." See Announcement: Moody's: Transformative potential of artificial intelligence still years away, despite rapid recent growth, Moody's Investors Service, Feb. 8, 2018.

¹²⁰ See Moody's Announces Investment in QuantCube, AI-Based Predictive Analytics Firm, Moody's Corporation, May 29, 2018.

¹²¹ See, e.g., id. (announcing Moody's Corporation had made a strategic minority investment in a provider of real-time, artificial intelligence-based predictive analytics); Antoine Gara, Wall Street Tech Spree: With Kensho Acquisition S&P Global Makes Largest A.I. Deal In History, Forbes.com, Mar. 6, 2018, available at <https://www.forbes.com/sites/antoinegara/2018/03/06/wall-street-tech-spree-with-kensho-acquisition-sp-global-makes-largest-a-i-deal-in-history/#a00466867b85> (discussing S&P Global's agreement to buy an artificial intelligence and analytics firm and quoting the CEO of S&P Global, Douglas Peterson, as saying in a statement that "Via this acquisition, S&P Global is demonstrating a strong commitment to not just participating in the fintech evolution, but leading it.").

VI. CONFLICTS OF INTEREST

NRSROs operate under a combination of two business models, and there are potential conflicts of interest inherent in both. Most of the NRSROs, including the larger NRSROs, primarily operate under the “issuer-pay” model, which is subject to a potential conflict in that the credit rating agency may be influenced to determine more favorable (i.e., higher) ratings than warranted in order to retain the obligors or issuers as clients. This conflict could affect an entire asset class if, for example, an NRSRO becomes known for issuing higher credit ratings with respect to such class, resulting in that NRSRO’s retaining or attracting business from most or all issuers of securities in such class.¹²² The potential for such a conflict to influence the ratings process may be particularly acute with respect to structured finance products, where transactions are arranged by a relatively concentrated group of sponsors, underwriters, and managers, and rating fees are particularly lucrative.¹²³

The other business model is the “subscriber-pay” model which means that investors pay the rating agency a subscription fee to access its ratings. This model is also subject to potential conflicts of interest. For example, an NRSRO may be aware that an influential subscriber holds a securities position (long or short) that could be advantaged if a credit rating upgrade or downgrade causes the market value of the security to increase or decrease or that a subscriber invests in newly issued bonds and would obtain higher yields if the bonds were to have lower ratings.

Another example of a conflict in a “subscriber-pay” model is that the NRSRO may be aware that a subscriber wishes to acquire a particular security but is prevented from doing so because the credit rating of the security is lower than internal investment guidelines or an applicable contract permit. An upgrade of the credit rating of the security by the NRSRO could remove this impediment to investing in the security. These potential conflicts could be mitigated to the extent that an NRSRO has a wide subscriber base and subscribers have different interests with respect to an upgrade or downgrade of a particular security.

Section 15E and the related Commission rules contain provisions addressing conflicts of interest. For example, Rule 17g-5 identifies certain conflicts of interest that are prohibited under all circumstances¹²⁴ and other conflicts of interest that are prohibited unless an NRSRO has publicly disclosed the existence of the conflict and has implemented policies and procedures reasonably designed to address and manage such conflict.¹²⁵ One such prohibited conflict of interest is Rule 17g-5(c)(8), which was added by the NRSRO Amendments. In accordance with this rule, an NRSRO is prohibited from issuing or maintaining a credit rating where a person

¹²² Some authors, however, have written about the effect of reputational concerns on the motivation of rating agencies to provide accurate ratings. See, e.g., Steven L. Schwarcz, Private Ordering of Public Markets: The Rating Agency Paradox, 2002 U. ILL. L. REV. 1 (2002); Harold Cole and Thomas F. Cooley, Rating Agencies, NBER working paper No. 19972 (Mar. 2014).

¹²³ A Senate Report related to the Dodd-Frank Act noted, for instance, that conflicts of interest in the process of rating structured financial products contributed to the issuance of inaccurate ratings by rating agencies and, accordingly, to the mismanagement of risks by financial institutions and investors. See S. Report No. 111-176 (2010).

¹²⁴ See Rule 17g-5(c).

¹²⁵ See Rule 17g-5(a)(1)-(2); Rule 17g-5(b); and Form NRSRO, Exhibits 6-7. Additional requirements apply to the “issuer-pay” conflict of interest in the context of credit ratings of asset-backed securities. See Rule 17g-5(a)(3).

within the NRSRO who participates in determining or monitoring the rating, or developing or approving procedures or methodologies used for determining the rating, also (a) participates in sales or marketing activities of the NRSRO or its affiliate or (b) is influenced by sales or marketing considerations.¹²⁶

The annual examinations conducted by Staff in accordance with Section 15E(p) are required to include, among other things, a review of the management of conflicts of interest by the NRSRO and the policies of the NRSRO governing post-employment activities of its former personnel.¹²⁷ Information regarding the examinations, including any essential findings with respect to these review areas, is included in OCR's annual examination reports.¹²⁸

VII. CONCLUSION

The Staff will continue to conduct its oversight function with respect to NRSROs, including the performance of Staff examinations, and engage in other activities in furtherance of OCR's regulatory mission, as described in this Report.

¹²⁶ See Rule 17g-5(c)(8).

¹²⁷ See Section 15E(p)(3)(B).

¹²⁸ The examination reports can be found under "Summary Examination Reports" in the "Reports and Studies" section of the OCR webpage, available at <http://www.sec.gov/ocr>.