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**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**[Release No. 34-84289; File No. S7-22-18]**

**RIN 3235-AM05**

**Amendments to Rules for Nationally Recognized Statistical Rating Organizations**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is proposing amendments to rules for nationally recognized statistical rating organizations ("NRSROs") under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments would provide an exemption from a rule for NRSROs with respect to credit ratings if the issuer of the security or money market instrument referred to in the rule is not a U.S. person, and the NRSRO has a reasonable basis to conclude that all offers and sales of such security or money market instrument by any issuer, sponsor, or underwriter linked to such security or money market instrument will occur outside the United States. In addition, the amendments would make conforming changes to similar exemptions in two other Exchange Act rules. The Commission is requesting comment on the proposed rule amendments.

**DATES:** Comments should be received on or before November 5, 2018.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

- Send an email to rule-comments@sec.gov. Please include File Number S7-22-18 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

All submissions should refer to File Number S7-22-18. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.

**FOR FURTHER INFORMATION CONTACT:** Harriet Orol, Kevin Vasel, or Patrick Boyle, at (212) 336-9080, Office of Credit Ratings, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, NY 10281.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing amendments to:

| Commission Reference | | CFR Citation (17 CFR) |
|---|---|---|
| Securities Exchange Act of 1934 (Exchange Act)[1] | Rule 17g-5(a)(3) | § 240.17g-5(a)(3) |
| | Rule 17g-7(a) | § 240.17g-7(a) |
| | Rule 15Ga-2 | § 240.15Ga-2 |

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[1] 15 U.S.C. 78a *et seq.*

## I. Background

### A. Rule 17g-5(a)(3)

In 2009, the Commission adopted amendments to 17 CFR 240.17g-5 ("Rule 17g-5") designed to address conflicts of interest arising from the business of determining credit ratings, and to improve competition and the quality of credit ratings for structured finance products, by

making it possible for more NRSROs to rate such securities.[2] The amendments established a program ("Rule 17g-5 Program") by which an NRSRO that is not hired by an issuer, sponsor, or underwriter (collectively, "arranger") is able to obtain the same information that the arranger provides to an NRSRO hired to determine a credit rating for the structured finance product at the same time the information is provided to the hired NRSRO.[3]

The Rule 17g-5 Program operates by requiring a hired NRSRO to maintain a password-protected website containing a list of each structured finance product for which it is currently in the process of determining an initial credit rating.[4] The list must be in chronological order and identify the type of structured finance product, the name of the issuer, the date the credit rating process was initiated, and the website where the arranger of the structured finance product represents that the information provided to the hired NRSRO can be accessed by non-hired NRSROs.[5] The hired NRSRO must provide free and unlimited access to the website it maintains pursuant to the Rule 17g-5 Program to any non-hired NRSRO that provides a copy of a certification it has furnished to the Commission in accordance with 17 CFR 240.17g-5(e).[6]

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2 Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009) ("Rule 17g-5 Adopting Release"). The term "structured finance product" as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction. This broad category of financial instruments includes an asset-backed security as defined in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)) and other types of structured debt instruments, including synthetic and hybrid collateralized debt obligations. See, e.g., Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 72936 (Aug. 27, 2014), 79 FR 55078, 55081 n.18 (Sept. 15, 2014) ("2014 NRSRO Amendments").

3 Rule 17g-5 Adopting Release, supra note 2, 74 FR at 63832. See also 17 CFR 240.17g-5. Throughout this release, an NRSRO that is not hired by an arranger is referred to as a "non-hired NRSRO." An NRSRO that is hired by an arranger is referred to as a "hired NRSRO."

4 See 17 CFR 240.17g-5(a)(3)(i).

5 Id.

6 See 17 CFR 240.17g-5(a)(3)(ii); 17 CFR 240.17g-5(e).

The Rule 17g-5 Program also requires the hired NRSRO to obtain a written representation from the arranger of the structured finance product that can be reasonably relied on by the hired NRSRO.[7] Such representation must include: that the arranger will maintain a password-protected website that other NRSROs can access; that the arranger will post on this website all information the arranger provides to the hired NRSRO (or contracts with a third party to provide to the hired NRSRO) for the purpose of determining the initial credit rating and undertaking credit rating surveillance; and that the arranger will post this information to the website at the same time such information is provided to the hired NRSRO.[8]

Prior to the June 2, 2010 compliance date for the Rule 17g-5 Program, the Commission by order granted a temporary conditional exemption to NRSROs from Rule 17g-5(a)(3). This temporary conditional exemption (the "existing Rule 17g-5(a)(3) exemption") applies solely with respect to credit ratings if: (1) the issuer of the security or money market instrument is not a U.S. person (as defined under 17 CFR 230.902(k)); and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the United States.[9] These conditions were designed to confine the existing Rule 17g-5(a)(3) exemption's application to credit ratings of structured finance products issued in, and linked to, financial markets outside of the United States. The Commission granted this relief in light of concerns raised by

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7 See 17 CFR 240.17g-5(a)(3)(iii).

8 Id.

9 See Order Granting Temporary Conditional Exemption for Nationally Recognized Statistical Rating Organizations from Requirements of Rule 17g-5 Under the Securities Exchange Act of 1934 and Request for Comment, Exchange Act Release No. 62120 (May 19, 2010), 75 FR 28825 (May 24, 2010) ("Exemptive Order").

various foreign securities regulators and market participants that local securitization markets may be disrupted if the rule applied to transactions outside the United States.[10] The Commission has extended the existing Rule 17g-5(a)(3) exemption several times, most recently until the earlier of December 2, 2019, or the compliance date set forth in any final rule that may be adopted by the Commission that provides for a similar exemption.[11]

### B. Rule 17g-7(a) and Rule 15Ga-2

In 2014, the Commission adopted Rule 17g-7(a) and Rule 15Ga-2. Rule 17g-7(a) requires an NRSRO, when taking a rating action, to publish an information disclosure form containing specified information about the related credit rating.[12] For example, the information disclosure form must specify, among other things, the version of the methodology used to determine the credit rating, a description of the types of data relied upon to determine the credit rating, and information on the sensitivity of the credit rating to assumptions made by the NRSRO.[13] The NRSRO must also attach to the information disclosure form an attestation affirming that no part of the credit rating was influenced by any other business activities, that the credit rating was based solely upon the merits of the obligor, security, or money market

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[10] Id. at 28826-27. Such foreign securities regulators and market participants indicated that arrangers of structured finance products located outside the United States generally were not aware that they would be required to make the representations prescribed in Rule 17g-5 in order to obtain credit ratings from NRSROs and were not prepared to make and adhere to the new requirements set forth in Rule 17g-5(a)(3). These commenters also identified potential conflicts with local law in non-U.S. jurisdictions as a concern. Id.

[11] See 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, Exchange Act Release No. 82144 (Nov. 22, 2017), 82 FR 56309 (Nov. 28, 2017).

[12] 17 CFR 240.17g-7(a)(1). Rule 17g-7(a) sets forth the required format and content of the information disclosure form and specifies that the form (and other items required by Rule 17g-7(a)) must be published in the same manner as the credit rating that is the result or subject of the rating action.

[13] See 17 CFR 240.17g-7(a)(1)(ii)(B), (H), and (M). For a comprehensive discussion of the required content of the form, see 2014 NRSRO Amendments, supra note 2, 79 FR at 55167-77.

instrument being rated, and that the rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.[14]

Rule 17g-7(a) also requires an NRSRO, when taking a rating action, to publish any executed Form ABS Due Diligence-15E containing information about the security or money market instrument subject to the rating action received by the NRSRO or obtained by the NRSRO through the website maintained by an arranger under the Rule 17g-5 Program.[15] Form ABS Due Diligence-15E is the form on which a person employed by an NRSRO, issuer, or underwriter to provide third-party due diligence services in connection with an asset-backed security must, among other things, describe the scope and manner of the due diligence provided, summarize the findings and conclusions of its review, and certify that it conducted a thorough review in performing the due diligence.[16]

Rule 15Ga-2 also relates to third-party due diligence services and requires the issuer or underwriter of an asset-backed security that is to be rated by an NRSRO to furnish to the Commission Form ABS-15G containing the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[17]

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14 17 CFR 240.17g-7(a)(1)(iii).

15 17 CFR 240.17g-7(a)(2).

16 Rule 17g-10 identifies Form ABS Due Diligence-15E as the form on which the certification required pursuant to Exchange Act Section 15E(s)(4)(B) must be set forth. See 17 CFR 240.17g-10; see also 15 U.S.C. 78o-7(s)(4)(B).

17 See 17 CFR 240.15Ga-2; 17 CFR 249.1400. Forms ABS-15G are made publicly available through the Commission's EDGAR system. See 17 CFR 232.101(a)(xvi).

In response to concerns raised by commenters when the rules were proposed,[18] the Commission included paragraph (a)(3) in 17 CFR 240.17g-7 ("Rule 17g-7") and paragraph (e) in Rule 15Ga-2 to provide an exemption from the disclosure requirements for certain offshore transactions.[19] The Commission closely modeled the language of the Rule 17g-7(a) exemption on the existing Rule 17g-5(a)(3) exemption.[20] The Commission noted that it was appropriate for the Rule 15Ga-2 exemption to be aligned with the Rule 17g-7(a) exemption so that there is a consistent approach to determining when the Commission's NRSRO rules apply to offshore transactions.[21]

## II. Proposed Rule Amendments

### A. Rule 17g-5(a)(3)

In the Exemptive Order, the Commission requested comment regarding the application of Rule 17g-5(a)(3) to transactions outside the United States, including whether any specific

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18 With respect to Rule 17g-7(a), a commenter suggested that local laws could impede the ability of an NRSRO to obtain or disclose information about the issuer as required by the proposed rule. See 2014 NRSRO Amendments, supra note 2, 79 FR at 55165. Similarly, with respect to Rule 15Ga-2, a commenter indicated that application of the rule to offshore transactions may conflict with foreign securities laws and other laws, rules, and regulations. See 2014 NRSRO Amendments, supra note 2, 79 FR at 55184, n.1420. As discussed in Section II.A. of this release, similar concerns regarding potentially overlapping or conflicting foreign regulations have been raised by commenters with respect to Rule 17g-5(a)(3).

19 See 2014 NRSRO Amendments, supra note 2, 79 FR at 55165, 55184-85. See also 17 CFR 240.17g-7(a)(3) (providing for an exemption if: (1) the rated obligor or issuer of the rated security or money market instrument is not a U.S. person; and (2) the NRSRO has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument, only in transactions that occur outside the United States); 17 CFR 240.15Ga-2(e) (providing for an exemption with respect to offerings of asset-backed securities if: (1) the offering is not required to be, and is not, registered under the Securities Act; (2) the issuer of the rated security is not a U.S. person; and (3) the security will be offered and sold upon issuance, and any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States).

20 2014 NRSRO Amendments, supra note 2, 79 FR at 55165.

21 Id. at 55185 n.1422.

conflicts would arise with respect to foreign regulators, regulations, and laws.[22] In subsequent extension orders, the Commission continued to provide interested parties with the opportunity to comment. The Commission received a number of comment letters in response to these requests for comment.[23]

Commenters on the Exemptive Order and extensions generally have supported the existing Rule 17g-5(a)(3) exemption, with many commenters expressly requesting that such exemption be extended indefinitely, made permanent, or codified in Rule 17g-5(a)(3).[24] In support of the existing Rule 17g-5(a)(3) exemption, some commenters indicated that broad application of Rule 17g-5(a)(3) to credit ratings of structured finance products offered and sold by non-U.S. persons outside the United States could disrupt local securitization markets or inhibit the ability of local firms to raise capital.[25]

Specifically, some commenters discussed potentially overlapping regulatory regimes as a reason the exemption was appropriate.[26] For example, one commenter indicated that new

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22 See Exemptive Order, supra note 9, 75 FR at 28825, 28828.

23 Comment letters received in response to the request for comment regarding the application of Rule 17g-5(a)(3) to transactions outside the United States are available at https://www.sec.gov/comments/s7-04-09/s70409.shtml.

24 See, e.g., letter from Rick Watson, Managing Director, Association for Financial Markets in Europe / European Securitisation Forum, dated November 11, 2010 ("AFME 2010 Letter"); letter from Jack Rando, Director, Capital Markets, Investment Industry Association of Canada, dated September 22, 2010 ("IIAC Letter"); letter from Masamichi Kono, Vice Commissioner for International Affairs, Financial Services Agency, Government of Japan, dated November 12, 2010 ("Japan FSA Letter"); letter from Takefumi Emori, Managing Director, Japan Credit Rating Agency, Ltd., dated June 25, 2010 ("JCR Letter"); letter from Patrick D. Dolan, Chair, Structured Finance Committee, New York City Bar Association, dated October 20, 2016 ("NYC Bar Association Letter"); letter from Richard Johns, Executive Director, Structured Finance Industry Group, and Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, dated July 19, 2017 ("SFIG/AuSF Letter"); letter from Masaru Ono, Executive Director, Securitization Forum of Japan, dated November 12, 2010 ("SFJ Letter").

25 See, e.g., AFME 2010 Letter; letter from Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, dated June 25, 2010 ("AuSF Letter"); Japan FSA Letter; JCR Letter; SFJ Letter. Other commenters indicated more generally that such application of the rule could have a negative impact on foreign markets. See, e.g., IIAC Letter; NYC Bar Association Letter; SFIG/AuSF Letter.

26 See, e.g., AFME 2010 Letter; Japan FSA Letter; SFJ Letter.

securitization disclosure requirements in Europe take a different approach in regulating the same general activity as Rule 17g-5(a)(3).[27] In an earlier comment letter, this commenter asserted that subjecting European market participants to overlapping regulatory regimes may impose significant compliance issues and an increased execution burden.[28] In this commenter's view, the application of Rule 17g-5(a)(3) in a non-U.S. offered context may be disruptive to local markets because the rule does not reflect certain features specific to the securitization market in Europe.[29]

Commenters also supported the exemption based on the disclosure of confidential information that could result from the application of Rule 17g-5(a)(3) to non-U.S. offered transactions.[30] One commenter indicated that compliance with Rule 17g-5(a)(3) could potentially conflict with local bank confidentiality and/or data protection laws.[31] Other commenters also identified concerns regarding the posting of confidential information through the Rule 17g-5 Program, stating that a reluctance to disclose confidential information to non-hired NRSROs could cause market participants to provide less information to hired NRSROs[32] or to forgo obtaining credit ratings on structured finance products.[33]

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27 See letter from Richard Hopkin, Managing Director & Head of Fixed Income, Association for Financial Markets in Europe, dated November 1, 2017 ("AFME 2017 Letter").

28 See AFME 2010 Letter.

29 See AFME 2010 Letter; AFME 2017 Letter.

30 See, e.g., AFME 2010 Letter; JCR Letter; SFJ Letter.

31 See AFME 2010 Letter.

32 See SFJ Letter. This commenter asserted that it would be difficult for Japanese market participants to obtain an adequate level of comfort regarding how non-hired NRSROs that are neither established in Japan nor have an affiliate registered in Japan would protect confidential information posted pursuant to the Rule 17g-5 Program.

33 See JCR Letter. This commenter noted a concern that an arranger may "be held liable to a third party for disclosing such party's sensitive, proprietary information" through the Rule 17g-5 Program.

One commenter also discussed business practices and characteristics of the securitization market in its jurisdiction that, according to the commenter, may make the Rule 17g-5 Program less likely to be effective.[34] Among other things, the commenter indicated that it is not customary for credit rating agencies in Japan to issue unsolicited ratings on structured finance products.[35] The commenter posited that, unless an NRSRO is established in Japan or has a Japanese affiliate, it may not have the requisite knowledge and expertise to rate Japanese structured finance products.[36] This commenter also suggested that, given the smaller and less mature securitization market in Japan as compared to the United States, market participants in Japan may utilize other sources of financing rather than bear the costs associated with the Rule 17g-5 Program.[37]

A number of commenters also advocated for the existing Rule 17g-5(a)(3) exemption based on principles related to international comity, asserting that the Commission has a limited interest in regulating securities offered and sold exclusively outside the United States and that these transactions are more appropriately regulated by the relevant local authorities.[38] A number of these commenters pointed to 17 CFR 230.901 through 230.905 ("Regulation S"), which excludes offers and sales that occur outside the United States from the registration requirements under Section 5 of the Securities Act of 1933 ("Securities Act"),[39] as evidence, in the

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34 See SFJ Letter.

35 Id.

36 Id.

37 Id.

38 See,e.g., AFME 2010 Letter; AuSF Letter; IIAC Letter; Japan FSA Letter; JCR Letter; NYC Bar Association Letter; SFJ Letter. Some of these commenters posited that these policy considerations are particularly acute given that Rule 17g-5(a)(3) impacts both the regulated entities (i.e., NRSROs) and their customers (i.e., the issuers of rated structured finance products). See, e.g., NYC Bar Association Letter.

39 See 17 CFR 230.901 through 230.905.

commenters' view, of the Commission's limited interest in regulating securities offered and sold solely outside the United States.[40]

The Commission has considered the views and policy considerations expressed by commenters and preliminarily believes it is appropriate to provide relief regarding the application of Rule 17g-5(a)(3) to transactions outside the United States. The Commission is of the view that such an approach is consistent with the approach it has taken in other contexts, and with notions of international comity and the generally limited interest of the Commission in regulating securities offered and sold exclusively outside of the United States. For example, in adopting Regulation S,[41] the Commission stated that "[p]rinciples of comity and the reasonable expectations of participants in the global markets justify reliance on laws applicable in jurisdictions outside the United States to define requirements for transactions effected offshore."[42] The Commission believes that the approach it articulated in adopting Regulation S applies similarly to the proposed exemption to Rule 17g-5(a)(3)—i.e., that providing relief regarding the application of Rule 17g-5(a)(3) to transactions outside the United States recognizes the reasonable expectations of participants in the global markets in defining requirements for transactions effected outside the United States.

For the reasons discussed above, the Commission preliminarily believes that it is not necessary or appropriate in the public interest or for the protection of investors to require NRSROs and arrangers to comply with Rule 17g-5(a)(3) with respect to ratings of structured

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40 See, e.g., AFME 2010 Letter; AuSF Letter; NYC Bar Association Letter.

41 17 CFR 230.901 through 230.905.

42 See Offshore Offers and Sales, Securities Act Release No. 6863 (Apr. 24, 1990). As described in the Commission's adopting release for Regulation S, Regulation S relates solely to the applicability of the registration requirements of Section 5 of the Securities Act and does not limit in any way the scope or applicability of the antifraud or other provisions of the federal securities laws.

finance products offered and sold exclusively outside the United States and that it is therefore appropriate to propose to codify, with certain clarifying changes, the existing Rule 17g-5(a)(3) exemption.[43] The proposed exemption only applies to the provisions of paragraphs (i) through (iii) of Rule 17g-5(a)(3). It does not limit in any way the scope or applicability of the other requirements in Rule 17g-5 or other provisions of the federal securities laws, including the antifraud provisions.

Accordingly, the Commission proposes to add new paragraph (a)(3)(iv) to Rule 17g-5 to provide that the provisions of paragraphs (i) through (iii) of Rule 17g-5(a)(3) will not apply to an NRSRO when issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction, if: (1) the issuer of the security or money market instrument is not a U.S. person (as defined in 17 CFR 230.902(k)); and (2) the NRSRO has a reasonable basis to conclude that all offers and sales of the security or money market instrument by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in Regulation S).[44]

The first condition of the proposed exemption to Rule 17g-5(a)(3)—that the issuer of the structured finance product must not be a U.S. person—is designed to limit relief to non-U.S. issuers. To this end, and for purposes of the exemption, the Commission is proposing that "U.S. person" have the same definition as under Regulation S.[45] Consequently, to qualify for the exemption, the NRSRO would have to be determining a credit rating for a structured finance

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[43] Codifying an exemption to Rule 17g-5(a)(3) also will standardize the manner in which the exemptions to Rule 17g-5(a)(3), Rule 17g-7(a), and Rule 15Ga-2 are promulgated. Unlike the existing Rule 17g-5(a)(3) exemption, the Rule 17g-7(a) and Rule 15Ga-2 exemptions are included in the rule text and not subject to expiration. See supra Section I.B.

[44] See proposed new paragraph (a)(3)(iv) of Rule 17g-5.

[45] See 17 CFR 230.902(k).

product issued by a person that is not a U.S. person. This condition is identical to the corresponding condition in the existing Rule 17g-5(a)(3) exemption.

The second condition of the proposed exemption to Rule 17g-5(a)(3)—that the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States—would limit the relief to transactions offered and sold exclusively outside the United States. This condition contains certain modifications to the corresponding condition in the existing Rule 17g-5(a)(3) exemption. The Commission is proposing these modifications for two reasons: (1) to clarify the relationship between the proposed exemption and Regulation S—i.e., that the exemption applies when all offers and sales of a structured finance product by any arranger linked to the structured finance product are excluded from the registration requirements of Section 5 of the Securities Act in reliance on Regulation S; and (2) to clarify that the standards in the second condition are not the same as the standards that are developing in the case law with respect to Section 10(b) of the Exchange Act following the Supreme Court's decision in Morrison v. National Australia Bank, Ltd., 561 U.S. 247 (2010). The second condition of the proposed exemption closely tracks the language of Regulation S[46] and specifies that the phrase "occur outside the United States" has the same meaning as in Regulation S. The proposed modifications are not designed to change the scope of the second condition of the proposed exemption from the corresponding condition in the existing Rule 17g-5(a)(3) exemption.[47]

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46 See 17 CFR 230.901.

47 From its inception, the existing Rule 17g-5(a)(3) exemption has been linked to Regulation S. For instance, in the Exemptive Order, the example given of a transaction that occurs outside the United States is a transaction that complies with the applicable safe harbor under Rules 903 and 904 of Regulation S. See Exemptive Order, supra note 9, 75 FR at 28827.

The determination of whether an NRSRO would have a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States would depend on the facts and circumstances of a given situation. To have a reasonable basis to reach such a conclusion, the NRSRO generally should ascertain how any arranger linked to the structured finance product intends to market and sell the structured finance product and to engage in any secondary market activities (i.e., re-sales) of the structured finance product, and whether any such efforts and activities will occur in the United States (including any "directed selling efforts," as defined in Regulation S).[48]

For instance, an NRSRO could obtain from the applicable arranger a representation upon which the NRSRO can reasonably rely that all offers and sales by the arranger of the structured finance product to be rated by the NRSRO will occur outside the United States. For example, the arranger's representation could provide assurances that all such offers and sales will be conducted in accordance with the applicable safe harbor under Regulation S.[49] In determining whether it is reasonable to rely on any such representation, an NRSRO should evaluate the representation in light of other information known to the NRSRO, such as information in the relevant transaction documents, any ongoing or prior failures by the arranger to adhere to its representations, and any pattern of conduct by the arranger of it failing to promptly correct breaches of its representations.

An NRSRO generally should reevaluate the reasonableness of its basis for concluding that the structured finance product will be offered and sold outside the United States if the

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[48] 17 CFR 230.902(c).

[49] See 17 CFR 230.903 and 904.

NRSRO obtains information during the course of its engagement that could cause it to reasonably believe there are activities inside the U.S. In this regard, the NRSRO could include in any representation obtained from an arranger a mechanism for the arranger to promptly notify the NRSRO of any change that would render the representation untrue or inaccurate.

### B. Conforming Amendments to Rule 17g-7(a) and Rule 15Ga-2

As discussed in Section I.B. of this release, Rule 17g-7(a) and Rule 15Ga-2 contain exemptions similar to the existing Rule 17g-5(a)(3) exemption. The Commission closely modeled the language of the Rule 17g-7(a) exemption on the existing Rule 17g-5(a)(3) exemption.[50] The Commission then aligned the Rule 15Ga-2 exemption to the Rule 17g-7(a) exemption so that there is a consistent approach to determining when the Commission's NRSRO rules apply to offshore transactions.[51]

The Commission continues to believe that it is appropriate for there to be a consistent approach to determining how Rule 17g-5(a)(3), Rule 17g-7(a), and Rule 15Ga-2 apply to offshore transactions. Commenters raised similar concerns with respect to all three rules regarding the potential conflicts between such rules and foreign regulations and practices with respect to transactions offered and sold exclusively outside the United States.[52] As discussed in Section II.A. of this release, the Commission believes that it has a limited interest in regulating securities offered and sold solely outside the United States (a view which is also consistent with international comity).

Further, as discussed in Section II.A. of this release, the proposed modifications to the conditions of the existing Rule 17g-5(a)(3) exemption are not designed to change the scope of

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50 2014 NRSRO Amendments, supra note 2, 79 FR at 55165.

51 Id. at 55185 n.1422.

52 See supra note 18 and Section II.A.

the exemption, but rather to clarify how the exemption relates to Regulation S. The Commission believes that clarifying the conditions to the exemption with respect to Rule 17g-5(a)(3) without also clarifying the substantially identical conditions to the exemptions in Rule 17g-7(a) and Rule 15Ga-2 could raise interpretive questions regarding the intended application of those exemptions. Accordingly, to promote clarity and consistency, the Commission proposes to amend Rule 17g-7(a) and Rule 15Ga-2 to align the exemptions to such rules with the proposed exemption to Rule 17g-5(a)(3).[53]

Specifically, the Commission proposes to amend the third condition of the Rule 15Ga-2 exemption to clarify that the exemption is available only if all offers and sales of an asset-backed security by any issuer, sponsor, or underwriter linked to the security will occur outside the United States (as that phrase is used in Regulation S).[54]

Likewise, the Commission proposes to amend the second condition of the Rule 17g-7(a) exemption to clarify that the exemption is available only if an NRSRO has a reasonable basis to conclude that: (A) with respect to any security or money market instrument issued by a rated obligor, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in Regulation S); or (B) with respect to a rated security or money market instrument, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in Regulation S).[55]

As is the case with the proposed exemption to Rule 17g-5(a)(3), the determination of whether an NRSRO would have a reasonable basis to conclude that all offers and sales of the

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53 See supra Section II.A.

54 See proposed revised paragraph (e)(3) of Rule 15Ga-2.

55 See proposed revised paragraph (a)(3)(ii) of Rule 17g-7.

applicable securities or money market instruments by any arranger linked to such securities or money market instruments will occur outside the United States would depend on the facts and circumstances of a given situation. The discussion in Section II.A. of this release regarding how an NRSRO may obtain such a reasonable basis for purposes of the proposed exemption to Rule 17g-5(a)(3) also applies for purposes of the proposed amendment to Rule 17g-7(a).

The proposed amendment to Rule 17g-7(a) also clarifies that the second condition of the Rule 17g-7(a) exemption applies differently in the case of rated obligors than it does in the case of rated securities or money market instruments. In the case of rated securities or money market instruments, the condition to the Rule 17g-7(a) exemption applies in the same way as the condition to the proposed Rule 17g-5(a)(3) exemption—i.e., an NRSRO must have a reasonable basis to conclude that all offers and sales of the rated security or money market instrument by any arranger linked to that security or money market instrument will occur outside the United States. For the Rule 17g-7(a) exemption to apply with respect to a rating of an obligor, however, an NRSRO must have a reasonable basis to conclude that the condition is satisfied with respect to all securities or money market instruments issued by that obligor. Accordingly, if any of a rated obligor's securities or money market instruments are offered and sold by an arranger linked to those securities or money market instruments within the United States, the exemption would not apply to rating actions involving the credit rating assigned to the obligor as an entity. The Commission previously discussed the distinction between the application of the exemption with respect to rated obligors and rated securities or money market instruments in the adopting release for Rule 17g-7(a).[56] The proposed amendment to Rule 17g-7(a) more clearly states this distinction in the rule text itself.

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[56] See 2014 NRSRO Amendments, supra note 2, 79 FR at 55165 n.1107.

## III. Request for Comment

The Commission generally requests comment on the proposal to add new paragraph (a)(3)(iv) of Rule 17g-5 and to amend paragraph (a)(3)(ii) of Rule 17g-7 and paragraph (e)(3) of Rule 15Ga-2. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is it appropriate for the Commission to amend Rule 17g-5(a)(3) to provide an exemption from the rule with respect to credit ratings where the issuer of the structured finance product is not a U.S. person and the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance produce will occur outside the United States? Why or why not?

2. Would the proposed exemption be consistent with the Commission's general approach to regulating securities offered and sold exclusively outside the United States?

3. Is it appropriate for the Commission to amend Rule 17g-7(a) and Rule 15Ga-2 to conform to the proposed exemption in Rule 17g-5(a)(3)? Why or why not?

4. Are there other ways in which the Commission should consider amending Rule 17g-5, Rule 17g-7, and Rule 15Ga-2? Please be specific.

5. What information might an NRSRO consider in order to form a reasonable basis to conclude that all offers and sales of a structured finance product by any arranger linked to the structured finance product will occur outside the United States?

6. What actions might an NRSRO take to ensure that it continues throughout the ratings process to have a reasonable basis to conclude that all offers and sales of a structured finance product by any arranger linked to the structured finance product will occur outside the United States? In what circumstances might an NRSRO need to reevaluate its conclusion?

7. Should Rule 17g-5(a)(3) be amended to require an NRSRO to take specific actions in order to obtain and continue to ensure that it has a reasonable basis to conclude that all offers and sales of a structured finance product by any arranger linked to the structured finance product will occur outside the United States? If so, how? For example, should an NRSRO be required to obtain from the applicable arranger a representation upon which the NRSRO can reasonably rely that all offers and sales by the arranger of the structured finance product to be rated by the NRSRO will occur outside the United States?

8. If the Exemptive Order were allowed to expire without amending Rule 17g-5(a)(3) as proposed, are there any jurisdictions where applicable law would preclude compliance with Rule 17g-5(a)(3)? If so, what impact would application of Rule 17g-5(a)(3) to structured finance products offered and sold in such jurisdictions have on NRSROs? Would NRSROs and their affiliates be precluded from issuing ratings of structured finance products in such jurisdictions?

9. What actions would NRSROs and arrangers need to take in order to comply with Rule 17g-5(a)(3) if the Exemptive Order were allowed to expire without codifying the existing Rule 17g-5(a)(3) exemption? How much advance notice would market participants currently relying on the Exemptive Order require in order to prepare to comply with Rule 17g-5(a)(3)?

10. If the Exemptive Order were allowed to expire without codifying the existing Rule 17g-5(a)(3) exemption, would any NRSROs use information available through the websites maintained by arrangers under the Rule 17g-5 Program to determine and monitor credit ratings with respect to transactions that would be exempted by the proposed rule?

In responding to the specific requests for comment above, the Commission encourages interested persons to provide supporting data and analysis and, when appropriate, suggest modifications to the proposed rule text. Responses that are supported by data and analysis assist

the Commission in considering the practicality and effectiveness of a proposed new requirement as well as evaluating the benefits and costs of the proposed rule.

## IV. Paperwork Reduction Act

The proposed amendments to Rule 17g-5(a)(3) and Rule 17g-7(a) contain new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[57] The Commission will submit the proposed rule amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[58] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

The titles and OMB control numbers for the collections of information are:

(1) Rule 17g-5, Conflicts of interest (OMB control number 3235-0649); and

(2) Rule 17g-7, Disclosure requirements (OMB control number 3235-0656).

The amendments to Rule 15Ga-2 do not contain a collection of information requirement within the meaning of the PRA.

### A. Summary of Collection of Information under the Proposed Rule Amendments and Proposed Use of Information

#### 1. Proposed Amendments to Rule 17g-5(a)(3)

The Commission is proposing amendments to Rule 17g-5(a)(3) that would provide an exemption to the rule with respect to credit ratings of structured finance products if the issuer of the structured finance product is not a U.S. person and the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the

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57 44 U.S.C. 3501 et seq.

58 See 44 U.S.C. 3507(d); 5 CFR 1320.11.

structured finance product will occur outside the United States.[59] In order to have a reasonable basis for such a conclusion, an NRSRO may collect information from an arranger. For instance, an NRSRO may elect to obtain a representation from an arranger regarding the manner in which the structured finance product will be offered and sold. Such information regarding the manner in which the structured finance product will be offered and sold may be necessary for an NRSRO to determine whether the proposed exemption applies with respect to the rating of the structured finance product.

### 2. Proposed Amendments to Rule 17g-7(a)

The Commission is proposing amendments to an existing exemption in Rule 17g-7(a). The proposed amendment would clarify that, in order for the exemption to apply, an NRSRO must have a reasonable basis to conclude that: (A) with respect to any security or money market instrument issued by a rated obligor, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States; or (B) with respect to a rated security or money market instrument, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States.[60] In order to have a reasonable basis for such a conclusion, an NRSRO may collect information from an arranger or obligor. For instance, an NRSRO may elect to obtain a representation from an arranger regarding the manner in which a rated security or money market instrument will be offered and sold or from an obligor regarding the manner in which all its securities and money market instruments have been offered and sold. Such information may be

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[59] See proposed paragraph (a)(3)(iv) of Rule 17g-5; see also supra Section II.A. (discussing the proposed exemption in more detail).

[60] See proposed paragraph (a)(3)(ii) of Rule 17g-7; see also supra Section II.B. (discussing the proposed amendments in more detail).

necessary for an NRSRO to determine whether the proposed exemption applies with respect to a rating action.

### B. Respondents

Rule 17g-5(a)(3) applies to NRSROs that rate structured finance products. Currently, there are seven NRSROs that are registered in the issuers of asset-backed securities ratings class that could rely on the proposed exemption to Rule 17g-5(a)(3).

Rule 17g-7(a) applies to all rating actions taken by an NRSRO. There are currently ten credit rating agencies registered with the Commission as NRSROs that could rely on the proposed exemption to Rule 17g-7(a).

### C. Burden and Cost Estimates Related to the Proposed Amendments

#### 1. Proposed Amendments to Rule 17g-5(a)(3)

The Commission is proposing amendments to Rule 17g-5(a)(3) that would provide an exemption to the rule with respect to ratings of certain structured finance products if, among other things, the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States.[61] The proposed amendment would codify the existing Rule 17g-5(a)(3) exemption, with certain clarifying changes.

The Commission preliminarily believes that NRSROs will modify their processes to reflect the clarifying changes being proposed to the exemption. For instance, an NRSRO that currently seeks written representations from an arranger to support the reasonable belief required under the existing Rule 17g-5(a)(3) exemption may modify the form of the representation to

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[61] See proposed paragraph (a)(3)(iv)(B) of Rule 17g-5; see also supra Section II.A. (discussing the proposed exemption in more detail).

conform to the language of the condition as proposed. The Commission estimates that it would take an NRSRO approximately five hours to update its process for obtaining a reasonable basis to reflect the clarifying language in the proposed exemption, for an industry-wide one-time burden of approximately 35 hours.[62]

In order to have a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States, the Commission preliminarily believes that NRSROs will likely seek information from arrangers, thereby resulting in associated costs. The Commission estimates that an NRSRO would spend approximately two hours per transaction gathering and reviewing information received from arrangers to determine if the exemption applies. The Commission also currently estimates that approximately 267 rated transactions would be eligible for the proposed exemption in a given year and that each transaction is rated by approximately two NRSROs,[63] resulting in a total aggregate annual hour burden of 1,068 hours.[64]

### 2. Proposed Amendments to Rule 17g-7(a)

The Commission is proposing conforming and clarifying amendments to an existing exemption in Rule 17g-7(a). The proposed amendment would clarify that, in order for the exemption to apply, an NRSRO must have a reasonable basis to conclude that: (A) with respect to any security or money market instrument issued by a rated obligor, all offers and sales by any

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62 5 hours x 7 NRSROs registered to rate asset-backed securities = 35 hours.

63 These estimates were calculated using information, as of September 5, 2018, from the databases maintained by Asset-Backed Alert and Commercial Mortgage Alert. Isolating the transactions coded in the databases as "Non-U.S." offerings provided an estimate of the number of transactions that would have been eligible for the proposed exemption. The databases also specify the number of NRSROs rating each transaction, which was used to calculate the average number of NRSROs per transaction (1.90). For purposes of the Commission's estimates, the number of NRSROs per transaction was rounded to the nearest whole number. The estimates represent the average number of transactions and NRSROs per transaction for the years ended December 31, 2015, 2016, and 2017.

64 2 hours x 267 transactions x 2 NRSROs per transaction = 1,068 hours.

issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States; or (B) with respect to a rated security or money market instrument, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States.[65]

The Commission preliminarily believes that NRSROs will modify their processes to reflect the proposed amendments to the Rule 17g-7(a) exemption. For instance, an NRSRO that currently seeks written representations from an obligor or arranger to support the reasonable belief required under the Rule 17g-7(a) exemption, as currently in effect, may modify the form of the representation to conform to the language of the condition as proposed to be amended. The Commission estimates that it would take an NRSRO approximately five hours to update its process for obtaining a reasonable basis to reflect the proposed amendment to the Rule 17g-7(a) exemption, for an industry-wide one-time burden of approximately 50 hours.[66]

**D. Collection of Information is Required to Obtain a Benefit**

The proposed collection of information is required to obtain or maintain a benefit. In order to form a reasonable basis to conclude that all offers and sales of the structured finance product will occur outside the United States, an NRSRO likely will gather certain information from the arranger including, for example, obtaining from the arranger a representation to that effect. The determination of a reasonable basis would be necessary for the proposed exemption to Rule 17g-5(a)(3) and the proposed amended exemption to Rule 17g-7(a) to apply.

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65 See proposed paragraph (a)(3)(ii) of Rule 17g-7; see also supra Section II.B. (discussing the proposed amendments in more detail).

66 5 hours x 10 NRSROs = 50 hours.

### E. Confidentiality

Any information obtained by an NRSRO from an obligor or arranger to establish a reasonable basis will not be made public, unless the NRSRO, obligor, or arranger chooses to make it public. Information provided to the Commission in connection with staff examinations or investigations would be kept confidential, subject to the provisions of applicable law.

### F. Request for Comment

The Commission requests comment on the proposed collections of information in order to: (1) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information should direct their comments to the OMB, Attention: Desk Officer for the U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-22-18. Requests for materials submitted to the OMB with regard to these collections of information should be in writing, refer to File No. S7-22-18, and be submitted to the U.S. Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736. OMB is required to make a decision concerning the collection of information between 30 and 60 days

after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

## V. Economic Analysis

### A. Introduction

As discussed above, the Commission is proposing to amend Rule 17g-5(a)(3) to provide an exemption from the rule with respect to credit ratings where the issuer of the structured finance product is not a U.S. person, and the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States. The Commission is also proposing conforming amendments to similar exemptions set forth in Rule 17g-7(a) and Rule 15Ga-2. The Commission is sensitive to the costs and benefits of its rules. When engaging in rulemaking that requires the Commission to consider or determine whether an action is necessary or appropriate in the public interest, Section 3(f) of the Exchange Act requires that the Commission consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[67] In addition, Section 23(a)(2) of the Exchange Act requires the Commission to consider the effects on competition of any rules the Commission adopts under the Exchange Act, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[68]

The Commission has considered the effects of the proposed amendments on competition, efficiency, and capital formation. Many of the benefits discussed below are difficult to quantify, in particular when considering the potential impact on conflicts of interest or

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[67] See 15 U.S.C. 78c(f).

[68] See 15 U.S.C. 78w(a)(2).

competition. Consequently, while the Commission has, wherever possible, attempted to quantify the economic effects expected to result from this proposal, much of the discussion below is qualitative in nature. Moreover, because the existing Rule 17g-5(a)(3) exemption is currently in effect (and has been in effect since May 19, 2010—i.e., prior to the compliance date for Rule 17g-5(a)(3)), there has been no effect on transactions outside the United States because changes in the market related to the application of Rule 17g-5(a)(3) have not occurred with respect to these transactions as a consequence of the Exemptive Order. Where the Commission is unable to quantify the economic effects of the proposed amendment, the Commission provides a qualitative assessment of the potential effects and encourages commenters to provide data and information that could help quantify the costs, benefits, and the potential impacts of the proposed amendment to Rule 17g-5(a)(3) on efficiency, competition, and capital formation.

The Commission's preliminary view is that the codification of current practices with respect to Rule 17g-5(a)(3) is appropriate when compared to the alternative of allowing the existing Rule 17g-5(a)(3) exemption to expire, as discussed below. This view was shared by the various commenters who requested that the existing Rule 17g-5(a)(3) exemption be extended indefinitely, made permanent, or codified in Rule 17g-5(a)(3).[69]

As discussed in Section II.B. of this release, the amendments to Rule 17g-7(a) and Rule 15Ga-2 are conforming and clarifying in nature. Further, unlike the existing Rule 17g-5(a)(3) exemption, the Rule 17g-7(a) and Rule 15Ga-2 exemptions are already included as part of the rule text, and thus not subject to expiration. Therefore, the Commission's preliminary view is

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[69] See supra note 24 and accompanying text.

that the proposed amendments to Rule 17g-7(a) and Rule 15Ga-2 will not have a material impact on efficiency, competition, and capital formation or impose new costs of any significance.

### B. Baseline and Affected Parties

The Exemptive Order serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the proposed codification of the existing Rule 17g-5(a)(3) exemption is considered.

Currently, pursuant to the Exemptive Order, NRSROs are exempt from the requirements of paragraphs (i) through (iii) of Rule 17g-5(a)(3) for credit ratings where: (1) the issuer of the security or money market instrument is not a U.S. person (as defined under 17 CFR 230.902(k)); and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the United States. As a result, with respect to such structured finance products, NRSROs are currently not required to comply with the requirements of Rule 17g-5(a)(3), including the requirement to obtain from the arranger a representation that the arranger will maintain a website containing all information the arranger provides to the hired NRSRO in connection with the rating.

Similarly, the existing exemptive language of paragraph (a)(3) of Rule 17g-7 and paragraph (e) of Rule 15Ga-2 serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the amendments to such rules are considered. As previously noted, the Commission believes the amendments to Rule 17g-7(a) and Rule 15Ga-2 are clarifying and conforming in nature and do not substantively deviate from the baseline.

The economic and regulatory analysis in this section reflects structured finance product markets and the credit rating industry as they exist today. We begin with a summary of the approximate number of NRSROs that would be directly affected by the proposed codification and features of the regulatory and economic environment in which the affected entities operate. A discussion of the current economic environment will provide a framework for assessing how the proposed regulation may impact efficiency, competition, and capital formation in this market.

Currently, ten credit rating agencies are registered with the Commission as NRSROs.[70] Of the ten NRSROs, seven are currently registered in the class of credit ratings for issuers of asset-backed securities.[71] Among these seven, three of the larger NRSROs accounted for approximately 96 percent of credit ratings outstanding as of December 31, 2017; [72] these three firms have operations outside of the United States.

The credit rating industry is highly concentrated and this market structure persists, in part, as a result of the costs associated with building the necessary reputational capital. In addition, large and incumbent NRSROs benefit from economies of scale, as well as from switching costs that issuers are likely to bear if they were to consider using different NRSROs. These costs provide incentives for issuers to use the services of NRSROs that they have

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70 The following credit rating agencies are currently registered as NRSROs: A.M. Best Rating Services, Inc. ("A.M. Best"); DBRS, Inc. ("DBRS"); Egan-Jones Ratings Company; Fitch Ratings, Inc. ("Fitch"); HR Ratings de México, S.A. de C.V. ("HR Ratings"); Japan Credit Rating Agency, Ltd. ("JCR"); Kroll Bond Rating Agency, Inc. ("KBRA"); Moody's Investors Service, Inc. ("Moody's"); Morningstar Credit Ratings, LLC ("Morningstar"); and S&P Global Ratings ("S&P").

71 The seven NRSROs registered to rate asset-backed securities are: A.M. Best; DBRS; Fitch; KBRA; Moody's; Morningstar; and S&P.

72 The three NRSROs are Fitch, Moody's, and S&P. The percentage of credit ratings outstanding attributable to Fitch, Moody's, and S&P was calculated using information reported by each NRSRO on Item 7A of Form NRSRO with respect to its annual certification for calendar year 2017. 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 class of credit ratings for which an NRSRO is registered is reported on Item 7A of Form NRSRO.

preexisting relationships with and represent a barrier that newcomers entering the market for credit ratings would need to overcome to compete with incumbent credit rating agencies.

In addition to the above economic barriers to entry, there exist some commercial and other barriers to entry.[73] For instance, the investment guidelines of fixed income mutual fund managers and pension plan sponsors often specify use of the ratings of particular credit rating agencies, and many of these guidelines refer to the larger NRSROs by name. Some fixed income indices also require ratings by specific NRSROs, thus increasing the demand for ratings from those NRSROs. However, it has been reported that some investors are changing their guidelines to include ratings from additional NRSROs, and several of the smaller NRSROs have reported success in gaining market share with respect to the issuers of asset-backed securities.[74]

Gathering comprehensive data on foreign issuances of asset-backed securities is difficult given the breadth of markets and products one needs to consider and that data may not be available for several lesser-developed markets. Further, it is often not clear whether these issuances are made by non-U.S. persons. However, there has been an increase in the issuances of asset-backed securities worldwide since 2011, with the issuances amounting to approximately $693.9 billion in 2017.[75] For example, when considering all underwriters for deals in Europe, while the trend has varied over the past five years, the two highest annual issuance totals over

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73 See 2017 Annual Report on Nationally Recognized Statistical Rating Organizations, available at https://www.sec.gov/ocr/reportspubs/annual-reports/2017-annual-report-on-nrsros.pdf, 24-25 (discussing various potential barriers to entry including economic, commercial, and regulatory barriers).

74 See id. at 21-24.

75 See Asset-Backed Alert (Rankings for Issuers of Worldwide Asset- and Mortgage-Backed Securities), available at https://www.abalert.com/rankings.pl?Q=100. See also Commercial Mortgage Alert (CMBS Summary—Global CMBS Issuance in 2017), available at https://www.cmalert.com/rankings.pl?Q=67. The information on these websites, reported as of September 5, 2018, indicates that, notwithstanding a slight decline in issuances in 2016, there has been an upward trend in the total annual issuances of asset-backed securities from 2011 through 2017.

such period were achieved in 2016 and 2017.[76] Asset-backed securities constitute a growing market in Europe and other major financial markets, and, as discussed below, any application of Rule 17g-5(a)(3) to transactions outside the United States could affect the functioning of these foreign markets.[77]

### C. Anticipated Costs and Benefits, Including Potential Effects on Efficiency, Competition, and Capital Formation

#### 1. Potential Benefits

As discussed above, the Commission issued the Exemptive Order in 2010, and an extension of the Exemptive Order is currently in effect. Because the proposed exemption to Rule 17g-5(a)(3) and amendments to Rule 17g-7(a) and Rule 15Ga-2 would generally maintain the status quo,[78] we do not expect the amendments would result in any major economic effects. For the same reason, we also do not expect this rulemaking to affect efficiency, competition, or capital formation in any major way.

To the extent that the proposed amendments to Rule 17g-5(a)(3) would enhance the certainty of the future status of an exemption to this rule, they could result in marginal economic benefits to arrangers, NRSROs, and regulators. Specifically, if NRSROs and arrangers expect to

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76 See Asset-Backed Alert (Rankings for Bookrunners of European Structured Finance Deals), available at https://www.abalert.com/rankings.pl?Q=98, information reported as of September 5, 2018. Total issuances in Europe amounted to approximately $101.1 billion in 2016 and approximately $95.5 billion in 2017. Id.

77 See, e.g., the SIFMA databases that cover historical issuances and outstanding values in Europe, the United States, and Australia for the following: asset-backed securities, collateralized debt obligations/collateralized loan obligations, commercial mortgage-backed securities, and residential mortgage-backed securities, available at http://www.sifma.org.

78 Although the language of the second condition of the proposed exemption to Rule 17g-5(a)(3) differs from the comparable condition set forth in the Exemptive Order, and conforming changes are being proposed to the corresponding conditions in Rule 17g-7(a) and Rule 15Ga-2, the changes are clarifying in nature and the Commission does not believe they will alter the status quo. See supra Section II. The conforming changes being proposed in Rule 17g-7(a) and Rule 15Ga-2, however, could result in changes from the current state. Specifically, those changes could avoid potential confusion by arrangers and NRSROs that could result from differences in the language of the conditions set forth in the rules.

be required to comply with Rule 17g-5(a)(3) in the future, they may allocate personnel and financial resources to correspond with foreign and U.S. regulators and to set up applicable websites in anticipation of future compliance. By promulgating an exemptive rule without a set termination date, the Commission preliminarily believes the proposed amendment would eliminate the need to incur such costs. Furthermore, by reducing the need to incur such costs, the proposed amendment could allow issuers and smaller NRSROs to expand in the global structured finance market, and could improve competition.

The proposed exemption would not necessarily result in more intense competition between issuers and other intermediaries because issuers would continue to offer structured finance products as they do under the current regulatory regime. Further, all existing NRSROs rating structured finance products could continue to rely on the exemption as they do currently under the extended Exemptive Order; therefore, competition among these existing credit rating agencies would most likely not be affected by the proposed exemption.

**2. Potential Costs and Other Anticipated Effects**

Similarly, because the existing Rule 17g-5(a)(3) exemption is currently in effect, the proposed amendment to Rule 17g-5(a)(3) should not impose any significant additional costs on NRSROs or arrangers of structured finance products relative to the baseline.

However, as is the case with the existing Rule 17g-5(a)(3) exemption, issuers and NRSROs may incur some expenses in relying on the proposed exemption to Rule 17g-5(a)(3), which is conditioned on an NRSRO having a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States. In order to have a reasonable basis for such a conclusion, the Commission preliminarily believes that NRSROs will likely seek representations from

arrangers, thereby resulting in associated costs. The Commission currently estimates that approximately 267 rated transactions would be eligible for the proposed exemption in a given year.[79] To the extent that NRSROs seek representations to support their reasonable belief, the Commission estimates that it would cost an arranger approximately $720 per transaction to provide such representations,[80] for total aggregate annual costs for all arrangers of approximately $192,240.[81]

Similarly, for an NRSRO that chooses to seek representations to support its reasonable belief, the Commission estimates that it would cost the NRSRO approximately $720 per transaction.[82] The Commission further estimates that each transaction is rated by approximately two NRSROs,[83] for total aggregate annual costs for all NRSROs of $384,480.[84] Thus, to the extent that all NRSROs seek representations for all transactions eligible to rely on the proposed exemption to Rule 17g-5(a)(3) each year, the Commission estimates the proposed amendment would result in total annual costs of $576,720.[85]

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79 See supra note 63.

80 Calculated as 2 hours per transaction x legal fee for a compliance attorney at $360 per hour = $720. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association (SIFMA). For example, the estimated wage figure for compliance attorneys is based on published rates for compliance attorneys, modified to account for a 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate for 2013 of $334 for compliance attorneys. See Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. These estimates are adjusted for inflation based on Bureau of Labor Statistics data on CPI-U between January 2013 (230.280) and January 2018 (247.873). Therefore, the 2018 inflation-adjusted effective hourly wage rates for compliance attorneys are estimated at $360 ($334 x 247.873/ 230.280). All effective hourly wage rates discussed throughout the release rely on the same SIFMA data inflation adjusted to January 2018.

81 Calculated as $720 per transaction x 267 annual transactions = $192,240.

82 Calculated as 2 hours per transaction x legal fee for a compliance attorney at $360 per hour = $720.

83 See supra note 63.

84 Calculated as $720 per transaction x 267 annual transactions x 2 NRSROs per transaction = $384,480.

85 Calculated as $720 per transaction x 267 annual transactions (for arrangers) + $720 per transaction x 267 annual transactions x 2 NRSROs per transaction (for NRSROs) = $576,720.

In addition, although the conditions with respect to the exemption to Rule 17g-5(a)(3) are substantially the same under the Exemptive Order, NRSROs may incur a modest one-time cost to conform their processes to reflect the clarifying change being proposed to one of the conditions to the exemption. For instance, an NRSRO that currently seeks written representations from an arranger to support the reasonable belief required under the Exemptive Order may modify the form of the representation to conform to the language of the condition as proposed. The Commission expects an NRSRO's in-house attorney would oversee revisions to the form representation and that there would be a one-time burden of five hours for the language to be revised, approved, and documented. Accordingly, the Commission estimates a one-time aggregate cost of $12,600 for NRSROs to adjust their procedures to reflect the clarifying language of the proposed exemption.[86]

Similarly, additional one-time costs may be incurred by NRSROs to modify their processes to reflect the proposed conforming amendments to the conditions with respect to the Rule 17g-7(a) exemption. The Commission expects the one-time costs incurred by such NRSROs to approximate the costs set forth with respect to Rule 17g-5(a)(3) above. As with Rule 17g-5(a)(3), the Commission expects an NRSRO's in-house attorney would oversee revisions to the form representation with respect to the Rule 17g-7(a) exemption and that there would be a one-time burden of five hours for the language to be revised, approved, and documented. Accordingly, the Commission estimates a one-time aggregate cost of $18,000 for

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[86] Calculated as 5 hours per NRSRO x legal fee for a compliance attorney at $360 per hour x the 7 NRSROs registered to rate asset-backed securities = $12,600.

NRSROs to adjust their procedures to reflect the proposed conforming changes to the Rule 17g-7(a) exemption.[87]

The Commission believes that no similar costs will be incurred by issuers and underwriters as a result of the proposed amendment to Rule 15Ga-2, given that such rule relates to an obligation of the issuer or underwriter of a structured finance product and there is no equivalent need to obtain information from a third party to determine if the Rule 15Ga-2 exemption applies.

### 3. Alternative Considered: Allow Exemptive Order to Expire

The Commission considered the alternative of allowing the current extension of the Exemptive Order to expire without codifying an exemption to Rule 17g-5(a)(3). The Commission preliminarily believes that this alternative is not consistent with notions of international comity or the Commission's limited interest in regulating securities offered and sold exclusively outside the United States. As discussed in Section II.A. of this release, the Commission believes principles of international comity and reasonable expectations of participants would be better served by not allowing the expiration of the current extension of the Exemptive Order. The Commission has nevertheless considered the economic effects of this alternative, and, as with its economic analysis of the proposed exemption to Rule 17g-5(a)(3), the Commission solicits comment, including estimates and data from interested parties, which could help it refine its analysis of the economic effects of this alternative.

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[87] Calculated as 5 hours per NRSRO x legal fee for a compliance attorney at $360 per hour x all 10 NRSROs = $18,000.

### a. Benefits

This alternative offers several potential economic benefits. The last three decades have witnessed an increase in the globalization of financial markets and in cross-border trading. Greater international capital flows can contribute to the development of new product markets and industries by enabling issuers to raise capital in markets around the world. The Commission considered the potential implications of the expiration of the existing Rule 17g-5(a)(3) exemption on cross-listing activity for U.S. and non-U.S. issuers.[88] One possible factor that hypothetically could affect the flow of capital from U.S. markets to foreign alternative trading venues is the costs associated with complying with U.S. securities laws. If complying with Rule 17g-5(a)(3) implies higher costs for issuers of structured finance products, and the costs affect the choice of an issuer's venue, non-U.S. issuers may benefit from the current exemptive relief by obtaining funding at a lower all-in cost than similarly situated U.S. issuers. If the Exemptive Order were to expire, however, such non-U.S. issuers would be unable to pursue such a strategy because they would have the same regulatory treatment as U.S. issuers. As a result, if the existing Rule 17g-5(a)(3) exemption were to expire, U.S. and non-U.S. issuers may compete for funding on more even terms.

Investors and issuers globally could obtain potential economic benefits, such as reduced conflicts of interest and informational efficiency in credit ratings, if arrangers were required to comply with the Rule 17g-5 Program. With respect to certain debt and structured finance products, credit ratings provided by non-hired NRSROs using information provided pursuant to the Rule 17g-5 Program could serve a verification function in capital markets by offering market

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[88] Although the Commission regulations are designed to promote competition, efficiency, and capital formation in U.S. markets and to protect U.S. investors, the Commission recognizes that some of its regulations impact market participants globally. When applicable, the economic effects to those market participants are discussed.

participants a broader set of opinions on the creditworthiness of those products.[89] This information could help investors in their decisions to augment the risk profiles of their portfolios through economic exposure to investment opportunities.[90]

Globalization, however, can be a conduit of risk and could lead to problems in one market or jurisdiction spilling over to other markets or jurisdictions.[91] If the existing Rule 17g-5(a)(3) exemption were to expire, then it is possible that any benefits of this rule with respect to the credit rating industry in the United States may apply to foreign markets as well, potentially reducing the risk of spillovers that may result from conflicts of interest that Rule 17g-5(a)(3) was designed to address.[92] Specifically, arrangers that engage in structured finance transactions in foreign markets would also need to maintain websites containing all information provided to hired NRSROs with respect to the rating of such structured finance products and provide access to any non-hired NRSRO that makes the required certifications. This may permit non-hired NRSROs to provide ratings of these products. The availability of additional ratings from an independent source may provide incentives to hired NRSROs to provide more accurate and unbiased ratings due to reputational concerns. Any additional ratings by non-hired NRSROs could, in turn, provide investors with independent views on the risk profiles of the structured

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89 See Rule 17g-5 Adopting Release, supra note 2, 74 FR at 63857.

90 See e.g., Arthur R. Pinto, Control and Responsibility of Credit Rating Agencies in the United States, American Journal of Comparative Law, Vol. 54 at 341-56 (2006). See also John R.M. Hand et al., The Effect of Bond Rating Agency Announcements on Bond and Stock Prices, Journal of Finance, Vol. 47, No. 2 at 733-52 (1992).

91 For instance, the European sovereign debt crisis renewed the debate on the role credit rating agencies play during crises and the interdependence between different financial markets. This debt crisis has included sovereign credit rating downgrades, widening of sovereign bond and credit default swap spreads, and pressures on stock markets. See, e.g., Manfred Gärtner et al., PIGS or Lambs? The European Sovereign Debt Crisis and the Role of Rating Agencies, International Advances in Economic Research, Vol. 17, No. 3 at 288 (2011). See also Valerie De Bruyckere et al., Bank/Sovereign Risk Spillovers in the European Debt Crisis, Journal of Banking & Finance, Vol. 37, Issue 12 at 4793-809 (2013).

92 See Rule 17g-5 Adopting Release, supra note 2, 74 FR at 63857.

finance products and improve the reliability of the credit ratings of these products.[93] The potential improvement in the quality of ratings in foreign markets could attenuate the risk of spillovers, which could benefit financial markets globally.

The Commission notes, however, that the possible benefits attributable to the expiration of the Exemptive Order for Rule 17g-5(a)(3) should be viewed in light of the concerns expressed by commenters (as described in Section II.A. of this release). If any foreign laws limit the information an arranger is able to post on the website maintained pursuant to the Rule 17g-5 Program, a hired NRSRO may not have sufficient information on which to base a credit rating or, if the arranger provides information to a hired NRSRO that it cannot also post to the website, the hired NRSRO will not be able to reasonably rely on the representation it received from the arranger.[94] In either case, NRSROs effectively would be precluded from rating structured finance products in such jurisdictions, attenuating the benefits described above.

**b. Costs**

Several costs of expiration of the existing Rule 17g-5(a)(3) exemption are relevant to consider. As mentioned earlier, the Commission currently estimates that approximately 267 rated transactions would be eligible for the proposed exemption to Rule 17g-5(a)(3) in a given year.[95] If the existing Rule 17g-5(a)(3) exemption were allowed to expire, the requirements of

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93 See, e.g., Daniel Covitz and Paul Harrison, Testing Conflicts of Interest at Bond Rating Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate, Federal Reserve Board Working Paper No. 2003-68 (2003), for evidence on the role of reputation among credit rating agencies. However, there is also some evidence to the contrary, wherein the argument is that if reputation losses are lower in an industry due to increased competition, then there are lesser incentives to provide accurate ratings. See Bo Becker and Todd Milbourn, How Did Increased Competition Affect Credit Ratings?, Journal of Financial Economics, Vol. 101, No. 3 at 493-514 (2011).

94 See supra notes 7-8 and accompanying text.

95 See supra note 63.

Rule 17g-5(a)(3) would apply with respect to these transactions. The Commission preliminarily estimates the following costs as a result of expiration of the existing Rule 17g-5(a)(3) exemption.

The Commission believes that expiration of the existing Rule 17g-5(a)(3) exemption would result in an annual increase in costs of $155,916 for NRSROs for additional website maintenance and associated compliance costs.[96] The Commission also estimates an annual increase in costs of $45,924 for arrangers to post information about new structured finance product transactions to the related websites.[97] Additionally, if certain sponsors do not also currently issue rated structured finance products in transactions that occur within the United States (which are currently subject to the requirements of Rule 17g-5(a)(3)), then they may incur one-time costs to set up websites. The Commission estimates that it would take a sponsor 300 hours to develop a system, as well as the policies and procedures governing the disclosures,

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96 The Commission estimates that it will take approximately one hour per transaction for website maintenance and that an NRSRO would have a webmaster perform these responsibilities, at a cost of $244 per hour. The Commission further estimates that each transaction will be rated by approximately two NRSROs (see supra note 63). Therefore, the estimated annual cost for website maintenance by NRSROs involved with 267 structured finance ratings would be $130,296 (267 transactions x 1 hour per transaction x $244 per hour x 2 NRSROs per transaction). In addition, the Commission estimates that compliance personnel at an NRSRO will spend, on average, one hour per month to monitor compliance with the requirements of the Rule 17g-5 Program. Staff estimates a $305 per hour figure for a compliance manager. Therefore, the estimated annual compliance cost would be $25,620 (12 months per year x 1 hour per month x $305 per hour x 7 NRSROs registered to rate asset-backed securities). As a result, the total estimated annual cost for NRSROs would be $155,916 ($130,296 website maintenance cost + $25,620 compliance cost).

97 The Commission estimates that it will take an arranger approximately one hour per transaction to post the information it provides to a hired NRSRO to the related website. The Commission believes that an arranger would have a junior business analyst perform these responsibilities, at a cost of $172 per hour. Therefore, based on the estimate of 267 rated transactions per year, the estimated annual cost for arrangers to make such information available on the related website would be $45,924 (267 transactions x 1 hour per transaction x $172 per hour).

resulting in a total of up to 41,400 hours across 138 sponsors.[98] The Commission estimates that the average one-time cost to each sponsor would be $81,300, and the total aggregate one-time cost across all sponsors would be up to $11,219,400.[99] Finally, on an ongoing basis, the Commission estimates an annual increase in costs of $2,231,453 for arrangers to make additional information about these transactions available on the related websites each month and to monitor compliance with its obligations over the life of the structured finance products. [100]

In addition to these direct compliance costs, expiration of the existing Rule 17g-5(a)(3) exemption could result in costs that are difficult to quantify. For instance, an incremental

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98 Total hours to develop systems would be 41,400 (138 sponsors x 300 hours per sponsor). The number of sponsors was estimated using information as of September 5, 2018 from the Asset-Backed Alert and Commercial Mortgage Alert databases. Isolating the transactions coded in the database as "Non-U.S." offerings and sorting the data by sponsor (in the case of the Asset-Backed Alert database) or seller (in the case of the Commercial Mortgage Alert database) enables an estimate of the number of separate sponsors that would be eligible for the exemption. The estimate represents the average number of such sponsors for the years ended December 31, 2015, 2016, and 2017. We note that the estimate of the aggregate hours across all sponsors represents upper bounds, as it is plausible that some sponsors also issue structured finance products in U.S.-based transactions and would have already incurred any such one-time costs.

99 As discussed in the Rule 17g-5 Adopting Release, the Commission believes that a sponsor would use a compliance manager and a programmer analyst to perform these functions, and each would spend 50% of the estimated hours conducting these tasks. The average hourly cost for a compliance manager is $305 and the average hourly cost for a programmer analyst is $237. Therefore, the average one-time cost to a sponsor would be $81,300 ([150 hours x $305 per hour] + [150 hours x $237 per hour]). The aggregate cost across all sponsors would be up to $11,219,400 (138 sponsors x $81,300 per sponsor). We note that these estimates represent upper bounds. As noted in note 98, some sponsors may have already incurred any one-time set up costs in connection with U.S.-based issuances. In addition, it is plausible that sponsors will obtain these services for a much lower cost from web service providers.

100 The Commission estimates that it will take an arranger approximately half an hour per month for each transaction to make such information available on the related website. The hourly burden per transaction for a year is 6 hours (0.5 hours per month x 12 months). The Commission believes that an arranger would have a junior business analyst perform these responsibilities at a rate of $172. Further, we relied on the Rule 17g-5 Adopting Release to infer the total number of outstanding deals under surveillance. In that release, the Commission indicated that, on average, an arranger will issue 20 new deals a year and will have 125 outstanding deals, or 6.25 outstanding deals for every new deal. Combining this with our estimate of 267 new transactions per year yields an estimate of 6.25 x 267 = 1,669 outstanding deals. Combining these estimates, the annual cost for arrangers to provide information on ongoing deals is $1,722,408 (1,669 outstanding transactions x $172 per hour x 6 hours per year). In addition, the Commission estimates that compliance personnel at an arranger will spend, for each outstanding transaction, one hour per year to monitor compliance with its requirements in connection with the Rule 17g-5 Program. The Commission estimates a $305 per hour figure for a compliance manager. Therefore, the estimated annual compliance cost would be $509,045 (1 hour per transaction, per year x $305 per hour x 1,669 outstanding transactions). As a result, the total estimated annual ongoing cost for arrangers would be $2,231,453 ($1,722,408 website maintenance cost + $509,045 compliance cost).

increase in costs resulting from the applicability of the Rule 17g-5 Program may vary significantly from transaction to transaction, contributing to the difficulty in quantifying such costs. A bespoke transaction may require significantly more communications between the arranger and the hired NRSRO than a transaction by a frequent issuer of similar securities, resulting in the incurrence of higher costs to arrangers. Moreover, the Rule 17g-5 Program requires that information must be posted to the arranger's website at the same time such information is provided to a hired NRSRO. If the exemption were to expire, information that may have previously been communicated verbally to a hired NRSRO may need to be memorialized in writing. In certain cases, an arranger may enlist outside counsel to draft or review materials to be provided to a hired NRSRO, resulting in additional costs.

Further, there are potential negative economic consequences. Since the global financial crisis there have been other efforts, in addition to the Dodd-Frank Wall Street Reform and Consumer Protection Act,[101] to assess and regulate the credit rating industry as well as to encourage market participants to establish stronger internal credit risk assessment practices. As discussed in Section II.A. of this release, commenters have expressed concerns that the requirements of Rule 17g-5(a)(3) could potentially be duplicative of or conflict with regulations applicable to NRSROs and arrangers in foreign markets, and thus harm the competitive position of NRSROs in those markets.[102] Failure to provide relief regarding the application of Rule 17g-5(a)(3) to transactions offered and sold exclusively outside the United States may be viewed as inconsistent with notions of international comity.

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101 Pub. L. No. 111-203, 124 Stat. 1376, H.R. 4173 (July 21, 2010).

102 See supra notes 26-33 and accompanying text.

The expiration of the existing Rule 17g-5(a)(3) exemption may lead to losses for NRSROs if, as commenters suggest, conflicts exist between the requirements of the Rule 17g-5 Program and foreign laws that limit the information available to NRSROs. Some NRSROs could be precluded from rating structured finance products in such jurisdictions, which could lead to loss of revenue associated with credit ratings that NRSROs currently provide under the existing Exemptive Order. NRSROs may also experience losses as a result of the expiration of the existing Rule 17g-5(a)(3) exemption due to competitive pressures in the foreign markets from credit rating agencies that are not registered as NRSROs ("non-NRSRO rating agencies") and therefore not subject to Rule 17g-5(a)(3). Expiration of the existing Rule 17g-5(a)(3) exemption may also lead to new compliance costs for NRSROs and arrangers relating to posting information on the websites with respect to credit ratings maintained by NRSROs that had previously been subject to the exemption. From the point of view of arrangers, additional costs of compliance could result in a decline in their issuances of structured finance products if alternative non-NRSRO rating agencies are unavailable or unacceptable to arrangers or investors.

Finally, if the existing Rule 17g-5(a)(3) exemption were allowed to expire, this could also raise legal barriers to entry for smaller NRSROs that may be planning to expand their foreign ratings business.[103] The increased set-up costs may lower such NRSROs' incentives to rate structured finance products in those foreign markets.

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[103] Three of the four smaller NRSROs registered in the class of credit ratings for issuers of asset-backed securities list foreign affiliates as credit rating affiliates on their most recently filed Form NRSRO. Form NRSRO filings can be accessed through the Commission's EDGAR system.

## VI. Small Business Regulatory Enforcement Fairness Act

Under the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[104] the Commission must advise OMB as to whether the proposed regulation constitutes a "major rule." Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (i) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) a significant adverse effect on competition, investment, or innovation. If a rule is "major," its effective date will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential annual economic impact of the proposed amendments to Rule 17g-5(a)(3), Rule 17g-7(a), and Rule 15Ga-2, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

## VII. Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act of 1980 ("RFA")[105] requires the Commission to undertake an initial regulatory flexibility analysis of the proposed rule amendments on small entities unless the Commission certifies that the proposal, if adopted, would not have a significant economic impact on a substantial number of small entities.[106] Pursuant to 5 U.S.C. 605(b), the Commission hereby certifies that the proposed amendments to

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104 123 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and 15 U.S.C., including as a note to 5 U.S.C. 601).

105 5 U.S.C. 601 et seq.

106 See 5 U.S.C. 605(b).

Rule 17g-5(a)(3), Rule 17g-7(a), and Rule 15Ga-2 would not, if adopted, have a significant economic impact on a substantial number of small entities.

The proposed amendment to Rule 17g-5(a)(3) would provide an exemption from the requirements of paragraphs (i) through (iii) of Rule 17g-5(a)(3) with respect to credit ratings if the issuer of the structured finance product is not a U.S. person, and the NRSRO has a reasonable basis to conclude that all offers and sales of the structured finance product by any arranger linked to the structured finance product will occur outside the United States. The proposed amendments to Rule 17g-7(a) and Rule 15Ga-2 conform the existing exemptions with respect to such rules to the proposed amendment to Rule 17g-5(a)(3) in order to reflect certain clarifying changes to the conditions thereof.

The Commission's rules do not define "small business" or "small organization" with respect to NRSROs. However, 17 CFR 240.0-10(a) provides that, for purposes of the RFA, a small entity "[w]hen used with reference to an 'issuer' or a 'person' other than an investment company" means "an 'issuer' or 'person' that, on the last day of its most recent fiscal year, had total assets of $5 million or less."[107] The Commission has stated in the past that an NRSRO with total assets of $5 million or less would qualify as a "small" entity for purposes of the RFA.[108]

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107 See Rule 0-10(a).

108 See, e.g., Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564, 33618 (June 18, 2007); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (Feb. 2, 2009), 74 FR 6456, 6481 (Feb. 9, 2009); Rule 17g-5 Adopting Release, supra note 2, 74 FR at 63863.

The Commission continues to believe this threshold of total assets of $5 million or less would qualify an NRSRO as "small" for purposes of the RFA.[109]

Currently, there are ten credit rating agencies registered with the Commission as NRSROs and, based on their most recently filed annual reports pursuant to 17 CFR 240.17g-3,[110] two NRSROs are small entities under the above definition. Neither of these two NRSROs is currently registered for the class of credit ratings for issuers of asset-backed securities.

The Commission preliminarily believes that the proposed amendments to Rule 17g-5(a)(3) would not, if adopted, have a significant economic impact on a substantial number of "small entities" as defined by the RFA. The proposed amendment to Rule 17g-5(a)(3) applies exclusively to rated structured finance products and the NRSROs that are considered small under the above definition are not currently registered for the class of credit ratings for issuers of asset-backed securities.

The Commission preliminarily believes that the proposed amendments to Rule 17g-7(a) would not, if adopted, have a significant economic impact on a substantial number of "small entities" as defined by the RFA. Although Rule 17g-7(a) applies to all NRSROs, including the two NRSROs that qualify as "small" for purposes of the RFA, the Commission preliminarily believes that the economic impact of the proposed amendments to Rule 17g-7(a) would not be significant. The Rule 17g-7(a) exemption is already included as part of the rule text, and the proposed amendments to such exemption are clarifying in nature.[111] The Commission

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109 Under Section 601(3) of the RFA, the term "small business" is defined as having "the same meaning as the term 'small business concern' under Section 3 of the Small Business Act, unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

110 See Rule 17g-3.

111 See supra Section II.B. (discussing the proposed amendments to Rule 17g-7(a) in more detail).

preliminarily believes NRSROs may incur modest one-time costs to modify their processes to reflect the proposed amendments to the Rule 17g-7(a) exemption,[112] but that any ongoing annual costs related to the exemption, amended as proposed, are likely to be unchanged relative to the existing exemption.

The adopting release for Rule 15Ga-2 certified that Rule 15Ga-2 and the amendments to Form ABS-15G will not have a significant economic impact on a substantial number of small entities.[113] As is the case with Rule 17g-7(a), the Rule 15Ga-2 exemption is already included as part of the rule text, and the proposed amendments to such exemption are clarifying in nature.[114] In addition, Rule 15Ga-2 relates to an obligation of the issuer or underwriter of a structured finance product and there is no need to obtain information from a third party to determine if the 15Ga-2 exemption applies. As such, the Commission preliminarily believes that no costs will be incurred by issuers and underwriters as a result of the proposed amendment to the Rule 15Ga-2 exemption.

The Commission encourages written comments regarding this certification. We solicit comment as to whether the proposed amendments to Rule 17g-5(a)(3), Rule 17g-7(a), and Rule 15Ga-2 could have a significant economic impact on a substantial number of small entities. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

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112 The Commission estimates that it will take an NRSRO approximately 5 hours to modify its processes to reflect the proposed amended language of the exemption. The Commission believes that the work will likely be completed by a compliance attorney at $360 per hour, resulting in a cost of $1,800 for each NRSRO. See supra note 87 and accompanying text.

113 See 2014 NRSRO Amendments, supra note 2, 79 FR at 55257.

114 See supra Section II.B. (discussing the proposed amendments to Rule 17g-7(a) in more detail).

## VIII. Statutory Authority

The Commission is proposing an amendment to 17 CFR 240.17g-5(a)(3), 17 CFR 240.17g-7(a), and 17 CRF 240.15Ga-2 pursuant to the authority conferred by the Exchange Act, including Sections 15E, 17(a), and 36 (15 U.S.C. 78o-7, 78q, and 78mm).

**List of Subjects in 17 CFR Part 240**

Reporting and recordkeeping requirements, Securities.

**Text of Proposed Amendment**

In accordance with the foregoing, the Commission proposes that title 17, chapter II of the Code of Federal Regulations be amended as follows:

**PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for part 240 continues to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78n-1, 78*o*, 78*o*-4, 78*o*-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 *et seq.*; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

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Section 240.15Ga-2 is also issued under sec. 943, Pub. L. 111-203, 124 Stat. 1376.

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Section 240.17g-7 is also issued under sec. 943, Pub. L. 111-203, 124 Stat. 1376.

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2. Amend § 240.15Ga-2 by revising paragraph (e) to read as follows:

**§240.15Ga-2 Findings and conclusions of third-party due diligence reports.**

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(e) The requirements of this rule would not apply to an offering of an asset-backed security if certain conditions are met, including:

(1) The offering is not required to be, and is not, registered under the Securities Act of 1933;

(2) The issuer of the rated security is not a U.S. person (as defined in § 230.902(k)); and

(3) All offers and sales of the security by any issuer, sponsor, or underwriter linked to the security will occur outside the United States (as that phrase is used in §§ 230.901 through 230.905 (Regulation S)).

* * * * *

3. Amend § 240.17g-5 by adding paragraph (a)(3)(iv) to read as follows:

**§240.17g-5 Conflicts of interest.**

(a) * * *

(3) * * *

(iv) The provisions of paragraphs (a)(3)(i) through (iii) of this section will not apply to a nationally recognized statistical rating organization when issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction, if:

(A) The issuer of the security or money market instrument is not a U.S. person (as defined in § 230.902(k) of this chapter); and

(B) The nationally recognized statistical rating organization has a reasonable basis to conclude that all offers and sales of the security or money market instrument by any issuer,

sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in §§ 230.901 through 230.905 (Regulation S) of this chapter).

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4. Amend § 240.17g-7 by revising paragraph (a)(3) to read as follows:

**§240.17g-7 Disclosure requirements.**

(a) * * *

(3) *Exemption.* The provisions of paragraphs (a)(1) and (2) of this section do not apply to a rating action if:

(i) The rated obligor or issuer of the rated security or money market instrument is not a U.S. person (as defined in § 230.902(k) of this chapter); and

(ii) The nationally recognized statistical rating organization has a reasonable basis to conclude that:

(A) With respect to any security or money market instrument issued by a rated obligor, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in §§ 230.901 through 230.905 (Regulation S) of this chapter); or

(B) With respect to a rated security or money market instrument, all offers and sales by any issuer, sponsor, or underwriter linked to the security or money market instrument will occur outside the United States (as that phrase is used in §§ 230.901 through 230.905 (Regulation S) of this chapter).

* * * * *

By the Commission.

Date: September 26, 2018.

Brent J. Fields,
Secretary.