

## Rating Agency Reform – 2009 in Review

It was a busy year for rating agency reform in 2009, with multiple rulemaking actions by the US Securities and Exchange Commission (the Commission) covering diverse topics. The table below briefly summarizes the action during the year with respect to new rules and proposals that are likely to directly affect issuers, sponsors or underwriters (collectively referred to below as arrangers) of asset-backed securities (ABS), including mortgage-backed securities (MBS). We also separately summarize other new or proposed rules relating to internal conduct of nationally recognized statistical rating organizations (NRSROs), compliance, reporting and similar matters.

The Credit Rating Agency Reform Act of 2006 empowered the Commission to regulate NRSROs. The Commission adopted initial rules for this purpose

in June 2007. Insofar as the rules discussed below regulate the conduct of NRSROs, those rules are further exercises of the Commission's power under the 2006 Act and build on the initial 2007 rules. The rules discussed here are separate from the risk assessment procedures adopted by the Federal Reserve Bank of New York (the New York Fed) under the Term Asset-Backed Securities Loan (TALF) Facility for non-mortgage ABS.<sup>1</sup>

### New or Proposed Rules That Affect Arrangers

For each of the new or proposed rules that seem likely to have a direct impact on arrangers, we have briefly summarized the rule, indicated its status and footnoted an online location for the relevant Commission release.

SUMMARY OF RULE	STATUS
Facilitates unsolicited ratings by enabling NRSROs that are not hired to rate an ABS to access the same rating-related information that the arranger provides to hired NRSROs. Arrangers will be required to post this information on a password-protected site and provide access to NRSROs that request access, and that provide a certificate confirming that they will maintain confidentiality and use the information only for rating purposes. Regulation FD has also been amended to avoid having this process trigger broader disclosure obligations.	Final; compliance required 6/2/10 <sup>2</sup>
The no-advise rule, which prohibits NRSROs from providing any structuring advice relating to the ABS that they rate. The adopting release provides some guidance on the line between permitted feedback and prohibited recommendations, but we expect that it will take some time to work out the distinction in practice.	Final; compliance required since 4/10/09 <sup>3</sup>
Proposal to require separate rating symbols for ABS and non-ABS ratings or disclosure about the differences in rating methodologies has been deferred. However, the Commission has requested public comment on other means to differentiate between ABS and non-ABS ratings.	Deferred; comments due by 2/2/10 <sup>4</sup>

SUMMARY OF RULE	STATUS
<p>Proposals to eliminate references to NRSRO ratings in several rules and forms with great significance for the ABS market, including the instructions to Form S-3 that permit shelf registrations of ABS, Rule 415 (an alternative path to shelf registration for MBS), Rule 3a-7 (an exemption from registration under the Investment Company Act designed for ABS), Regulation AB, Regulation M (relating to stabilizing transactions) and Rule 2a-7 (regulating money market funds).</p>	<p>Proposed; comment period ended 12/8/09<sup>5</sup></p>
<p>Proposal to require specific disclosures about credit ratings that are used in connection with an offering of securities, including disclosure about what a credit rating covers and any material limitations on the scope of the rating, and whether any preliminary ratings were obtained from other rating agencies (which the Commission refers to as “ratings shopping”).</p>	<p>Proposed; comment period ended 12/14/09<sup>6</sup></p>
<p>Concept paper seeking comment as to whether NRSROs should lose their existing exemption from Securities Act liability as experts with respect to registration statements.</p>	<p>Concept release; comment period ended 12/14/09<sup>7</sup></p>

## Other New and Proposed Rules Relating to NRSRO Conduct

In February<sup>8</sup> and December<sup>9</sup> releases, the Commission adopted rules relating to conflicts of interest<sup>10</sup>, expanded recordkeeping<sup>11</sup>, disclosure<sup>12</sup> and reporting<sup>13</sup> requirements for NRSROs. In December<sup>14</sup>, the Commission proposed additional rules (or amendments to existing rules) that would require NRSROs to furnish a new annual compliance report, disclose additional information about the sources of their revenues and make publicly available a consolidated report containing information about revenues of the NRSRO attributable to persons paying the NRSRO for the issuance or maintenance of a credit rating.

## Endnotes

<sup>1</sup> To facilitate the New York Fed’s independent risk assessment of proposed TALF-eligible ABS, sponsors must “provide to the New York Fed, at least three weeks in advance of the applicable TALF subscription date, all data on the ABS or its underlying exposures that the sponsor or issuer has provided to any NRSRO. The New York Fed reserves the right to request further information from the sponsor or issuer in connection with performing its review and expects issuers to provide any additional data provided to any NRSRO to also be promptly provided to the New

York Fed.” TALF Terms and Conditions, available at [http://www.newyorkfed.org/markets/talf\\_terms.html](http://www.newyorkfed.org/markets/talf_terms.html). In addition, the New York Fed will not review any proposed TALF-eligible ABS unless the sponsor consents to discussions between the New York Fed and each applicable NRSRO concerning the credit quality of the ABS and the underlying exposures.

<sup>2</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-28496.pdf>.

<sup>3</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-2513.pdf>.

<sup>4</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-28497.pdf>.

<sup>5</sup> These proposals were set out in three releases, which addressed the topic from the perspective of rules administered by the Commission’s Divisions of Corporation Finance, Investment Management, and Trading and Markets, respectively: Release No. 33-8940, available at <http://sec.gov/rules/proposed/2008/33-8940.pdf>; Release No. IC-28327, available at <http://sec.gov/rules/proposed/2008/ic-28327.pdf>; and Release No. 34-58070, available at <http://sec.gov/rules/proposed/2008/34-58070.pdf>. The comment period was extended by a release that is available at <http://sec.gov/rules/proposed/2009/33-9069.pdf>. See our prior update at <http://www.mayerbrown.com/publications/article.asp?id=5142&nid=6> for more details about these proposals. While the Commission voted in September 2009 to remove rating references from a few relatively technical rules, all of the key ABS-related rules mentioned in the table above remain under consideration. The Commission has received a great deal of resistance to these changes but has not yet been willing to abandon the proposals.

- <sup>6</sup> Available at <http://www.sec.gov/rules/proposed/2009/33-9070.pdf>.
- <sup>7</sup> Available at <http://www.sec.gov/rules/concept/2009/33-9071.pdf>.
- <sup>8</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-2513.pdf>.
- <sup>9</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-28496.pdf>.
- <sup>10</sup> These rules require a separation between personnel who participate in a rating decision and those who negotiate the fee for the rating and also prohibit rating recipients from giving gifts valued over \$25 to rating personnel.
- <sup>11</sup> Under the expanded requirements, NRSROs must (i) maintain a record of all of their ratings and subsequent rating actions (which is subject to examination by the Commission), and publish this information on a delayed basis, (ii) maintain a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued on a structured finance product, if a quantitative model is a substantial component in the process of determining the credit rating, (iii) retain records of third-party complaints regarding the performance of a credit analyst in determining credit ratings and (iv) disclose default and rating transition statistics for each class of credit rating used by the NRSRO, broken out over 1-, 3- and 10-year periods.
- <sup>12</sup> These require NRSROs to disclose: (i) how rating decisions are affected by information about verification performed on underlying assets or assessments of the quality of originators; (ii) how frequently ratings are reviewed, and whether

different models or criteria are used for ratings surveillance than for initial ratings determinations; (iii) whether changes made to models and criteria for determining initial ratings are applied retroactively to existing ratings; and (iv) whether changes made to models and criteria for performing ratings surveillance are incorporated into the models and criteria for determining initial ratings.

- <sup>13</sup> NRSROs are now required to report to the Commission annually on the number of ratings actions taken in each ratings class.
- <sup>14</sup> Available at <http://edocket.access.gpo.gov/2009/pdf/E9-28497.pdf>.

*If you have any questions with regard to the new final or proposed rules, or any other topic addressed above, please contact the author of this Client Update listed below or any of the partners in the Securitization practice. Please go here <http://www.mayerbrown.com/securitization/> to learn more about our Securitization practice.*

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