

held by money market funds? Are there readily available public sources of information sufficient to calculate credit spreads on domestic and foreign debt securities? Are there other model-based statistical scoring systems and/or market-based alternatives that would be viable alternatives to NRSRO ratings?

Question 5: What are the advantages and disadvantages of requiring the SROs to set appropriate standards for broker-dealers to use in determining rating categories for net capital purposes? What form might these standards take?

Question 6: What are the advantages and disadvantages of eliminating the "objective test" from rule 2a-7, and relying solely on the "subjective test"—the credit analysis performed by the adviser to the money market fund—for the purposes of determining asset quality?

Question 7: What are the advantages and disadvantages of relying upon specified investor sophistication, large size denomination, or asset and structure experience criteria for purposes of determining Form S-3 eligibility? Should the Commission explore these possibilities in more depth? If so, what specific criteria should be considered?

Question 8: Are there alternatives other than those discussed above that might be better substitutes for the NRSRO designation in particular Commission rules?

Question 9: If the Commission discontinued using the NRSRO designation, should an entity other than the Commission recognize NRSROs for uses other than Commission rules? If another entity, which entity? How would the transition from the Commission to that entity take place?

Question 10: If, on the other hand, the Commission should continue to use the NRSRO designation in some Commission rules, could that designation be eliminated from other rules? If so, which rules?

B. Recognition Criteria

Since the Commission adopted the NRSRO designation, Commission staff has developed a number of criteria for assessing the credit rating agencies whose ratings can be used for regulatory purposes. Before recognizing a credit rating agency as an NRSRO, the Commission staff first determines that the rating agency satisfies certain established criteria. The single most important criterion is that the rating agency is widely accepted in the U.S. as an issuer of credible and reliable ratings by the predominant users of securities ratings. The staff also reviews the operational capability and reliability of

the rating agency, including: (1) The organizational structure of the rating agency; (2) the rating agency's financial resources (to determine, among other things, whether it is able to operate independently of economic pressures or control from the companies it rates); (3) the size and experience and training of the rating agency's staff (to determine if the entity is capable of thoroughly and competently evaluating an issuer's credit); (4) the rating agency's independence from the companies it rates; (5) the rating agency's rating procedures (to determine whether it has systematic procedures designed to produce credible and reliable ratings); and (6) whether the rating agency has internal procedures to prevent the misuse of non-public information and to minimize possible conflicts of interest, and whether those procedures are followed. These criteria are intended to reflect the view of the marketplace as to the credibility of the credit rating agency, and were developed, in part, after evaluating public comments received by the Commission on the NRSRO designation.

While some commenters believe that the current NRSRO recognition criteria are appropriate given the objectives of the NRSRO designation, others have commented that the criteria impose barriers to entry into the business of acting as a credit rating agency. Commenters have also indicated that the current NRSRO recognition process is not sufficiently transparent.

In addition, in light of recent corporate failures, some have criticized the performance of the credit rating agencies. Concerns also have been raised regarding the training and qualifications of credit rating agency analysts.

If the Commission retains the NRSRO designation, the Commission could seek to improve the transparency of the NRSRO recognition process by developing the following approach:

- The Commission could specify in more detail the types of information applicants need to provide to demonstrate, and that could be reviewed in evaluating, satisfaction of the various NRSRO criteria. For example, in reviewing the general acceptance of a rating agency as an issuer of credible and reliable ratings, the Commission could clarify that the review would consider evidence such as: (1) Attestations from authorized officers of users of securities ratings representing a substantial percentage of the relevant market that the applicant's ratings are credible and actually relied on by the user; (2) interviews with representatives of such users regarding

the same; and (3) statistical data demonstrating market reliance on the applicant's ratings (e.g., market movements in response to the applicant's rating changes).

- A rating agency that confines its activity to a limited sector of the debt market could be recognized as an NRSRO. The appropriateness of recognizing as an NRSRO a rating agency that confines its activity to a limited, or largely non-U.S., geographic area also could be considered.

- Recognition of NRSROs could occur through Commission action (rather than through staff no-action letters).

- Applications for NRSRO recognition could be publicized by the Commission, and public comment sought on the credibility and reliability of the applicant's ratings.

- The Commission could develop supplemental criteria that would be used to evaluate ratings quality applicable to both rating agencies performing traditional fundamental credit analysis and those primarily reliant on statistical models.

- A rating agency could be required to follow generally accepted industry standards of diligence, to be developed in consultation with a broad-based committee of market participants, in performing its ratings analysis.

- The Commission could establish a time period (e.g., 90 days from receipt of all required information) to serve as a goal for action on NRSRO applications.

To assist the Commission in determining whether to modify the criteria currently used to recognize NRSROs (assuming the Commission continues to utilize the NRSRO concept), we seek commenters' views in response to the following questions:

Existing Substantive Criteria

Question 11: Are the criteria currently used by Commission staff to determine whether a credit rating agency qualifies as an NRSRO appropriate? If not, what are the appropriate criteria? How should a determination be made as to whether a credit rating agency has met each criterion?

Question 12: Is it appropriate to condition NRSRO recognition on a rating agency being widely accepted as an issuer of credible and reliable ratings by the predominant users of securities ratings in the United States (e.g., underwriters, dealers, banks, insurance companies, mutual funds, issuers)? Would this general acceptance be verifiable through the examples set forth above (e.g., requiring verification through attestations from, and interviews with, authorized officers of