

agreeing to maintain specified records relating to its ratings business, including those relating to ratings decisions.

- The Commission could condition NRSRO recognition on a rating agency's agreeing to submit to regular Commission inspections and examinations to determine compliance with the appropriate regulatory regime for NRSROs.

- The Commission could condition NRSRO recognition on a rating agency's agreeing to provide Commission staff with access to all personnel and books and records.

- The Commission could condition NRSRO recognition on a rating agency's agreeing to cooperate with the Commission in relevant investigations, including providing access to records and personnel.

To seek commenters' views on whether credit rating agencies should be subject to ongoing oversight, the Commission requests responses to the following questions:

*Question 28:* Should NRSRO recognition be conditioned on an NRSRO's meeting the original qualification criteria on a continuing basis? If so, should a failure to meet the original qualification criteria lead to revocation of NRSRO recognition? Should some other standard of revocation apply?

*Question 29:* What would be the appropriate frequency and intensity of any ongoing Commission review of an NRSRO's continuing compliance with the original qualification criteria?

*Question 30:* Should NRSRO recognition be conditioned on a rating agency's filing annual certifications with the Commission that it continues to comply with all of the NRSRO criteria?

*Question 31:* Should the Commission solicit public comment on the performance of each NRSRO, including whether the NRSRO's ratings continue to be viewed as credible and reliable? If so, how frequently should public comment be solicited (e.g., annually)?

*Question 32:* Should NRSROs be subject to greater regulatory oversight? If so, what form should this additional oversight take? If necessary, should the Commission seek additional jurisdictional authority from Congress?

*Question 33:* Should NRSRO recognition be conditioned on a rating agency's registering as an investment adviser under the Advisers Act? If so, how should the various sections of the Advisers Act apply to NRSROs? Could the Advisers Act rules be amended to make them more relevant to the businesses of NRSROs? Alternatively, would it be more appropriate for the

Commission to adopt a separate registration and regulatory regime for NRSROs?

*Question 34:* Should NRSRO recognition be conditioned on recordkeeping requirements specifically tailored to the ratings business? Should NRSRO recognition be conditioned on a rating agency's maintaining records relating to the ratings business, including those relating to rating decisions?

*Question 35:* Are there minimum standards or best practices to which NRSROs should adhere? If so, how should these be established? By the Commission? By the industry, with Commission oversight? Should they be incorporated into the conditions for NRSRO recognition? Would it, or would it not, be a productive use of Commission resources to develop the expertise to review, e.g., issues related to the quality and diligence of the ratings analysis?

*Question 36:* If a currently recognized NRSRO gave up its NRSRO recognition because of concerns regarding the regulatory and liability environment, what effect, if any, would that action have on the market?

#### *D. Conflicts of Interest*

Conflicts of interest may arise in several areas within a credit rating agency. As registered investment advisers, the current NRSROs have a legal obligation to avoid conflicts of interest or disclose them fully to subscribers. Reliance by credit rating agencies on issuer fees could lead to a conflict of interest and the potential for rating inflation. While many commenters believe that NRSROs have effectively managed this conflict, they stress the importance of NRSROs implementing stringent firewalls, independent compensation, and other related procedures. The NRSROs have represented that they have implemented a number of policies and procedures designed to assure the independence and objectivity of the ratings process, such as requiring ratings decisions to be made by a ratings committee, imposing investment restrictions, and adhering to fixed fee schedules. In addition, they assert that rating analyst compensation is merit-based (e.g., based on the demonstrated reliability of their ratings), and is not dependent on the level of fees paid by issuers the analyst rates. Further, the NRSROs take the position that their reputation for issuing objective and credible ratings is of paramount importance and that they would not jeopardize their reputation by attempting to appease an issuer.

Some also believe that conflicts of interest can arise when credit rating agencies offer consulting or other advisory services to the entities they rate. The NRSROs generally represent that they have established extensive guidelines to manage conflicts in this area, including firewalls to separate their ratings services from other ancillary businesses. They also indicate that advisory services presently represent a very small portion of their total revenues. Commenters have also expressed concern that conflicts in this area could become much greater if these ancillary services were to become a substantial portion of an NRSRO's business, and suggestions were made that their percentage contribution to the total revenues of an NRSRO be capped. Others were concerned that issuers could be unduly pressured to purchase advisory services, particularly in cases where they were solicited by a rating analyst at an NRSRO.

Finally, some have expressed concern that subscribers, as a practical matter, have preferential access to rating analysts and, as a result, inappropriately may learn of potential rating actions or other nonpublic information.

To manage these potential conflicts of interest, the Commission could develop the following approach:

- NRSRO recognition could be conditioned on a rating agency's developing and implementing procedures to address issuer influence (e.g., prohibiting ratings employees from participating in the solicitation of new business or fee negotiations, and basing their compensation on factors other than business maintenance or development).

- NRSRO recognition could be conditioned on a rating agency's developing and implementing procedures to address subscriber influence (e.g., restricting private contacts between ratings employees and subscribers, to help prevent intentional or inadvertent disclosure of confidential issuer information and information regarding forthcoming rating changes).

- NRSRO recognition could be conditioned on a rating agency's developing and implementing procedures to address issues regarding ancillary fee-based services (e.g., establishing strict firewalls between ratings employees and ancillary business development, and prohibiting compensation of ratings employees from being impacted by revenues from these services).

- NRSRO recognition could be conditioned on a rating agency's having adequate financial resources (e.g., net assets of at least \$100,000, or annual gross revenues of at least \$1,000,000) to